Parliament of the Commonwealth of Australia

First Report of the
Senate Select Committee on Superannuation

Safeguarding Super

THE REGULATION

of

SUPERANNUATION

June 1992

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PREFACE

A civilised society endeavours to ensure that its citizens can maintain a reasonable standard of living during retirement. Governments have a key role to play in formulating policies for the provision of retirement income through either the social security system or private means.

In Australia, the past decade has seen fundamental change in the retirement incomes debate. An increasing awareness of changing demographic structures and the likely impact of these on government outlays, increased longevity and higher expectations about the standard of living of retirees have meant that we as a community have had to rethink the way in which we provide for retirement.

Consequently, significant changes have occurred including the introduction of a minimum pension standard expressed as a proportion of Average Weekly Earnings, the introduction of award superannuation, the growth of major industry superannuation funds, the establishment of a rollover market and a plethora of legislation concerning the taxation treatment of superannuation. It was in the context of these changes that the Senate established a select committee to inquire into and report on superannuation.

This first report of the Committee, *Safeguarding Super*, addresses those terms of reference which have a direct bearing on the security of superannuation funds and the need for such moneys to be invested in a way which maximises retirement savings. In this context the Committee acknowledges the work of the Australian Law Reform Commission (ALRC) in its recently published report on *Collective Investments: Superannuation* and further acknowledges that an exchange of views and ideas took place between the Commission and the Committee during the preparation of both reports.

The Committee heard evidence which has led it to conclude that, whilst there has been a small number of superannuation fund failures, there does not appear to be widespread malpractice in this industry. However, the Committee is conscious that increases in superannuation savings will inevitably attract operators who will seek to use superannuation moneys for their own use. The Committee was strongly of the view that appropriate safeguards need to be put in place now to minimise the risk of fraud, misappropriation and bad management practices.

This report defines those areas requiring attention and makes a number of recommendations on the structure of the industry and its prudential framework. The Committee is conscious that the costs and benefits of regulation need to be carefully considered and fine judgements are often made on the optimal level of government intervention. We think that the right balance has been struck in our recommendations.

It is the hope of the Committee that the recommendations contained in the report will be the subject of informed public discussion on superannuation.

NICK SHERRY
CHAIR
June 1992

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Senators R. Alston (Deputy Chair) N. Sherry (Chair), S. West

Rear left to right:

Senators J. Watson, C. Kernot and B. Childs.

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LIST OF ABBREVIATIONS

AAPBS	Australian Association of Permanent Building Societies
ABS	Australian Bureau of Statistics
ACM	Australian Chamber of Manufacturers
ACTU	Australian Council of Trade Unions
ADF	Approved Deposit Fund
AFCO	Australian Federation of Consumer Organisations
AIF	Australian Infrastructure Fund
AIIM	Australian Infrastructure Investment Management
AIRC	Australian Industrial Relations Commission
ALRC	Australian Law Reform Commission
AM	AM Corporation Ltd
AMP	Australian Mutual Provident Society
ARF	Australian Retirement Fund Pty Ltd (sponsoring organisations are the Australian Chamber of Manufacturers and the Australian Council of Trade Unions)
ASC	Australian Securities Commission
ASFA	Association of Superannuation Funds of Australia
ASX	Australian Stock Exchange Limited
ATO	Australian Taxation Office
AWE	Average Weekly Earnings
AWU	Australian Workers Union
BT	Bankers' Trust Australia
BUS	Building Unions Superannuation Fund for employer bodies and unions in the building industry, together with the ACTU
CFM	Commonwealth Funds Management Ltd
Corporations Law	The Corporations Law, set out in the *Corporations Act 1989*
County NatWest	County NatWest Australia Investment Management Limited
CPI	Consumer Price Index
DA	Deferred Annuity
DAF	Development Australia Fund
DIR	Department of Industrial Relations
DSS	Department of Social Security
EPAC	Economic Planning and Advisory Council
ETP	Eligible Termination Payment
GDP	Gross Domestic Product
HESTA	Health Employees Superannuation Trust Australia which administers the industry scheme for health employees
HOSTPLUS	Host Plus Pty Ltd. It is the superannuation scheme for persons in the hospitality and liquor industries
IAA	Institute of Actuaries of Australia
IFA	Investment Funds Association of Australia Limited
IOOF	Independent Order of Odd Fellows of Victoria
IOSCO	International Organisation of Securities Commissions

IR&D Board	Industry Research and Development Board (Department of Industry, Technology and Commerce)
ISC	Insurance and Superannuation Commission
ITAA	*Income Tax Assessment Act* 1936
Jacques Martin	Jacques Martin Pty Ltd
LIA	*Life Insurance Act 1945*
LIFA	Life Insurance Federation of Australia
Mercers	William M Mercer Campbell Cook and Knight
MLC	MLC Ltd
MMBW	Melbourne and Metropolitan Board of Works
MTIA	Metal Trades Industry Association
NML	National Mutual Life Association of Australasia Limited
Noble Lowndes	Noble Lowndes Superannuation and Consultants Limited
OSS Regulations	Regulations under the *Occupational Superannuation Standards Act 1987*
OSSA	*Occupational Superannuation Standards Act 1987*
PST	Pooled Superannuation Trust
RBA	Reserve Bank of Australia
RBL	Reasonable Benefits Limit
REST	Retail Employees Superannuation Trust (an industry superannuation fund primarily for employees in the retail and pharmacy industries)
RISA	Retirement Income Savings Accounts
Rothschilds	Rothschild Australia Asset Management Limited
SGL	Superannuation Guarantee Levy
STA	Superannuation Trust of Australia (whose Trustee is Employer Union Superannuation Pty Ltd)
Tasplan	Tasplan Superannuation Fund for employees and employers in the private sector in Tasmania
TCA	Trustee Companies Association of Australia
TPC	Trade Practices Commission
TPF&C	Towers Perrin Forster and Crosby, Inc
Westscheme	Westscheme Pty Ltd is the superannuation scheme for employees and employers in the private sector in Western Australia

GLOSSARY

Term	Definition
Accumulation Fund	A superannuation plan where the employer and/or employees contribute a set amount that accumulates and earns income for the benefit of the members.
Allocated Pension	A pension where the member has his own account against which pension payments are debited and to which any investment earnings are credited. The pension will continue until the death of the pensioner, or until the account is exhausted. Upon death, any balance remaining in the account is paid to a designated beneficiary as a (taxable) lump sum payment, or is applied to secure a further pension payment to a surviving spouse.
Annuity	A private pension for a fixed term or for life usually bought with a member's Eligible Termination Payment (ETP). An annuity can be bought so that regular repayments are made back to the member in the form of a pension.
Approved Deposit Fund (ADF)	A tax-effective method of investing a member's ETP. The lump sum payment and the earnings on it remain tax free while in the fund. An ADF has to be withdrawn by age 65.
Arms' Length	A term which refers to the relationship between the employer company and the members of a superannuation fund. If the members of the fund are employees of the sponsoring company, an arms' length fund is said to exist.
Award Based Contributions (or Award Superannuation)	Contributions determined by an Industrial Tribunal paid by the employer to a superannuation plan for all eligible employees.
Beneficiary	The person who receives the benefit from a superannuation plan, annuity, pension, death or disability insurance.
Capital Guaranteed Fund	The original capital and sometimes declared investment return are guaranteed.
Capital Stable Fund	These funds have slightly more risk than capital guaranteed funds because, in addition to low risk fixed interest assets, they often include investments in low risk equities or shares.

Commutation	Term used to describe the process whereby one type of superannuation benefit is commuted (changed) to another type, for example conversion from a pension to a lump sum.
Deferred Annuity Fund (DAF)	Money held in an annuity until retirement, after which regular payments are made to the member.
Defined Benefits Fund	A superannuation fund that contracts to pay a member a fixed or defined amount of money that is linked to the salary level.
Dependency Ratio	Proportion of non-workers (defined as those under 15 and over 65) to those of working age.
Eligible Termination Payment (ETP)	The lump sum paid to a member on retirement, job termination or death. It includes superannuation contributions and accrued sick leave, but not holiday pay or long service leave. ETPs can be rolled over into approved rollover funds (ADFs and DAFs).
Equities	Stocks and shares not bearing fixed interest.
Family Fund	A superannuation fund which is a non-arms' length fund in which the members of the fund are owners of the sponsoring business.
Friendly Society	A society which by voluntary subscriptions provides for the relief or maintenance of its members and their families in sickness, old age, etc.
Fund Administrator	The person nominated by the fund trustees to receive contributions and on their instructions make payments to retirees and transfer assets to the fund manager for investment.
Fund Manager	The person nominated by fund trustees to invest assets of a superannuation fund.
In-House Asset	An investment made by a superannuation fund in the company sponsoring the superannuation plan, that is, the company which is employing the contributors to the fund.
Lien	The right to hold property or to have it sold or applied for payment of a claim.

Term	Definition
Life Office	A firm which sells life insurance and other insurance products, for example, life cover, superannuation bonds, annuities and superannuation.
Life Policy	A contract of insurance agreed to when a person purchases life insurance.
Lost Member	The classification given to a member of a superannuation fund whose current postal address is not available.
Lump Sum Benefit	A benefit paid out in a single cash payment.
Master Trust	A trust arrangement which allows a single trustee appointed by the promoters of funds to administer and manage the superannuation funds of a number of employers.
Occupational Superannuation	Pension or retirement benefit arising from an employment contract.
Portability	Allowing a superannuation plan to be transferred from one fund (or one employer) to another.
Preservation	Maintenance of a member's entitlements in a superannuation fund until a specified minimum age (usually at least 55).
Prudential Controls	The measures instituted to supervise and control activities in the superannuation industry to ensure the security of contributor's funds.
Reasonable Benefits Limit (RBL)	The maximum limit on the amount a member can receive from superannuation, ADFs or DAFs, with preferential taxation treatment. The limit can be calculated from a member's highest average salary.
Repatriation of Surplus	The act of transferring surplus assets in a superannuation fund to the sponsoring employer.
Rollovers	When a member changes jobs and takes an ETP from a superannuation fund, ADF or DAF, this lump-sum can be transferred to other schemes without losing the tax advantage.
Securities	Financial instruments which are evidence of debt or of property. Bonds, certificates of stock and shares are documents which indicate the existence of a security.

Surplus	Those assets of a superannuation fund that represents the excess of accrued earnings and contributions over the fund's accumulated liabilities.
Superannuation Fund	Fund designed to produce retirement benefits for members. To attract tax concessions, it must have these characteristics: (a) be indefinitely continuing, and (b) be maintained solely for following purposes: provision of benefits for fund members, or for dependants of each member in the event of death, or any other purpose allowed by the Insurance and Superannuation Commission in writing.
Trust	A fiduciary relationship in which one person (the trustee) holds the title to property for the benefit of another (the beneficiary).
Trust Deed	Formal document setting out rules governing how a fund operates.
Trustee	The person or persons responsible for carrying out the rules of a Trust Deed.
Unfunded Superannuation	A superannuation plan where no fund has been established but superannuation benefits have been defined; and the employer meets the costs of benefits as they arise.
Vesting	The established entitlement of a member to his or her own contributions to a superannuation fund, the employer's contributions, and accrued interest.

LIST OF RECOMMENDATIONS IN RELATION TO:

(Chapters 1 and 2 do not contain any recommendations)

– CONSTITUTIONAL ARRANGEMENTS

Recommendation 3.1:

The Committee recommends that the Government seek wider counsel on its powers over superannuation and, following this, legislate directly for the regulation of superannuation, relying on a combination of its constitutional powers over taxation, corporations and pensions.

Recommendation 3.2:

The Committee recommends that the Government explore the possibility of obtaining a referral by the states, either formal or de facto, of their power over superannuation.

– REGULATION OF SUPERANNUATION FUNDS:

Recommendation 4.1:

The Committee recommends that the ISC become the sole regulator of superannuation products to give certainty and clarity to the operation of the industry.

*However, the Committee acknowledges that the RBA and ASC may consider it necessary to impose some additional requirements on institutions which fall within the ambit of their regulatory responsibilities. If this is the case, there is clearly a need for greater **effective** co-ordination between the regulatory authorities than occurs at present.*

The Committee recommends that the RBA, ISC, ASC and TPC liaise both formally and informally on a regular basis.

Recommendation 4.2:

The Committee recommends that an independent review of ISC resources be carried out following tabling of the Government's response to this report so that ISC resources are compatible with its increased regulatory responsibilities. The Committee endorses the 'user pays' concept as a means of supplementing budgetary allocations.

The review should include analysis of improvements required to procedures to ensure that the ISC is able to provide figures on the superannuation industry for the previous financial year at the time its Annual Report is tabled in Parliament. The Committee believes that it is unacceptable that statistics produced by the ISC are up to four years out of date.

Recommendation 4.3:

The Committee recommends that the Government introduce legislation to give a greater degree of statutory independence to the ISC by appointing a panel of commissioners with proven expertise in superannuation from a wide cross-section of the community.

Recommendation 4.4:

The Committee recommends that the Occupational Superannuation Standards Act (OSSA) be amended or replaced so that the duties and responsibilities of trustees and directors of corporate trustees are clearly spelt out, including a duty:

- *to maintain a diversified portfolio unless members advise to the contrary;*
- *to maintain an appropriate level of liquidity;*
- *to limit the level of in-house investment (see Chapter 7);*
- *to keep proper accounts;*
- *to ensure the equitable treatment of members of superannuation funds;*
- *to inform members about matters materially affecting the fund;*
- *to seek independent legal, auditing, and actuarial advice;*
- *to avoid conflicts of interest; and*
- *to be personally responsible for the administration of the trust.*

To facilitate consumer understanding of trust deeds, the Committee recommends that the legislation prescribe the wording of these provisions in trust deeds.

The Committee further recommends that neither the original trust documents nor any amendment of them can authorise a departure from any of the statutory requirements.

Recommendation 4.5:

The Committee recommends that all trustees should be Australian residents and be required to pass a 'fit and proper person' test analogous to that required under the Corporations Law.

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.

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.*

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.

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.*

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.*

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.*

Recommendation 4.12:

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

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.

– TRUSTEE REPRESENTATION:

Recommendation 5.1:

The Committee recommends that the requirement for equal employer/employee representation should apply to all funds with arms' length members; that is, funds with five or more members.

Recommendation 5.2:

The Committee recommends that a list of persons willing to serve as trustees be maintained by the ISC which would be authorised to provide both employee and employer groups with details of the list to assist in the selection of trustees.

The Committee further recommends that in the event that employer or employee groups were unable to agree on a mechanism for selection of their nominees, the ISC be given arbitration powers (provided the matter is not under consideration by the AIRC) and that the ISC's determination be binding on all parties. Where such determinations are made by the ISC, they should operate for a period no longer than three years.

Recommendation 5.3:

The Committee recommends that employer-sponsored and industry funds have no mandatory requirements for independent trustees and that this be left to individual funds. However, to lessen the possibility that trustees could be pressured or coerced by particular interests associated with the fund, the Committee recommends that trustees be provided with legislative protection against action which would unfairly disadvantage them. For member trustees, this would include protection against unfair dismissal and discrimination in career advancement.

Recommendation 5.4:

The Committee believes that trustee education is essential for the long term viability of the industry and recommends that such education be given high priority by both the Government and the industry. Recognising that the structure of the superannuation industry is still evolving, particularly with respect to trustee representation, the Committee recommends that prescribed courses and training should not apply for the time being.

The Committee further recommends that the ISC should require details of the educational qualifications and/or superannuation-specific training or experience of

persons nominated as trustees. If the educational qualifications or superannuation-specific experience of trustees as monitored by the ISC have not shown significant improvement after three years, compulsory education standards should apply. The Committee commends the establishment of the Australian Institute of Superannuation Trustees Inc, and recommends that nationally accredited courses in superannuation be available in all states within five years.

Recommendation 5.5:

The Committee recommends that all master trust arrangements, including those offered by life offices, be required to have an independent public trustee.

Recommendation 5.6:

The Committee recommends that each individual plan or sub-plan with arms' length members in master trust arrangements be required to have a policy committee comprising equal representatives of employers and employees to advise the trustee.

Recommendation 5.7:

The Committee recommends that Regulation 13(e) of the OSS Regulations be amended to require all plans nominated in industrial awards to have equal employer/employee representation.

– SURPLUSES AND INACTIVE ACCOUNTS:

Recommendation 6.1:

The Committee recommends that the Government conducts an investigation to determine whether surpluses are being used for the purposes that are intended; that is, to act as a reserve against investment fluctuations. Following this review, the Committee recommends that the Government re-examine the 1995 timetable for removing the tax deductibility to the fund of a repatriation of surplus to the employer.

Recommendation 6.2:

The Committee recommends that OSSA be amended so that for defined benefit schemes:

- *all trust deeds be required to include clauses outlining the methods by which a surplus can be repatriated to the sponsoring employer, and that any changes required to give effect to this requirement be submitted to members for approval beforehand;*
- *members be given at least three months' prior notice before a surplus is repatriated;*
- *members must be supplied with a summary when such notice is given which includes the financial status of the fund, including the accrued retirement benefits index;*

- *members upon request are entitled to a copy of the original trust deed and all amendments and dates of amendments up to the date of the proposed or actual repatriation of any surplus or transfer;*

- *a minimum funding standard be satisfied immediately after repatriation – this minimum standard to be at least 110% of accrued retirement benefits;*

- *the amount of surplus that can be held in a fund is restricted – the level to be an amount not more than 20 per cent of the liabilities of the fund; and*

- *where members are to be transferred from one scheme to another, members must be advised of the clause(s) in the deed under which the transfer is being effected;*

- *where members are to be transferred from one scheme to another, that members be given two months' prior notice so that they have adequate time to seek advice on the implications of the transfer.*

Recommendation 6.3:

The Committee recommends that the fund's actuary be required to report on the level of employee and employer contributions in the context of members' RBLs.

Recommendation 6.4:

The Committee recommends that the Government investigate the nature and extent of reserves in accumulation schemes and whether reserves are being maintained for their proper purposes. The Committee further recommends that the status of reserves in accumulation schemes be clarified in the OSS Regulations.

Recommendation 6.5:

The Committee recommends that:

- *a central fund be established for lost member accounts so that all funds can be swept periodically, say every six or 12 months, in order that administration charges on such accounts be minimised;*

- *the accounts could be identified either by tax file numbers or by a superannuation number;*

- *an appropriate Commonwealth agency should tender out the administration of such a fund on a fee for service basis, on a long term contract (for example, five years) and that arrangements be made with the Australian Tax Office so that information on the balance of the account could be forwarded to individuals; and*

- *where the person is in irregular employment or changes employment frequently, the person should have the option of rolling over contributions in the central fund into an appropriate industry or employer scheme.*

– IN-HOUSE ASSET RULE:

Recommendation 7.1:

The Committee recommends that funds which do not have arms' length members be subject to the same rules as other funds. The Committee considers that to do otherwise would provide scope for tax avoidance.

Recommendation 7.2:

The Committee recommends that the in-house assets rule be reduced from ten per cent to five percent.

– REGULATION OF FUND MANAGERS:

Recommendation 8.1:

The Committee recommends that trustees who act as investment managers of superannuation funds be required to have a dealers licence. It is intended that such licensing requirements would operate in conjunction with entry requirements for trustees as outlined in Chapter 4. Trustees whose only investments were bank deposits would be exempt from the dealers licence requirements.

Recommendation 8.2:

The Committee recommends that a 'fit and proper person' test be introduced to all investment managers similar analogous to the conditions under the Life Insurance Act (LIA). The Committee further recommends that the need for capital adequacy be examined by the ISC and ASC. The Committee considers that a minimum level of capital adequacy expressed as some percentage of cash flow is desirable for funds managers, as are minimum educational qualifications, but is anxious that any such controls do not discourage niche marketing and that Australian practice is consistent with that overseas.

The Committee further recommends that the need for formal industry-specific educational qualifications be examined by the ISC and the ASC and investment competency measures, similar to dealers licensing requirements, be considered by the ISC in its review of the Life Insurance Act.

Recommendation 8.3:

The Committee recommends that the TPC monitor the funds management industry to ensure that it remains open and competitive.

Recommendation 8.4:

The Committee considers that the 'bundling' of services by the actuarial firms warrants further examination by the ISC and TPC, particularly as actuarial advisers to superannuation funds are not subject to any regulatory oversight.

Recommendation 8.5:

The Committee supports legislation requiring trustees to establish investment targets and for investment managers to report against those targets. The Committee recommends that trustees be able to seek compensation from fund managers where the latter have failed to fulfil the conditions of the management contract.

Recommendation 8.6:

The Committee recommends that the ISC, the Institute of Actuaries, the Australian Institute of Trustees Inc and other professional bodies devote resources to improving public awareness of long term returns, as well as improving the ability of funds managers to focus on those long term returns.

The Committee further recommends that trustees be required to explain to members the strategies being employed to achieve a real rate of return over a given period, preferably at least five years.

– INVESTMENT BY SUPERANNUATION FUNDS

Recommendation 9.1:

Given the attractiveness of infrastructure investment for superannuation funds, the Committee recommends that the anomalies in the Income Tax Assessment Act (ITAA) which discourage investment in infrastructure by superannuation funds be removed.

Recommendation 9.2:

The Committee recommends that no investment controls be placed on superannuation funds to compel them to invest in particular areas such as development or venture capital or infrastructure.

The Committee further recommends that trustees should have to report to members and to the ISC on investments in new asset classes such as development and venture capital and infrastructure investment.

Recommendation 9.3:

The Committee recommends that the issue of directing investment of superannuation moneys be re-examined by an appropriate Senate Committee within three years.

Recommendation 9.4:

The Committee recommends that no special restrictions be placed on superannuation funds investing overseas.

– INSTITUTIONAL COMPETITION:

Recommendation 10.1:

The Committee recommends that the existing legislative differences between ADFs and superannuation funds be removed.

Recommendation 10.2:

The Committee supports the entry of new entrants into the superannuation industry as this will widen consumer choice and introduce more competition to the industry.

The Committee recommends that cross-subsidisation of the administration costs of bank superannuation products and other banks products be legislatively prohibited under the Banking Act and that this be monitored by the Reserve Bank.

The Committee further recommends that legislation require consumers to be adequately informed about the implications of a low risk profile for bank account superannuation in terms of retirement benefits, and that the ISC and the industry conduct an education campaign to explain to consumers the importance of risky assets in an investment portfolio.

Recommendation 10.3:

The Committee recommends that the annuity market be opened up to firms of sufficient size and financial strength. Such funds would be required to meet special solvency and reporting requirements as evidence of their ability to provide indexed income streams.

Recommendation 10.4:

The Committee recommends that the Government introduce legislation to regulate the provision of allocated pensions and other flexible retirement income products as soon as possible.

The Committee further recommends that unit trust arrangements meeting solvency and reporting requirements be allowed to offer term-certain annuities.

