SUBMISSION
TO THE FINANCIAL SYSTEM INQUIRY

Prepared by the
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EXECUTIVE SUMMARY

This submission is made to the Financial System Inquiry by the Association of Superannuation Funds of Australia Limited (ASFA). ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members.

ASFA acknowledges that considerable change has occurred within the Australian financial system since 1981. However, rather than deregulation, we would note that superannuation funds are experiencing considerably more regulation now than 15 years ago. This has partially arisen as a result of the integration of superannuation through public policy into the nation's broader retirement income system, an approach which now enjoys broad and bipartisan support.

The purpose of the regulation must be to allow superannuation funds to meet their key objective: the provision of retirement income. Prudential supervision rests primarily with trustees, supported by the government sponsored prudential system, the current Superannuation Industry Supervision (SIS) regime which formalises the underlying trust obligations. The main enforcement body is the Insurance and Superannuation Commission (ISC).

The basis of this regulatory regime is the requirement that fund trustees comply with broad principles, which exist in both trust law and are codified in statutory obligations under SIS. This principle-based approach affords both strong prudential controls and flexibility. While a robust system of penalties for non-compliance are available to the regulator, the current enforcement strategy of the Insurance and Superannuation Commission is generally co-operative, aimed towards creating a 'culture of compliance'. We would note, however, that there are areas where its strength, flexibility and potential simplicity are being eroded, with creeping prescription and complexity in legislation.

In addition to the unique role played by superannuation in public policy, there are several characteristics of superannuation that should influence its regulation. These include:

- its compulsory nature for employees (unlike most other savings and investments, which are voluntary),
- the very large number of funds, including many funds that may comprise only one or two people,
- the large number of financially unsophisticated individuals who are required to participate for public policy reasons, and
- the very long term nature of the investment.

The introduction of Retirement Savings Accounts (RSAs) creates a new type of superannuation-like product, operating along side traditional superannuation. It is ASFA's view that the regulation of RSAs must not undermine the current trust-based system and that the strength, simplicity and flexibility inherent in the existing regulatory system be maintained and enhanced. The Association draws attention to the need to examine carefully the Government's intention to prudentially regulate, through their current regulator (Reserve Bank of Australia for banks, Australian Financial Institutions Commission for other deposit-taking institutions or the ISC for life offices or super funds), the entities which will provide RSAs while the ISC will regulate the standards of the product. The problems associated with dual regulation are well known. Separation of prudential from functional regulation must be approached with care.

The Association argues that a consistent regulatory regime applying to all providers of retirement income savings products needs to exist not merely to benefit current members and beneficiaries, but also to reassure consumers. When the Government introduces increased choice of superannuation fund and choice of investment within a fund, consumers must be assured that they are dealing with like products that are subject to similar requirements and that their investments are both secure and earning for their future retirement.

Consumers must also have access to an efficient, cheap and timely dispute resolution mechanism in situations where they have legitimate complaints. The operations of the Superannuation Complaints Tribunal (SCT) have not, in the main, met these criteria and have placed additional cost burdens on funds and ultimately members.

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1. Changes Affecting Superannuation Funds since 1981

The terms of reference for this inquiry call for a review of financial deregulation flowing from the 1981 *Inquiry into the Australian Financial System*, chaired by the late Sir Keith Campbell. We recognise that the Campbell Inquiry marked a critical turning point in the Australian economy, particularly for the banking sector.

The Campbell Inquiry did not, however, focus on non-lending sectors of the financial system such as superannuation funds. In 1981, superannuation funds were a considerably smaller component of the Australian financial system than they are today. At that time, most superannuation funds were established by employers, and concentrated in the public sector and among large private sector employers and covered less than one half of the workforce. Though relying on the trustee structure, superannuation funds faced little external regulation and benefits drawn by members were generally in the form of a lump sum, which attracted minimal taxation.

We argue that, rather than 'deregulation', superannuation funds have actually experienced increased levels of external regulation since 1981. Indeed, this increased level of external regulation has accompanied the integration of superannuation with broader public policy objectives over the past 15 years. However, this regulation has primarily been principle-based standards which, as defined by the Industry Commission, 'outline the desired outcomes by specifying the spirit or broad intention of the regulation and require interpretation according to circumstances'.[1]

What changes have affected superannuation funds over the past 15 years? Underlying most of these changes is the acceptance by both the previous and the current Federal governments that superannuation is more than just an investment vehicle, it is a central component of retirement incomes policy. This current regime of superannuation seeks to ensure intergenerational equity, namely lifting the burden of providing retirement income from future taxpayers and placing it on current income earners who will eventually benefit. As well, the current superannuation regime seeks to promote improved national savings, which benefit the long term prospects of the Australian economy.

Several changes have taken place over the past 15 years in the regulation of superannuation which have helped bring about these policy objectives. These include:

- a tax regime which has increasingly sought to have benefits taken as income streams rather than as a lump sum, through changes made in 1983 and 1988;
- the introduction of the compulsory Superannuation Guarantee for employees in 1992; and
- a new and more demanding government sponsored prudential regime, SIS, in 1993, which replaced the Occupational Superannuation Standards Act and Regulations, which was introduced in 1987.

An expanded explanation of these changes is provided in Appendix A.

