

The Committee for the Financial System Inquiry
Treasury,
Parkes Place,
Parkes
ACT 2600

September 5, 1996

FAX: 06 263 2898

Dear Committee of Inquiry,

I enclose the submission from the Australian Institute of Superannuation Trustees for consideration as part of your inquiry into the Australian financial system.

I have enclosed one bound copy, one unbound copy and a computer disk with a copy of our submission in MS-DOS format Microsoft Word for your convenience.

We look forward to your Report. Please contact me if you wish to discuss any aspects of our submission or would like any further details from my organisation.

Yours sincerely,

Dr Diana Olsberg
Executive Director

**SUBMISSION TO THE FINANCIAL
SYSTEM INQUIRY**

**from the
AUSTRALIAN INSTITUTE OF
SUPERANNUATION TRUSTEES**

September, 1996

AUSTRALIAN INSTITUTE OF
SUPERANNUATION TRUSTEES INC.



INC NO. A022540897

**Australian Institute of Superannuation Trustees
National Secretariat
Level 12, 313 Latrobe Street,
Melbourne Victoria 3000**

AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES (AIST)

The Australian Institute of Superannuation Trustees (AIST) is a national non-profit organisation **run by trustees for trustees**. AIST is the only organisation solely dedicated to representing the interests of superannuation fund trustees in Australia.

AIST now has more than 800 members from over 350 corporate, industry and public sector funds which hold more than \$50 billion of accumulated assets.

Superannuation funds with a trustee structure which equally represents employers and members operate entirely for the financial interests of fund members. Such funds are accountable to and protect the interests of fund members. Trustees of these funds are personally legally liable for the efficient and effective operation of the funds and the protection of members' savings accumulated in the funds.

AIST has a national program of educational and other member services for trustees of these superannuation funds to enhance the skills and expertise of trustees and so the performance of superannuation funds. These services include:-

- A national program of education and training workshops and in-house educational programs for whole trustee boards.
- Special trustee-focussed education through regular local seminars, workshops & conferences. The seminar program comprises monthly seminars in Sydney and Melbourne and three seminars each year in Brisbane, Adelaide & Perth.
- A Practical Handbook for Superannuation Trustees - the most comprehensive reference book available for trustees - easy to understand with an easy to use format, and annually updated for latest developments.
- A quarterly National Newsletter with articles on timely issues, updates of AIST activities and other happenings of interest to trustees. Opportunities for input from AIST members to discuss experiences and opinions.
- Opportunities to become part of national and local communications and information networks for trustees.

EXECUTIVE SUMMARY

- Superannuation has a uniquely Australian form of regulation in the legislated requirement for equal representation of employers and members on the trustee boards of the funds. This trustee structure ensures the protection, accountability and efficiency of the funds for members. The trustee structure operating under fiduciary requirements ensures that there is no conflict of interest between shareholders and fund members, so that all the money which goes into the funds is there for members' benefits. The trustee structure must be enforced and supported as the primary regulatory process to protect and advance members' benefits.
- Recently introduced more stringent legislative and regulatory procedures under the Superannuation Industry (Supervision) Act 1993 (SIS) have strengthened the existing trustee structure. This prudential framework, under the stewardship of the Insurance and Superannuation Commission (ISC), has proven to be extremely effective. The checks and balances provided by the system of prudential supervision and the independence and accountability of trustees provides an extremely strong measure of protection against fraud and malfeasance. Also, representatives of employers and members on the trustee boards have personal legal fiduciary obligations, responsibilities and liabilities. Failure to comply with these responsibilities leaves trustees open to significant penalties.
- AIST strongly believes that there is need to retain a specialist superannuation regulator, and that this should continue to be the ISC - either as a stand-alone regulator or as an autonomous unit within a mega-regulator. It is essential that this specialist superannuation regulatory body with particular professional expertise in the prudential supervision and regulation of superannuation funds continues to operate within a specific regulatory regime designed solely for the superannuation industry.
- There are substantial differences between superannuation and other deposit-taking financial institutions. There are also substantial differences between superannuation and other financial 'products'. These differences make it necessary to have specialised and flexible regulation and prudential supervision of superannuation.
- Prudential supervision of superannuation encompasses a much broader level of intensive, continuing, flexible and interactive engagement than regulation of other financial institutions and services.
- All superannuation, including all types of superannuation funds and Retirement Savings Accounts, should fall within the ambit of a single superannuation regulator. As banks and other financial institutions are to offer Retirement Savings Accounts, we believe that either:-
 1. RSA's should operate under the provisions of the SIS legislation and be subject to regulation by the ISC (or whichever body regulates the rest of the superannuation industry), and any financial institutions including superannuation funds should be allowed to offer them; or
 2. RSA's should not be used for genuine superannuation savings, but should be limited in scope in a similar way to the Superannuation Holding Accounts Reserve (ie they should be restricted to being a short term holding account which would be

transferred to a superannuation fund once the amount in the account reached a certain size).