The Committee notes that if the Government does not address broader socio-economic issues in this context, such as the preservation age, there could be a substantial cost to revenue from such arrangements.

– DISPUTE RESOLUTION MECHANISMS:

Recommendation 11.1:

The Committee recommends that the ISC produce simply worded, descriptive literature on superannuation, suitable for distribution to all existing and prospective fund members through the individual funds.

Recommendation 11.2:

The Committee recommends that, as a matter of high priority, the OSS Regulations be amended to require that, as a condition of compliance, each fund should:

- *develop and publish its policies relating to dispute resolution;*
- *nominate a person or persons to whom queries and complaints should be addressed;*
- *undertake that, if that person cannot resolve the matter, it will be referred to the trustees, who should be required to make a decision within 90 days of referral to them and to provide reasons for that decision in writing; and*
- *notify full particulars of these procedures to members on entry and annually thereafter.*

Recommendation 11.3:

The Committee further recommends that these provisions should be fully implemented within two years of their promulgation and that the ISC should monitor their introduction and operation.

Recommendation 11.4:

The Committee recommends the establishment by legislation of an external disputes resolution mechanism, at the earliest practicable date, with the following features:

- *a management board comprising nominees of the Commonwealth and participating state governments, industry bodies and representatives of the unions, women's and consumer groups;*
- *a review authority chaired by an ombudsman, who would sit with two other members drawn from a panel of fund trustees and other people with appropriate experience. The ombudsman and panel members would be appointed by the Minister from names submitted by the board;*
- *staff and supporting facilities arranged by the board and financed equally by participating governments and industry groups;*
- *the functions of the existing superannuation review mechanisms conducted by LIFA and the participating states to be transferred to the new authority;*
- *the authority should not have power to review cases on their merits but should be confined to ensuring that the trustees' powers have been exercised properly and that all relevant evidence has been considered;*
- *decisions of the authority would be final and binding on all parties; and*
- *the ombudsman and the management board should publish annual reports.*

CHAPTER 1

INTRODUCTION

Terms of Reference

1.1 On 5 June 1991 the Senate established a Select Committee on Superannuation to inquire into, and report on, the following matters:

(a) the constitutional arrangements governing superannuation;

(b) the taxation arrangements which apply to superannuation;

(c) the adequacy of prudential control arrangements applying to superannuation funds;

(d) the implications for the financial system of the expected growth in superannuation fund assets;

(e) the investment of moneys by superannuation funds;

(f) the ownership of surpluses in defined benefit superannuation funds;

(g) the level and structure of fees and commissions charged in relation to superannuation fund membership and asset management;

(h) the information available to members of superannuation funds;

(i) the representation of fund members in trustee structures of superannuation funds;

(j) the dispute resolution mechanisms available to members of superannuation funds;

(k) the rules applying to contributions and the vesting and preservation of benefits;

(l) the appropriate means of providing adequate superannuation for part time and casual employees and the feasibility of providing superannuation for people outside the workforce;

(m) the rate of employer non-compliance with superannuation awards;

(n) the possibilities for simplifying superannuation;

(o) the feasibility of providing improved benefits to superannuation arrangements in lieu of increased contributions under superannuation awards in appropriate circumstances;

(p) the need for an appropriate target and timetable for the achievement of adequate levels of superannuation; and

(q) any other relevant matters, including superannuation arrangements existing in other countries.

Conduct of the Inquiry

1.2 The Committee commenced its inquiry by placing advertisements in daily newspapers in each capital city calling for written submissions. In addition, the Committee made contact with the major industry organisations associated with superannuation inviting their participation. Letters were written to each of the State premiers and Territory chief ministers and relevant Commonwealth ministers seeking their participation.

1.3 During the period August 1991 – May 1992, over 200 written submissions (listed in Appendix 1) totalling more than 3 000 pages of evidence were received. With the exception of a very small number which contained possibly adverse or irrelevant evidence, the Committee published all submissions on receipt. This approach assisted in keeping its work at the forefront of public debate and allowed witnesses to have the benefit of access to the views of other witnesses prior to appearing at the inquiry.

1.4 The Committee made a decision not to hear any oral evidence until it had received almost all of its written submissions and had had the opportunity to consider in private sittings some of the complex issues which underpin retirement incomes policy. Consequently, during October-November 1991 a series of technical briefing sessions were convened which were addressed by senior public servants, members of key professional bodies associated with superannuation and Committee secretariat staff. This aspect of the inquiry greatly assisted Committee members in understanding and appreciating many of the issues which arose in both oral and written evidence.

1.5 Public hearings, on 24 separate occasions, were conducted in Canberra, Sydney, Melbourne, Brisbane, Perth, Adelaide and Hobart during the period 10 February 1992 to 3 June 1992. The transcript of evidence for these hearings includes oral submissions from over 200 witnesses drawn from the public and private sectors, professional bodies, community and welfare groups as well as individuals (listed in Appendix 2). Over 2 500 pages of oral evidence was recorded by *Hansard.* Again, in keeping with the Committee's stance of releasing evidence to promote public debate, uncorrected *Hansard* transcripts were circulated with the proviso that any re-publication be accompanied by an acknowledgment of their status as uncorrected proofs.

1.6 In conducting its inquiry, the Committee did not set out to pursue individuals or organisations with the intention of finding instances of maladministration, misappropriation or fraud. Instead, where pursued, such lines of inquiry were embarked upon with a view to making recommendations to improve the regulatory infrastructure which governs the administration and investment of superannuation funds.

1.7 The resolution establishing the Committee required that it report to the Senate on or before the last day of sitting in May 1992 but that it have leave to report from time to time on its proceedings and evidence taken, along with making any such interim recommendations as it may deem fit. In this regard, on 9 December 1991, the Committee Chair tabled in the Senate a background paper entitled *Super System Survey – A Background Paper on Retirement Income Arrangements in Twenty-One Countries*, which principally addressed term of reference (q), and briefly reported on the progress of the inquiry.

1.8 On 25 March 1992, following the public hearings convened in Perth, the Chair tabled a letter to the Treasurer and relevant transcripts of proceedings which expressed the Committee's concerns about the affairs of the Byrnwood Superannuation Fund. The Chair also took the opportunity to give another brief report on the progress of the inquiry.

1.9 The volume and complexity of evidence under consideration by the Committee presented it with considerable difficulties in meeting its reporting deadline. This problem was compounded when, on 4 May 1992, the Senate referred to the Committee, with another tight reporting deadline, the Superannuation Guarantee Bills. It was with these considerations in mind that the Committee sought the agreement of the Senate to extend its time of reporting.

1.10 With the Senate's concurrence, the Committee's reporting schedule is as follows:

Reporting Strategy

(i) present a report on regulatory issues which addresses terms of reference (a), (c), (d), (e), (f), (h), (i) and (j) to be tabled before the Senate concludes its 1992 Autumn sittings;

(ii) present a report on or before 17 June 1992 on the Superannuation Guarantee Bills which addresses terms of reference (l), (m), (o) and (p); and

(iii) present a report on or before 10 September 1992 which addresses those terms of reference and other relevant matters not covered in previous reports, that is, terms of reference (b), (g), (k), (n) and (q). This report will focus on consumer issues, simplification of superannuation, the interaction between superannuation and the social security system and other matters not addressed in earlier reports.

1.11 The Committee acknowledges and records its thanks to those individuals and organisations who assisted the inquiry by making written and/or oral submissions. The Committee also acknowledges its use of material contained in a previous Senate report on retirement incomes entitled *Income Support for the Retired and the Aged – An Agenda for Reform* which was tabled by the Standing Committee on Community Affairs in August 1988.

Notation Used in this Report

1.12 This report refers to written and oral evidence taken at both the Committee's on-going inquiry into superannuation issues and its specific inquiry into the Superannuation Guarantee Bills. In order to clarify which inquiry is being referred to, the Committee adopted the following practice:

- written submissions to the on-going (or general) inquiry are referred to as 'Sub No. xx';

- written submissions to the inquiry into the Superannuation Guarantee Bills are referred to as 'SG Sub No. xx' (SG standing for 'superannuation guarantee');
- oral evidence to the general inquiry (recorded in the uncorrected proof copy of *Hansard*) appears as 'Evidence, p xx'; and
- oral evidence to the inquiry into the Superannuation Guarantee Bills (recorded in the uncorrected proof copy of *Hansard*) appears as 'SG Evidence, p xx'.

CHAPTER 2

RETIREMENT INCOMES IN AUSTRALIA

2.1 The retirement incomes policy which operates in Australia has two components: the provision by government of an age pension funded from consolidated revenue and private superannuation plans supported by taxation concessions. There has also been a small group of retirees who have relied on investments not supported by superannuation tax concessions. For most of Australia's history since 1908, the emphasis in the area of retirement incomes has been on the age pension. Recently, however, demographic, social and economic forces have given superannuation a greater prominence, and underpin the decision of the Senate to establish a committee to inquire into superannuation.

PENSIONS

Historical Developments

2.2 A Commonwealth Government funded age pension was introduced in 1909 following the enactment of legislation in 1908 based on section 51 (xxiii) of the Constitution, which allows the Commonwealth to make laws with respect to invalid and old age pensions. This initiative superseded pension schemes which had been established as early as 1900 in New South Wales, Victoria and Queensland.

2.3 With the exception of the 1970s, for most of the period since 1909 the pension has been granted on the basis of need established by a means test which has been used to limit the availability of the benefit and to ensure that it is granted on the basis of genuine need.

2.4 Between 1920 and 1970, age pension coverage increased from 32 per cent to 60 per cent of the eligible population. During the 1970s, significant liberalisation of the means test occurred and following a number of reforms, age pension coverage peaked in 1978 at almost 78 per cent. In 1980 those in receipt of service, widow, invalidity and aged pensions accounted for 87 per cent of the eligible age group. [1]. Table 2.1 shows the trends in pension coverage for 1971-91. Liberalisation of the means test in the 1970s resulted in over 87 per cent of the population of pension age receiving a pension in some form (i.e. service, widow, invalidity or aged pension). Further changes to the means test have reduced the level of coverage to 75.6 per cent.

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1 Statistics Section, DSS *Social Security Pensioners and Beneficiaries as a Proportion of the Population and Labour Force*, Canberra 1992.

Table 2.1

PENSION COVERAGE 1971-91
(Recipients of Service, Widow, Invalidity & Aged Pensions)

Year	Pensioners of Age Pension Age as Percentage of Population of Age Pension Age %	Year	Pensioners of Age Pension Age as Percentage of Population of Age Pension Age %
1971	64.8	1981	86.2
1972	64.8	1982	85.3
1973	70.6	1983	85.6
1974	75.8	1984	83
1975	79.6	1985	80.6
1976	82.7	1986	79
1977	84.7	1987	77.7
1978	86.1	1988	78
1979	86.7	1989	76.9
1980	87.1	1990	75.8
		1991	75.6

Source: Statistics Section, Department of Social Security, Canberra

2.5 A major government initiative in the development of a retirement incomes policy to address the medium and long term needs of an ageing population occurred in 1989 with the release of the *Better Incomes: Retirement into the Next Century* statement, which endorsed the key conclusions of the Cass Review of the social security system, viz:

- *any major changes in retirement income policy need to be gradual in view of the long term expectations, plans and commitments involved;*
- *the aged pension should remain the cornerstone of equity and adequacy in the retirement income system;*
- *improvements in arrangements for retirement income will need to occur within the context of the present age pension and superannuation systems;*
- *incentives to work and incentives to save must be maintained and improved; and*
- *arrangements should be as simple as possible, consistent with the need for equity and effectiveness.*[2]

2 Minister for Social Security *Better Incomes: Retirement Income Policy in the Next Century 1989.* AGPS, p 17.

Ageing Population and Dependency Ratios

2.6 The *Better Incomes Statement* expressed a commitment to 'maintain the age pension as an adequate base level of income for older people'[3] but went on to state that persons retiring in the future would require a standard of living consistent with that experienced whilst in the workforce. The statement also signalled that one of the real challenges facing governments would be the retirement income needs of an ageing population. The Department of Social Security (DSS) submission[4] to the inquiry stated that, as the large post war baby boom generation begins to reach age pension age in 20 years' time, there will be around 4.1 million people aged 65 and over, or 17 per cent of the projected population. In the year 2031 these figures will rise to 5.2 million people or around 20.1 per cent of the projected population. This compares with around 11 per cent today, or 1.9 million people.

2.7 In a number of submissions, reference was made to aged 'dependency ratios', that is, the ratio of labour force participants to aged persons. A more complete picture of dependency can be given by using a total dependency ratio, which recognises that children, the disabled and the middle-aged who are adult care givers experience very limited labour force participation. Crude dependency ratios (those which take into account children and aged persons only) express the number of dependent persons per 100 members of the labour force and give a different view of the ageing population issue. They show that the ageing of the population is offset somewhat by a declining dependency on the part of the younger population. Table 2.2[5] shows Australia's position relative to other selected industrialised countries for 1980, 2000 and 2025. Whilst Australia's crude dependency rate is less than some of its overseas counterparts, it will increase significantly and present a major challenge to retirement incomes policy makers.

2.8 The challenge of an ageing society was taken up by the Jones Committee in its recent report on expectations of life into the 21st century[6]. Whilst that Committee's report down-played the ageing population problem, it found that the dependent elderly make heavy demands on the social welfare and health system and that, unlike the costs of caring for children, a small proportion only of the costs is met from private sources.

2.9 Other commentators[7] suggest that dependency ratios are limited because they do not take into account the differential expenditure levels of the very old and the very young, economic growth and changing expectations regarding an adequate level of retirement income.

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3 *ibid* p 3.

4 Sub No. 127, pp 2-4.

5 J H Schultz et al, *Economics of Population Ageing* 1991, Auburn House NY. pp 71-76.

6 Report of the House of Representatives Standing Committee for Long Term Strategies *Expectations of Life* Canberra, AGPS, 1992, p 61.

7 *op cit* Schultz et al, p 3.

Table 2.2

Total Crude Dependency Ratios for Selected Industrialised Countries, 1980–2025

Country	1980	2000	2025
Sweden	71	61	82
United Kingdom	69	64	78
France	65	63	79
Australia	64	59	71
United States	62	60	78
Federal Republic of Germany	60	66	87
USSR	60	70	75
Japan	57	62	78

Source: United Nations, Department of International Economic and Social Affairs, 1985. *Periodical on Ageing: 1984.* Vol. 1, No. 1. New York: United Nations.

Notes:

(i) The total crude dependency ratio is the number of 'dependent' persons per 100 persons of labor-force age and equals $\frac{(\text{ages } 0\text{-}14) + (\text{ages } 60 +)}{\text{ages } 15\text{-}59} \times 100$.

(ii) Countries are ranked by 1980 total dependency ratio.

Pension Outlays

2.10 The Economic Planning and Advisory Council (EPAC)[8] estimated that age pension outlays will increase from 2.8 per cent of GDP in 1985 to 4.5 per cent in 2025 if age pensions as they are presently structured increase in line with movements in average weekly earnings. DSS analysis of the ageing population issue also indicates that the national pension bill will increase considerably. Its projections show that age pension outlays will grow from 2.5 per cent in 1991 to around 5.1 per cent in 2031 if the single pension is maintained at or around 25 per cent of average weekly earnings[9].

Current Age Pension Policy

2.11 Current government policy provides age pensions to people who have reached the age of 65 for men and 60 for women, subject to residency and income and assets tests. Pensions are also paid to the spouses and eligible carers of age pensioners[10]. The standard pension has been set at or above a level of 25 per cent of average weekly earnings and is indexed twice yearly according to movements in the Consumer Price Index.

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8 Sub No. 127, p 3.

9 *ibid.*

10 DSS Annual Report 1990 – 1991, p 81.

2.12 At 30 June 1991 there were 1.41 million persons in receipt of the age pension. The Commonwealth anticipated spending $10.36 billion on age pensions in 1991-92. To these figures should be added service pensioners in receipt of a total of $2.34 billion, resulting in overall pension outlays of $12.06 billion.

2.13 Unlike most other OECD countries, Australia does not require that retirees take retirement benefits in pension form. In recent years the Government has sought to encourage benefits in this form by having a higher Reasonable Benefit Limit (RBL) for people who take at least half their superannuation benefit as lifetime non-commutable indexed pensions or annuities.[11]

2.14 One of the problems of this policy which has been the subject of considerable attention during the Committee's hearings is the practice of 'double dipping'. Double dipping involves taking a superannuation lump sum which has received significant tax concessions, consuming it rapidly and then receiving an age pension. Whilst the evidence given to the Committee was largely anecdotal and not based on any systematic longitudinal data, 'double dipping' is common in Australia.[12] It was submitted, however, that there are legitimate uses for lump sums other than purchasing an income stream, for example, paying out mortgages and other debts. Double dipping is facilitated by the preservation age for superannuation benefits being set at a lower age than the age pension age for men (65 years) and women (60 years). It is this policy scenario which allows some retirees who retire before the pensionable age to spend their lump sums and at a later stage become eligible for the full pension[13] or a greater pension benefit than would have been available had the lump sum not been dissipated.

2.15 Retirees who take superannuation benefits not subject to compulsory preservation age before age 55 have them taxed at significantly higher rates. Award superannuation contributions and contributions for which tax deductions are allowed are subject to preservation. However, compulsorily preserved benefits can be accessed under the hardship provisions of the *Occupational Superannuation Standards Act* (OSSA), taxed at a pre 55 years rate and used for purposes other than retirement. These issues will be examined in detail in the Committee's third report.

SUPERANNUATION

A National Superannuation Scheme

2.16 There have been a number of attempts to replace the non-contributory pension with a national superannuation scheme funded by earnings-based contributions from all employees and/or levies on employers. The first general initiative occurred in the period 1909–39 and was given impetus by the movement towards national superannuation schemes in Europe, where a number of countries were already providing compulsory pensions funded by both individual and government contributions.

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11 Sub No. 195, p 35.

12 Sub No. 127, pp 14-15.

13 *ibid.*

2.17 During this period three governments, all of them comprising non-Labor party coalitions, mooted and/or passed laws to replace the non-contributory age pension. The culmination of these initiatives was the passing of the *National Health and Pensions Insurance Act 1938* which provided for flat rate benefits funded by flat rate contributions by both employers and employees as from 1939. However, the difficult economic conditions and the onset of the Second World War resulted in the legislation not being implemented.

2.18 During World War II, Labor governments embraced the concept of national superannuation. The National Welfare Fund, established in 1943 by the Curtin Government, was designed to finance pension benefits and provide a base from which future payments could be made but had as its initial objective the financing of the war effort.

2.19 In 1945 the Chifley Government introduced an additional levy on personal income tax which, along with a payroll tax from employers, was credited to the National Welfare Fund. There was, however, no direct link between contributions and benefits and the pension continued to be allocated on the basis of the means test. The National Welfare Fund, whilst established as a means of establishing a base from which a national superannuation fund could be operated, was in practice merely an accounting device until its abolition in 1985.

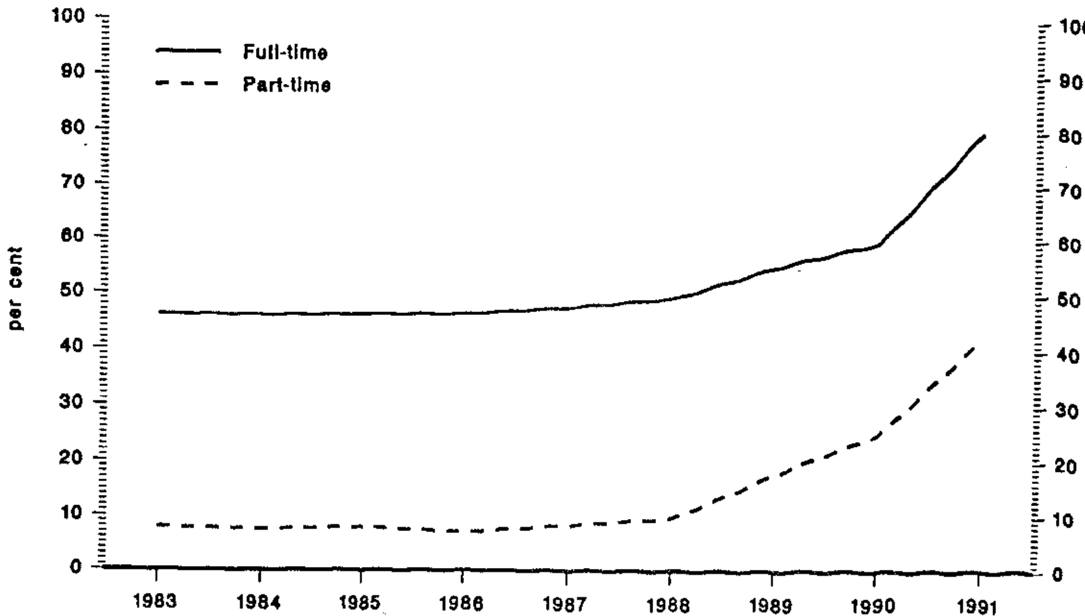
2.20 Further attempts to institute a national superannuation scheme were made in 1973 when the National Superannuation Inquiry, chaired by Professor K.J. Hancock, by majority made recommendations to the Whitlam Government which were subsequently submitted to the Fraser Government and rejected in 1979.

Award Superannuation

2.21 The first formal development in occupational superannuation in Australia is believed to have occurred in 1862 when the Bank of New South Wales introduced a pension scheme for its employees. Other advances in occupational superannuation occurred when public sector schemes for State and Commonwealth employees were introduced as early as 1884, in the case of NSW, and the first Commonwealth scheme was set up in 1922. Commonwealth involvement in encouraging employment-based superannuation in the private sector commenced in 1915 when legislation was passed allowing employers to deduct superannuation contributions against assessable income. There occurred some growth in this type of superannuation but it did not become widespread in the white collar workforce until the post-World War 2 period.

2.22 The first survey of superannuation coverage conducted by the Australian Bureau of Statistics (ABS) in 1974 revealed that 32 per cent of all employees were covered. The next set of survey data published in 1979 saw this figure rise to 43 per cent. Figure 2.1 shows the relative growth of superannuation coverage for full and part-time employees from 1983 to 1991.

Figure 2.1



Source: ABS (Cat. No. 6344.0) – Graph courtesy of Statistics Group, Parliamentary Library.

2.23 ABS data[14] on the pattern of superannuation coverage by sex, industry and nature of employment (whether full or part-time) reveals marked differences in the spread of superannuation. For example, highest overall levels of coverage have been achieved in public administration and defence (90 per cent), communications (92 per cent), electricity and water (94 per cent) whereas the lowest levels of coverage were recorded in recreation, personal and other services (47.1 per cent), agriculture, fishing, forestry and hunting (52 per cent) and construction (61.2 per cent).

