

4.39 The ACTU told the Committee that:

... all of the directors of corporate trustees of industry funds are liable personally because they are all corporate trustees. ... [The ACTU has] advised trustees that they ought to take out insurance and get very clear undertakings and reports from administrators and others to whom they delegate powers.²⁷

4.40 ASFA has also promoted a voluntary trustee insurance scheme.²⁸ The ASC suggested that an industry-wide compensation scheme such as solicitors' fidelity funds or stock exchange fidelity funds would be appropriate.²⁹ It argued that:

... straight fraud, straight crime is usually adequately fundable within a modest compensation scheme ... But, if you go wider than that, it is just transferring assets from one sector to another.³⁰

4.41 Whilst indemnity insurance could be required of all trustees and directors of corporate trustees, the Committee believes that this would be unnecessarily costly and impact adversely on small funds. The Committee strongly believes that there should be a mechanism to enable members to be compensated for fraud and was of the view that a defalcation fund was the most appropriate mechanism.

Recommendation 4.6:

The Committee recommends that legislation prescribe that an industry fidelity fund be established to protect members in the event of fraud. Levies would be determined by reference to size of assets.

Powers of Regulator

4.42 Under current arrangements the only penalty the ISC can impose for breach of OSSA and associated Regulations is to withdraw tax concessions. In effect, the perpetrators of the breach (the trustees) are immune from penalty whilst the victims (the members) suffer severe financial disadvantage if the ISC is unable to enforce the rules (for example, see the case study on ABC Engineering). There was widespread consensus in evidence put to the Committee that a range of penalties to fit the crime was needed. Both the ISC and the ASC strongly argued that the regulator should have powers to act to protect members' interests.

²⁷ Evidence, pp 363-4.

²⁸ Sub No. 89, p 33.

²⁹ Evidence, pp 1316-17.

³⁰ *ibid*, p 1317.

Recommendation 4.7:

The Committee recommends that OSSA be amended or replaced so that:

- *the ISC can impose a range of civil penalties and institute criminal proceedings against trustees and directors of corporate trustees;*
- *the ISC has power to remove trustees and directors of corporate trustees and appoint judicial managers where it suspects that trustees/directors are not fulfilling their fiduciary obligations. Such powers would need to have appropriate safeguards for individuals who were subsequently found to be innocent of any wrong doing; and*
- *the ISC be given power to institute civil proceedings against trustees and directors of corporate trustees on behalf of members.*

4.43 Evidence given to the Committee by a range of witnesses and the ISC's description of its own activities raise doubts about the ISC's ability to discharge its increased responsibilities without a substantial change in its corporate philosophy. The concern of the Committee is that staff who may have been able to discharge administrative and functional tasks well, will not be able to pursue the more interventionist and activist role for the ISC envisaged by this report.

Recommendation 4.8:

The Committee recommends that sufficient resources be given to ISC staff retraining development and recruitment so that it can discharge its increased responsibilities as envisaged in this report.

Rights of Members

4.44 If implemented, the recommendations outlined above will greatly improve the level of investor protection available to members of superannuation schemes. However, the Committee believes that as trustees have powers to amend the scheme and the members have little or no choice of fund, legislation should also specify the rights of members.

Recommendation 4.9:

The Committee recommends that OSSA be amended or replaced so that the rights of members are clearly identified in legislation including:

- *the right to seek recovery of loss from trustees and directors of corporate trustees;*
- *the right to information about financial statements, auditors and actuarial reports, investment strategy and change in ownership of the corporate trustees;*
- *the right to information about proposed changes to the trust deed;*
- *the right of access to an alternative dispute resolution process; and*
- *the right for benefits to remain unencumbered, i.e. the employer cannot place a lien over actual or emerging benefits.*

4.45 Whilst the Committee supports the principle of members having powers to remove trustees and directors of corporate trustees through meetings, it is concerned that for a large geographically disparate membership, grievances against trustees may be more effectively addressed by the ISC or industrial relations tribunals. It appeared to the Committee that whereas the ISC has acknowledged expertise in superannuation, industrial relations tribunals have a great deal of expertise and experience in negotiating settlements to work-related grievances. The Committee believes that many potential grievances against trustees could be resolved by conciliation and arbitration such as occurs in the industrial relations tribunals. However, the Committee recognises that tribunals may only have powers to arbitrate disputes between members and trustees in funds nominated in industrial awards. This raises the spectre of the ISC arbitrating on disputes between trustees and members for certain employer-sponsored schemes and master trust arrangements and the industrial relations tribunals arbitrating where the fund is nominated in an industrial award. In such circumstances there is clearly scope for divergence in the interpretation of any legislative guidelines regarding the powers of members to convene a meeting. Accordingly, the Committee believes that further work as outlined in the following recommendation is required.