- AIST recommends that the Government considers ways of reducing regulatory costs and burdens on superannuation funds. Certain functional regulatory requirements which currently are duplicated in the ISC, ASC and ATO may productively be aggregated under a single regulatory process. This would produce cost-saving efficiencies and deliver more focussed control of important financial operations. It is important too that regulatory procedures and prudential supervision be not so bound by legislative fiat that the regulatory bodies be prevented from engaging with industry bodies such as AIST in efforts to improve and streamline operational procedures in the implementation of the requirements of the legislation.

We hope and expect that any changes in institutional regulation will take due notice of the need to eradicate unnecessary duplication and overlapping regulatory procedures which do not add value.

- The trustees of Australia's superannuation funds are committed to working together with the Government to protect the industry and fund members' benefits as they have done so effectively in the past.

INTRODUCTION

The Australian Institute of Superannuation Trustees has continuing and extensive experience with the regulation and prudential supervision of all sectors of the superannuation industry. This experience arises both from our direct engagement with the regulatory bodies the ASC and the ISC and through the experience of the constituent members of our organisation.

AIST seeks to ensure that we in Australia have the most prudentially secure, cost effective and efficient regulation of the superannuation industry:-

- for the benefit of the trustee boards which have responsibility for and manage the funds,
- for the efficient management and administration of the funds, and
- for the fund members - those working men and women of Australia whose future lifestyles in retirement depend largely upon the benefits derived from the funds.

THE TRUSTEE STRUCTURE AND SUPERANNUATION REGULATION

Australia has a unique system for the regulation of occupational superannuation funds which we believe offers international best practice and accounts for the high level of probity of the system, and the continued trust and faith of the general public in the funds. By law in this country the trustee boards of all superannuation funds with more than five members must comprise equal representation for the employers who contribute to the funds and the employees who are members of the funds.

It is the shared responsibilities of trustees representing the interests of employers and employees, both dedicated under fiduciary requirements to protect the interests of fund members, which has given us a superannuation system that has been substantially free of the sorts of misadventures of the Maxwell kind in the United Kingdom.

There are important and compelling reasons for continuing to rely on the trustee structure in regulating superannuation in Australia, and all superannuation and retirement savings vehicles should be required to operate under a trustee structure and fiduciary requirements. Reasons include:-

- The trustee structure operating under fiduciary requirements ensures that there is no conflict of interest between shareholders and fund members, so that all the money which goes into the funds is there for members' benefits.
- Equal representatives of employers and members on the trustee boards have personal legal fiduciary obligations, responsibilities and liabilities. Failure to comply with these responsibilities leaves individual trustees open to significant penalties.
- The trustee structure ensures the protection, the efficiency and the accountability of Australia's superannuation funds. Recently introduced more stringent legislative and regulatory procedures under the Superannuation Industry (Supervision) Act 1993 (SIS)

underpins this. The prudential framework under the stewardship of the Insurance and Superannuation Commission (ISC) has proven to be extremely effective.

- The checks and balances provided by the system of prudential supervision and the independence and accountability of trustees provides an extremely strong measure of protection against fraud and malfeasance.
- The trustee structure has applied for a very long time in Australia, and has proven itself to be a highly successful regulatory structure.
- There is a well established body of statute and common law principles applying to trustees which have evolved over a long period.
- The trustee system draws people from diverse backgrounds, qualifications and experience who bring independence and contribute a range of skills and expertise which are unique to the financial services sector.
- The trustee structure provides a line of direct accountability for members which assures continued public trust and faith in the funds.
- Through the requirements of the SIS Act and the direction of trustees, communications and full disclosure with members has been given a high priority. Communications have also been made user-friendly and comprise full disclosure of all fees and charges.
- Through their direct accountability to members, trustees have introduced a much more competitive environment and have significantly reduced the costs of administration and investment management expenses for the funds.
- Trustees of the funds, both employer and employee representatives, have undertaken training and access extensive professional expertise and advice when making major decisions.