2.24 Superannuation coverage by gender data shows that female coverage has increased from 26.3 per cent in 1979 (this figure reflected full-time employment only) to 78.5 per cent (full and part-time data) in 1991 which is two percentage points less than male coverage. The part-time – full-time 1991 coverage data indicates that full-time workers (80 per cent) are twice as likely to have superannuation coverage compared to their part-time counterparts (42.3 per cent).[15]

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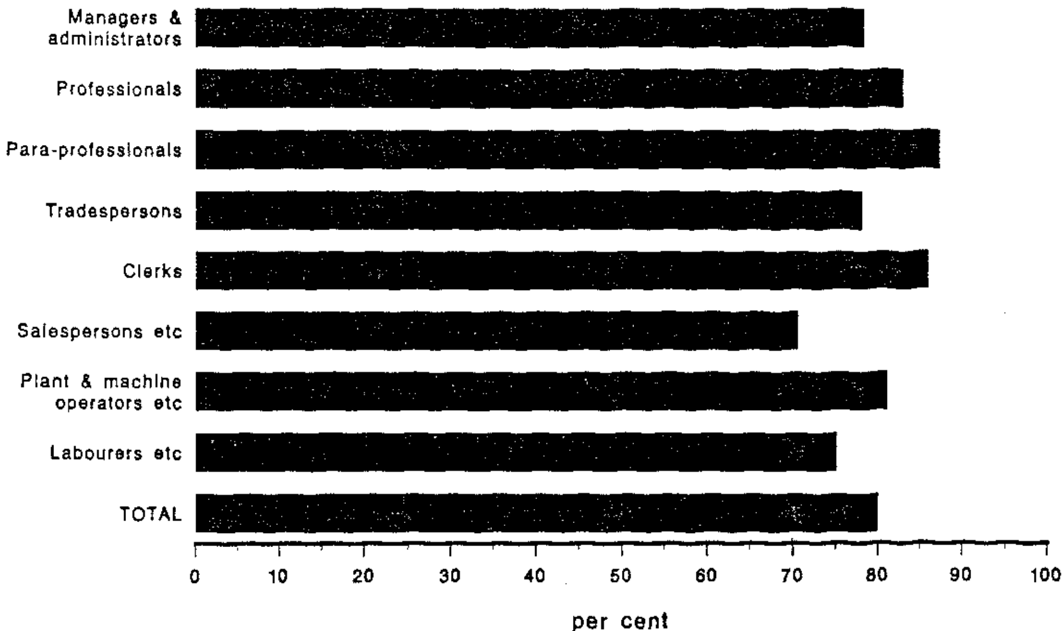
14 ABS *Employment Benefits Australia*, July 1991.

15 *ibid*

2.25 Occupational status also appears to be an aspect of coverage in which significant differences prevail. For example, ABS data[16] shows that 97.5 per cent of managers and administrators, and 94 per cent of professionals have superannuation coverage. However, only 55 per cent of sales persons are covered. Figure 2.2 shows the relative coverage of superannuation by occupational status.

Figure 2.2



Source: *Employment Benefit Australia*, July 1991, ABS (Cat. No. 6334.0) – Graph courtesy Statistics Group – Parliamentary Library.

2.26 A key development in moves to increase significantly the level of coverage of superannuation occurred in 1986 when the Australian Council of Trade Unions (ACTU) was successful in having the Conciliation and Arbitration Commission (the Commission) decide that it would formally approve agreements between employers and employees relating to contributions to approved superannuation funds resulting from wage increases up to a maximum of 3 per cent. However, the Commission at that juncture was not prepared to arbitrate on superannuation awards.

2.27 There followed a decision in 1987 under which the (now) Australian Industrial Relations Commission (AIRC), in addition to certifying agreements and making consent awards (in cases of last resort), announced it would arbitrate on superannuation matters including disputes about the funds into which contributions should be paid. Following the

16 *ibid.*

decisions of the Commission and the AIRC, superannuation has become an integral feature of almost all of the awards of the AIRC and the relevant State tribunals, and coverage has been extended to over 70 per cent of awards including 90 per cent of employees subject to a federal award[17]. In addition, there is a significant number of employees who are not covered by award superannuation but are in receipt of retirement income benefits from their employer.

2.28 The 1990–91 wage case included a claim by the ACTU, supported by the Government, for a further three per cent round of award contributions to superannuation. In April 1991 the AIRC adjourned the superannuation claim and requested that the Commonwealth Government convene a national conference on superannuation involving all relevant parties. Instead, the Government announced that it would instead pursue compulsory superannuation coverage by passing legislation. The Committee notes that the business community has made requests of the Government to convene a national conference on superannuation and that this opportunity has not been taken up.

Compulsory Employment Based Superannuation

2.29 In the August 1991 Budget, the Treasurer foreshadowed the Government's intention of introducing a Superannuation Guarantee Levy (SGL) commencing on 1 July 1992. In December 1991, the Treasurer issued a paper on the levy which stated that it would facilitate:

- *a major extension of superannuation coverage to employees not currently covered by award superannuation;*

- *an efficient method of encouraging employers to comply with their obligation to provide superannuation to employees; and*

- *an orderly mechanism by which the level of employer superannuation support can be increased over time, consistent with retirement income policy objectives and the economy's capacity to pay*[18].

2.30 As stated above, the SGL is designed to address inter alia the problem of non-compliance. Evidence given to the Committee by the Department of Industrial Relations (DIR)[19] was that, out of 2 880 000 private sector employees covered by awards, approximately 2 050 000 were actually receiving award superannuation. The expressed reasons for non-compliance, the monetary value of which is estimated to be accruing at a rate of $700 million per year, are threefold. First, and most significant according to DIR, is basic employer ignorance about the fact that an obligation exists. Second, there is a group of employers who understand that an obligation exists but are unable to come

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17 DIR Sub No. 81, p 10.

18 Superannuation Guarantee Levy Paper, December 1991.

19 Sub No. 81. Additional evidence of 1 May 1992, pp 2-3.

to grips with its complexities and therefore do not meet their obligations.[20] Third, there is a group of employers who are aware of the obligation and its provisions but elect not to comply with the relevant award/s. The Committee only knows of one survey which has been carried out on non-compliance (the DIR Survey) and therefore it was not able to reach a conclusive view on the reasons for this problem. A number of employer organisations contested the findings, saying that the capacity to pay was an issue for firms in financial difficulties. A further reason for non-compliance, given by one employer body, is the reluctance of some employers to contribute to a superannuation fund which has been nominated by a wage tribunal and which may not be the fund preferred by the employer or employee.[21]

2.31 The Government stated that the SGL will increase breadth of coverage by encouraging employers to provide a minimum level of superannuation set initially at three per cent for small business with payrolls of less than $500 000 and five per cent for larger businesses. Those employers not providing the minimum level of coverage will be liable for a penalty to cover the superannuation guarantee shortfall, the major portion of which will be deposited by the Australian Taxation Office (ATO) into complying funds for the benefit of those employees on whose behalf it was collected.

2.32 The Government plans to increase the depth of coverage by requiring that over a period of nine years the percentage will increase to nine per cent. It is further proposed to find ways whereby employee contributions and tax cuts could be harnessed to increase the contribution level to 12 per cent by 2000-2001.

Superannuation Targets

2.33 In its hearings, the Committee sought opinions from a number of expert witnesses regarding the level of contributions which would be required to generate a retirement income consistent with predetermined living standards. Generally, the advice to the Committee was that contributions of between 10 and 15 per cent over a 40 year period were needed to generate a retirement income of between 40 and 70 per cent of final salary. There was no universal agreement on what a minimum level of desirable, let alone taxpayer subsidised, retirement income should be. Also, there was no general agreement on who should meet the costs of increased superannuation contributions and what timetable for its introduction should be adopted. This lack of consensus on a fundamental question in the retirement incomes debate illustrates the need for vigorous community discussion on this issue.

2.34 A useful starting point in such a discussion is contained in evidence given by William M Mercer Campbell Cook and Knight (Mercers) which advised that a person on average weekly earnings would need to contribute five to six per cent of salary over a working lifetime to generate income equal to the present single age pension.[22]

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20 Evidence, pp 1833-4.

21 Evidence, p 879.

22 Evidence, p 3.

2.35 The Institute of Actuaries submitted that, based on an employer contribution of ten per cent and an employee (or member) contribution of five per cent plus a real rate of return on investment income of two per cent, net of tax, and assuming current tax arrangements, the following lump sum benefits would be generated:[23]

Table 2.3

Institute of Actuaries Lump Sum Projections

Years of Contribution	After tax lump sum benefit from contributor of 15% of salary
25	4.1 years of salary
30	5.1 years of salary
35	6.2 years of salary
40	7.4 years of salary

2.36 Should the member purchase an annuity with the above mentioned lump sums the following net income streams based on a retirement salary of $35,000 would be generated:

Table 2.4

Institute of Actuaries Annuity Projections*

Years of Contribution	Gross of Tax Indexed Annual Annuity resulting from Above Lump Sums
25	31% of Salary
30	39% of Salary
35	47% of Salary
40	56% of Salary

****Assumptions***

(i) life-time annuity indexed to the CPI
(ii) male age 65 with a spouse age 62 (this is not substantially different to a female age 65 with a spouse age 68)
(iii) 50 per cent reversion of annuity to spouse
(iv) no guaranteed minimum payment period
(v) purchase price of $13 200 per $1 000 per annum of annuity (expenses have been ignored).

[23] Sub No. 108 Appendix, pp 8-10.

2.37 The Association of Superannuation Funds of Australia (ASFA) used the Government's projected increase in compulsory superannuation contributions as per the SGL (final projection nine per cent employer and three per cent employee contribution in lieu of a wage increase) and found that the following benefits would accrue to members[24]:

Table 2.5

ASFA Lump Sum and Pension Benefits Table*

Age (as at 1991)	Benefit at 65 (before benefits tax)	
	Lump Sum (multiple of final salary)	Pension – % of final salary
Assuming a real rate of investment return of 4 per cent:		
25	9.03	60.2%
35	5.44	36.3%
45	2.94	19.6%
55	1.21	8.4%
Assuming a real rate of investment return of 2 per cent:		
25	5.91	39.4%
35	4.00	26.7%
45	2.42	16.1%
55	1.10	7.3%

**Assumptions*

(i) Employer contributions: 9% of salary
(ii) Member contributions: 3% of salary
(iii) Tax on employer contributions: 15%
(iv) Expenses and insurances: 10% of contributions
(v) Pension annually CPI indexed: 85% pension reversion to spouse upon retiree's death
(vi) Commutation factor is 15 – i.e. if a lump sum benefit were convertible to a pension/annuity, the first annual payment would be equal to one fifteenth of that lump sum.

The Superannuation Industry

2.38 Superannuation in Australia is a most complex matter. It is provided in and outside the workplace and by a range of financial institutions. Figure 2.3 attempts to place in context the various types and classes of superannuation and other forms of retirement income.

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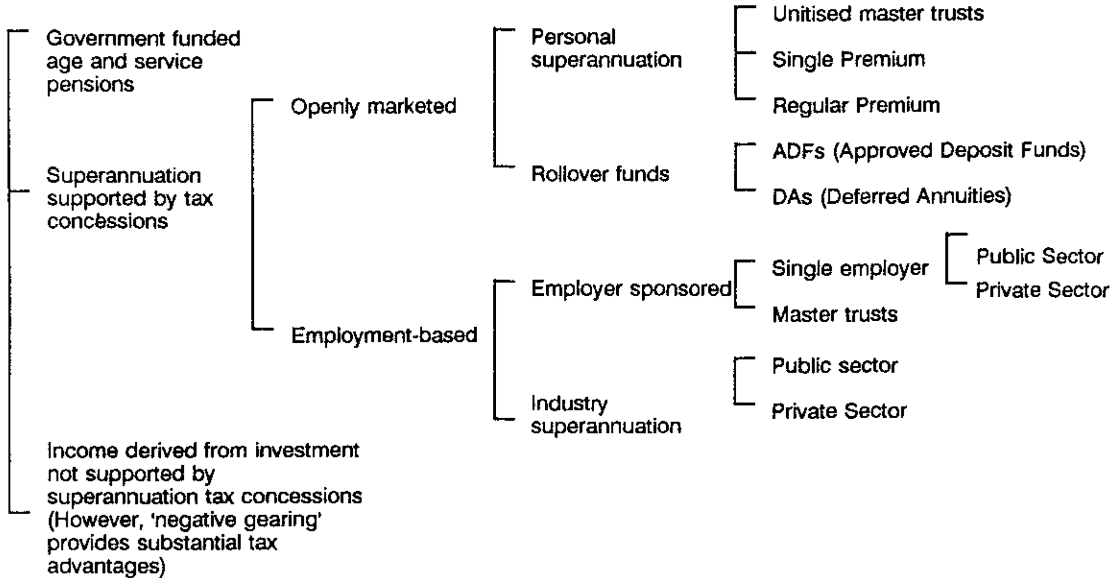
24 Sub No. 89, p 28.

Figure 2.3



2.39 The superannuation fund to which an individual belongs largely depends on employment status. There are two broad categories of superannuation schemes, namely, openly marketed (or publicly available) schemes and employer sponsored (or employment based) superannuation. Under current legislation superannuation funds which comply with the regulations administered by the Insurance and Superannuation Commission (ISC) are eligible for tax concessions on superannuation contributions, fund income and benefits paid, which in the *1991 Tax Expenditure Statement* were estimated to be $3.6 billion.

Openly Marketed Superannuation

2.40 Openly marketed superannuation schemes fall into two classes. The first, **personal superannuation**, is usually taken up by the self-employed or those employees whose employer does not offer superannuation as part of an employment package or, in cases where it is provided, it is insufficient to fund retirement.

2.41 Contributors to personal superannuation can choose to contribute by way of single premium or pay on a regular premium basis (super savings plan). Traditionally, life offices, friendly societies and firms offering unitised trust arrangements have been the major offerers of personal superannuation, although more recently banks have taken an increasing interest.

2.42 **Rollover funds**, the second form of openly marketed superannuation, were introduced to encourage persons changing employment or opting for early retirement to

preserve superannuation entitlements until retirement age is reached. These funds are operated by banks and other financial institutions **(Approved Deposit Funds – ADFs)** and life offices **(Deferred Annuities – DAs)** and deposits are restricted to **Eligible Termination Payments (ETPs).** ETPs include payments made to employees when leaving employment. They can include payments from a superannuation fund or any other inducements to retire early but exclude accrued annual and long service leave. Rollover funds receive concessional tax treatment in that the tax liability is deferred until retirement age.

Employment Based Superannuation

2.43 Employer sponsored superannuation and industry award schemes constitute this class of superannuation. Employer sponsored schemes can be both contributory (where both employer and employee contributions are made) or non-contributory (where only the employer contributes). These funds have trust deeds which establish whether the scheme is a defined benefit or defined contribution (or accumulation) scheme. In the case of **defined benefit schemes,** it is usual for the employee to make a contribution based on a percentage of salary and for the employer to bear the risk in that a certain benefit as defined in the trust deed is payable to the employee on retirement. Rates of return on fund earnings, and other factors such as the number of contributors who leave the fund early and are not paid their full actuarial entitlement, can result in the fund accruing an actuarial deficit or surplus in which case the employer has certain rights and/or duties under the relevant trust deed to adjust contributions to balance assets and liabilities. This matter is further commented on in Chapter 6.

2.44 **Defined contribution** (or accumulation) schemes entail employees and employers making pre-determined contributions, usually based on a percentage of wages, into a fund which grows according to the success of investment activities. At certain intervals, usually 12 months, member accounts are credited with a proportion of investment income. Therefore, the size of the accumulated funds on retirement is difficult to estimate with a high degree of precision, although actuarial models can give useful approximations of final accumulated funds. The great majority of award-based industry schemes are accumulation, or defined contribution, schemes.

Master Trusts

2.45 Current regulations mean that a complying fund can have any number of members. In the interests of efficiency many funds elect to use the services of experts to assist in the administration of the fund and funds management. To this end, some employers, especially those operating small businesses, enter into **master trust** arrangements in which the administration and management of funds is handled by an independent trustee appointed by the promoter of the fund. Master trusts are offered by life insurance firms, banks and other specialist financial institutions. There is a range of master trust products available including those which allow contributors to elect their own risk and return profiles under which funds can be invested.

2.46 Another option available to employer based funds is to conduct their own fund administration and trustee responsibilities, but contract out the investment of member funds by placing funds in **a pooled superannuation** trust (PST). PSTs only accept funds in amounts above a set threshold level, for example $50 000.

Public Sector Superannuation

2.47 Public sector funds, which have a membership of approximately two million employees, constitute a significant component of employer sponsored superannuation. These funds are usually established under statutes of parliament rather than trust deeds but have trustees appointed to administer each scheme. They are subject to Commonwealth regulations relating to superannuation funds, are government guaranteed in respect of benefit payments and, in most cases, are unfunded. An unfunded scheme is one where an employer has not contributed to match liabilities as they accrue. The level of unfunded liabilities[25] for public sector superannuation schemes has been estimated to be approximately $80 billion[26].

Industry Schemes

2.48 Industry schemes were established in response to decisions of the various wage tribunals to award workers a three per cent wage equivalent in the form of employer contributions to occupational superannuation funds to provide new or improved benefits in certain industries. These funds are usually administered by trustees nominated by the peak union and employer organisations.

2.49 Most industry funds are defined contribution, or accumulation, schemes. In 1991 approximately 2.3 million employees were members of industry schemes.[27]

2.50 There are also a number of award superannuation schemes in the public sector which were set up following the three per cent award superannuation decisions of the Commission, the AIRC and State wage tribunals. According to an ASFA survey, over one million public sector employees belong to this category of superannuation fund.

The Growth and Composition of Superannuation Funds

2.51 Government policy changes, the advent of award superannuation and changing community expectations regarding the need to contribute to retirement have had a significant impact on superannuation fund assets, which have grown from $32.6 billion in 1983 to a current level of $140 billion and are estimated to reach between $300 and $600 billion by 2000.[28] Figure 2.4 shows this trend. A more precise estimate of the level of funds in the year 2000 can only be made when a long term earning rate firms and longer term government policy regarding taxation and compulsory contributions is finalised.

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25 A small number of private sector employer sponsored superannuation funds have unfunded liabilities.

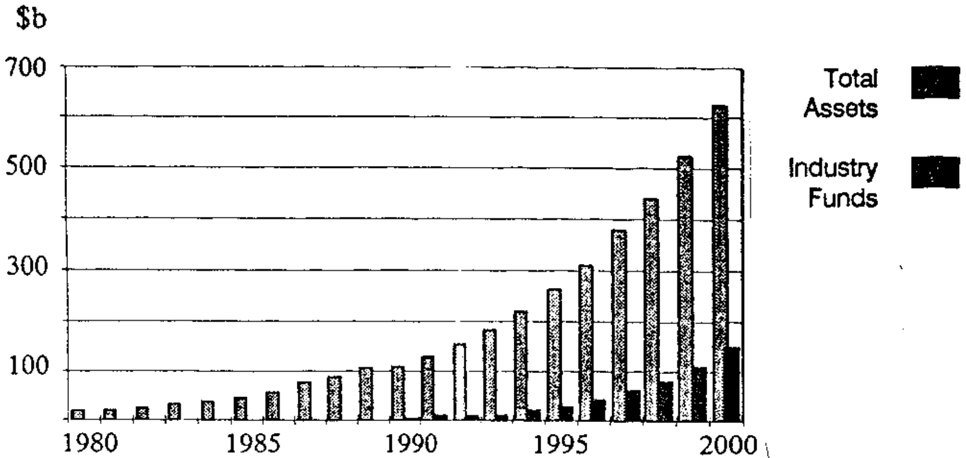
26 *Superfunds*, November 1991, pp 18-21.

27 *Superfunds*, September 1991, pp 15-16.

28 ISC Submission, No. 151, p 15.

Figure 2.4

Superannuation Industry – Asset Growth 1980-2000



Graph courtesy of Colonial Mutual Investment Management – Infrastructure Development Corporation. (Attached to Submission No. 210.)

2.52 Dr Vince Fitzgerald of the Allen Consulting Group has conducted research into the growth of the components of superannuation stocks based on 1991 Budget policies. He estimates that in 2010 superannuation assets will total approximately $1 400 billion in current dollars, or 7.5 per cent of current GDP, compared with five per cent in 1991.

2.53 The composition of investment for Australia's superannuation assets as at 31 March 1991 appears in Table 2.6.

Table 2.6

Superannuation Fund Assets, 31 March 1991	Percentage %
Short term and liquid assets	11.25
Loan, placements	6.96
Fixed interest securities	20.81
Equities, units in trust	32.56
Land, buildings non financial assets	14.92
Overseas assets	13.45

Source: ABS data, but taken from V W Fitzgerald *Australia's Superannuation Savings: Nestegg or Honey Pot?* October 1991, p 44.

2.54 A breakdown of superannuation assets by financial sectors as estimated from ISC and ABS statistics as at June 1991 appears in Table 2.7.[29]

Table 2.7

	$ billion
Private and public sector superannuation funds	68
Life Offices (including annuities)	59
Approved Deposit Funds	8
Total	135

2.55 Evidence given to the inquiry indicated that fund assets were concentrated in the larger funds, for example, in 1987/88, according to ISC data, the largest 462 funds had an average level of assets of $58 million whereas 99 per cent of funds had on average assets of approximately $145 000[30].

Conclusion

2.56 In the chapters which follow, the Committee addresses in greater depth a number of the issues and trends raised in this introduction. The need for an enhanced regulatory environment more attuned to the needs of the industry and its participants is one of the key themes which emerges. Another theme is the need for consumers of superannuation to have their interests protected and upheld to ensure that the system meets their retirement income needs. Finally, the report examines the need for increased competition in the superannuation industry and makes recommendations to foster competition in the context of the rapid growth of superannuation funds.

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29 *ibid.*

30 *ibid* p 15.

CHAPTER 3

CONSTITUTIONAL ARRANGEMENTS

The Problem

3.1 The overwhelming weight of views put to the Committee sought a single, Commonwealth regulator over all superannuation products, irrespective of the type of institution involved.

3.2 The Committee supports this view, given the size, complexity and economic and social ramifications of the industry. The Constitution, however, does not confer direct power over superannuation on the Commonwealth, other than that covering its own employees, which it exercises, and as a component of its unfettered powers over the Territories under s122, which it does not exercise.

3.3 In the absence of specific Commonwealth power, the States must be presumed to be able to regulate superannuation directly, except to the extent that the Commonwealth is able to operate indirectly through its other powers.

3.4 In consequence, superannuation is currently regulated by a range of Commonwealth and State laws and authorities, a situation which leads to unnecessary confusion, uncertainty and inefficiency.

The Current Regulatory Regime

3.5 All of the States and the Northern Territory conduct superannuation schemes for their employees and those of their instrumentalities. The extent of Commonwealth power over these schemes, particularly with regard to regulation and taxation, is a matter of both political and legal dispute.