These changes have taken place in the context of general acceptance of the long-standing and accepted principle of trusteeship in relation to the management of superannuation funds. Most of these changes attempt to better regulate superannuation, so the system can substantially achieve the assigned policy objectives of providing retirement income for Australian, both now and in the decades to come.

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[1] *Regulation and its Review: 1994-95* (1995) The Industry Commission. Melbourne, p.13.

2. Current Regulatory and Prudential Regime

There are two main structures which ensure adequate regulation of superannuation funds so that they meet the long term objectives of providing retirement income for members: the trustee system and the government sponsored prudential regime.

1. Trustee System

The trustee system has long been the accepted mechanism for managing superannuation funds. The main principles of trusteeship, namely a trustee designated to administer funds in the best interests of the beneficiaries, is suited to the administration of superannuation funds with their long term objectives and often large number of financially unsophisticated members.

The trustee system precludes investment decisions taken in the interests of the employer, the union, any of the trustees or the institution providing the superannuation product; it also prevents other parties being able to exercise influence over the decision except in very limited circumstances. Although superannuation arrangements may be offered by a series of financial service providers, the fund must have a trust structure.

2. Government Sponsored Prudential Regime

Superannuation funds are regulated by the Superannuation Industry Supervision (SIS) regime, a collection of regulation primarily centred around the *Superannuation Industry (Supervision) Act 1993*. This regulatory regime is built upon the fact that the responsible entity is the trustee. SIS places a series of requirements on the way in which trustees manage superannuation funds. The duties of trustees under trust law are reiterated within the principle-based requirements set out in SIS, namely that funds are to be invested prudently and with the sole purpose of providing for the beneficiaries. Penalties, including fines and imprisonment, are imposed on the trustees for breaches of SIS.

The SIS regime places certain obligations upon superannuation trustees, including operating standards for:

- disclosure of information to members
- management and trusteeship of the fund
- the benefits and payment standards
- accepting contributions and benefit accruals granted
- financial and actuarial reporting

The main regulatory body in charge of administering and interpreting the SIS regime is the Insurance and Superannuation Commission (ISC). The main regulatory body which receives and acts upon member complaints is the Superannuation Complaints Tribunal (SCT). More detail regarding the government sponsored prudential regime, including other regulation which affects superannuation, is set out in Appendix A.

The ISC functions as both prudential regulator, in promoting safe practices within institutions, and as a consumer regulator, in areas such as disclosure requirements. We note that although areas such as disclosure may be primarily concerned with protecting consumer interests, it also functions as an additional prudential check on fund trustees.

In our view, maintaining the trustee structure is paramount for the sound prudential management of superannuation funds. The trust relationship, with its origins in English common law, provides a simple, strong and flexible structure within which superannuation funds can operate. It is easily understood, with its obligation placed on the trustees to make decisions in the best interests of fund members, and can be applied to funds of all sizes. The current trustee system has served superannuation funds, trustees and fund members well.

The current regulatory approach towards superannuation funds contains strong elements of principle-based regulation. For instance, trustees are entrusted to carry out their duties by meeting a series of principles, which find their origins in trust law but are formalised in the statutory obligations set out in SIS. These obligation include the duty to manage investments for the sole purpose of providing for beneficiaries, to be prudent managers of money and to carry out their responsibilities in a fair and reasonable manner.

A principle-based approach to regulation, as currently exists in aspects of superannuation regulation, acknowledges that regulation cannot effectively prescribe or anticipate all potential activities. As has been noted in reports such as the Industry Commission's *Regulation and its Review 1994-95*, this approach permits flexible interpretation and enforcement in a rapidly changing environment.

The regulatory regime for superannuation is also flexible in that it does not prescribe onerous investment controls. Acting within the broad principles, trustees can seek optimal long term returns from their investment decisions. Rather than requiring a certain amount of capital to be held in reserves or directing or limiting the type and nature of investments, superannuation trustees have the full range of investment possibilities. This enables trustees to tap the power of the market for the long term benefit of fund members and beneficiaries. Trustees also maintain discretion in determining the funding rate and the election of trustees is currently open to flexible approaches, depending on the circumstances of the particular fund.

As well, the enforcement strategy adopted by the Insurance and Superannuation Commission is primarily co-operative rather than combative. ISC audits of superannuation funds, as they are currently conducted, aim to be educative and promote better practice rather than being intrusive and penalty-focussed. The ISC has worked with the industry to promote what we believe is a 'culture of compliance' among trustees.

While there have been some areas of overlap between the ISC and the Australian Securities Commission, in areas such as the regulation of investment advise to consumers, we would support measures to resolve such overlaps and inconsistencies.

However, we do have concerns about creeping prescription unnecessarily entering the regulation of superannuation funds. One example of such prescription is the requirement for a separate treatment of the use of derivatives in addition to the normal risk management procedures. Increasing levels of prescriptive obligation may result in a preoccupation with addressing the form of compliance rather than the substance.