SUPERANNUATION FUNDS IN AUSTRALIA

Occupational superannuation now represents the largest new repository of domestic savings in Australia, and the accumulated capital will be a significant factor in this country's future economic growth. There are now approximately 120,000 superannuation funds in Australia, holding about \$240 billion of accumulated assets. About 115,000 of these funds are small private 'Mum and Dad' funds with less than five members. The remaining 5,000 funds are:-

- **Corporate funds** which provide a repository for superannuation contributions for employees within one enterprise. The trustee boards of these funds equally represent the employers and employees within the enterprise.
- **Multi-employer industry funds** which provide a repository for superannuation contributions for employees usually within one industry sector. The trustee boards of these funds equally represent employers or employer associations and employees or unions within the one industry sector.
- **Public sector funds** which provide a repository for superannuation contributions for employees in government and other statutory enterprises. The trustee boards of these funds equally represent employers or employer associations and employees or unions within the particular public sector organisation or statutory enterprise..
- **Master trust or Public Offer funds** which provide a repository for superannuation contributions for employees covering many employers are controlled by a trustee board, but do not have employer or employee representatives or fund member representatives on that board.

GOVERNMENT SUPERVISION AND REGULATION OF SUPERANNUATION

Government regulation of superannuation in Australia has been a process of evolutionary development reflecting both the progress of government national retirement income policies and legislation and the development of occupational superannuation funds and associated financial services.

With the growth of occupational superannuation following the Second World War, superannuation funds were regulated under the Life Insurance Act 1945. With the moves in the 1980s to extend the provision of occupational superannuation, the Occupational Superannuation Standards Act 1987 (OSSA) was introduced. That Act and the regulations made under it established a supervisory regime, operating standards and benefit limits for superannuation funds, compliance with which was a precondition for tax concessions.

An industry regulator the Insurance and Superannuation Commission (ISC) and commissioner the Insurance and Superannuation Commissioner were established to monitor and regulate compliance with the legislation and operating standards.

Significant changes have occurred in the past decade including the introduction of award superannuation, the growth of major industry superannuation funds, the introduction of compulsory superannuation for most employees, the establishment of tax advantaged rollover vehicles to encourage pension stream benefits, and a plethora of legislation concerning the taxation treatment of superannuation.

With the enormous growth in superannuation funds which resulted from the extension of superannuation across the workforce, reliance by the Commonwealth on taxation powers to regulate superannuation was considered insufficient. Legislation to strengthen prudential supervision of superannuation was introduced in 1993 with the enactment of the Superannuation Industry (Supervision) Act 1993 (SIS).

The SIS Act and its regulations significantly strengthened the powers of the ISC and supported and strengthened the existing trustee structure. Many new obligations and responsibilities were placed upon trustees and stringent personal liabilities and penalties were instituted. New, more demanding and rigorous operating and administrative standards were also instituted for superannuation funds. As well, intensive and continuing review procedures conducted by the ISC have produced significant advances in the expertise of the trustees and the efficient administration of the funds.

The increasing numbers of funds which have become corporatised and the trustee boards converted to corporate entities has brought many more superannuation funds within the jurisdiction of the Australian Securities Commission (ASC). This has resulted in considerable duplication and increased reporting requirements which may not be necessary and are certainly extremely costly to the funds and so effectively impact upon members' benefits. There are also considerable obligations on superannuation funds for regular and extensive reporting to the Australian Tax Office (ATO).

THE SPECIAL NATURE OF GOVERNMENT REGULATION OF SUPERANNUATION

AIST believes that a significant level of Government regulation of the superannuation system is necessary. However, the regulation and prudential supervision of superannuation funds is different to the regulation of other deposit-taking financial institutions.

The large number of superannuation funds and their decentralised and frequently isolated situation make it necessary for any Government regulation and supervision to retain the existing system of prudential regulation and guidelines which support the unique features of the trustee system.

The Federal Budget 1996 announced the introduction of certain legislative changes regarding superannuation. It therefore becomes even more important that some stability is retained in the institutional and organisational structures of the regulation of the system.

AIST advocates that the existing regulatory and supervisory provisions of the SIS Act and the regulatory and supervisory structures of the ISC be retained, and be allowed to continue to develop in consultation with the superannuation sector.

AIST strongly believes that there is need to retain a specialist superannuation regulator, and that this should continue to be the ISC - either as a stand-alone regulator or as an autonomous unit within a mega-regulator. It is essential that a specialist superannuation regulatory body with particular professional expertise in the prudential supervision and regulation of superannuation funds continues to operate within a specific regulatory regime designed solely for the superannuation industry.