Recommendation 4.10:

The Committee recommends that the ISC, in conjunction with union, employer and industry groups, examine the practicalities of OSSA giving members the right to requisition a meeting for the purpose of:

- *giving directions to the trustees or directors of the corporate trustees which are consistent with the terms of the deed; and*
- *removing the trustees or directors of the corporate trustee provided that any trustees appointed subsequently maintain the requirement for equal employer/employee representation.*

4.46 Whilst some witnesses suggested that superannuation funds be required to have annual general meetings³¹, the Committee does not believe the cost of such meetings could be justified at present given the relatively uneducated membership. The Committee suggests that a requirement for annual general meetings be kept under review, but that priority be given to increasing community understanding of superannuation.

4.47 The Committee notes that the new information disclosure requirements to operate from 1 July 1992 have been generally endorsed by the industry but believes that there are three areas where information disclosure could be further improved:

- (i) audit by the fund's auditor;
- (ii) compliance auditing by the ISC; and
- (iii) increasing the amount of information publicly available.

³¹ Sub Nos. 38, 48.

Figure 4.5

ABC Engineering*

ABC Engineering is owned by its Australian partners (53 per cent) and by UK interests (47 per cent).

In 1978 the company established a contributory superannuation fund. The fund was a defined contribution fund requiring contributions of 5% of salary by both the employer and employee. At least two of the three trustees of the fund were directors of the firm.

No regular statements were provided to members and employees who left the firm received their benefits by way of payments made from the firm rather than the fund.

Late in 1988 it became apparent that one of the directors of the firm, who was also a trustee of the superannuation fund, had embezzled money from both the firm and the fund. This director appeared to have sole responsibility for investment of the superannuation funds assets and for maintaining its accounts. The director committed suicide before the full extent of the fraud was uncovered.

The directors of ABC called a Board meeting to discuss the extent of compensation to fund members. The meeting was advised that around \$600 000 was owed to the members. The Board agreed to meet this liability from the firms' assets, subject to the agreement of 75% of shareholders as required by the firm's Articles of Association. The UK shareholders refused to approve the transaction and ABC has since refused to accept responsibility for the fund loss.

Since then, other allegedly fraudulent acts have been uncovered and the directors of the company have been involved in extensive legal action against each other.

In 1990 a UK director came to Australia to try to resolve the situation. Further litigation commenced and in August 1991 all employees of the firm were dismissed without receiving any of their superannuation benefits. The total liability of the fund to its 12 members is now estimated at \$975 500.

The members have not been able to take legal action themselves against the directors of the firm and trustees of the fund because of the cost of court action (estimated to be in excess of \$500 000) and their own difficult financial situation.

*Note: Names have been changed because the submission has not been published. The Committee believes the circumstances to be factual.

4.48 In circumstances where superannuation funds are managed and invested by the private sector, the auditor assumes special significance for the security of funds. Some witnesses, including Mr Boffa³², County NatWest,³³ the Attorney General's Department³⁴ and Prudential³⁵, agreed that the Government could be more prescriptive in what it required of auditors. The Committee notes that the ISC has begun discussions with the accounting profession with a view to improving the superannuation content of professional development programs and that the ISC is participating with the

³² Evidence, p 522.

³³ Sub No. 98, p 105.

³⁴ Sub No. 107.

³⁵ Sub No. 41.

accounting profession and others in the drafting of an audit guide for superannuation funds which will be made available to auditors generally.³⁶

4.49 The Committee believes that the auditor plays a key role in prudential supervision because the ISC relies on the certification of an independent auditor as to a fund's compliance with the OSS Regulations. The joint submission from the Institute of Chartered Accountants and the Society of Certified Practising Accountants made some particularly useful suggestions with regard to that role³⁷ and the Committee's recommendations reflect this input.

³⁶ Sub No. 151, p 13.

³⁷ Sub No. 119.