Another area of concern is the operation of the Superannuation Complaints Tribunal (SCT), established in 1994. While we acknowledge and support the need for a body which handles the complaints of members and consumers, we have some concern about the ability of the SCT to adequately handle such matters in a quick and efficient manner. In particular, we have grave reservation about the ability of the SCT, as it currently functions, to deal with the additional responsibilities associated with Retirement Savings Accounts (RSAs). This is not to diminish our belief that consumer convenience and confidence demands a single complaints handling body for superannuation and like products. We acknowledge also the potential benefits of a 'one-stop shop' for member and consumer complaints across all financial services and products.

The Eighteenth Report of Senate Select Committee on Superannuation (April 1996) identified many of the problems with the SCT. These include administrative problems and slow processing of complaints. While we acknowledge that a new organisation such as the SCT might require an initial period for developing systems and processes, the report identified that a lack of experience in the superannuation area, poor internal systems and poor staff management all hampered the SCT's operation. In addition, the requirement for either the Chair or Deputy Chair to sit in relation to all matters, limited the SCT's ability to deal with complaints in a timely fashion.

These administrative problems, combined with the powers of the SCT to replace trustees' decisions with its own have created uncertainty and apprehension among trustees. Also, the recent ***Pope and Ors v Lawler and Ors***, *Federal Court, 7 May 1996* decision, where a judge overturned the decision of both the trustees and the SCT in the payment of a death benefit, is placing considerable administrative burdens on trustees as they attempt to interpret the implications of the judge's decision and meet their statutory obligations at the same time. We argue that the SCT's operation be further reviewed to prevent any onerous 'second-guessing' of the trustees' decisions, and permit the SCT or any future complaints body to expedite trivial or simple complaints.

Finally, we suggest that the principle-based approach in superannuation regulation may actually provide valuable insights for future reform. This would particularly be the case if the Inquiry sought to suggest ways of moving away from the more prescriptive regulatory approach that exists elsewhere in the financial services industry. However, superannuation funds have, somewhat conveniently, relied upon the established notion of trusteeship to broadly define the rights and obligations of fund trustees, members and beneficiaries. The rights and obligations which flow from the contractual relationship in a retail situation may make a similar principle-based approach in other areas of financial services somewhat less practical.

3. Impact of these Changes

As has already been noted, the integration of superannuation into the broader public policy fabric has seen considerable change in how superannuation is externally regulated. We note that this approach ensures both strong prudential safeguards and flexibility.

Within the context of public policy and regulatory change, superannuation funds have grown dramatically in size and diversity over the past 15 years. While the number of funds has fluctuated between 127,000 in 1986-87 and 74,000 in 1990-91, the total fund assets have consistently increased throughout the 1980s and into the 1990s. In nominal terms, the assets held in superannuation funds rose from $21.6 billion in 1982-83 to $243.8 billion by March of 1996. More details regarding the size and shape of superannuation funds are set out in Appendix B.

These assets are held in a wide variety of asset classes. Importantly, superannuation funds are critical players in providing much needed capital within Australia. Currently, superannuation funds hold $81 billion in Australian equities, a full one-third of all superannuation assets, and an estimated 15% of all share equities held in Australia.

The majority of Australians are now covered by superannuation. Recent figures from the Australian Bureau of Statistics show that 87% of full-time employees, and 62% of part-time employees in Australia, are covered by superannuation. Lower, but still considerable, is the 42% of self-employed people who are covered by superannuation. In total, 81% of the 8.1 million Australians employed as of November 1995 were covered by superannuation.

The 1980s and 1990s have also seen an increase in the diversity of superannuation funds. Most of the industry funds, which now offer a low cost alternative in superannuation, were established in the period since 1981. The trustee boards of these funds now have equal representation of employers and members, as do funds sponsored by single employers. Public offer funds, provided by financial institutions such as life office subsidiaries, are also important players which emerged in the 1980s. As well, in recent times we have seen varied interest in ‘excluded’, the so-called DIY superannuation funds, often favoured by the self-employed and small business people.

Diversity has also emerged in highly competitive areas such as asset allocation consultancies, fund management and custodian services, as trustees constantly weigh up the costs and benefits of alternative services.

Lastly, in addition to compulsory contributions (which exist for public policy reasons) superannuation funds are competing against other investment vehicles for voluntary contributions. Indeed, the Insurance and Superannuation Commission estimates that over half of the $26 billion contributed to superannuation in 1995 were voluntary contributions, that is contributions over and above those required under the Superannuation Guarantee. Obviously superannuation remains an attractive competitor to other investments for many Australians.

4. Factors Affecting the Future

The ageing population is a critical issue which confronts the superannuation industry, as it does all of Australian society. It was a realisation of this massive demographic shift that partially drove the acceptance of the current reforms regarding the role of superannuation within our retirement income policy.

The form in which superannuation benefits are taken will be an increasingly important issue for regulators of the future. With the current system still in its infancy, much of the regulatory attention has been directed towards the collection of contributions and the managing of those funds. However, as more and more members near retirement age, it will be incumbent upon policy makers and regulators to consider how best to manage superannuation benefits.

We expect increasing attention by policy makers over the coming decades to encourage benefits to be taken as an income stream throughout retirement, rather than as lump sums. Further we would expect policymakers to address the need to better integrate superannuation benefits and the age pension, to better ensure a retirement income system which is both fair and sustainable. Other policy matters such as the elimination of age discrimination, increased female participation in the paid workforce and changing family structures and social mores will all be important challenges for the superannuation industry and regulators to deal with.