3.6 The New South Wales, Queensland and South Australian Governments stressed to the Committee their view that Commonwealth intervention in the internal affairs of their funds was an unnecessary and unwelcome duplication of regulatory power.[1] At a subsequent hearing, a delegation representing all State and Territory governments put it to the Committee that:

> *... since the State governments are subject to so many other regulations and stipulations about the conduct of their employees and the way they run their financial affairs, another layer from the Commonwealth is quite unnecessary and simply adds to the complexity and the cost of the schemes.*[2]

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1 Evidence, pp917-18, 1176-77, 1499-1504.

2 SG Evidence, p 124.

3.7 The States were concerned that they would be required to amend their superannuation legislation retrospectively in order to comply with the guarantee legislation.[3] They were strongly opposed to any suggestion that they should be compelled by Commonwealth legislation to fund their schemes.[4]

3.8 Further, the South Australian Government's Superannuation Fund Investment Trust recently challenged the Commonwealth's power to levy tax on its income. The High Court, in a majority decision, found that the Fund's interest income was taxable but ruled unanimously that the assessment for capital gains tax was in breach of s114, which exempts State property from Commonwealth taxation.[5]

3.9 Trusts, friendly societies, building societies and credit unions, all of which have, or could have, activities relevant to superannuation, fall within the ambit of the States. Insofar as fraud may take place within funds, this would also be a matter for State action.

3.10 The Commonwealth's power over invalid and old age pensions – s51 (xxiii) – has been used since 1908, with the introduction of means-tested pensions for males aged 65 and over and females aged 60 and over.

3.11 The insurance power – s51 (xiv) – is the base on which the *Life Insurance Act* 1945 and the *Insurance and Superannuation Commissioner Act* 1987 rest. Under the former Act, many superannuation-related products offered by life insurance companies, including life policies, annuities, master trusts and personal superannuation, are subject to direct Commonwealth regulation.

3.12 When income tax was introduced in 1915, the income of superannuation funds was exempt from the new tax and both employers and employees were allowed deductions in respect of their contributions.

3.13 This early grant of tax relief is significant in that it opened the way for conditions to be attached, that is, the taxation concessions could be made subject to compliance with whatever requirements the government imposed on the funds. Thus, the taxation power – s51 (ii) – became the foundation on which the Commonwealth's control of superannuation was built and on which the *Occupational Superannuation Standards Act* 1987 (OSSA) rests. That Act and the regulations made under it establish a supervisory regime, operating standards and benefit limits for funds, compliance with which is a precondition for the tax concessions.

3.14 Reliance by the Commonwealth on the tax power to regulate superannuation, however, has many unsatisfactory features. In particular, a failure by trustees to comply with OSSA is not an offence in itself and therefore "offenders" cannot be prosecuted by any federal agency. The only penalty is loss of tax concessions, which punishes the members, who may also be the victims, and not the perpetrators.

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3 *ibid*, p 114.

4 *ibid*, p 120.

5 Australian Financial Review, 26-2-92.

3.15 For this reason, there is power under OSSA to waive the penalty in the case of less serious offences, effectively allowing them to go unpunished. In other circumstances, loss of tax concessions may be an inadequate penalty where, for example, the members have suffered serious financial losses as a result of the trustees' actions.

3.16 The conciliation and arbitration power – s51 (xxxv) – has been invoked through the inclusion of provisions for industry-wide superannuation in federal industrial awards. This has greatly expanded the proportion of the workforce covered by superannuation. The power does not, however, permit the Commonwealth to legislate directly in the area, nor does it embrace workers whose conditions are governed by State awards or workplace agreements.

The Scope for Wider Powers

Towards Universal Superannuation Coverage

3.17 The recent and proposed increases in superannuation coverage and the parallel increase in the volume of investable funds have, in the wake of a small number of failures in the collective investment industry, brought into question the adequacy of the regulatory powers available to the Commonwealth. Furthermore, notwithstanding the rapid spread of award superannuation, the number of people involved remain well short of the Government's target of virtually universal coverage. The previous chapter describes the limitations of existing policy and how the Government proposes to increase depth and breadth of coverage. Some of the implications of these changes will be dealt with in a later report.

3.18 In pursuit of this objective, the Superannuation Guarantee legislation is an attempt to make the provision of a specified level of cover compulsory for all employees between 18 and 65. The use of the taxation power to achieve this end has been called into question by a legal challenge to its similar use under the *Training Guarantee Levy Act*. For this and other reasons, the Government is examining other avenues through which it may be able to exercise a more secure and more comprehensive degree of regulatory power over superannuation.

3.19 It is possible that the Commonwealth could legislate for superannuation for employees in areas where it has general powers, such as banking – s51 (xiii) – insurance s51 (xiv) – interstate and overseas trade and commerce – s51 (i) – and, subject to the existence of an appropriate treaty, the external affairs power – s51 (xxix). Such action would not, however, enable it to exercise any general power over superannuation.

3.20 The insurance power may offer further scope, insofar as many schemes provide life and/or disability cover for employees. However, the uncertainty inherent in the investment-linked benefits provided by defined contribution schemes casts considerable doubt on whether they would be held to be 'insurance'.

3.21 Reliance on the pensions power was strongly advocated by LIFA.[6] With regard to the possible use of this power – s51 (xxiii) – Mr Dennis Rose QC, Chief General Counsel, Attorney-General's Department, told the Committee that –

> *the pensions power – the power to make laws with respect to invalid and old age pensions – would enable the Commonwealth Parliament to regulate private superannuation schemes so far as they provide for pensions for people over 60 or to people who are incapacitated, either wholly or partially.*[7]

3.22 He believed that the power would extend to lump sum benefits only in so far as they were paid in commutation of pensions, but not otherwise. It would not extend to the regulation of those aspects of schemes which dealt with the provision of benefits to dependants of deceased employees.[8]

3.23 Nevertheless, he felt that these gaps in the scope of direct regulation could be covered by prudential controls designed to ensure the financial viability of funds to pay pensions. These controls could take into account both actual and contingent liabilities of funds, including those benefits which could not be directly regulated.[9]

Increased Prudential Controls

3.24 Another power which offers scope for the general regulation of superannuation is that over trading or financial corporations – s51 (xx). The Commonwealth has proposed that one of the conditions for superannuation funds' eligibility for the taxation concessions should be that the trustee of every fund beyond a minimum size be an incorporated body.[10] Although the corporations power has not been fully tested, there is a strong probability that a company whose principal function was to act as trustee of a superannuation fund would be regarded as a financial corporation.[11]

3.25 A combination of the corporations and pensions powers was advocated by the ISC and the ALRC.[12]

3.26 Reliance on the corporation power would enable the directors of the trustee company to be held directly accountable to the controlling authority, which could institute

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6 Sub 114, p 6.

7 Evidence, pp 1197-98.

8 *ibid.*

9 *ibid.*

10 *Review of Supervisory Framework for the Superannuation Industry,* Commonwealth Treasurer, Ministerial Statement, 20 August, 1991 p 5.

11 Evidence, p 1198.

12 Sub No. 151, p 2; *Collective Investments, Superannuation* ALRC Report No. 59, p 61.

proceedings against them for breaches of the relevant legislation. Mr Rose expressed the view that:

> *the use of the tax power combined with the corporations power really offers the simplest, neatest scheme because there are no holes in that as there are in the pensions power.*[13]

3.27 Subsequent to the appearance of Mr Rose, the ISC told the Committee that it had been advised by the Attorney-General's Department that the Commonwealth could exercise, through the ISC, an enforcement power over superannuation funds which would be based on a combination of the taxation, corporations and pensions powers.[14]

3.28 The Committee welcomes these proposals as offering an immediate and effective method of regulation within the Commonwealth's own powers.

> ***Recommendation 3.1:***
>
> *The Committee recommends that the Government seek wider counsel on its powers over superannuation and, following this, legislate directly for the regulation of superannuation, relying on a combination of its constitutional powers over taxation, corporations and pensions.*

Longer Term Measures

3.29 In the event that this solution should be found to be inadequate for any reason, four further possibilities were considered by the Committee as offering longer term prospects –

- the passage by all States and Territories of uniform legislation;
- the referral by all States to the Commonwealth, as provided by s51 (xxxvii), of their powers over superannuation;
- the automatic adoption by the States and Territories of Commonwealth legislation applying in the ACT, as amended from time to time; and
- seeking an amendment of the Constitution.

3.30 The first of these would be a task of major proportions, as it would require complete unanimity among all governments over every detail of the legislation and every subsequent amendment.

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13 Evidence, p 1199.

14 *ibid*, pp 1847-48.

3.31 The second, advocated by Mercers, would also involve substantial political difficulties but, if it could be achieved, would provide a simple and direct regulatory framework.[15]

3.32 The third, proposed by Mr Julian Lucas, amounts to a de facto referral of power and has been adopted successfully in the case of the corporations law.[16] In the Committee's view, it would be as effective as a formal referral of power.

3.33 Finally, it would be open to the Government to seek to amend the Constitution by way of referendum, as recommended by ASFA, the accounting bodies and Westpac, to give the Commonwealth power over superannuation but, in the light of the past record of lack of success in constitutional referendums, the Committee is not attracted to this course.[17]

Recommendation 3.2:

The Committee recommends that the Government explore the possibility of obtaining a referral by the states, either formal or de facto, of their power over superannuation.

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15 Sub No 79, App. 5, p 3.

16 Evidence, p 311.

17 Sub Nos 89, p 10; 119, p 6; 132, p 5.

CHAPTER 4

REGULATION OF SUPERANNUATION FUNDS

> *The superannuation system which is proposed by the present Government is perhaps unique by world standards. It will be a curious combination of compulsory but private sector located funding. It has the potential, as we see it, to be the best combination of features in the world, comprising competition, in the free market sense, and prudential government guidance. But we make a very strong proviso to that, that these ingredients be blended in the right balance.*
> Ken Dance, ASFA, Evidence p 643.

4.1 Under OSSA, the rights of members to receive benefits must be fully secured at all times. This provision has meant that a superannuation scheme is usually set up as a trust. A trust is an arrangement under which assets are held by specified persons (the legal trustees) who are legally bound to use those assets for the benefit of other persons (i.e. the beneficiaries of the trust).

4.2 The general duties of a trustee are:

- to observe the terms of the trust deed and carry out the duties defined in the deed;
- to act impartially;
- to act in the best interest of members;
- to act personally, i.e. not to delegate responsibility;
- not to derive a profit from the trust;
- to keep proper accounts and to provide information to members;
- to properly invest trust funds; and
- to avoid conflicts of interest.

4.3 A paper by Lord Browne-Wilkinson notes the differences between traditional and superannuation trusts. These differences include the points that, in superannuation trusts:-

- the beneficiaries are not volunteers;
- there is an underlying contract of employment;
- the size of the trust fund is variable;
- the employer continues to have a financial interest; and
- the trustees have power to amend the scheme.[1]

4.4 Nonetheless, he concluded that with codification of certain aspects of trust law, trusts were the appropriate entity for superannuation funds. This was a view shared in many submissions to the Committee including those from the ISC, the ASC, the Attorney-General's Department, Treasury, ASFA, LIFA and others.

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1 The Right Honourable Lord Browne-Wilkinson *Equity and its Relevance to Superannuation Today*, paper presented to a National Conference for Lawyers on Superannuation, February 1992, pp 1.5-1.10

4.5 Given the strong preference for retaining the trust structure of superannuation, the Committee has focused on the areas where it believes current prudential controls are inadequate.

What is Prudential Supervision?

4.6 The goals of prudential supervision have been identified by the Government as being to ensure that:

- superannuation remains a secure, efficient and viable means by which people can provide for their own retirement; and
- the superannuation industry contributes to the Government's broader economic goals of promoting savings, efficient investment and sustainable economic growth.[2]

4.7 Within these broad macro-economic goals, the ISC sees the primary objective of prudential supervision as placing superannuation savings at the lower end of the risk spectrum thus enabling them to perform an effective role in the retirement income system[3]. This is a view shared by the Treasury which argues that the primary purpose of supervision is to provide appropriate security for retirement savings while not inhibiting the accumulation of adequate retirement income from superannuation[4]. In this context, Treasury noted that:

- absolute security of superannuation benefits is not attainable;
- there are significant costs to an inappropriate level of supervision; and
- there are 'moral hazard' dimensions to prudential supervision.[5]

4.8 The ASC traverses similar ground and suggests that:

> *... the primary goal in the regulation of superannuation should be to promote efficiency in the capital markets by ensuring that investor protection and investor confidence are maintained and by encouraging competition through the creation of a 'level playing field' between superannuation and other comparable investment products and between their issuers.*[6]

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2 *Statement on the Prudential Supervision of the Superannuation Industry*, released by the Treasurer concurrently with 1991/92 Budget.

3 Sub No. 151, p 2.

4 Sub No. 195, p 20

5 *ibid* p. 21

6 Sub No. 186, p 3.

4.9 The Committee supports these goals and believes that the appropriate regulatory framework is one in which:-

- the duties, powers and responsibilities of trustees and directors of corporate trustees are clearly defined;
- the rights of members to information, action against trustees and directors and alternative dispute resolution mechanisms are unambiguous; and
- the powers of the regulator to protect members' interests are identified in legislation.

4.10 A regulatory framework which satisfies the above criteria will promote investor protection and ensure equity between members. **Provided the regulatory framework does not discriminate between different providers of superannuation, such a regulatory structure should also enhance the efficiency and competitiveness of the industry and contribute to broader macro-economic goals.**

Figure 4.1

the need for supervision

Prudential supervision of the superannuation industry is necessary because:

- the Government has mandated national retirement incomes provision in the private sector and has made it clear that it will not provide either an implicit or explicit guarantee for superannuation funds;
- superannuation savings have an important place in the national economy, currently representing 5% of GDP and are forecast by the year 2000 to increase to 6-7% of GDP;
- for most people, superannuation represents the second largest asset after the family home; with the SGL superannuation will become increasingly important;
- superannuation is relatively illiquid and the individual has little or no choice of fund into which contributions are made; and
- substantial tax concessions are given to superannuation.

Current Arrangements

4.11 Currently, regulation of retirement investments is arranged on institutional rather than functional lines. As a consequence:

- life insurance companies offering superannuation are governed by the ISC;
- banks offering superannuation are governed by the RBA, the ISC and the ASC;
- friendly societies, building societies and credit unions are governed by various pieces of State legislation;
- managers outside these structures must comply with both ISC and ASC regulations.

4.12 All submissions received by the Committee recognise that the Commonwealth Government has a role to play in enforcing minimum prudential standards. The OSSA currently contains prudential and reporting standards (see Figure 4.2) and new

information disclosure standards will apply from 1 July 1992. Requirements under the Corporations Law and LIA are shown in Figures 4.3 and 4.4.

Figure 4.2

the existing prudential and reporting standards under OSSA are:

- equal member and employer representation on trustee boards of funds which have 200 or more members (to apply to all large funds from 1995);
- a prohibition on borrowing by funds other than for short term cash flow purposes (i.e. a prohibition on gearing);
- a requirement that investments by funds other than in in-house assets must be at arm's length (i.e. must be on commercial terms);
- a restriction on loans to, or investments in, an employer sponsor to 10 per cent of total assets, subject to some transitional provisions;
- a requirement that the rights of members to benefits be fully secured and not subject to lien;
- a prohibition, subject to some transitional provisions, on a fund lending money to members;
- a requirement that the fund's accounts must be audited once a year by an independent auditor;
- in the case of defined benefit funds, a requirement that actuarial reports be prepared at least once every three years;
- a requirement to report to members when they join a fund, annually, on termination of membership and on request; and
- a prohibition against reduction of accrued benefits, other than with the approval of all members or with the approval of the Insurance and Superannuation Commissioner.

There are also specific requirements under OSSA relating to pooled superannuation trusts and approved deposit funds.

4.13 The new information disclosure requirements (reproduced in the Attachment to this chapter) have generally been endorsed by the industry and will substantially improve the level of investor protection by making the financial details and investment policies of the fund readily available. Notwithstanding the existing and proposed new requirements, OSSA is fundamentally flawed because:-

- the penalty for failure to comply with the legislation (withdrawal of tax concessions) detrimentally affects members' entitlements;
- members can only take action against trustees for mismanagement or fraudulent behaviour through costly and uncertain court action;
- the rights, powers and responsibilities of trustees are not defined in the legislation;

- the ISC has no powers to appoint judicial managers to preserve the assets of the fund or to take other action to protect fund members;
- the responsibilities of fund managers, auditors and other financial advisers to trustees and members are not clearly identified;
- the legislation is silent on the ownership and disposition of surpluses; and
- there is no alternative dispute resolution mechanism.

Figure 4.3

Superannuation arrangements which are subject to the Corporations Law are subject to the following requirements:

- a prospectus must be issued in respect of offers and invitations to acquire an interest. That document must contain all the information material to make an informed investment decision;
- all persons involved in preparing the prospectus are liable to compensate investors for loss as a result of false or misleading statements in, or omissions from, the prospectus;
- the management company is required to hold a securities dealers licence. In order to obtain such a licence, an applicant must satisfy the ASC of the educational qualifications and experience of its office holders. In addition, the ASC must believe that the applicant will perform its duties efficiently, honestly and fairly;
- the ASC usually requires, as a condition of the licence, that the management company maintain an adequate level of liquid assets;
- the arrangement must be constituted by a deed approved by the ASC in relation to which there is an approved trustee. In determining whether or not to approve a trustee the ASC has adopted the policy of not doing so unless it is satisfied that the trustee and its officers have the necessary experience, qualifications, knowledge and skills to discharge their functions adequately. The trustee must not be associated with the management company;
- the independent trustee holds the assets of the trust and is charged with protecting the interests of investors;
- the approved deed is required to contain certain covenants which are generally aimed at protecting the interests of investors. A contravention of these covenants is a contravention of the Corporations Law, giving rise to civil consequences; and
- generally speaking, funds must not be lent, or invested, in the management company or trustee or their associates. The ASC has an extensive range of powers to conduct investigations and to enforce the Corporations Law.

4.14 There is widespread agreement that prudential supervision needs to be improved and that there needs to be a lot more certainty and clarity in the law. However, there is divergence about how this might be achieved.

4.15 ASFA believes that the philosophy underpinning reform to prudential supervision should be:

> *To enhance trustees' capacity and willingness to represent members properly, not to interfere with their decision making.*[7]

However, a number of caveats were attached to this statement. In particular, ASFA:

- supported minimum entry requirements for trustees;
- supported the equal trustee representation standards that have been put in place;
- considered there should be a range of sanctions to fit the transgressions made by trustees;
- supported increased member disclosure;
- considered that implementation of an industry-wide alternative disputes resolution mechanism was perhaps desirable; and
- considered some trust law principles could be codified and included in Federal legislation.[8]

4.16 ASFA's views were shared by many submissions to the Committee. However, LIFA suggested that any new rules must consider factors such as the need for enhanced education and training of trustees and the new accounting standards for superannuation funds.[9] LIFA is strongly opposed to superannuation trustee incorporation and suggests that the Government should draw on the pensions power contained in the Constitution to legislate on trustee matters.[10]

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7 Evidence, p 643.

8 *ibid.*

9 Sub No. 114.

10 *ibid.*

Figure 4.4

The prudential requirements of the LIA are:

- Applications for registration as a life insurance company must contain detailed information covering:
  - constituting documents and articles of the company
  - ownership of the company
  - board and management structures and experience
  - auditor and actuary for the company
  - detailed new business strategy, plans and supporting documents
  - detailed financial projections for at least 10 years
  - source and extent of financial support for the company.
- Proposed changes in the ownership of control of life insurance companies must be notified to the ISC for prior screening and approval.
- Life companies must have a Principal Officer who is resident in Australia and primarily responsible for its local operations. They must also have an Approved Auditor and an Appointed Actuary. Persons who are convicted of an insurance offence or dishonest conduct or who are, or have been, bankrupt or insolvent are disqualified from being a Director, Principal Officer or Appointed Actuary.
- The life insurance business of the company must be conducted through statutory funds which are akin to trust funds for policyholders. Each statutory fund must have separate and distinct assets which cannot be mortgaged or charged for any purpose other than to secure a bank overdraft.
- In addition to the solvency requirements applying to statutory funds there are minimum capital requirements outside of statutory funds. Shareholder companies must maintain $10 million in paid-up capital and share premium. Companies without share capital must maintain assets of $10 million outside of statutory funds. In both cases $5 million of these assets must not be invested, directly or indirectly in a related company.
- The ISC requires life insurance companies to lodge financial and statistical returns at regular intervals, including actuarial reports on their financial position.
- The annual accounts of a life insurance company must be audited by an auditor approved by the ISC.
- A registered life insurance company must have an Appointed Actuary who is responsible for carrying out all the actuarial tasks required by the legislation, which are:
  - certification as to the suitability of the premium rates for any life insurance product before it can be issued by the company;
  - an annual investigation into the financial condition of the life insurance company, including the valuation of its policy liabilities; and
  - approve of the allocation and distribution of any surplus disclosed by a valuation.
- All single premium and regular premium life insurance products can only be sold to individuals via a Discharge Statement which must contain generalised information about the product being sold. For all products there must also be an annual statement on the performance of the policy provided to policyholders.
- For regular premium products a policy information statement is required to be issued to the policyholder when the policy document is provided. It must contain a clear statement in plain English of the nature of the contract, the level of guarantees and policy specific early termination values.
- The ISC has powers to investigate any life insurance company which appears to be in financial difficulties or has breached the Life Insurance Act. Such an investigation may lead to the ISC directing the company as to the operations of its life insurance business or the ISC applying to the Court for the appointment of a judicial manager or for the winding-up of the company.

4.17 Mercers suggested in their evidence to the Committee that there were four arms to regulation aimed at achieving the objective of a simple, easy to run system and one which would increase the level of safety. These were member trustees, regular, understandable disclosure, diversification of assets and regular financial examination.[11]

4.18 The ISC in its submission suggested that the measures announced in the 1991/92 Budget should provide an adequate level of protection for members' benefits while not restricting the competitiveness and efficiency of the superannuation industry.[12] It suggested that:

> *it is essential that the ISC should have the necessary powers to ensure that the fund members are adequately protected. However, such powers should derive directly from the OSS legislation, not from trust deeds of individual funds.....It is our view that this should involve codifying in the OSS legislation the more important trustee obligations under trust law.*[13]

4.19 The ASC believes that the current regulation of collective investments, of which superannuation is a part, is inadequate for both investor protection and competitive neutrality between different types of collective investments[14]. It suggested to the Committee that:-

- superannuation trusts should be held in the name of a responsible entity which is totally responsible for the administration of that trust;
- if that responsible entity puts investments with a custodial trustee, then the custodial trustee should be an approved depository;
- if the responsible entity is carrying on investment, that investment manager must hold a dealer's licence;
- the regulator for superannuation funds should have sufficient power to be able to act extremely quickly in relation to perceived fraud or mismanagement by responsible entities, and be able to act very quickly in relation to removal of directors or removal of the entire responsible entity.[15]

4.20 AMP, County NatWest, BT, Westpac and others all stressed the importance of a specialist regulator. BT told the Committee that:

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[11] Sub No. 79, pp 37-38.