There are already concerns that onerous Government regulatory requirements are significantly increasing administration costs in the funds. The often seemingly unnecessary duplication and overlapping regulatory requirements of the ISC, ASC and ATO continues to be an issue of considerable concern with negative impact upon members' benefits. As well, Government requirements are pushing trustee boards of the funds into short term investment policies, which are not in the best interests of members or national economic growth.

Organisations such as AIST are working towards contributing to streamlining the amount of Government regulation by strengthening the processes of prudential controls and regulation through the trustee boards of the funds.

AIST seeks to continue to liaise with the ISC, ASC and ATO in the hope of reducing duplication and overlapping regulatory requirements for the funds. We would hope and expect that any changes in institutional regulation would take due notice of the need to eradicate unnecessary duplication and overlapping regulatory procedures which do not add value.

Superannuation is different to other savings products. The extent of prudential supervision is broader than for other deposit-taking vehicles. Prudential supervision of superannuation funds must take into account not only the financial viability of the funds, but the prudent management and administration of the funds in their capacity to maximise the benefits for

the members. This is not only a consumer issue but rather addresses the very institutional character of the funds. Such prudential supervision encompasses the internal and external control procedures of the funds, the quality of contracts with service providers to the funds, the investment strategies, asset allocation, capital exposure and investment returns of the funds, the benefit allocation procedures, communications and disclosure, dispute resolution, and many other issues.

Superannuation is compulsory, unlike most other financial ‘products’. As a consequence the normal protection of “caveat emptor” does not apply. Compulsion has three aspects.

1. The decision for people to contribute to superannuation is not voluntary.
2. The amount of basic contributions is established by legislative fiat.
3. The money is locked away and unable to be accessed until an age specified in legislation (currently 55, but increasing to 60 and even later).

This compulsion places enhanced requirements on the Government regulator to ensure that members’ benefits are protected, that investment returns are maximised and fees and charges kept to a minimum.

The issue of compulsion for example poses great problems for regulation of retirement savings accounts where investment returns will be lower and accumulated savings and thus retirement benefits disadvantaged.

Superannuation funds have longer term liabilities than the remainder of the financial services sector, and hence can adopt broader investment objectives and longer term investment strategies.

In superannuation funds which operate under an equal representative trustee structure and which are bound by fiduciary requirements, there is no conflict of interest between shareholders and fund members, so that all the money which goes into the funds is there for members’ benefits. The special regulatory advantages of this trustee structure are explained earlier in this submission on pages 6 and 7.

The range of superannuation fund member benefits and member services, and the management and administration of superannuation funds are complex processes, requiring specialist regulatory personnel.

Superannuation involves regulations and processes which do not apply to other financial products, such as vesting, preservation etc.

Superannuation funds are diverse, requiring a flexible supervisory process. Superannuation funds range from large industry funds with more than one million account holders, to small corporate funds with less than 20 account holders, different types of fund benefits structures - defined benefit funds, defined contribution or accumulation funds, or hybrid funds which provide both defined benefit and accumulation benefit structures. Funds may be corporate funds, public sector funds, industry funds, excluded funds or master trust or public offer funds. Funds also provide approved deposit funds, pension funds, allocated pension funds, and other rollover and pension stream products for members.

Superannuation contributions are increasingly part of enterprise level negotiations concerning wages and working conditions between employers and employees at a single enterprise. The negotiation of contributions to superannuation, the split between employer and employee contributions etc are therefore industrial relations issues which affect the funds.

Any Government regulatory process must ensure that extensive member disclosure requirements are in place in every fund, and that these requirements are regularly monitored and evaluated. The general public must be educated to be properly informed regarding comparative fees and charges. This becomes increasingly important should there be introduction of legislation requiring choice of fund and employee investment choice in the funds.

AIST believes that all superannuation savings should fall within the ambit of a single superannuation regulator. As Banks and other financial institutions are to offer Retirement Savings Accounts, we believe that either:

1. RSA's should operate under the provisions of the SIS legislation and be subject to regulation by the ISC (or whichever body regulates the rest of the superannuation industry) and any financial institutions including superannuation funds should be allowed to offer them; or
2. RSA's should not be used for genuine superannuation savings, but should be limited in scope in a similar way to the Superannuation Holding Accounts Reserve (ie they should be restricted to being a short term holding account which would be transferred to a superannuation fund once the amount in the account reached a certain size).