As the population ages and the benefits of the current superannuation system are increasingly apparent, we expect there to be growing consumer understanding and confidence in superannuation.

We agree that there will be an ever-increasing blurring of traditional lines between the institutional providers of financial services, including superannuation. However, we should not assume that this eliminates the differences between products offered by the financial sector. Just because a financial institution 'takes your money, then later gives it back to you plus some', in no way renders apparently similar financial products identical. Different products often serve very different needs and objectives.

The objective of superannuation is to provide retirement income. This point is clearly recognised and accepted and has been reinforced by public policy and bipartisan support. Regulation must be crafted which ensures that superannuation funds and 'superannuation-like' products can meet this objective.

Retirement Savings Accounts (RSAs)

The introduction of Retirement Savings Accounts (RSAs) creates a new type of 'superannuation-like' product, operating along side traditional superannuation. It is ASFA's view that the regulation of RSAs must not undermine the current trust-based system and that the strength, flexibility and simplicity inherent in the existing system be maintained and enhanced. The Association draws attention to the need to examine carefully the Government's intention to provide for prudential regulation of the entity which provides RSAs through its current regulator (Reserve Bank of Australia for banks, Australian Financial Institutions Commission for other deposit-taking institutions or the ISC for life offices or super funds) while the ISC regulates the standards of the product. The problems with dual regulators are well known. Separation of prudential from functional regulation, including consumer protection, must be approached with care.

The lack of a trustee structure will undoubtably create certain difficulties, many of which have been identified by the Government. These include how to deal with decisions which require trustee discretion, such as the payment of death and disability benefits, and the clear liability and accountability placed upon trustees in the prudential framework. Further we would argue that the lack of a trustee structure means that consumers with RSAs will miss out on the benefits flowing from superannuation funds, such as involvement in fund affairs and the long term, strategic approach in investments.

Choice of fund

The introduction of RSAs has been promoted by the Government as a means to increase choice and competition in superannuation, which in their view would putting downward pressure on fees and charges and encouraging better standards of service.

However, the government expects choice within superannuation to be further expanded through other measures.

One is the proposed abolition of superannuation provisions from all federal awards and barring the Australian Industrial Relations Commission (AIRC) from dealing with superannuation as an employment matter, as set out in the *Workplace Relations and Other Legislation Amendment Bill 1996*, currently before the Senate. While such reforms would eliminate award-based requirements for superannuation contributions to be directed to specific funds, such reforms alone would not actively encourage choice of fund, merely eliminate one source of compulsion. The Government now believes that agreements between employers and employees at the enterprise, workplace or individual level should determine where contributions should be directed.

Further, the Government proposes that superannuation funds must provide choice of investment within a fund to members by 2000. However, little detail has been provided on what this would mean and how it would be implemented.

Obviously, a choice-driven environment requires the maintenance of high standards of prudential control, not merely to ensure the adequacy of a fund, but also to reassure consumers of the viability of their future benefit.

Choice of fund and choice of investment within a fund will also require funds to adopt electronic commerce solutions if they are to control costs and manage administration efficiently. This will introduce a new dimension to regulation.

Consumer education and protection

We would argue that consumers must be educated and informed in such a choice-driven environment as contemplated by the current Government so that they can make appropriate choices, given their circumstances. It is only through the creation of an informed consumer base can we hope to have a choice-driven system that works for the benefit of consumers. We believe that it is jointly the responsibility of the government, regulators and the industry to ensure that consumers are educated and informed.

As well, adequate disclosure requirements are critical, especially if consumers are expected to compare the relative strengths and weaknesses of different products and providers. ASFA would expect equitable treatment for all like products, including RSAs. If a product is labelled as a superannuation product, then consumers need to be able to expect consistency and transparency when dealing with such products which claim to do the same or similar things.

We also believe that consumers should have recourse to an efficient complaint and dispute resolution mechanism when they are provided with material or information that is misleading or false, or for members when they feel their rights under SIS or the trust deed have not been met.

We see the potential benefit in a single consumer regulator. An initial 'clearing house' or 'one-stop shop' for complaints about financial services by clients, customers, members or shareholders (as well as their estates or beneficiaries) would avoid confusion and prevent 'forum shopping' by consumers of financial services. However, we would expect that superannuation matters would be dealt with in the context of a regulatory framework which acknowledges the unique aspects of superannuation, in particular the obligations placed upon trustees.

Only through effective consumer protection, adequate disclosure and restraints on potential abuses of market power can the superannuation system hope to effectively deliver benefits to consumers, particularly in a more competitive environment driven by individual choice.

5. Alternative Regulatory Possibilities

Regulation does not exist as an end in itself but in order to meet other objectives. For instance, it aims to protect the interests of those unable to protect themselves. It attempts to curb inappropriate actions while encouraging appropriate ones. All the while it seeks to avert a calamitous situation, where a sizeable failure or fraud would harm participants and undermine confidence within the institutions and possibly the wider economy.

Obviously there are compliance costs associated with regulation. As such the benefits gained from the regulations should be weighed up against the costs of a regulatory regime which is overly cumbersome or prescriptive.