[12] Sub No. 151, p 13.

[13] Attachment to supplementary submission, Sub No. 151.

[14] Evidence, p 1301.

[15] Evidence, Hartnell, pp 1301-02.

> *... there is a great difference between an approach to regulation which is supervisory, based on information and understanding of the risks in the products and developments in the industry, and looking to take early action like the Reserve Bank does to steer the whole system in the right direction ... the other extreme [approach]is prescriptive, relies on writing down rules and perhaps even on force-fitting new types of institutions into existing rules – in this case force-fitting superannuation into a corporation law framework – and relies mainly on ex post prosecution when something goes wrong.*[16]

4.21 In its recent report on collective investments, the ALRC recommended that the law should provide that the conditions under which a superannuation fund, ADF or a PST attract taxation concessions include a condition that, at all times during the relevant year of income, there was a 'responsible entity' for the fund and that the responsible entity would be regulated by use of either the corporations power or the pensions power.[17]

4.22 It was also suggested at the public hearings that it might be more appropriate to separate the legal rights and responsibilities of directors and members of superannuation schemes and the access to tax concessions. The ASC suggested that:

> *... the major problem with collective investments generally is that, to the extent the trustee is a company, the company has high fiduciary responsibilities to the beneficiaries but the directors who are running the company do not. So the law will not personally impose on those directors an equivalent responsibility to the high fiduciary standard that is on the company. That effectively means that one can get a trustee company going into liquidation .... but the directors do not have the same personal level of responsibility in respect of the high trust that the company carried.*[18]

4.23 Mr Langfield-Smith in his evidence to the Committee suggested the ISC continue to regulate the taxation and prudential aspects of superannuation but the ASC consider all the relevant aspects of investor protection[19]. He went on to argue that the ASC takes:

> *... a more effective stand in terms of attempting to get wide input to all their policy statements, which indicates the way in which they exercise their discretionary powers and it is now a requirement that they hold a public hearing before they formulate a policy. That is the sort of thing that the Insurance and Superannuation Commission does not do, although it tends to consult the people being regulated*

[16] Evidence, p 840.

[17] ALRC, Report No. 59, p 31.

[18] Evidence, pp 1314-15.

[19] Sub No. 156, p 1.

and ignores employees ....[20]

4.24 Taking a slightly different tack, AM suggested that it would be appropriate to introduce certain prudential standards for public funds in a similar way to the current specific rules for industry funds.[21]

4.25 Evidence that the Committee received from individuals and welfare and consumer groups indicates that the ISC is seen as a 'captive' of the industry. There was a clear perception that ISC staff did not consult with consumer groups or devote sufficient resources to consumer issues. AFCO, in its evidence to the Committee, stated that the ISC had low credibility with consumers.[22]

Proposed New Framework

Regulator

4.26 As many witnesses stressed to the Committee, the superannuation industry does not necessarily need more rules but rather, it needs a consistent industry-wide framework in which to operate over the long term. As already noted, the ASC regarded superannuation as one form of collective investments and argued that it should be subject to the same rules as other collective investments. The Commonwealth Bank argued strongly for a common set of regulations for the industry because:

it will certainly increase the scope for efficiency of the industry by reducing the administrative burden and hence reducing the costs of running superannuation, which ultimately will reflect in the price of products to the consumer.[23]

4.27 BT, Rothschilds and the IFA have canvassed the possibility of superannuation and other forms of collective investments being subject to separate legislation with the one regulator administering the rules.

4.28 Westpac told the Committee that it:

firmly believes that a single, superannuation regulator for all investment products, including superannuation, is not desirable given the complex technical differences that exist among various investment products. We believe that the ISC should continue to be the lead regulator for superannuation and should be able to use powers under the corporations law to review, audit, investigate and monitor the activities of superannuation fund managers and trustees. It already has significant experience and knowledge of the superannuation industry and has developed a

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[20] *ibid.*

[21] Sub No. 96, p 5.

[22] Evidence, p 1941.

[23] Evidence, p 822.

sound and informative style of consultation with the industry. The benefits associated with consultation include a non-adversarial dialogue between providers and regulator and a relatively free transfer of information.[24]

4.29 The Committee considers that superannuation differs from other collective investments in a number of important respects. Firstly, superannuation generally is a condition of employment and therefore is not chosen in the same way as investments in unit trust arrangements. Secondly, superannuation is illiquid and frequently the member may not be able to access the benefit until age 55, implying that it is an investment which is held for decades rather than a number of years. Finally, superannuation is an essential part of the Government's retirement incomes policy and consumers are therefore entitled to clear, consistent regulation for all superannuation products. Accordingly, the Committee believes that there is a need for a specialist superannuation regulator.

4.30 Bearing in mind the rapid growth of the industry since 1983, along with the product innovation and substantial regulatory change, the Committee believes that the ISC has the technical expertise and understanding of the superannuation industry to assume primary supervisory responsibility.

Recommendation 4.1:

The Committee recommends that the ISC become the sole regulator of superannuation products to give certainty and clarity to the operation of the industry.

However, the Committee acknowledges that the RBA and ASC may consider it necessary to impose some additional requirements on institutions which fall within the ambit of their regulatory responsibilities. If this is the case, there is clearly a need for greater ***effective*** *co-ordination between the regulatory authorities than occurs at present.*

The Committee recommends that the RBA, ISC, ASC and TPC liaise both formally and informally on a regular basis.

4.31 If the ISC is to remain the primary regulator of the superannuation industry, its level of resources needs to be addressed. The Committee examined the Budget allocation for the ISC and the ASC, along with their respective responsibilities.

4.32 The ASC is the sole national authority responsible for the administration of the national Corporations Law regulating corporations, securities and futures markets. Some of the companies that report to the ASC are public superannuation funds and fund managers. The ISC is the primary regulator of the superannuation industry and is responsible for administering OSSA, LIA and the Insurance Agents and Brokers Act.

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[24] Evidence, p 673.

4.33 Superannuation funds and life offices hold around 20 per cent of the total market capitalisation on the Australian Stock Exchange.[25] If foreign companies listed on the Australian Stock Exchange but not having operations on a significant scale in Australia are excluded, the figure is towards 30 per cent.[26] There is thus a need to ensure that the ISC has adequate resources to be an effective regulator.

Table 4.1

RESPONSIBILITIES AND FUNDING OF THE ASC AND ISC

	ASC	ISC
Regulatory responsibilities (30/6/91)	892 749 companies	166 general insurance companies 56 life insurance companies 904 general insurance brokers 46 life insurance brokers 100 000 + superannuation funds
Appropriation 1991/92	$129.622 million	$14.593 million
Number of Offices around Australia (30/6/91)	Head office: Melbourne 22 regional offices	Head office: Canberra Two regional offices

4.34 The Committee believes that the ISC is inadequately resourced to carry out its present functions, let alone to assume the additional responsibilities envisaged by this report. The Committee notes that the Department of Finance is currently examining the resource needs of the ISC and that RBL administration may be passed to the Australian Taxation Office. The Committee urges the Government to attach high priority to upgrading the resources of the ISC.

[25] V W Fitzgerald and I R Harper *Super Preferred or Level Playing Field?*, p 38.

[26] *ibid.*

Recommendation 4.2:

The Committee recommends that an independent review of ISC resources be carried out following tabling of the Government's response to this report so that ISC resources are compatible with its increased regulatory responsibilities. The Committee endorses the 'user pays' concept as a means of supplementing budgetary allocations.

The review should include analysis of improvements required to procedures to ensure that the ISC is able to provide figures on the superannuation industry for the previous financial year at the time its Annual Report is tabled in Parliament. The Committee believes that it is unacceptable that statistics produced by the ISC are up to four years out of date.

4.35 The Committee was concerned that welfare and consumer groups saw the ISC as a captive to the superannuation industry. Also, the Committee considered that the ISC was unable to be as frank in its evidence to this inquiry as were the TPC and the ASC. The Committee believes this reflects the ISC's role in advising Government on policy matters. A greater degree of statutory independence would enable the ISC to more fully represent the interests of all those affected by superannuation matters, as well as enhancing the consultative and deliberative processes of the ISC.

Recommendation 4.3:

The Committee recommends that the Government introduce legislation to give a greater degree of statutory independence to the ISC by appointing a panel of commissioners with proven expertise in superannuation from a wide cross-section of the community.

Duties of Trustees

4.36 The Committee supports the continuation of existing arrangements whereby retirement income savings are managed and invested by the private sector. In this context, greater legislative certainty needs to be given to the duties, policies and responsibilities of trustees and directors of corporate trustees. The Committee supports the view put by many witnesses that trust law principles should be codified and included in legislation.

Recommendation 4.4:

The Committee recommends that the Occupational Superannuation Standards Act (OSSA) be amended or replaced so that the duties and responsibilities of trustees and directors of corporate trustees are clearly spelt out, including a duty:

- *to maintain a diversified portfolio unless members advise to the contrary;*
- *to maintain an appropriate level of liquidity;*
- *to limit the level of in-house investment (see Chapter 7);*
- *to keep proper accounts;*
- *to ensure the equitable treatment of members of superannuation funds;*
- *to inform members about matters materially affecting the fund;*
- *to seek independent legal, auditing, and actuarial advice;*
- *to avoid conflicts of interest; and*
- *to be personally responsible for the administration of the trust.*

To facilitate consumer understanding of trust deeds, the Committee recommends that the legislation prescribe the wording of these provisions in trust deeds.

The Committee further recommends that neither the original trust documents nor any amendment of them can authorise a departure from any of the statutory requirements.

4.37 Given the fiduciary responsibilities of trustees, the Committee considers that a 'fit and proper' person test should be applied to all persons nominated or elected as trustees. This would mean that any person who was a declared bankrupt or who had been convicted of fraud or dishonest conduct would be ineligible to act as a trustee.

Recommendation 4.5:

The Committee recommends that all trustees should be Australian residents and be required to pass a 'fit and proper person' test analogous to that required under the Corporations Law.

4.38 In recent months there has been a great deal of discussion about the need for a defalcation fund and/or a reserve fund. The Committee accepts the arguments against a reserve fund but notes that the superannuation regulatory regime centres on trustees and disclosure.

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.

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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 meetings[31], 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 Boffa[32], County NatWest,[33] the Attorney General's Department[34] and Prudential[35], 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

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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 role[37] 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.

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38 Sub No. 151, p 13.

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

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;

(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.

CHAPTER 5

TRUSTEE REPRESENTATION

5.1 Given the increasing importance of superannuation in personal wealth (see Table 5.1) the Committee believes that the issue of representation on trustee structures assumes increased significance. In this chapter, the term 'trustee' should, depending on the context, be taken to mean:

- a natural person who is a trustee of a fund;
- a corporation which is the trustee of a fund; or
- a natural person who is a director of a corporate trustee.

Table 5.1

THE ASSETS AND LIABILITIES OF THE HOUSEHOLD SECTOR

	% change 1981-1989		
	nominal	real	real per capita
Monetary Assets:			
Notes and Coin	144	31	16
Deposits	185	53	36
Other Financial Assets:			
Equities	254	90	69
Unit Trusts	1315	660	574
Public Sector Securities	-14	-54	-59
Superannuation and Life Insurance	339	136	110
Total Financial Assets	245	85	64
Physical Assets:			
Owner-occupied housing	190	56	38
Investment housing	157	38	22
Consumer Durables	120	18	5
TOTAL ASSETS	193	57	40
Liabilities:			
Mortgages	168	44	28
Other Borrowing	176	47	31
TOTAL LIABILITIES	171	45	29
NET WORTH	196	59	41

Source: RBA Bulletin, November 1991

5.2 The Committee received a range of views about possible changes to existing requirements for trustee representation. Under current rules, only private sector funds established on or after 16 December 1985 and public sector funds established on or after 25 May 1988 with 200 or more members are required to have equal member and employer representation. Using figures provided by the ISC for 1987-88, this represents less than one per cent of all superannuation funds (see Table 5.2). From 1995, all funds

with 200 or more members will be required to have equal employer/employee representation. However, master trust arrangements can obtain exemptions under OSSA for equal employer/member representation.

5.3 Some of the points put to the Committee are that:

- current arrangements and those foreshadowed to apply from 1995 are satisfactory;[1]
- further proposals on trustee representation should be deferred until after 1995;[2]
- all trustees should be required to be members of the fund;[3]
- member representative trustees should be elected by the members;[4]
- equal representation of members and employers on trustee boards or management committees should be extended to all schemes with arms' length members;[5]
- the concept of equal representation and employee members is appropriate for large industry-based funds but there should be no compulsion for smaller funds;[6]
- equal employer/employee representation rules are inappropriate for public funds and life office master trusts;[7]
- the appointment of an authorised public trustee corporation as trustee should be considered;[8]
- participation of employers and employees in the trustee function is inconsistent with the prescribed interests provisions of the Corporations Law and so a board of management advising an independent public trustee may be more appropriate;[9]

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1 Sub Nos. 100, 151.

2 Sub Nos. 89, 73.

3 Sub Nos. 8, 52.

4 Sub Nos. 107, 26, 52, 82.

5 ALRC recommendation plus Sub Nos. 79, 90, 128, 113.

6 Sub No. 95.

7 Sub Nos. 138, 73, 120.

8 Sub No. 156.

9 Sub Nos. 119, 117, 120 and 156.

Table 5.2

ALL SUPERANNUATION FUNDS : NUMBER OF FUNDS BY INDUSTRY CATEGORY AND MEMBERSHIP SIZE – 1987-88
(Number)

Industry Category	Membership Size											Total
	Not Stated	0	1 to 2	3 to 5	6 to 10	11 to 50	51 to 199	200 to 500	501 to 1 000	1 001 to 10 000	More than 10 000	
1986-87	3 217	227	92 138	19 289	5 092	4 768	1 481	486	185	202	48	127 133
1987-88	3 515	54	83 575	17 145	4 436	4 266	1 533	488	219	248	51	115 530
1987-88 –												
Agriculture, Forestry, Fishing & Hunting	163	2	5 164	1 608	288	149	40	11	1	3	–	7 429
Mining	41	1	669	137	41	104	54	24	8	13	–	1 092
Manufacturing	358	4	6 800	2 426	883	1 025	493	197	86	75	3	12 350
Construction	33	1	1 128	271	40	31	4	5	–	4	–	1 517
Electricity, Gas & Water	307	7	9 802	2 073	463	371	86	19	5	8	3	13 144
Wholesale & Retail Trade	700	11	17 390	4 842	1 178	958	216	46	15	17	2	25 375
Transport & Storage	126	3	3 824	819	209	217	63	13	7	13	2	5 296
Communications	42	–	1 139	155	59	88	46	19	9	9	–	1 566
Finance, Property & Business Services	694	11	18 477	2 493	685	580	195	56	32	21	2	23 246
Community Services	196	3	6 140	547	149	235	122	28	10	8	–	7 438
Recreational, Personal & Other Services	354	11	11 331	1 437	308	284	77	13	2	8	2	13 827
Fund membership covers a large number of industries	*31*	–	*785*	*211*	*99*	*187*	*132*	56	44	69	36	*1 650*
Not Stated	470	–	926	126	34	37	5	1	–	–	1	1 600
TOTAL	3 515	54	83 575	17 145	4 436	4 266	1 533	488	219	248	51	115 530

Source: *ISC*

- where representation on boards of trustees is equal as between employers and employees, there should be an outside chairperson with no voting rights. This would facilitate consensus;[10]

- for funds with 100 or more members or $5 million in assets there ought to be a requirement for an independent trustee;[11]

- investors in master trusts do not have effective representation;[12]

- there should be a requirement for a minimum number or proportion of the board of trustees to comprise persons competent in superannuation;[13]

- it is not necessary to have public trustees because the manager will generally have better resources and skills to discharge fiduciary duties;[14] and

- trustees should be required to undergo specialist education.[15]

5.4 Traversing this contentious ground has not been easy for the Committee. The Committee believes that the issue of trustee representation can be separated into distinct parts:

- firstly, whether member representation is desirable and if so, the threshold level at which this should apply. Related to this issue is whether trustees should be elected or nominated by employer and employee groups;

- secondly, the need for an independent trustee on employer-sponsored and industry funds or whether there should be an independent custodial trustee;

- thirdly, whether minimum education qualifications should apply; and

- fourthly, the particular circumstances of master trusts and whether a private sector public trustee should be required for life office master trusts.

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10 Sub Nos. 138, 141.

11 Evidence, p 623.

12 Sub Nos 138, 141.

13 Sub No. 95.

14 Sub No. 105.

15 Sub Nos 66, 108, 119, 115.

Member Representation

5.5 Various witnesses have argued that member representation is in itself a good protective safeguard against fraud and malpractice. The Committee endorses the comments made by the ISC, the ACTU, ASFA and others that active member interest is a potent form of prudential supervision.[16]

5.6 Mercers argue that:

> *Member trustees is something to be encouraged for two reasons: one, it engenders a spirit of cooperation between management and employees ... At the other level, our experience is that member trustees become the best salesmen for superannuation in the work force. If they believe in it, and see the benefits of it, they spread the gospel.*[17]

5.7 Leaving aside the issue of master trusts, most submissions to the Committee supported member representation on trustee structures for large funds. One of the few to not support this principle was Mr W A Lee, who objected to the requirement for equal employer/employee representation on the following grounds:

- neither representatives were selected for their expertise; and
- decisions by employee/employer representatives may be guided by political, rather than purely financial policies.[18]

5.8 ASFA repeatedly made the point in its evidence[19] that trustees, whether they are elected or nominated by employees or employers, have a duty to act in the best interests of all members of the fund.

5.9 Having regard to the fact that the moneys in superannuation funds belong to the members, the Committee believes that there is a need for an arms' length relationship between the employer and the superannuation fund and that members have a right to participate in the decision making process of the fund.

5.10 Both Mr Noel Davis[20] and Mr Jeremy Henderson[21] in their evidence to the Committee suggested that member representatives can be compromised in their position as trustees because their jobs are important to them. Whilst Mr Davis suggested that the way around this was to have at least one independent trustee, Mr Henderson suggested that nominations should come from the appropriate peak union body and that

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16 Evidence, p 643, 1721.

17 Evidence, p 37.

18 Sub No. 78, p 5.

19 Evidence, p 643, 649, 652.

20 Evidence, p 623.

21 Evidence, p 1622.

communication processes were very important so that members were aware of who the trustees were and how they could be contacted.

5.11 With respect to the threshold level at which equal employer/employee representation should apply, the Committee endorses the view put by the ISC[22], Jacques Martin[23] and others, that the threshold should be lower than the current level of 200 members. The Committee notes that the recent ALRC report on collective investments[24] recommended that equal employer/employee representation apply where funds had 50 or more members. The Committee recognises that the vast majority of funds (87 per cent)[25] have fewer than five members and that, under the ALRC proposal, 2 539 funds would be subject to the equal trustee representation requirement.

5.12 However, assuming that all funds with five or more members had arms' length members, implementation of the ALRC recommendation would mean that around 8 700 funds[26] would be exempt. In effect, approximately 3.5 times as many funds with arms' length members would be exempt from the equal trustee representation requirement as those that were subject to it. The Committee heard some evidence to suggest that improper and fraudulent practices were more likely to occur in small funds. The circumstances of the Byrnwood case (see Figure 5.2) and ABC Engineering (see Chapter 4) bear this out and therefore the Committee favours a threshold lower than the current level of 200 members.

Recommendation 5.1:

The Committee recommends that the requirement for equal employer/employee representation should apply to all funds with arms' length members; that is, funds with five or more members.

5.13 The Committee is conscious that many witnesses expressed concern about the reticence of employees to put themselves forward for nomination as trustees because of the perceived onerous responsibilities. The Committee recognises that in many small, non-unionised workplaces employees may be unwilling to nominate themselves as trustees yet would have difficulty in nominating persons who could represent their interests. As trustee representation is still evolving, the Committee considers it premature at this stage to require all trustee representatives to be elected by the membership and suggests that further consideration be given to means by which employees in non-unionised workplaces can be represented if they do not wish to be trustee themselves. A list of possible nominees maintained by the ISC would be one means of overcoming this difficulty.

22 Sub No 51.

23 Sub No 90.

24 ALRC, Report No. 59, p 178.

25 Derived from Table 5.2.

26 *ibid.*

5.14 The Committee received representations from one of the employer groups involved in the health care industry about a dispute involving the selection of employer representatives for Health Employees Superannuation Trust Australia Ltd (HESTA)(see Figure 5.1)[27]. The Committee understands that under current arrangements there is no provision for an independent arbitrator to adjudicate on such issues.

Recommendation 5.2:

The Committee recommends that a list of persons willing to serve as trustees be maintained by the ISC which would be authorised to provide both employee and employer groups with details of the list to assist in the selection of trustees.

The Committee further recommends that in the event that employer or employee groups were unable to agree on a mechanism for selection of their nominees, the ISC be given arbitration powers (provided the matter is not under consideration by the AIRC) and that the ISCs determination be binding on all parties. Where such determinations are made by the ISC, they should operate for a period no longer than three years.

Figure 5.1

Case Study – HESTA

The National Association of Nursing Homes and Private Hospitals is an employer association representing the industrial and political interests of private health care proprietors. Members of the Association are required to make award superannuation contributions on behalf of their employees to the fund.

The rules of the HESTA fund provide that election of employer directors is determined by a ballot of the employer members of the fund. However, employer contributors are not automatically 'members' of the fund. The National Association of Nursing Homes and Private Hospitals alleges that some of the original employer directors have sought to monopolise representation in the trustee structure of HESTA by 'stacking' an annual general meeting to vote out of office a director representing the National Association and that they failed to admit as new members of the fund any nursing home or private hospital employer contributor to HESTA who is a member of the National Association.

An employer representative trustee of HESTA, Mr Wynward, advised the Committee that the rules of HESTA provide that only those organisations of employers or employees that contemplate HESTA in the industrial award structure and which are registered or are recognised by Federal or State industrial tribunals can be eligible to apply for membership of HESTA.

Source: Sub Nos 56, 144, 157, 165.

[27] Sub Nos 56, 144.

Independent Trustees and Custodial Trustees

5.15 ASFA in its evidence to the Committee noted that:

> *The independent trustee is more removed in terms of voting... and perhaps less open to being influenced in the process, if that is a significant risk. But they are also less in touch with the members and the views of members and what is actually happening in the workplace. It needs to be borne in mind that the rules in regard to equal representation also provide for decisions by two thirds of the trustees voting in favour. So, effectively, an independent trustee does not solve a deadlock ...*[28]

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[28] Evidence, p 652.