Recommendation 4.11:

The Committee recommends that:

- *OSSA be amended to require the fund's auditor to be independent of the sponsoring employer(s), union(s) or promoter;*
- *A Board of Superannuation Auditors be established and that only auditors registered with the Board be able to sign the audit certificates on superannuation funds' annual returns;*
- *registered superannuation auditors be required to audit anti-fraud internal controls within the fund and report to members on the fund's procedures for:*
 - *regular reconciliation of accounts*
 - *regular supply of statements from investment managers*
 - *checks on benefit entitlements, proof of identity etc. before benefits are made*
 - *authorisation of payments to members, investment managers and creditors*
 - *custody procedures for share certificates, bonds and stocks etc.*
 - *signatory procedures;*
- *where the registered superannuation auditor believes internal controls are inadequate, the auditor be required to advise the ISC if the scheme has failed to take action to rectify deficiencies identified in the audit within two months;*
- *registered superannuation auditors be required to report on the assets and liabilities of superannuation plans, including the level of in-house assets and if the fund is a defined benefit fund, whether the fund is underfunded and/or its capacity to meet promised benefits;*
- *registered superannuation auditors be given powers to audit the decision making process of the fund's investment managers for the selection of asset categories, sectors and securities;*
- *registered superannuation auditors be required to advise the ISC of any qualified finding on the superannuation scheme; and*
- *relevant details of the actuarial report be incorporated in the audit report following each actuarial review.*

4.50 If the Committee's recommendation in respect of internal audits is accepted, the ISC compliance audit can be targeted at areas where there is reason to believe members' entitlement might be at risk. The ISC acknowledges that its audit program needs strengthening and consultations have begun with the Australian Taxation Office on how

the ISC audit effort can be co-ordinated with that of the ATO.³⁸ The Committee believes that the ISC is inadequately resourced to carry out this function at present.

Recommendation 4.12:

The Committee recommends that high priority be attached to the ISC developing an effective random audit program.

4.51 In order to facilitate greater investor protection and public awareness of superannuation, the Committee believes that there should be wider discussion of superannuation issues. By requiring disclosure to the public at large, the investment strategies and financial statements of funds can be analysed by industry experts, the financial community and the media. The Committee notes the ALRC recommended that only large funds be required to provide information to the ASC.³⁹ However, evidence presented to the Committee indicates that problems are more likely to arise in small funds.

Recommendation 4.13:

The ISC should be required to create and maintain a national database along the lines of the ASC companies database so that the financial press and industry experts can report independently on superannuation funds with arms' length members; that is, funds with five or more members. The information available on the database should include:

- *financial information;*
- *names of trustees, fund managers, fund administrators, auditors and other advisers;*
- *proposed amendments to trust deeds;*
- *proposed repatriation of surpluses;*
- *performance against benchmarks.*

The Committee recommends that financial information on the database should be available within six months of the end of the financial year or at the time the information is made available to members if this is earlier.

4.52 The Committee recognises that implementation of the recommendations in this report will impose additional costs which may particularly disadvantage smaller funds. However, the Committee considers it desirable that some existing small funds join master trust arrangements so that ISC resources can be better targeted on audit and compliance procedures.

³⁸ Sub No. 151, p 13.

³⁹ ALRC Report No. 59, *op cit*, p 134.

ATTACHMENT – CHAPTER 4

TEXT OF NEW INFORMATION DISCLOSURE REQUIREMENTS RELEASED BY THE TREASURER CONCURRENTLY WITH THE 1991/92 BUDGET. THE STANDARDS WILL APPLY FROM 1 JULY 1992

OCCUPATIONAL SUPERANNUATION STANDARDS (OSS) REGULATIONS: DISCLOSURE OF INFORMATION TO MEMBERS OF SUPERANNUATION FUNDS

Existing reporting arrangements

Existing Occupational Superannuation Standards Regulations reporting arrangements are primarily concerned with the provision of benefit entitlement information to superannuation fund members. An outline of these arrangements is set out in the Attachment to this paper.

Certain funds may also be subject to separate reporting arrangements which require that information relating to the financial and administrative affairs of the fund be provided to trustees or members. Life offices are required to provide information to policyholders under ISC Circulars 273, 276, 290 and 291 which deal with single premium as well as regular premium products. Funds structured as prescribed interests are subject to the disclosure and other provisions of the Corporations Law.