Further, the public policy role now played by superannuation, in areas such as retirement income, national savings objectives and government budgetary planning, must inform decisions regarding how superannuation is regulated.

In addition to the unique role played by superannuation in public policy, there are several characteristics of superannuation that should influence its regulation. These include:

- its compulsory nature (unlike most other savings and investments, which are voluntary);
- the huge number of funds, including funds that may only cover a handful of people;
- the large number of financially unsophisticated individuals who are required to participate for public policy reasons; and
- the very long term nature of the investment.

These characteristics demand a particular regulatory approach. They require a system of prudential regulation which is strong. At the same time, there needs to be a system which is flexible enough to harness the benefits of the market while meeting public policy objectives. We argue that the trustee system, the principle-based standards set out in SIS and the cooperative enforcement strategy of the ISC, affords the correct mix between strong prudential controls and flexibility.

We warn against any attempts to overly prescribe what is required of trustees. A principle-based approach needs to be adhered to and prescription avoided, if trustees are not to be burdened with unnecessary compliance costs and are unable to respond flexibly and in the members' best interests.

Whether superannuation funds were regulated by a superannuation division of a 'mega-regulator' rather than the ISC, or under a superannuation section of a future *Financial Services Act*, rather than through SIS, is not our major concern. We can see the benefit of a single prudential regulatory body spanning across all financial services. We recognise that this would:

- prevent 'forum shopping';
- enable glaring and unworkable inconsistencies to be dealt with;
- ensure that the conglomerates (who may cross-subsidise various institutional activities) and new entrants in providing 'financial services' (be they telecommunication companies, computer networks or as yet undreamt of service providers) be fully captured and examined within the regulatory system.

Superannuation funds or superannuation-like products should be subject to a prudential regime which will enable the specific concerns and objectives presented by superannuation to be met. We would therefore expect any superannuation division within a 'mega-regulator' to essentially supplement the trustee system, as does the ISC in enforcing the SIS system.

Appendices

Appendix A - Review of the Regulatory Regime Affecting Superannuation Funds in Australia since 1981

Appendix B - Selected Facts and Figures on Superannuation Funds in Australia

Appendix C - The Association of Superannuation Funds of Australia Limited (ASFA)

Appendix A - Review of Regulatory Regime Affecting Superannuation Funds in Australia since 1981

Tax changes

Changes to superannuation tax since 1983 have been designed to encourage the retention of termination benefits in the superannuation system until retirement, and to make taking benefits as an income stream more attractive than taking benefits as a lump sum.

Until 1983, lump sum payments were essentially tax free with only 5% of such a benefit included as taxable income. Lump sums from pre-1983 service were grandfathered; those from post-1983 service were taxable at 15% (plus the Medicare levy) up to a threshold of $50,000; and lump sum amounts above that threshold were taxable at 30% (plus levy).

In 1988, a wide assortment of tax changes affecting superannuation was introduced, which included:

- a tax on superannuation fund income was introduced;
- the deduction available for personal contributions was increased;
- a tax rebate for superannuation pensions and annuities provided; and
- a new system of Reasonable Benefit Limits (RBLs) was introduced.

In 1992, a series of modifications to the tax treatment of superannuation took place including a flat (rather than age-related RBL), the (deferred) raising of the preservation age to 60 and a 15% rebate on pensions and certain types of annuities.

Compulsory superannuation contributions

In 1986, the Australian Conciliation and Arbitration Commission handed down its findings on a productivity case in which the Australian Council of Trade Unions (ACTU) had sought a national award of a 3% superannuation payment for Australian workers, in lieu of a 4% wage increase flowing from productivity gains. This ACTU claim had the support of the Labor Government, as a trade-off for wage restraint. Although the Commission refused to include a superannuation payment as part of the award, it eventually decided to arbitrate for a 3% award superannuation payment to all employees working under awards where negotiations on superannuation between employers and unions had broken down. This meant that eventually all employees working under Federal awards (and State awards when the decision flowed on) would be eligible for a minimum of 3% superannuation cover. Thus many employees, previously not in receipt of superannuation contributions, became entitled to occupational superannuation provided by their employer.

There were a number of shortcomings in award superannuation. While the provision of award superannuation did lead to a massive increase in the number of Australians receiving occupational superannuation support, a large number of workers are not employed under an award. Consequently, many workers remained without occupational superannuation entitlements. There were also problems with the enforcement of award superannuation payments, as many employers either ignored award requirements or failed to negotiate for award superannuation with their employees.

The Government, in continuation of its policy of containing wage increases and encouraging national savings, negotiated with the ACTU for a further 3% superannuation award contribution from employers in return for moderated wage claims. However, in 1991 the Industrial Relations

Commission adjourned consideration of the award increase in the face of concerted opposition from employers and because of concern with the non-compliance with existing award provisions.

All of this was occurring within a climate of belief that the ageing of the population would lead to a crisis situation in the early twenty-first century. Given the pay-as-you-go nature of the Australian age pension system, the ageing of the population would result in a relatively small proportion of the population in employment supporting a comparatively large group of retirees from taxes which were therefore likely to become excessive.