Figure 5.2

Case Study – The Byrnwood Case

Byrnwood Pty Ltd traded as Peters Bakeries & Swan Lake Natural Foods, and employed 40-50 employees. Most of the production workers were members of the Federated Miscellaneous Workers Union (FMWU), many of them from non-English speaking backgrounds.

The company ran a defined benefit scheme for employees called the Byrnwood Superannuation Fund. The last actuarial review of the fund was conducted for the 1988/89 financial year. At that stage the fund was healthy, and the actuary recommended in January 1990 that no payments need be made by the employer. In addition, the Award required the employer to pay 3% superannuation into a nominated industry fund.

On 12 November 1990 Coopers & Lybrand advised suppliers, customers and staff that they had been appointed as Receiver Manager to Byrnwood P/L.

On 18 November 1990 the Receiver Manager advised the FMWU at a meeting of his concern with respect to the state of the fund. He appointed three staff to audit the fund.

On 18 December 1990 the Receiver Manager wrote to all employees advising them that the company had not remitted certain superannuation payments including those payable by the company for award superannuation and those deducted from employees' wages.

There was no arms' length relationship between the employer and the superannuation fund. The employer, Byrnwood Pty Ltd, was also the trustee of the Byrnwood Superannuation Fund. The Receiver Manager advised the FMWU that it was only acting in the capacity of employer, and was therefore not in a position to act as trustee of the fund.

However, since the Trust Deed provided for the Principal Employer to appoint and remove trustees, the Receiver Manager indicated that he would give consideration to appointing a nominee of the members as trustee. In view of concerns with respect to the question of the liabilities of the trustees, this invitation was not accepted.

The company had $6.7 million of secured debts, mainly to ANZ and Standard Chartered Finance. In addition, approximately 90 per cent of the superannuation fund's assets, or $435,105, had been lent as an unsecured loan to Byrnwood, which the receiver indicated there was no chance of recovering.

The former employees not only lost their jobs but their superannuation benefits. The opportunities for the members to take action against the former trustees of the fund were extremely limited because of the cost and uncertainty of court action. In addition, one of the former directors was a declared bankrupt and another was domiciled in Hong Kong.

The Byrnwood case highlights the need for an arms' length relationship between employer and trustees and the need for the ISC to be able to take action on behalf of members.

Source: Evidence, pp 1608-14.

5.16 Professor Knox told the Committee that he thought any requirement for an independent trustee could:

> *... be an extra piece of bureaucracy that is unnecessary.*[29]

5.17 The ASC in its evidence argued strongly for a majority of independent trustees because if the law is built around employee or employer controlled trustees, there is always the possibility of Maxwell-type problems.[30] The ISC also spoke in favour of independent trustees, arguing that:

> *... there must be circumstances where trustees, for whatever set of reasons, who are there representing certain interests - and so-called independently - do not always act in an independent fashion.*[31]

5.18 TCA said that there are several advantages to a corporate (public) trustee, principally, independence and the fact that such companies have the necessary expertise in investment strategies, taxation and legal issues. Moreover, it was argued that a public trustee has a responsibility to keep abreast of developments and this is not always possible for private trustees.[32]

5.19 On the balance of evidence, the Committee believes that a single independent trustee would not break a deadlock and that with the new reporting requirements to operate from 1 July 1992, trustee decisions will be open to far greater scrutiny than is presently the case. Moreover, if the Committee's recommendations in respect of penalties for breaches of legislation are accepted, trustees may be less likely to succumb to particular pressure.

Recommendation 5.3:

The Committee recommends that employer-sponsored and industry funds have no mandatory requirements for independent trustees and that this be left to individual funds. However, to lessen the possibility that trustees could be pressured or coerced by particular interests associated with the fund, the Committee recommends that trustees be provided with legislative protection against action which would unfairly disadvantage them. For member trustees, this would include protection against unfair dismissal and discrimination in career advancement.

Education

5.20 The Committee heard a range of views about whether trustees should be required to have specialist education.

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29 Evidence, p 898.

30 Evidence, pp 1307-1308.

31 Evidence, p 1850.

32 Evidence, p 262.

5.21 ASFA commented that:

> *... [trustees] should be ordinary, honest, careful people with a great deal of commonsense. The job is to look after and represent fund members and to balance their conflicting interests. They do not need to be professionals to do this. They may need to seek advice from experts and engage them to perform various services, where appropriate.In many ways they are perhaps parallel to politicians, who do not have to be experts, but they have available to them expert advice.*[33]

5.22 The joint submission from the accounting bodies noted that a high level of skill and knowledge is required of a superannuation fund trustee. Many trustees are forced to rely on the use of advisers to clarify, explain and administer their funds and the submission argued that if legislation were to prescribe minimum levels of skill and knowledge of company directors, similar action should be taken in relation to superannuation fund trustees.[34] The West Australian Minister for Industrial Relations believes that it is necessary to establish an Australia-wide syllabus for training courses for trustees and suggested that the ISC would be a suitable body to establish it.[35]

5.23 BUS noted in its evidence to the Committee that it supported:

> *... the proposal to develop an Australian Institute of Superannuation Trustees Inc to help in promotingexcellence and integrity by trustees in the performance of their duties on behalf of members, to assist in developing the knowledge and skills of trustees and to create a forum* ***which currently does not exist*** *where trustees of industry funds, corporate funds and public sector funds could share experiences and assist each other.*[36] [Emphasis added]

5.24 Since BUS gave its evidence to the Committee, the Australian Institute of Superannuation Trustees Inc has been founded by the Conference of Major Superannuation Funds as an independent non-profit, incorporated association with the following objectives:

- to promote ethical and effective performance standards by trustees;
- to improve the knowledge and skills of trustees, including the administration and management of assets of superannuation funds;
- to develop a code of conduct for trustees; and
- to enhance the sound management and security of superannuation by trustees on behalf of their members.

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33 Evidence, p. 643

34 Sub No. 119.

35 Sub No. 115.

36 Sub No. 7, p 377.

5.25 County NatWest in its submission suggested that the introduction of secondary and tertiary subjects in superannuation will facilitate development of the long-term perspective which is needed if superannuation and retirement incomes policy is to be successful.[37] ACM believes that there is an argument for the establishment of formal education courses specialising in superannuation and suggests that responsibility rests with government to provide or subsidise training for trustees.[38]

5.26 On the question of compulsory education, the Committee notes that many witnesses argued strongly for compulsory, specialist training. Mr Renton in his evidence to the Committee noted that:

> *... You can have an admirable truck driver, but he does not necessarily have the skills and the resources to make investment-type decisions or superannuation-type decisions... there are plenty of people who could be elected by members of funds and be members' representatives without necessarily being expert in superannuation matters.*[39]

5.27 MMBW suggested that trustee education be obligatory[40] whilst MTIA suggested that reasonable member representation should be provided subject to the individual trustees being capable of properly exercising their responsibilities. In order to carry out responsibilities, trustees require appropriate knowledge of, and where possible due experience in, the related legal, financial, administrative and investment disciplines.[41] ASFA argued that it was not appropriate to mandate minimum educational qualifications because it cuts across the whole notion of a representative trustee.[42]

5.28 The Committee believes that the trade union movement, ASFA and other industry groups have made significant progress in educating trustees. The Committee is also of the view that employers are increasingly conscious of the need to allow trustees to be adequately trained and supported.

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37 Sub No. 98, p 24.

38 Sub No. 95, p 15.

39 Evidence, p 139.

40 Sub No. 66, p 2.

41 *ibid.*

42 Evidence, p 649.

Recommendation 5.4:

The Committee believes that trustee education is essential for the long term viability of the industry and recommends that such education be given high priority by both the Government and the industry. Recognising that the structure of the superannuation industry is still evolving, particularly with respect to trustee representation, the Committee recommends that prescribed courses and training should not apply for the time being.

The Committee further recommends that the ISC should require details of the educational qualifications and/or superannuation-specific training or experience of persons nominated as trustees. If the educational qualifications or superannuation-specific experience of trustees as monitored by the ISC have not shown significant improvement after three years, compulsory education standards should apply. The Committee commends the establishment of the Australian Institute of Superannuation Trustees Inc, and recommends that nationally accredited courses in superannuation be available in all states within five years.

Master Trusts

5.29 Master trust arrangements can be provided by banks, life offices and funds managers. Under OSS Regulation 13(e), certain master trusts may obtain approval from the ISC to be exempt from the equal representation rules. Together with other legislative requirements this means that:

> *For Banks:* The Reserve Bank requires that an independent public trustee must be appointed for any fund managed by a subsidiary of a bank in which investments are available to the public. Failure to do so will require banks to hold capital against those managed funds.
>
> *For Life Offices:* There are no requirements under OSSA or LIA for public superannuation funds managed by life offices to have an independent public trustee.
>
> *For Funds Managers:* Public superannuation funds subject to the Corporation Law must have an independent public trustee.

5.30 With respect to life offices, the Committee is concerned about the potential for a conflict of interest to arise where the trustees are also employees of the fund promoter.

5.31 BT stated that private sector public trustees are not suitable or necessary to protect the interests of the unit holders.[43] BT commented that:

> *... trustee companies were really a creature from the last century or some other time which were there to do a particular limited role with respect to*

43 Sub No. 105, p 6.

administration of private estates and so forth. With the rapid development of the unit trust industry, they have grown to have this new role which is on a scale many times greater than that old business. In a lot of the cases the trustee companies do not have the capital to actually fulfil the fiduciary role right to the end of the course.

5.32 BT also commented that public trustees do not have the systems to put adequate fiduciary controls or audit controls in place and that they added inefficiency to the system.[44] AM, in its submission, argued that life offices should be required to have a public trustee.[45]

5.33 National Mutual argued that independent custodial trustees would be introduced at substantial cost.[46] However, in the absence of a private sector public trustee, it is possible for conflicts of interest to arise as the evidence by National Mutual Ltd (NML) and Mr Foley made clear (see Figure 5.3). It is of concern to the Committee that National Mutual's action appears to be at odds with Regulation 5 of the OSS Regulations which state that:

... a trustee of a superannuation fund must not be a party, or give effect, to the exercise of a lien over prescribed benefits by another person.

Figure 5.3

Case Study – Mr Foley v NML

Mr Foley alleged that NML, acting on the verbal advice of an employer, illegally withheld the accumulated contributions which were due to an employee whose services had been terminated. Apparently, there was an undisclosed sum of money owed by the employee to the employer which was the reason for the instruction to withhold payment. According to Mr Foley, this case highlights the need for an arm's length relationship between the superannuation fund manager and the trustee.

In its evidence to the Committee, NML stated that the trustees applied the lien at the request of the employer. The trustee was National Mutual Superannuation. When queried by the Committee about the discrepancy between the two witnesses, National Mutual responded by noting that:

Mr Foley is asserting that in respect of a lien a document is required. At law that is not so, in my view. A lien is an event, an act, not a document.
(Evidence, p 1904.)

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44 Evidence, pp 847-848.

45 Sub No. 96, p 5.

46 Evidence, p 1883.

> ***Recommendation 5.5:***
>
> *The Committee recommends that all master trust arrangements, including those offered by life offices, be required to have an independent public trustee.*

5.34 The other area of concern to the Committee is that master trust arrangements are not required to have member representation. AMP advised the Committee that, as the independent trustee may have a similar role in a number of plans or be involved in other activities, to have directors representative of employers and employees was unlikely to be practicable.[47] It suggested, however, that similar representation could be achieved by the establishment of a policy committee.

5.35 The policy committee could be structured so that each individual plan – or in the case of multi-employer plans, each sub-plan – could have equal representation in line with current regulations. AMP saw the advantages of a policy committee as being that:

- legal responsibilities could rest with the independent corporate trustee and appropriate sanctions would be available under the corporations power of the Constitution; and

- member nominees are more likely to put themselves forward where responsibilities are advisory rather than legal.[48]

5.36 AMP noted that in respect of personal superannuation plans, there was no need for representation through a committee because the decision to join or leave the fund was solely at the members' discretion. However, the Committee notes in this context that the effect of early termination on policy values may prevent individuals from 'voting with their feet'.

> ***Recommendation 5.6:***
>
> *The Committee recommends that each individual plan or sub-plan with arms' length members in master trust arrangements be required to have a policy committee comprising equal representatives of employers and employees to advise the trustee.*

5.37 Another issue brought to the attention of the Committee was a loophole in OSS Regulation 13(e). This Regulation enables the Commissioner to grant an exemption from the equal employer/employee representation requirement for occupational superannuation funds established after 16 December 1985.

5.38 The AWU claimed in its submission to the Committee that the National Superannuation Fund administered by Federation Life Insurance (now Financial Synergy) and the Australian Farm Superannuation Plan (managed by Australian Eagle) should not

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47 Sub No. 120, p 35.

48 *ibid.*

have been given interim listing by the ISC under Regulation 13(e) of the OSS Regulations[49]. Both these plans are nominated in the Pastoral Industry (Superannuation) Award 1988 and, unlike other industry funds, there is no requirement for equal employer/employee representation because they are sub-plans in a master trust.

5.39 The ISC told the Committee that the grafting of an industry fund onto a master trust arrangement, thereby avoiding the requirement for equal representation, was a loophole in the regulation and that there should be appeal mechanisms available to the various parties if exemption is given under OSS Regulation 13(e).[50] The Committee notes the ISC submission but believes stronger measures need to be taken which guarantee equal employer/employee representation.

Recommendation 5.7:

The Committee recommends that Regulation 13(e) of the OSS Regulations be amended to require all plans nominated in industrial awards to have equal employer/employee representation.

49 Sub No. 181, pp 6-7.

50 Supplementary submission to Sub No. 151.

CHAPTER 6

SURPLUSES AND INACTIVE ACCOUNTS

Surpluses in Defined Benefit Funds

6.1 The Committee heard a great deal of conflicting evidence about the ownership of the surpluses in defined benefit funds. In general, the industry has argued that the trust deed is the arbiter of who owns the surplus; but that where this is not clear, the sponsoring employer should be entitled to any of the surplus because the employer bears all of the investment risk. However, many in the industry acknowledge that there is a need for some legislative guidance. For example, Noble Lowndes in its submission to the Committee suggested that in addition to any trust deed requirements:

- there be a minimum funding standard which must be satisfied immediately after any repatriation;
- this minimum standard be that the market value of assets represent at least 110% of accrued retirement benefits; and
- details of any repatriation be disclosed to the fund members.[1]

6.2 The Attorney-General's submission notes that greater certainty as to the ownership of superannuation fund surpluses needs to be established to avoid costly court proceedings and to ensure equity.[2] The ALRC recommended repatriation of surpluses be illegal except where:

- the actuary has certified there is a surplus;
- the amount (or sum of the amounts) paid since the actuary's certificate was given is not more than 50% of the amount certified by the actuary;
- the responsible entity has given members two months written notice of the intended repatriation.[3]

6.3 ASFA, Mercers, and Mr Cliff Newman[4] argued in their evidence that if the Government were to regulate the treatment of surplus as it arises, employers will tend to under-fund, rather than contribute at the optimal level. They all stressed that a surplus can be a transitory affair because of movements in the stockmarket and other asset prices and that any legislative requirements need to be carefully considered.

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1 Sub No. 80, p 12.

2 Sub No. 107, p 19.

3 ALRC, Report No. 59, op cit p 248.

4 Evidence, pp 48, 664, 735.

6.4 From 1 July 1992, the ISC will require that a return of surplus be disclosed in advance to members. This will be a significant improvement on current rules which only require trustees to notify the members and the ATO within two weeks of the repatriation. The Committee is also aware that from 1995 the return of a surplus in a defined benefit fund to the sponsoring employer will no longer be tax deductible to the fund. Under current taxation arrangements, the surplus repatriated to the employer is included in the employer's assessable income and the fund is entitled to a corresponding deduction so that future deductible contributions up to the same amount may be made by the employer without attracting any tax liability to the fund. However, contributions of the same dollar amount made in later years will not, in real terms, be of the same value to the fund as the amount refunded. Any additional contributions beyond the amount of the repatriation will attract tax. From 1 July 1995, no deduction will be available to the fund on repatriation of the surplus and the future contributions will have to be increased to cover the cost of the tax.[5] These changed taxation arrangements will remove much of the incentive to return the surplus; hence, employers are more likely to take advantage of contribution holidays if the fund builds up a substantial surplus.

6.5 The Committee has some difficulty accepting the view of many in the industry that, because the employer bears all the investment risk, the employer should be entitled to the surplus where the trust deed is silent. The repatriation of surpluses, even if conducted in accordance with the trust deeds, always has the potential to destabilise the employer-employee relationship. The Committee was particularly concerned about the issues involving a surplus in defined benefit funds that were raised by Chifley Superannuation Services, Mr Noel Davis, Mr Cliff Newman, Mr Ian Langfield-Smith, the Shell Superannuation Rights Committee and Mr David Hughes. The Committee understands that all employer sponsored trust deeds have a provision for the employer to wind up the plan at any time should the employer so decide. This action may be taken to protect the employer from any major downside on the investment return.

6.6 Both the Shell Superannuation Rights Committee and Mr D Hughes[6] argued that surpluses arise from a variety of factors, including the vesting arrangements operating before 1987 which meant that members leaving the fund received only their own contributions plus a nominal rate of interest on those contributions, plus the investment return on employer and member contributions. They provided a schematic representation of how the surplus in the Shell fund arose (see Figure 6.1). Whilst Shell has not made a formal submission to the Committee, it has provided a copy of a letter sent to Shell staff regarding the surplus. An excerpt from that letter is given in Figure 6.2.

6.7 Both the Shell Superannuation Rights Committee and Mr Hughes argue that there should be:

> *some form of legislation to say that if members do contribute to superannuation funds, especially defined benefits funds, any surplus that is generated and subsequent re-allocation of assets, if there is any, should go*

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5 E A Slater, *Superannuation Fund Surpluses*, Butterworths, Service 14, Sydney 1991, p 12 412.

6 Evidence, p 632, p 636.

back in part to the members.[7]

6.8 Mr Noel Davis argued that large surpluses in superannuation funds are a form of tax minimisation[8] and suggested that restrictions similar to those which have been imposed in the United States and the United Kingdom be developed in Australia.[9] He suggested that if the surplus was restricted to an amount that was 10-20 per cent greater than the liabilities of the fund, this would represent an adequate reserve in the fund and there would be no tax avoidance as presently occurs.[10] The ATO told the Committee that to its knowledge the accumulation and repatriation of surpluses had not been used as a tax minimisation measure.[11]

Recommendation 6.1:

The Committee recommends that the Government conducts an investigation to determine whether surpluses are being used for the purposes that are intended; that is, to act as a reserve against investment fluctuations. Following this review, the Committee recommends that the Government re-examine the 1995 timetable for removing the tax deductibility to the fund of a repatriation of surplus to the employer.

6.9 Mr Davis also raised the issue of employers gaining access to the superannuation fund moneys by the employer company terminating the employment of their employees and re-employing them in an associated company. Unless the trust deed provides for vesting, the amount remains in the fund and invariably gets distributed to the principals of the organisation.[12] This was an issue vigorously taken up by Chifley Superannuation Services which calls the practice 'Legal Stealing'. (Refer to Figure 6.3.)

6.10 The Committee believes that much needs to be done to combat the problem of employers 'creaming off' the surplus. The Committee is particularly concerned about the repatriation of a surplus consequent to changes to the trust deed.

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7 *ibid*, p 634.

8 Evidence, p 621.

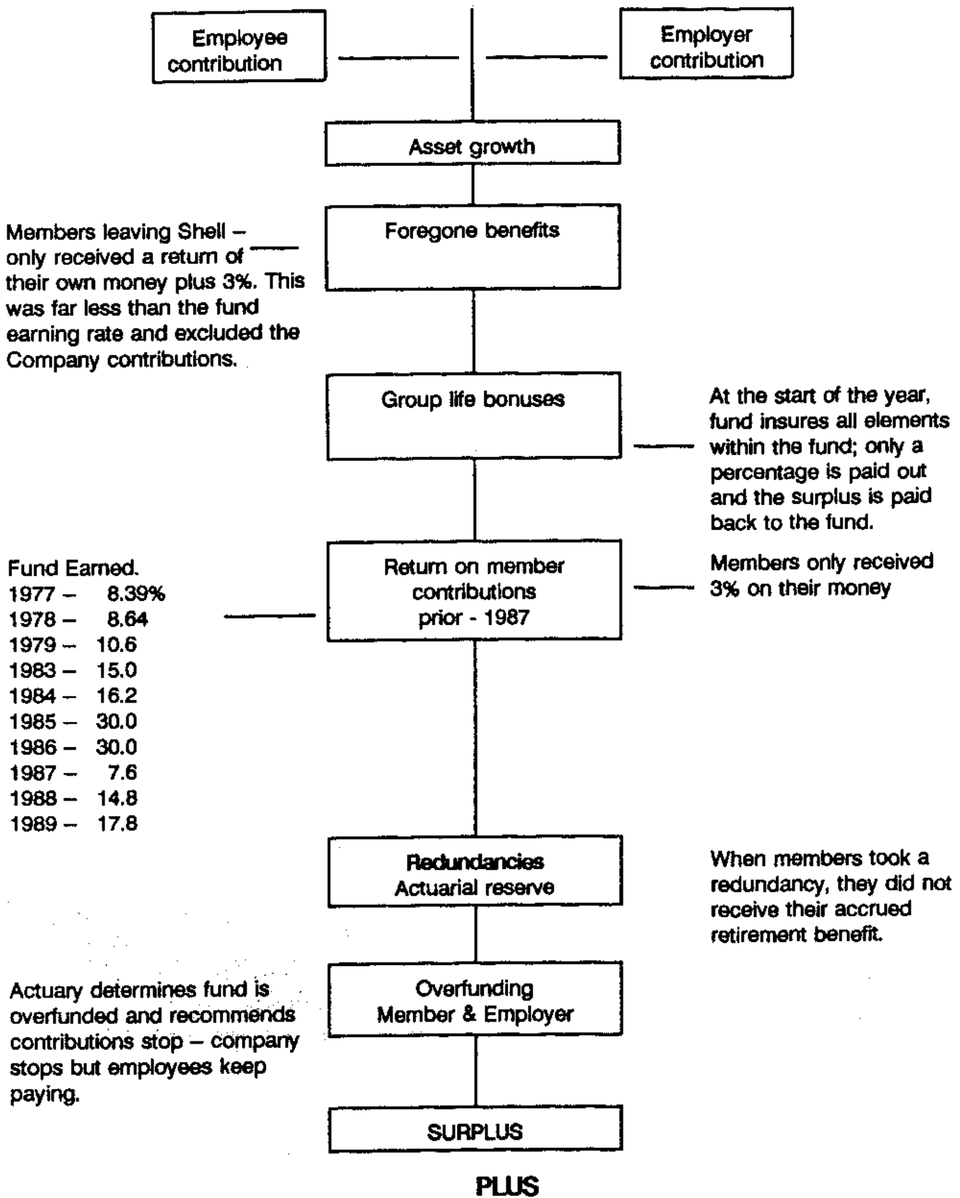
9 *ibid*.