Proposed wider reporting requirements

Amendments to the existing disclosure arrangements will give effect to the following additional requirements for superannuation funds. These proposals will, of course, be the subject of further consultation with industry and other bodies during the process of development of the necessary amendments to the OSS Regulations.

Appropriate arrangements of a similar nature remain to be developed for Approved Deposit Funds and, in addition, consideration will be given to the particular circumstances of Pooled Superannuation Trusts.

Commencement

The additional disclosure requirements for superannuation funds will apply to funds complying with the standards and conditions prescribed under the OSS Act and will be phased in from 1 July 1992. In particular, annual reports on the financial condition and administrative arrangements of funds will be required in respect of the 1992-93 and subsequent years of income.

Application

The additional disclosure requirements will apply to all funds with 5 or more members. The requirements will allow fund trustees either to provide the information set out in paragraphs 7-18 to members or to satisfy themselves that such information has been provided to members. The effect of this is that the requirements for provision of

information to members on their entry to a fund will be substantially satisfied in the case of life insurance based superannuation arrangements by the provision of information required under ISC Circular 290 by the life office, with additional information necessary to comply with these disclosure requirements being provided by the trustee or by the life office.

Additional information to be provided on request

On request by a member, trustees are to provide prompt and convenient access to, or to ensure prompt access is provided to:

- (a) audited accounts of the fund; and
- (b) fund governing rules, or provisions of the rules that are relevant to the particular interests and circumstances of the member.

Additional Annual Information to Members

Trustees are to provide each member with a notice or annual report, or be satisfied that each member is provided with appropriate notification, as soon as practicable but in any event within a period of not more than 6 months of the end of each year of income (9 months in the case of funds providing benefit statements to members more than once a year).

This notice will be required to contain all such information as members of superannuation funds would reasonably require, and reasonably expect to have provided, for the purpose of making an informed judgement as to the financial condition and administrative arrangements of the fund. Details of any significant or material change subsequent to the date of the notice will be required to be provided by addendum.

The notice will provide the following specified information:

- (a) the name of the superannuation fund;
- (b) a statement whether it is the trustees' intention to operate the fund as a complying superannuation fund and, if so, a statement that they have no reason to believe the fund will not be accepted as a complying superannuation fund or, if that is not the case, a statement of the reasons why it may not be or has not been accepted as a complying superannuation fund;
- (c) the following advice relating to fund or sub-plan accounts -
 - (i) where the accounts have been audited at the time of issue of the notice, advice that fund audited accounts and auditor's report are being distributed to members or are available on request by members. Where such audited accounts are not distributed to members with the notice, the notice is to include abridged financial information and a statement as to whether there

were any qualifications in the auditor's report and details of any such qualifications;

- (ii) where the accounts have not been audited at the time of issue of the notice, advice as to when the audited accounts are likely to be distributed or are likely to be available on request. Consideration will be given to requiring the relevant abridged financial information drawn from the draft accounts to be included. Details of any material variations to this financial information or any qualifications in an auditor's report received subsequent to the issue of the notice will be required to be provided to members;
 - (iii) the abridged financial information (to be developed by the ISC in consultation with relevant industry and other bodies and issued as guidelines) will show information such as the net assets available to pay benefits, the amount of investment revenue and contributions received and benefits paid, together with other key information of relevance to the fund type;
- (d) where employers of members contribute to a fund or sub-plan, a statement that all contributions which, to the knowledge of the trustees, are payable by employers have been received, or if there are known to be substantial or material arrears, information as to any action being taken regarding those arrears;
- (e) a statement of the fund or sub-plan investment objectives and the policy and strategy being used to meet those objectives. This statement will include -
- (i) details of the classes of assets (along the lines of those shown on the ISC Annual Return form) in which the fund or sub-plan was invested and details of the total assets of the fund or sub-plan at the last balance date and the immediately preceding balance date, subdivided to show the amount or proportion represented by each of those classes of assets;
 - (ii) an outline of any futures, options or other derivative mechanism strategies relevant to fund or sub-plan assets;
- (f) where at balance date the value included in the balance sheet of any single investment, or the combined value of all investments in the same or associated entities exceeds 10 per cent of the total value of the fund or sub-plan assets as shown in the balance sheet, a description of all such investments and their values. (This disclosure requirement will extend to investments made by a fund manager on behalf of a superannuation fund. An investment in a 'pooled' arrangement will be considered a single investment.);
- (g) where an investment manager or other financial advisers or consultants have been appointed to control the investment of all or any part of the fund, the name(s) of the manager(s) appointed and, if the manager is associated with the fund trustees, sponsor or administrator, details of that association;