One solution would be for the current generation in employment to make provision for their own retirement by contributing to superannuation. This need had been recognised in the 1989 *Better Incomes* Statement by the then Minister for Social Security. However, the existing levels of superannuation for the vast majority of the workforce were insufficient to avoid reliance on the age pension in retirement. The minimum award level (3%) was not rising with the urgency which many thought necessary to avoid the looming crisis in the funding of retirement income.

In August 1991, the Labor Government announced the introduction of the Superannuation Guarantee system (SG), established under the *Superannuation Guarantee (Administration) Act 1992* (SGAA) and commenced from 1 July 1992. This move required all employers to make superannuation contributions of 3% to a complying superannuation fund, for employees earning more than $450 a month. The SGAA further established a timetable for increases in the minimum level of employer contributions, to reach 9% by 2002. The SG and this timetable have is also accepted by the Coalition government.

The Labor Government also announced, in its May 1995 budget statement, its intention to introduce a compulsory 3% contribution by employees to be phased in from 1 July 1997. This was to be accompanied by a Government co-contribution which will be capped and means-tested. The Coalition government has broadly committed itself to these changes, but has reserved the right to alter the actual way in which the benefit is delivered.

Employers who fail to provide the minimum SG support for their employees to a complying superannuation fund are liable to pay the Superannuation Guarantee Charge to the Australian Taxation Office (ATO). Employers are able to count toward their SG obligations any superannuation contributions that they already make, including any made under industrial awards, provided they meet all requirements under the *SGAA.*

New Government Sponsored Prudential Regime

As award superannuation spread throughout the workforce in the mid and late 1980s, the Labor Government issued guidelines outlining standards relating to fund trustees and award superannuation arrangements. In July 1986, the Occupational Superannuation Group (OSG), the forerunner of the Insurance and Superannuation Commission (ISC), was set up to regulate superannuation funds and regulatory standards were published which amongst other things provided for:

1. full immediate vesting of award superannuation contributions by employers, which meant that the employee had an immediate full entitlement to the benefits arising from the employer's contributions; and

2. compulsory preservation of benefits arising from award contributions until retirement at or after age 55, where an employee became entitled to a benefit on ceasing employment.

These measures had the effect of enabling workers to accumulate a superannuation benefit at retirement age, albeit a small one, even though they may have worked for numerous employers.

In 1987 the position of Insurance and Superannuation Commissioner (ISC) was established to administer the *Occupational Superannuation Standards Act 1987* (OSSA) and Regulations, and to oversee the operations of superannuation funds. The Regulations supported the policy goals of fuller vesting, preservation and portability, and also enhanced the prudential supervision of superannuation, particularly by requiring improved reporting and communications between trustees, members, fund actuaries, auditors and the Government.

The Government enacted a package of legislation that sets out prudential standards for the superannuation industry. The major component of the package is the *Superannuation Industry (Supervision) Act 1993* (SIS) which replaced OSSA and had effect from the start of the 1994/95 year. This legislation has had a profound impact on the administration of superannuation funds because it provided the basis for Federal Government regulation and supervision of the superannuation industry.

Superannuation funds are currently regulated by the Superannuation Industry Supervision (SIS) regime, a collection of legislation and regulation primarily centred around the *Superannuation Industry (Supervision) Act 1993*. The SIS regime primarily places numerous obligations upon superannuation trustees including:

- disclosure of information to members
- management and trusteeship of the fund
- the benefits and payment standards
- when contributions may be accepted and benefit accruals granted
- financial and actuarial reporting

SIS places a series of restrictions on the way in which superannuation funds are handled. Broadly, the requirements placed on the trustees are reiterated, namely that funds are to be invested prudently and with the sole purpose of providing retirement income.
Other restrictions on how superannuation funds handle their money include:

- a prohibition on lending money
- a prohibition on granting financial advice to members or their relatives
- a prohibition on borrowing money, expect in certain restricted circumstance
- a requirement that investments be made with a view of achieving a commercial rate of return
- a ceiling on ‘in-house assets’

As well SIS requires all superannuation funds (including previously ‘excluded funds’ from the 1 July 1996) to prepare an investment policy which weighs up risk, cash flow, diversification and liabilities.

The Insurance and Superannuation Commission (ISC), formally established in 1987, controls the operation of superannuation funds, approved deposit funds (ADFs) and pooled superannuation trusts (PSTs) under SIS. Thus SIS sets out the minimum conditions with which a fund must comply in order to receive tax concessions available to regulated funds that have ‘complying status’. The ISC also regulates the insurance industry.

In order for a regulated fund to remain complying the trustees must ensure that the fund operates within the requirements of the SIS and trustees must complete an ISC Annual Return and lodge it with the prescribed fee. Ultimately, the assessment of compliance or non-compliance by the ISC determines the tax rate applied to the income of the fund. Compliance is assessed on the basis of the ISC Annual Return which requires certification by the trustees that they have complied with the regulations. It also requires certification by the independent auditors that the return is consistent with the accounts and records of the fund and that there was no evidence to suggest that the fund had not complied with the regulations.

In addition, the ISC also monitors funds for other breaches of SIS standards which call for penalties other than loss of compliance, and take appropriate action where such breaches are identified.

The ISC is becoming increasingly active in its own audit of funds and in assisting funds to achieve compliance through the education of fund members, trustees and other superannuation professionals. A further aim is to maintain appropriately high standards for responsible people in the industry by monitoring eligibility criteria and weeding out any unsuitable individuals.