10 *ibid*, p 622.

11 Evidence, p 2059.

12 *ibid*, pp 622-23.

Figure 6.1 HOW THE SHELL SURPLUS WAS MADE



PLUS

Fund receives a 15% tax credit for surplus removed.

Source: Shell Superannuation Rights Committee, Submission No. 166. (Similar diagram tabled by Chifley Superannuation Services at Sydney public hearings).

Figure 6.2

Shell's Response:

In 1990, most members of the Shell Australia Contributory Pension Fund (SACPF) exercised their choice to switch to a new Fund, the Shell Australia Superannuation Fund (SASF). There are many differences between the two funds, with the fund providing additional benefits to members and to the company, but what has led to the controversy is the difference in how they handle surpluses.

A surplus occurs when the amount in the fund is more than is needed to pay all fund benefits as estimated by the independent actuary. Under the SACPF, surpluses had to stay in the fund. The company could stop making contributions to the fund if there was a surplus, but it could not take the surplus back. Under the new SASF, Shell has the right to take the surplus back after allowing a cushion for safety sake. This is of benefit to Shell, since having the surplus to use in the business is worth more than suspending contributions until it is reduced.

The unions are arguing that 50 per cent of the surplus should be credited to union members' accounts. Shell is arguing that the surplus comes from excess company contributions not from employee contributions, and the company should control how it is dealt with.

At the time of the switch to the SASF, the surplus was between $250-$300 million. While the value of the surplus has moved with the value of the fund's investment portfolio and with benefits paid to members, it is obviously still substantial. It is not surprising therefore that some employees think it is worth a legal fight to try to get some of this money for themselves. On the legal front, only arguments about the appropriate forum to deal with the dispute have so far been heard in the Australian Industrial Relations Commission and the High Court, where a decision is pending. There has as yet been no hearing on the substance of the dispute. I believe our case is strong, but this is now a matter for the courts. The company is committed to the process and the decision will eventually be made as it should be made - legally and peacefully.

Why does Shell claim the Surplus?

Both the old SACPF and the SASF are 'defined benefits funds'. This means that employees' contributions and benefits are both fixed by the terms of the fund. The company's contributions are estimated in advance but, unlike the employees' contributions, they are not fixed. If the fund does worse than expected, the company's contributions go up. If the fund does better than expected, the company's contributions go down. Either way, your payments and your benefits stay the same. Shell takes the risks.

For many years, as a result of conservative actuarial estimates, Shell put more money into the SACPF than was needed to cover all the benefits, so the surplus grew. Eventually the fund's legal, tax and actuarial experts told us the surplus was getting much too high, far higher than any reasonable margin of safety, and high enough to endanger the tax preferred status of the fund. When we designed the SASF, treatment of the surplus was one of the things we changed. The SASF lets Shell get the surplus back when it chooses, instead of retrieving it a little at a time by taking a 'contributions holiday'. We did our best to explain this.

When Shell employees and members elected in 1990 to switch to the SASF – as more than 99% did – one of the things they also agreed was the change in how the surplus was handled. We recognised that you had a right to know that before you made your choice.

We therefore included information about the surplus and the company's intention in the materials sent to all members, and dealt with the issue specifically as a formal part of the approximately 100 site meetings held to discuss the switch.

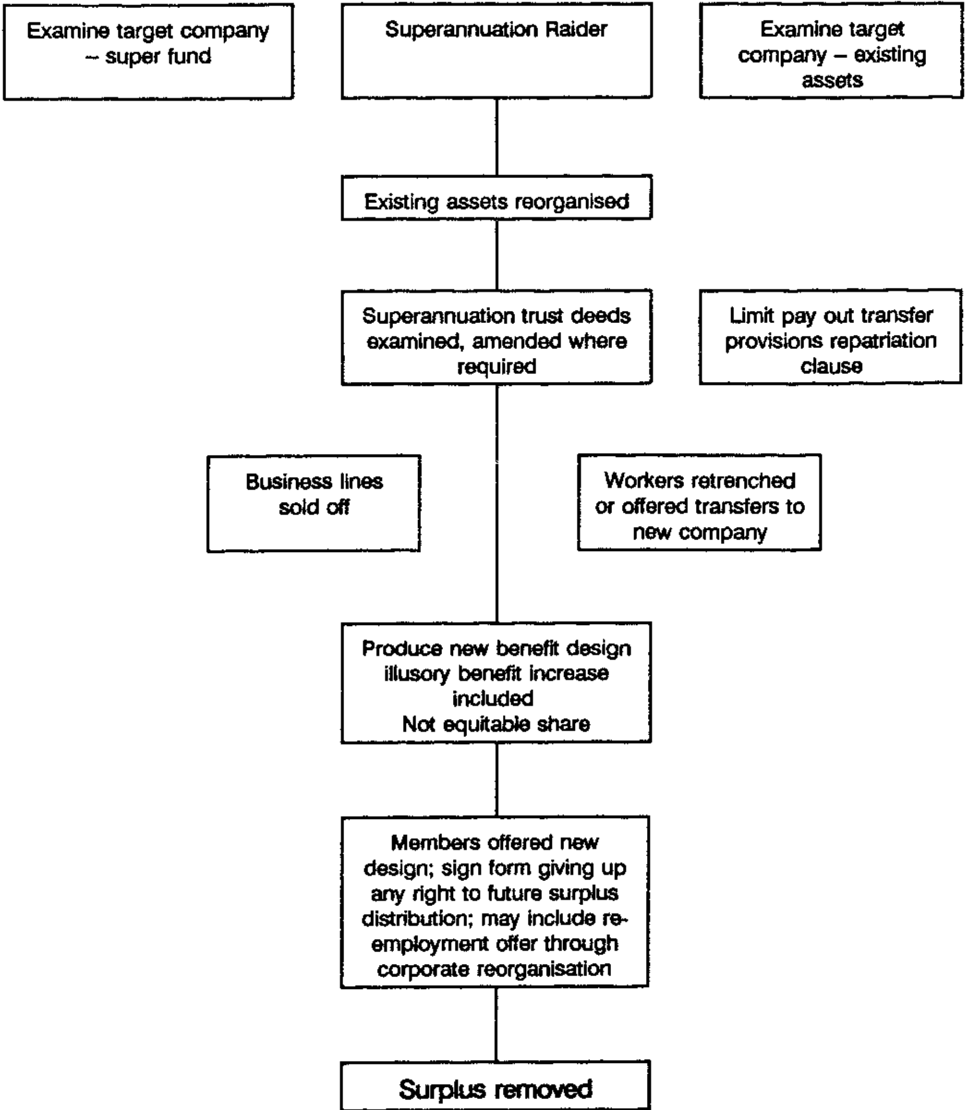
It was also addressed over the 'hot line' established to answer members' queries. The unions who are leading the fight now were certainly well informed from the outset, judging by the cartoons they circulated attacking Shell well before the 1990 transfer deadline.

How do I see this issue being resolved?

Objectively, Shell's old fund was at least equal to the best of its type in Australian industry. The new fund, the SASF, is better still. We have over 4 000 members, of whom about 1 900 are unionised. In addition, we have 1 100 pensioners. Our history has been for the one scheme to apply to all Shell employees, which I believe has been one of the strengths of Shell in comparison with many companies.

Source: Excerpt from letter to Shell staff, from Mr Ric Charlton, Shell Chair and Chief Executive Officer. Forwarded to the Committee following evidence given by Mr Hughes and Mr Collins.

Figure 6.3 **'LEGAL STEALING'**



Reproduced from documents tabled by Chifley Superannuation Services at Sydney public hearings, 18 February 1992.

6.11 The case put by Chifley Superannuation Services was that in the event of a takeover, members of the fund in the takeover target are transferred into the raider's superannuation fund and the surplus is tied up in the fund in the takeover target. Chifley contends that the new fund usually has what it calls 'illusionary' increased benefits, commonly better vesting, but the transfer provisions and winding up provisions in the new fund are different. Chifley suggested that key amendments to the original deed were:

- 'Members Interest' was changed to 'Accrued Rights';
- 'Equitable Distribution' was changed to 'Ascertained Benefit';
- 'No Reversion' was changed to 'Reversion to Employer'; and
- 'Company Contributions Irrevocable' was changed to 'Reversion to Employer'.

6.12 Mr Newman corroborated Chifley's evidence and said that he had

> *... seen the trust deed altered in such a way that the members can only get a certain level of benefit – it certainly would not be less than their vested benefits – and the balance can be repatriated to the principal employer under the trust deed.*[13]

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13 Evidence, p 728.

Recommendation 6.2:

The Committee recommends that OSSA be amended so that for defined benefit schemes:

- *all trust deeds be required to include clauses outlining the methods by which a surplus can be repatriated to the sponsoring employer, and that any changes required to give effect to this requirement be submitted to members for approval beforehand;*
- *members be given at least three months' prior notice before a surplus is repatriated;*
- *members must be supplied with a summary when such notice is given which includes the financial status of the fund, including the accrued retirement benefits index;*
- *members upon request are entitled to a copy of the original trust deed and all amendments and dates of amendments up to the date of the proposed or actual repatriation of any surplus or transfer;*
- *a minimum funding standard be satisfied immediately after repatriation – this minimum standard to be at least 110% of accrued retirement benefits;*
- *the amount of surplus that can be held in a fund is restricted – the level to be an amount not more than 20 per cent of the liabilities of the fund;*
- *where members are to be transferred from one scheme to another, members must be advised of the clause(s) in the deed under which the transfer is being effected; and*
- *where members are to be transferred from one scheme to another, that members be given two months' prior notice so that they have adequate time to seek advice on the implications of the transfer.*

6.13 Mr Langfield-Smith, in his evidence to the Committee, said that he was aware of some schemes which expressly limit the payout to the member to the RBL limit. However, the fund did not take that into account in determining the level of employee contributions so that employee contributions were in fact enabling employer contributions to be reduced. Mr Langfield-Smith said that under current regulatory arrangements the fact that employee contributions were excessive need not be brought to the attention of members.[14]

14 Evidence, p 169.

Recommendation 6.3:

The Committee recommends that the fund's actuary be required to report on the level of employee and employer contributions in the context of members' RBLs.

Surpluses in Accumulation Schemes – Lost or Inactive Members

6.14 In accumulation schemes, surpluses arise for three reasons:

- investment earnings are not credited in full to members' accounts;
- contributions on or behalf of lost members are credited to reserves; and
- where employer contributions do not immediately vest in the employee.

6.15 With respect to the first issue, the Committee believes that accumulation schemes should be able to build up reserves to smooth the investment returns that are available over a period of years. Smoothing of investment returns in this way may also help attenuate the focus on short term investment returns and redirect attention to the long term performance of the fund. The Committee is conscious however, that reserves in accumulation schemes raise concerns between different generations in the fund (inter-generational equity concerns) and that these require careful consideration.

Recommendation 6.4:

The Committee recommends that the Government investigate the nature and extent of reserves in accumulation schemes and whether reserves are being maintained for their proper purposes. The Committee further recommends that the status of reserves in accumulation schemes be clarified in the OSS Regulations.

6.16 The Committee heard a wide range of views on the best means of dealing with benefits attributable to lost members. The ISC noted in its evidence that tax file numbers should be used to trace inactive members and advised the Committee that it had 'worked feverishly'[15] on developing approved preservation vehicles. These would have included the development of an ADF for that purpose, but the Attorney-General's Department had advised that an approved deposit fund would not be able to accept such payments. The Committee was advised that the ISC was considering

> *allowing a fund, or groups of funds, to set up a superannuation fund, the sole purpose of which would be the sweeping in of such unclaimed moneys or to preserve benefits where the beneficiary cannot be found.*[16]

15 Evidence, p 1856.

16 *ibid.*

6.17 The ISC suggested at least two other options to the Committee. The first was that industries could decide to set up a vehicle to cover all industry funds with lost members, or employers could decide to set up a fund that covered employer-sponsored funds. The second approach would be to have an unclaimed-money approach with provisions similar to those in the Banking Act or in the LIA where moneys that were clearly not traceable to any particular individual would revert to consolidated revenue, but would be available at some later date if the individual was discovered.[17]

6.18 The Committee has conducted its own research on lost members (See Table 6.1). Survey results show that in the hospitality industry, lost and inactive members can be as high as 40% of total membership. The practice of dealing with lost members varies between funds and the Committee believes it desirable that uniform standards be developed.

Recommendation 6.5:

The Committee recommends that:

- *a central fund be established for lost member accounts so that all funds can be swept periodically, say every six or 12 months, in order that administration charges on such accounts be minimised;*
- *the accounts could be identified either by tax file numbers or by a superannuation number;*
- *an appropriate Commonwealth agency should tender out the administration of such a fund on a fee for service basis, on a long term contract (for example, five years) and that arrangements be made with the Australian Tax Office so that information on the balance of the account could be forwarded to individuals; and*
- *where the person is in irregular employment or changes employment frequently, the person should have the option of rolling over contributions in the central fund into an appropriate industry or employer scheme.*

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17 Evidence pp 1856-57.

Table 6.1

SURVEY OF LOST OR INACTIVE MEMBERS IN INDUSTRY FUNDS				
Name of Fund	Number of Members as at April 1992	No. of Lost or Inactive Members	% Members Lost or Inactive	Treatment of Lost Members Funds
ARF	279 400	30 700	11	Not addressed to date
BUS	188 000	Lost 35 000* Inactive 112 000#	18 60	Forfeiture to reserves provision in trust deed but not exercised to date.
HESTA	149 300	14 000	9.4	Unclaimed benefits return to fund
HOSTPLUS	104 200	41 000	40	Continued deduction account keeping fees
REST	287 900	Lost 25 300 Inactive 65 100	8.6 18.1	Forfeiture to reserves provision in trust deed but not exercised to date
STA	120 400	16 500	9.7	Forfeiture to reserves provision in trust deed but not exercised to date
TasPlan	31 200	7 200	23	Forfeiture to reserves provision in trust deed but not exercised to date
Westscheme	34 900	9 186	38	Not available
NSW Govt State Authorities Basic Benefit Scheme	Regular employees 103 000 Irregular employees 417 000	**	10 (statements returned)	Unclaimed moneys retained by Board
Qld Government GOSUPER Plan	280 600	Preserved Members 113 400***		Unclaimed moneys go to consolidated revenue account
WA Govt Employees Super Board	89 620	20	0.02	Unclaimed moneys retained in fund and available to beneficiaries at any time
SA State Superannuatio n Scheme	25 049	–	Less than 1% 'inactive' members	'Inactive' moneys paid into Government's unclaimed money account

* 'lost' defined as members for whom current address is not available.
\# 'inactive' defined as those who did not receive contributions in previous six months.
** Figures not available.
*** Includes members who have 'preserved' funds – actual number of 'lost members' not provided.

Source: Response to survey undertaken by Committee. Fourteen industry funds were asked to respond to a series of questions.

CHAPTER 7

IN-HOUSE ASSET RULE

7.1 Under the in-house asset rule, superannuation funds are limited in their power to invest in, or lend to, their sponsor companies. The rule is designed to prevent employers from regarding superannuation schemes as sources of internal funding for their businesses or using superannuation funds to defend themselves from a takeover bid. The in-house asset rule, being phased in to ten per cent by 1995, was examined by the Government, in consultation with the superannuation industry, last year and was found to be appropriate.

7.2 However, the Committee notes that the Attorney-General's submission to the Committee and the ALRC have both recommended a lower figure of 5%, arguing that an in-house investment is not the same as any other investment of a superannuation scheme because if the employer goes out of business, not only will members lose their jobs but their superannuation scheme will suffer a loss which it may not have suffered if it had not invested in-house.[1] The recent House of Commons Social Security Committee report on *The Operation of Pension Funds* noted other reasons in the UK context (see Figure 7.1). ASFA notes in its submission that the in-house asset standard may require refinement.[2]

Figure 7.1

ARGUMENTS AGAINST IN-HOUSE INVESTMENT

- A pension trust is there to provide superannuation independent of the fate of the employing/sponsoring company.
- In-house investment creates potential conflict of interest between the pension fund and the sponsoring company.
- The insider trading rules make it increasingly difficult for trustees to authorise transactions by their pension fund in the stock of the sponsoring company of which they may be directors or employers.
- When a pension fund undertakes the acquisition or disposal of stock of the parent company it sends signals to the stock market.
- It is difficult for trustees to act dispassionately with respect to the company's share price.
- The relationship between the sponsoring company and the fund manager means that there is scope for conflict if the fund manager wishes to change the share of the pension fund's assets invested in the sponsoring company.

Source: Cited in *The Operation of Pension Funds* Second Report of the Social Security Committee, House of Commons, session 1991-92, pp xvii-xviii.

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1 Sub No. 107, p 15, and ALRC, Discussion Paper 50, p 165.

2 Sub No. 89, p 28. ASFA notes 'The fact that the current in-house limits are based on the historical cost of assets can lead to some inappropriate results. However, it is recognised that a change to market value could create other problems. The ISC is currently addressing difficulties concerning the in-house asset standard.'

7.3 Mr Noel Davis in his evidence to the Committee [3] argued that when the financial circumstances of the employer become difficult, moneys in the superannuation fund are often regarded as being accessible and can be treated in one of three ways:-

- moneys can be lent to the employer;
- the funds can be wound up and the money in them distributed to the principals; or
- the moneys can be misappropriated through fraud.

7.4 Mr Davis noted that where a breach of the in-house asset rules is involved, the fund then attracts maximum marginal tax rates of 48.25 per cent,

> *but a desperate employer is not the least bit concerned that an adverse tax rate will be imposed on the superannuation money if it is a matter of survival.*[4]

7.5 Mr Davis went on to note that the loan can be made interest-free, in which case the superannuation fund does not pay the adverse tax rate, or alternatively, the employer can pay a low interest rate – in which case not much tax is paid by the superannuation fund. Moreover, even if the interest rate on the loan is at a commercial rate, the employer gets a deduction for 39 per cent and the fund is paying 48.25 per cent. If the two are regarded as being all part of the one, as some employers undoubtedly do, there is not much difference in terms of the tax deduction and the tax paid.[5]

7.6 Mr Lee in his submission argued that in-house investments should be prohibited.[6] Mr D Schwarz[7] said that all family funds, i.e. those with no arms' length members, should not have to comply with the in-house asset rule because of the cost of capital to small business. Mr Lucas made a similar point in his submission[8] and evidence to the Committee.

> ***Recommendation 7.1:***
>
> *The Committee recommends that funds which do not have arms' length members be subject to the same rules as other funds. The Committee considers that to do otherwise would provide scope for tax avoidance.*

7.7 Writing in the aftermath of the Maxwell fraud case, the recent House of Commons Social Security Committee report on *The Operation of Pension Funds* noted that:

> *Controls on self investment, ... are not a panacea. Indeed, it is the Committee's*

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3 Evidence, pp 622-24.

4 Evidence, p 622.

5 *ibid.*

6 Sub No. 78, p 7.

7 Sub No. 17, p 1.

8 Sub No. 22, p 3.

> *view that a complete ban on self-investment would be counterproductive. If self-investment were banned entirely, it would lead, in some cases, to the forced sale of pension fund assets, which could be directly contrary to the interests of employees and pensioners. There is also no evidence to suggest that even if there had been a total ban on self-investment this would have prevented Maxwell from carrying out his fraud since there would still have been the necessity for strong directors and trustees to oppose him. We do, however, believe that the government's introduction of a 5 per cent ceiling on self-investment with limited exclusions, is a prudent and sensible reform within the existing structure of the law.*[9]

7.8 The Committee notes that the proposed new information disclosure requirements to be introduced from 1 July 1992 (see Attachment A, Chapter 4) will require trustees to report percentages of asset classes and also to report to members any single asset that amounts to more than ten per cent of the assets of the fund at balance date by market value.[10] The Committee believes, however, that there remains scope for balance sheet restructuring and that it may be possible for funds to exceed the ten per cent rule during the year and not be detected unless the ISC is able to pursue an active audit program. As the Committee noted in Chapter 4 and in its earlier statement on the Byrnwood case[11], there is a need to improve ISC audit procedures at the earliest possible opportunity to detect breaches of the in-house assets rule and impose appropriate penalties on trustees.

7.9 The Committee recognises that any lowering of the in-house asset threshold is likely to cause some difficulties for the superannuation funds of those large employers which make up the top 20 stocks on the stock market. The Committee also believes small funds with arms' length members are at greater risk of insolvency. Figures by the ISC for 1986-87, show that small funds were more likely to have a level of in-house assets exceeding ten per cent(see Table 7.1) However, the Committee believes that the increased fiduciary duties of trustees, together with other changes to prudential arrangements recommended in this report, will not require a distinction to be made between small and large funds.

> ***Recommendation 7.2:***
>
> *The Committee recommends that the in-house assets rule be reduced from ten per cent to five percent.*

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9 Social Security Committee, op cit, p xix.

10 Prudential Supervision of the Superannuation Industry, Statement by the Treasurer.

11 Report to the Senate, March 1992.

Table 7.1

NUMBER OF FUNDS* IN EACH CATEGORY – 1986-87
PERCENTAGE OF INVESTMENTS IN IN-HOUSE ASSETS

Total Investments $	Nil	1-4%	5-9%	10-19%	20-29%	30+%	Total
Number of Funds							
0 to 100 000	55 095	1 182	1 795	2 864	3 276	9 117	73 329
100 001 to 200 000	7 476	451	614	597	676	1 560	11 374
200 001 to 500 000	4 214	280	358	366	341	798	6 357
500 001 to 1 000 000	1 314	50	72	55	58	171	1 720
1 000 001 to 10 000 000	1 687	47	64	28	24	58	1 908
10 000 001 and over	344	43	30	18	5	8	448
TOTALS	70 130	2 053	2 933	3 928	4 380	11 712	95 136+
No. of Funds in each category as a percentage of total funds	73.7%	2.6%	3.1%	4.1%	4.6%	12.3%	
$ million							
Total Investments	25 215	4 401	4 423	1 490	795	1 469	37 793
Total In-House Investments	–	83	333	231	193	756	1 596
In-House Investments as a percentage of Total Investments (average)	–	1.9%	7.5%	15.5%	24.3%	51.5%	4.2%

* Employer Supported Funds with assets not all in individual insurance policies.

Source: ISC. Figures for later years are not available.

CHAPTER 8

REGULATION OF FUND MANAGERS

> *Where regulation has the effect of creating barriers to entry or threatening the viability of small players or perpetuating concentration among fund managers, it is not in the interest of superannuation fund members or the community as a whole.*
> Linda Bardo Nicholls, County NatWest evidence, pp 99-100.

8.1 Fund managers play a vital role in the superannuation industry because they are charged with earning an investment return on the members' funds. During the course of the inquiry, four issues involving fund managers were highlighted:

- entry requirements for fund managers;
- concentration of fund management activities;
- the role of advisers; and
- accountability to trustees and members.