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- (h) a statement of the basis on which the fund's crediting rate and reserves are determined;
 - (i) the names of the trustees holding office during the period to which the notice relates, as well as at the reporting date to which the notice relates and, for each such trustee, advice as to whether that trustee was appointed by members, the employers or some other person or group;
 - (j) the names of the members of any separate sub-plan management committee at the reporting date;
 - (k) advice of fund or sub-plan members' right of access to the documents specified in OSS regulation 17(1)(i) and to the additional information specified to be provided on request at paragraph 7 above;
 - (l) advice as to where (and to whom) members may make inquiries regarding the fund (including requests for access to audited accounts, actuarial reports and governing rules or other information that is required under the Regulations to be available on request);
 - (m) in addition to the existing requirements for the disclosure of the amount or rate of net earnings allotted to the member, advice as to -
 - (i) the amount (or basis of calculation) of any fees, charges or other expenses charged to the member's account or to the fund or sub-plan;
 - (ii) the actual rate (or amount) of earnings of the fund or sub-plan in the year of income to which the accounts relate and in the previous two years of income (or such lesser period as may apply); and
 - (n) a summary of governing rule provisions, or the fund's policy, with respect to fees and charges applicable to accounts (whether active or dormant) including -
 - (i) initial or establishment charges;
 - (ii) continuing management, administrative service charges (including fees levied against fund earnings);
 - (iii) termination charges.

Missing Members

In recognition of administrative difficulties being experienced by funds, consideration will be given to providing some relaxation of the annual reporting requirements in a situation where it is clearly established that a member is no longer able to be traced.

Pension and deferred benefits

The arrangements will require members who are fund pensioners (including reversionary beneficiaries), or who have deferred benefits, to be advised once a year that the annual information outlined above is available to them on request.

Additional information to be provided prior to entry

Before joining a fund (in the case of an employer sponsored fund, before joining or as soon as is practical thereafter), trustees are to provide to a member or to be satisfied that a member is provided with:

- (a) a copy of the above mentioned additional annual information last issued to members, where necessary updated (by addendum if appropriate) to allow for material changes;
- (b) where a benefit relevant to a member is determined on the basis of actual or credited earnings, advice of the actual and credited rates which applied for each of the last three completed accounting periods. (In the case of unitised arrangements, unit price movements for each of the three accounting periods could be substituted.)

The existing Regulations will also be amended to make it clear that the member or prospective member need only be provided with details of the kinds of benefits provided by the fund or sub-plan for, or in respect of, that member.

Information to be provided at exit

Consideration will also be given to amendment of the existing disclosure requirement in respect of death benefit to ensure that advice of the amount of any death benefit that remains current after the date of exit from the fund, and the period of effect of such continuing cover, is provided.

Additional personal superannuation information before entry

In the case of personal superannuation (where not subject to prospectus requirements under the Corporations Law or ISC guidelines to life offices), in addition to the reporting requirements applicable to funds generally, trustees are to provide, or to be satisfied that the following additional information is provided, prior to entry to the fund:

- (a) the name and address of the controlling company or sponsoring organisation of the fund;
- (b) name and address of ultimate owner of corporate trustee (if different from the controlling company or sponsoring organisation above);

- (c) names and addresses of any administration managers or other appointments made by the trustee(s) in conjunction with the operation of the fund;
- (d) a summary of the key features of the operation of the fund;
- (e) the manner in which the value of the account will be determined on termination (to the extent that this is not provided in accordance with regulation 17(1)(g)).

Additional information relating to master trust and similar arrangements

The annual and entry disclosure requirements outlined above will apply to master trust or master fund arrangements in the same manner as they will apply to other superannuation funds, subject to provision of the following additional information:

- (a) the name and address of the company controlling or sponsoring the master trust fund; and
- (b) the identity of any relevant sub-plan.

Return of surplus to employer

Appropriate arrangements for the provision of information to members in advance of a repatriation of surplus moneys from a superannuation fund to a sponsoring employer will be developed.