Superannuation funds are not compelled to comply with SIS. However, by becoming complying superannuation funds they receive more generous tax concessions than if they had not sought to comply with SIS.

The current regulatory regime does afford some flexibility in dealing with the huge number of funds which only cover a few people. Funds with four or less members are considered excluded funds and are exempt from some of the requirements under SIS, due to the compliance costs. It has been recognised that it is appropriate to have a less extensive prudential and supervisory regime for small funds, in particular where the fund members and trustees are often the same people and often members of the same family.[2]

If found in breach of SIS, the superannuation fund may lose its favourable tax treatment, though this is not always the case. Serious breaches of SIS may result in trustees facing severe penalties, including imprisonment.

The Superannuation Complaints Tribunal was established under the *Superannuation (Resolution of Complaints) Act 1993* to deal with member complaints about decisions of trustees of regulated superannuation funds. It offers an alternative dispute resolution mechanism to a court of law.

The Tribunal may not deal with a matter unless it is satisfied that it has already been considered by a fund's internal dispute resolution procedure which must be established under SIS. To qualify as a complaint, the Tribunal must also be satisfied that the trustee has made a decision in relation to a member of a fund, and the complaint concerns that decision being in excess of trustee powers, an improper exercise of trustee powers, or, unfair or unreasonable.

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[2] The choice of four members as the cut-off however is somewhat arbitrary and it may be desirable to consider recasting "excluded" funds to make sure they are funds where members and trustees are in very close contact.

3. Other forms of regulation affecting superannuation funds

While the trustee system and the government sponsored prudential system form the basis of how superannuation funds are governed and regulated in Australia, it is obviously not the case that these are the only two areas which impact upon superannuation funds, either directly or indirectly. The Superannuation Guarantee, social security and age pension law, tax law, anti-discrimination law, industrial law (including individual awards and agreements), family law, corporations law, securities law and the legal regulation of other financial institutions and products (particularly those that claim to offer long term 'superannuation-like' products) all impact on the ability of the superannuation fund to meet its objectives.

<u>Australian Taxation Office</u>
The Australian Taxation Office (ATO) administers the *Income Tax Assessment Act 1936* (ITAA), and in particular, the tax rules on superannuation in respect of contributions, fund earnings, and benefits (including Reasonable Benefit Limits).

Under the ITAA the income of a complying fund is taxed at the concessional rate of 15%. The income of a non-complying fund is taxed at the highest personal marginal rate (currently 47% plus Medicare levy).

The ATO also administers the *Superannuation Guarantee (Administration) Act 1992.* Employers who fail to provide the minimum SG support for their employees to a complying superannuation fund are liable to pay the Superannuation Guarantee Charge to the ATO. The employer must calculate whether the SG contribution obligations have been met. If not, then the employer is liable to pay the SG Charge in respect of any employee for whom there is a shortfall. The employer has to prepare an SG statement and lodge it with the ATO, together with the payment of the SG Charge.

The ATO redistributes the shortfall payments plus interest to the relevant employees in the form of a voucher which can be lodged with a complying superannuation fund or ADF. The fund then has 14 days to claim payment from the ATO for the amount shown on the voucher.

<u>The Department of Social Security</u>
The Department of Social Security is responsible for the administration of a number of social security benefits, including the age pension, service pensions and related payments. The Department implements the income and assets tests associated with the age pensions and the various aspects of income accrual in managed investments.

<u>Industrial Relations Tribunals</u>
The Industrial Relations Tribunals in the Commonwealth sphere and in the various States have until recently had a role in the determination of disputes concerning award superannuation and even voluntary occupational superannuation to the extent that it is an industrial relations matter.

However under the proposed *Workplace Relations Bill 1996*, currently before a parliamentary committee, superannuation is a condition of employment that will be removed from awards. As such, the legislation sees superannuation as an employment matter 'that would generally be for determination at the enterprise or workplace level', in other words, within a certified agreement or Australian Workplace Agreement.[3]

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[3] *The Reform of Workplace Relations* (1996) Office of the Honourable Peter Reith. Canberra. p.8.

Human Rights and Equal Opportunity Commission
The Human Rights and Equal Opportunity Commission is the Federal body that administers the *Sex Discrimination Act 1984* and the *Disability Discrimination Act 1992*.

The *Sex Discrimination Act 1984* makes it unlawful to discriminate on the grounds of sex, marital status or pregnancy in the terms or conditions of employment or the provision of goods, services or facilities. Either or both of these aspects can apply to superannuation funds. The Act contains some specific exemptions for superannuation funds, but these are now quite limited.

Agencies exist in the various states and territories to administer their own anti-discrimination legislation.

Appendix B - Selected Facts and Figures on Superannuation Funds in Australia

1. Superannuation Funds, by Assets, Number of Funds and Number of Accounts, Australia, March 1996

Type of Fund	Total Assets ($billion)	Number of Funds	Number of Accounts (million)
Corporate (or "employer" superannuation funds)	48.9	3,340	1.3
Industry	13.7	100	5.5
Public Sector	62.9	100	2.8
Public- Offer (or "retail" superannuation funds)	57.4	960	6.0
Excluded (Under 5 members)	22.5	103,300	0.2
Balance of statutory funds	38.4		
Total Assets	***243.8***	***107,800***	***15.7****

Source: Insurance and Superannuation Commission *Superannuation Bulletin* Released July 1996, Figures for March 1996.
(* Totals may not exactly add up due to rounding of decimal points)

2. Employees with Superannuation Coverage, by gender and Employment Status, Australia, November 1995

Labour force status	Covered (million)	Covered (%)	Not covered (million)	Total Employed
Total Males employed	3.775	90.0%	0.831	4.606
Males employed full-time	3.571	85.5%	0.606	4.177
Males employed part-time	0.205	91.5%	0.224	0.429
Total Females employed	2.769	79.4%	0.716	3.486
Females employed full-time	1.822	88.8%	0.230	2.052
Females employed part-time	0.947	66.1%	0.486	1.433
Total persons employed	6.544	80.9%	1.548	8.092

Note: taken from Table 1 of *Superannuation Australia - November 1995* issued by the ABS 6319.0

3. Superannuation Member Accounts, by Gender, Australia, March 1996

Type of *Fund	Male 000's	Female 000's	Total Members 000's
Corporate	793	510	1,304
Industry	3.071	2,428	5,499
Public Sector	1,290	1,461	2,751
Retail	3,957	1,997	5,954
Excluded	124	83	207
Total	***9,236***	***6,479***	***15,751***

Source: Insurance and Superannuation Commission *Superannuation Bulletin* Released July 1996, Figures for March 1996.
(* Totals may not exactly add up due to rounding of decimal points)

4. Assets Held by Superannuation Funds, by Asset Class, Australia, March 1996

Asset Class	Amount ($billion)	Percentage of Total
Cash with banks	6.5	2.7%
Cash with others	4.0	1.6%
Loans	10.9	4.1%
Short-term securities	17.9	7.3%
Long term securities	41.7	17.1%
Equities	81.5	33.4%
Land & buildings	14.8	6.0%
Other Australian assets	8.8	3.6%
Overseas assets	34.7	14.2%
Other directly invested assets	2.5	1.0%
Directly invested assets of excluded funds	19.1	7.8%
Total assets	***243.8***	*

Source: Insurance and Superannuation Commission *Superannuation Bulletin* Released July 1996, Figures for March 1996.
(* Totals may not exactly add up due to rounding of decimal points)

5. Growth of Superannuation Funds and Assets, Australia, 1982-83 to 1995-96

	Number of Superannuation Funds	**Fund Assets ($ billions)**	**Fund Assets (% of GDP)**
1982-83	na	21.6	13.4
1983-84	na	na	na
1984-85	na	na	18.6
1985-86	na	na	21.1
1986-87	127,000	na	na
1987-88	123,000	94.9	31.7
1988-89	105,000	108.3	31.8
1989-90	88,000	124.3	33.5
1990-91	74,000	134.6	35.6
1991-92	76,000	154.1	39.9
1992-93	83,000	169.1	42.0
1993-94	86,000	185.4	43.5
1994-95	107,000	224.0	49.4
1995-96 (March figures)	107,800	243.8	na

Source: Piggott and Bateman (1996) Unpublished. Australia - Census of Superannuation Funds, 1982-83, ABS 5636.0; Superannuation Funds, Australia 1984-85, 1985-86, ABS 5649.0; Assets of Superannuation Funds and ADFs, ABS 5656.0 and ISC unpublished data.

6. Recent and Projected Superannuation Assets by Type of Fund, Australia, 1992-2019

	Billions of Dollars in current prices							
	Funds held for those in employment							
Year	Public Sector Defined Benefit Funds	Private Sector Defined Benefit Funds	Private Sector Defined Contribution Funds	Total SGC Funds	Personal & rollover funds	Self employed	Funds held for those retired	Grand Total all funds
1992	48	42	23	19	25	21	5	183
1993	51	45	25	22	29	22	9	203
1994	55	48	28	26	32	22	12	223
1995	60	53	31	32	37	24	14	251
1999	79	71	49	66	53	29	26	373
2004	115	106	85	147	77	36	44	610
2009	160	152	135	259	105	44	75	930
2014	212	207	196	400	140	51	122	1328
2019	270	270	270	572	186	56	188	1812

Notes: Based on *Aggregate and Distributional Analysis of Australian Superannuation using the RIMGROUP Model* by George P Rothman, presented at the Fourth Annual Colloquium of Superannuation Researchers, July 1996.

Appendix C - The Association of Superannuation Funds of Australia Limited (ASFA)

The Association of Superannuation Funds of Australia Limited (ASFA) is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members.

To this end, ASFA will apply its energies and resources in:

- promoting the importance and value of superannuation for Australians in providing for their retirement;

- providing advice which is (and is recognised as being) of the highest quality to Government and others on superannuation, all other aspects of retirement income policy, and in related areas;

- educating and informing its members and the public regarding all matters related to superannuation; and

- promoting best practice in the operations of superannuation funds;

and, in doing so, will continually strive to represent superannuation funds, their trustees and their members.

Our organisation represents and includes as members:

- public sector funds
- corporate funds
- industry funds
- public offer (or 'retail') funds; and superannuation service providers.