Entry Requirements

8.2 Entry requirements can take two forms:

- minimum capital or solvency requirements; and
- minimum educational qualifications.

8.3 Investment management services for superannuation funds are currently provided through one of three avenues:

- registered life insurance companies;
- companies holding a dealers licence provided by the ASC, including bank fund management activities; or
- directly by the trustees of the funds themselves.

8.4 The IAA noted in its submission that whilst the life insurance industry is closely regulated by the ISC with minimum capital adequacy standards and tests applied as to the fitness of persons to be involved in the management of life insurance companies and regular disclosure requirements, these tests did not necessarily extend to cover investment management competence.[1]

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1 Sub No. 108, p 6.

8.5 Under the ASC licensing requirements for dealers licences, greater emphasis is placed on investment management competence and the financial strength of the investment manager, and less emphasis is placed on capital requirements and regular reporting of investment management activities.[2]

8.6 Trustees of superannuation funds who directly invest the funds' assets are not required to hold a dealers licence, nor do minimum capital or solvency standards apply.

8.7 The Committee agrees with the IAA that the two questions requiring resolution are:

- whether trustees of superannuation funds who directly invest the assets of the fund should be licensed; and
- whether the ASC dealers licence requirements and the requirements for life insurance companies should be brought into line.[3]

8.8 With respect to the first issue, a dealers licence is prima facie evidence that the applicant has adequate educational qualifications and relevant experience. If the Committee's recommendations in Chapter 4 are implemented, only fit and proper persons would be able to be trustees or directors of corporate trustees. However, the Committee also considered that where the trustees are directly undertaking the investment management activities of the fund themselves, they should be subject to licensing requirements.

> *Recommendation 8.1:*
>
> *The Committee recommends that trustees who act as investment managers of superannuation funds be required to have a dealers licence. It is intended that such licensing requirements would operate in conjunction with entry requirements for trustees as outlined in Chapter 4. Trustees whose only investments were bank deposits would be exempt from the dealers licence requirements.*

8.9 Weighing the arguments for competitive neutrality between life offices and other fund managers was a difficult task for the Committee.

8.10 The IFA argued in its evidence that:

> *If you raise the quality and set proper prudential standards for those who are permitted to manage these [superannuation] funds, you will eliminate the large number of difficulties which may occur through incompetence or other things at a later date.*[4]

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2 *ibid* pp 6-7

3 *ibid*, p 7.

4 Evidence, p 2026.

8.11 To this end, the IFA supported a minimum level of capital adequacy so that managers can demonstrate that they are of substance and have sufficient capital to manage the business on a day-to-day basis. In addition, tertiary qualifications and a track record in funds management were seen as necessary.[5]

8.12 Rothschilds advised the Committee that, in the UK, regulations require fund managers to have sufficient resources to cover cashflow over some minimum period such as two months. This concept takes account of fund managers of different size and would not discriminate against small, niche fund managers who could offer specialist services but may not meet minimum capital requirements.[6] Rothschilds also suggested that fund managers should be registered and that they should have to undergo examinations.[7]

8.13 On this same question of entry requirements for fund managers, BT noted that:

> *The fact that there is no regulation does seem a bit surprising, but it is not obvious that it is having really adverse effects at the moment.*[8]

8.14 Nonetheless, BT supported entry requirements for fund managers, expressing a preference for entry controls analogous to the insurance industry.[9] (See Chapter 4 for details of prudential controls on life offices.)

8.15 The TCA told the Committee that:

> *The lessons that we have learnt from the last two or three years are that there has to be a commitment by the fund managers to the work they are doing ... Many of the fund managers have been totally undercapitalised ... if your own money is at stake you tend to have a far higher commitment...*[10]

8.16 The TCA suggested that fund managers be required to have a minimum capitalisation plus additional capitalisation related to the size of funds under management.[11] The joint submission from the accounting professions also suggests minimum capital requirements for fund managers.[12]

8.17 The TPC notes in its submission that prudential supervision should not be allowed to develop into a 'barrier to entry' in the superannuation industry. In particular, the

5 Evidence, pp 2026-2027.

6 Evidence, p 1551.

7 Evidence, p 151.

8 Evidence, p 851.

9 Evidence, p 852.

10 Evidence, p 262 -264.

11 Evidence, p 263.

12 Sub No. 119, p 11.

prudential rules should be flexible enough to encourage niche marketing.[13] In its evidence the TPC argued that:

> *Government policy does need to have regard to those outcomes sought by consumers and that regulations should interfere with those only where there is some sensible prudential reason.*[14]

8.18 The ALRC report proposes a 'fit and proper person' test for fund managers, and recommends that a corporation or individual should not have custody of the assets of a superannuation fund as investment manager unless it had a dealers licence and net assets of at least $5 million.[15] The ALRC made no recommendations with respect to other entry requirements, noting that the earlier proposal to have net assets of $5 million or be a member of a professional indemnity fund with cover of at least $5 million would not necessarily:

> *... guarantee the performance or integrity of an investment manager yet may operate to keep out of the industry small but talented investment managers.*[16]

8.19 The ALRC recommended that capital adequacy be addressed through dealers licence requirements, noting that if a risk-weighted capital requirement for securities dealers as proposed by IOSCO is implemented in Australia, additional minimum capital and net asset requirements will be unnecessary.[17]

8.20 It is axiomatic that life offices play an important role in fund management activities. As noted by the ANZ in its evidence:

> *The people with the huge history, the long track record and the very large volume of funds already under management are the long established life companies. They have just got so much more behind them in that area.*[18]

8.21 An article on 'Managed Funds' in the ABS publication *Economic Indicators* notes that:

> *Statutory funds of life offices are the major employers of professional fund managers. They had $90.1 billion invested through fund managers at 30 June 1991, or 95.6 per cent of their total unconsolidated assets.*

8.22 The Committee concluded that the fact that life offices were not required to meet investment management competency tests had not meant that their capabilities in this

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13 Sub No. 145 p 4.

14 Evidence, p 1251.

15 ALRC Report No 59, op cit pp 75-82.

16 *ibid*, p 81.

17 *ibid*.

18 ANZ evidence, pp 472-473.

regard were inferior to those of the rest of the fund management industry. Indeed, as the following section illustrates, life offices occupy a dominant position in the industry.

Recommendation 8.2:

The Committee recommends that a 'fit and proper person' test be introduced to all investment managers similar to the conditions under the Life Insurance Act (LIA). The Committee further recommends that the need for capital adequacy be examined by the ISC and ASC. The Committee considers that a minimum level of capital adequacy expressed as some percentage of cash flow is desirable for funds managers, as are minimum educational qualifications, but is anxious that any such controls do not discourage niche marketing and that Australian practice is consistent with that overseas.

The Committee further recommends that the need for formal industry-specific educational qualifications be examined by the ISC and the ASC and investment competency measures, similar to dealers licensing requirements, be considered by the ISC in its review of the LIA.

Concentration of Fund Management Activities

8.23 The fund management industry is heavily concentrated as Table 8.1 illustrates.

Table 8.1

MAJOR MANAGERS OF AUSTRALIAN SUPERANNUATION FUNDS

Funds under Management at June 1991

	$ billion
AMP	21.9
National Mutual	12.2
BT	10.3
Westpac	7.0
MLC	6.4
Top 5 Managers	57.8
Total Superannuation Industry	132.0
Top 5 as a percentage of the Industry	43.8%

Source: Noble Lowndes *Superannuation Investment Performance Monitor*, June 1991; and ISC Submission to the House of Representatives Standing Committee Inquiry Into the Banking Industry, August 1991 (updated).

8.24 The fund managers, in their evidence to the Committee, said that the industry was intensely competitive.[19]

8.25 BT argued that:

- in addition to the top five managers, there were more than 25 other managers of wholesale superannuation funds and a further 22 managers of ADFs and Rollover Funds;
- there is a very high level of real competition between fund managers and fund management in Australia and it is probably the most open and accountable business in the world; and
- there is a range of potential new entrants into the fund management business.[20]

8.26 AMP went on to suggest that tangible evidence of this competition was the net inflow and outflow of funds under management over the last two years.[21] Rothschilds also pointed to the number of new entrants into the industry – suggesting that 13 years ago there would have been eight or ten fund managers competing, whereas now there were in excess of 45.[22]

8.27 There was a divergence of views amongst the fund managers on whether concentration in fund management would continue. CFM suggested that whilst there has been a predominance of balanced fund managers in Australia to date, as trustees became more sophisticated there would be greater sector specialisation which would enhance competition in the industry.[23] Expressing a contrary view, Rothschilds suggested that if the regulatory environment continues to squeeze small company-sponsored funds there is a danger of greater concentration in the funds management industry because the larger company sponsored funds and industry funds tend to appoint the larger fund managers.

8.28 The Committee is satisfied that the funds management industry is open to new entrants and that no Government action is required to counter the dominance of a few fund managers. However, there was a suggestion by Jacques Martin that there is little price discrimination in the fees charged by the major fund managers. Jacques Martin told the Committee that:

> *... [fund management] is the only area of fees in superannuation which has not been savagely reduced by the advent of the industry scheme system.*[24]

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19 See for example AMP evidence, p 1746, BT evidence, p 853.

20 BT Sub No 105, pp 11-12.

21 Evidence, p 1746.

22 Evidence, p 150.

23 Evidence, p 1292.

24 Evidence, p 405.

8.29 However, as noted by AMP, the selection of a fund manager is not only determined by price. It suggested that the process was determined by a combination of factors, the primary ones being:

- the performance of the investment manager;
- the quality of individuals and the organisation concerned in a qualitative sense;
- the strength and depth of management; and
- the stability and risk profile attaching to the underlying performance.[25]

8.30 ACM advised the Committee that large funds are better placed to negotiate on the fees and charges by investment managers because they are offering a potential investment manager a very large sum of money.[26] ACM went on to argue that:

> *The capacity of a manager to manage a large sum spread in different avenues and produce a very competitive rate, or almost guarantee a certain rate above the average, requires a good deal of skill. It requires a great knowledge of the market place, in an increasingly complex market place, and a capacity to move very quickly. It also rests very largely on the skills of the individuals who are specifically managing that money, not necessarily the size or the credibility of an organisation with whom they might work.*[27]

8.31 If the track record and quality of the individuals and the investment strategy in the top fund managers are significantly ahead of the rest of the field, then fees charged could reflect this qualitative difference. So long as the industry remains open to new entrants who can prove their expertise in particular segments, the Committee does not believe Government action is warranted.

> *Recommendation 8.3:*
>
> *The Committee recommends that the TPC monitor the funds management industry to ensure that it remains open and competitive.*

Role of Advisers

8.32 The Committee has been advised that the normal procedure for the selection of a fund manager would be for trustees to seek expressions of interest. A short list would then be drawn up and the short-listed funds invited to make a presentation to trustees. Frequently, the final decision is referred to an investment committee. It would appear that almost all trustees of large funds engage a firm of consulting actuaries to advise

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25 Evidence, p 1746.

26 Evidence, p 423.

27 Evidence, p 424.

them in the shortlisting process and the ultimate selection of the fund manager.

8.33 It appeared to the Committee that the advisers sit at the apex of a triangle of power and effectively work as the 'gate-keeper' between the fund and the fund manager. They are the conduit through whom fund managers must work in reaching the trustees because the advisers undertake the quantitative modelling for trustees and help them design an asset allocation structure suitable to the particular scheme.

8.34 Whilst the Committee was not presented with any firm evidence that the relationship between advisers and fund managers on the one hand, and advisers and funds administrators on the other hand, materially affected the appointments made by trustees, it is clear to the Committee that the advisers occupy extremely influential positions and are not subject to any regulatory oversight.

8.35 CFM suggested to the Committee that:

> *The Australian experience at the moment is probably similar to that in the United States where there is a very powerful advisory function to trustees of new schemes and I think that relates to the newness of some of the trustees to their tasks ... From our experience, there is a considerable desire on the part of trustees to do the best by the contributors to their scheme and there is a feeling that they want to be fully briefed by advisers in relation to investment matters. But I am not aware of, nor to my knowledge have we seen a situation where there might be too great an influence by advisers.*[28]

8.36 The MMBW Employees Superannuation Fund had a more sanguine view, suggesting that there was complementarity between the actuary and the investment manager. It advised the Committee that:

> *... the actuary provides the 'number crunching' ... the investment adviser ... reviews the efficiency of our investment structure, examines alternative scenarios as to whether they will improve the return we are likely to get and the risk profile of the investments. You put the two together and see whether they fit.*[29]

8.37 Given the lack of financial expertise of many trustees, the Committee was of the view that the actuary would not only provide the number crunching but would also evaluate the investment strategy proposed by the fund manager. In addition, the Committee is aware that advisers employed by trustees are normally employees of the major actuarial consulting firms and these firms are also embarking on funds management and funds administration activities.

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28 Evidence, p 1289.

29 Evidence, p 255.

> *Recommendation 8.4:*
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> *The Committee considers that the 'bundling' of services by the actuarial firms warrants further examination by the ISC and TPC, particularly as actuarial advisers to superannuation funds are not subject to any regulatory oversight.*

Accountability to Trustees and Members

8.38 The Attorney-General's Department told the Committee that one area of regulation of collective investments that needed upgrading was:

> *... the superintendence by contributors of the investment strategies being followed by their trustees and fund managers.*[30]

8.39 This was a view put strongly by AFCO which told the Committee that the surveys of pooled investment managers and rollover vehicles which were undertaken by various firms were inaccessible to consumers because of the fees charged. AFCO advised the Committee that:

> *From our perspective as community advocates, that sort of elitism in information gathering of information distribution is completely unacceptable and is indicative of the elitism in terms of the management of the funds.*
>
> *We believe that the Government needs to blow that open by actually enabling consumers on the ground and particularly their statutory bodies, which are representing their interests, to access information that is relevant on these investment strategies. We are not going to change the fact that people with a particularly limited range of backgrounds and beliefs are managing our money. That is going to continue for a considerable period of time. However, we do need to actually get information about what they are doing out in the community so at least we have the opportunity to criticise it.*[31]

8.40 It appeared to the Committee that some funds were already taking positive steps to communicate the investment strategy of the funds to members. For example, ARF told the Committee that members should be advised of:

> *[the fund's] investment strategies and performance, the basis on which fund managers are chosen, and the asset allocation, crediting rates, fund earning rates, if we create reserves, and a reasonable outline of administration charges and fees.*[32]

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30 Evidence, p 1205.

31 Evidence, p 1949.

32 Evidence, p 319.

8.41 MTIA pointed to the STA which endeavoured:

> *... in a fairly positive way to communicate with members fairly regularly on the investment policy and performance of the fund. Quite apart from individual member statements and annual reports, special investment reports have been prepared and forwarded to all members of the fund. Those reports have gone into some detail as to what the investment strategy is, the asset class structure, and the investment managers who are used.*[33]

8.42 AMP cited in its evidence to the Committee that trustees are now taking much more formally their obligations with respect to investment strategies and goals[34] and are being more precise in specifying what they want the investment manager to do.[35] The Committee welcomes this development and notes that the new information disclosure requirements to operate from 1 July 1992 will require trustees to advise members of the fund's investment philosophy strategies and the strategies undertaken to achieve stated goals.

> *Recommendation 8.5:*
>
> *The Committee supports legislation requiring trustees to establish investment targets and for investment managers to report against those targets. The Committee recommends that trustees be able to seek compensation from fund managers where the latter have failed to fulfil the conditions of the management contract.*

8.43 Whilst there is no shortage of public information on returns achieved on funds under management, it was clear to the Committee that publication of such data on a monthly and quarterly basis focused attention on short-term returns rather than strategies which would assist in the long term growth of the fund. Whilst some funds publish investment returns against accepted industry benchmarks and measure the performance of the funds' manager, it is of concern to the Committee that the industry has failed to develop strategies which would enable trustees and members to evaluate the appropriate long-term investment strategies to meet the funds' liabilities.

8.44 The IR&D Board, in its evidence to the Committee, suggested that fund managers be required to report on long term performance. Speaking specifically about income streams, Mr Hanley, a former Chairman of the Board, said that:

> *... I really want to know how much my fund manager made in terms of long term income flow, because that is eventually wealth creation. I would also want to know how much he made from share trading, which I see as a zero sum game ... Lastly, I want to see what the inflation issue is and what the impact of inflation is on his performance. The guy I want to put my money*

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33 Evidence, p 981.

34 Evidence, p 1747.

35 *ibid.*

with is the fellow who can develop that long term, wealth creating, income flow ...[36]

8.45 The Institute of Actuaries noted in its submission that:

... a significant problem exists in that superannuation fund assets for many funds are invested for stability of investment returns rather than for achievement of high long-term returns.[37]

8.46 Satisfactory real investment returns are critical to funded defined benefit schemes since there is a clear relationship between the level of real investment returns and the level of contributions required to provide the benefits. In accumulation schemes, although the assets and liabilities are both dependent on investment earnings, the relationship between the earnings rate of the fund and a member's salary determines (other things being equal) the relationship between his/her benefit and the standard of living at retirement.

8.47 The IAA argued that the risk averse nature of superannuation trustees would become more of a problem in the future due to the introduction of the new accounting standard AAS25 relating to the valuation of assets in superannuation funds.[38] The IAA advised the Committee that in conjunction with other industry professions, it was developing a set of standards to focus trustees more towards a longer-term perspective.[39] The IAA felt that the education program currently under way will take a long time to show results.[40]

8.48 As many submissions to the Committee noted, focus on short-term investment returns has become more prevalent with the trend towards accumulation schemes. SBC Dominguez Barry outlined the problem to the Committee in the following terms:

Fund Managers have an obligation to maximise the return on funds within safe limits. The constraints are:

- *the three-monthly investment return mentality;*
- *the requirement to report against benchmarks on particular asset classes;*
- *the need to minimise the transmission effects to the Australian market from a major shakeout offshore through the use of options and future's contracts; and*

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36 Evidence, p 1969.

37 Sub No. 108, p 16.

38 *ibid*, p 12

39 *ibid*, p 14.

40 *ibid.*

- *liquidity – the need to get in and out of stock quickly.*[41]

8.49 With respect to developing longer term investment prospectives, the Alexander Consulting Group advised the Committee that:

> *funds investment and advice will be a growth area (over the next decade) and communicating to members whether the policy has been successful or not. Introducing virtually compulsory preservation on all benefits would tend to encourage funds to invest more in the equities market than in fixed interest because members would then be looking through until age 65 years at least, and then even beyond 65, if the cash-back pension-type arrangements come into place. In that case, they can afford to invest a large amount in equities, because if there is a negative return in any particular year, it is not really relevant in the long scheme of things, provided the long term trend is accomplished.*[42]

Recommendation 8.6:

The Committee recommends that the ISC, the Institute of Actuaries, the Australian Institute of Trustees Inc and other professional bodies devote resources to improving public awareness of long term returns, as well as improving the ability of funds managers to focus on those long term returns.

The Committee further recommends that trustees be required to explain to members the strategies being employed to achieve a real rate of return over a given period, preferably at least five years.

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41 Evidence, pp 1929-1930.

42 Evidence, p 869.

CHAPTER 9

INVESTMENT BY SUPERANNUATION FUNDS

9.1 There has been much debate recently over the investments made by superannuation funds. The Committee notes that trustees have generally adopted extremely conservative investment strategies as Table 9.1 illustrates. The previous chapter outlined the difficulties which arise when the focus is on short term returns.

Table 9.1

NON-LIFE OFFICE SUPERANNUATION FUNDS' AND ADF's ASSETS

Asset	Value as at June 1991 $ billion	Share of Intermediaries' holdings in this asset class	Share of funds' holdings in this asset class
Public sector securities	10.1	16.7%	13.2%
Deposits, loans and placements	15.4	5.1%	20.3%
Bills and promissory notes	7.1	8.2%	9.3%
Shares	21.6	42.9%	28.3%
Fixed assets	10.3	23.7%	13.5%
Foreign currency assets	10.0	15.1%	13.1%
Other assets	1.7	3.5%	2.2%
TOTAL	76.1	10.1%	100.0%

Source: V W Fitzgerald and I R Harper *Super Preferred or 'Level Playing Field'?* p 38.

9.2 Industry schemes have been particularly conservative in their investment strategies. The typical asset structure of a mature industry scheme is:[1]

Equities	35%
Fixed Interest	25%
Capital Guaranteed	25%
Listed Property Trusts	5%
Cash	10%

Other funds might have greater exposure to property and less in the way of capital guaranteed products. Only one witness suggested to the Committee that superannuation funds have at times been involved in 'speculative' activities.[2]

9.3 Figures provided by the ISC show that in 1987-88, 68 per cent of the $33.247 billion in assets (excluding life insurance policies) of private sector

1 *Development Capital and Potential Claims*, G A Grant, General Manager; Jacques Martin; Paper presented to IIR Conference.

2 Mr Daryl Dixon, SG Evidence, p 79.

superannuation funds was accounted for by the largest 462 funds (assets over $10 million) and 81 per cent by the largest 2 355 funds (assets over $1 million). For public sector funds, of the $33 billion in assets reported to the ABS in 1987-88, 85 per cent was accounted for by the largest 11 funds (assets over $500 million) and 95 per cent by the largest 25 funds (assets over $100 million).[3]

9.4 The ISC concluded that if each life office was treated as one 'fund', 74 per cent of the total assets of superannuation funds and ADFs is accounted for by 490 funds comprising:

- five life offices;
- 12 ADFs;
- 11 public sector funds; and
- 462 private sector funds; or[4]

87 per cent is accounted for by 2 422 funds comprising:

- ten life offices;
- 22 ADFs;
- 25 public sector funds; and
- 2 355 private sector funds.

9.5 Alternatively, if a common threshold of $10 million across all categories is set, the largest 600 funds account for 91 per cent of total assets, that is:

44 life offices;
32 ADFs;
62 public sector funds; and
462 private sector funds.

9.6 This means that there are only 462 private sector funds, or less than one per cent of all superannuation funds, that are significant in a funds management sense.[5] A survey of industry funds in the September 1991 issue of *Superfunds* showed that only five funds undertook the investment management function themselves and all other funds employed life offices or BT or Westpac as their fund managers.

9.7 One of the most strident criticisms of superannuation funds, life offices and fund managers is that they have not invested in 'high risk' or 'patient capital' ventures to any great extent.

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3 Unpublished evidence.

4 *ibid.*

5 There are approximately 100 000 superannuation funds in Australia. See Table 9.2.

9.8 Jacques Martin told the Committee that:

> *... if you can find a fund manager with more than 30 stocks in his Australian equities portfolio, you have someone who is madly diversified. You have fund managers with as few as 20 stocks.*[6]

9.9 The conservatism of trustees and funds managers has led to calls for direction of superannuation funds investments. The main arguments for superannuation fund investments being channelled into particular areas are that:

- superannuation funds receive tax advantages and as a *quid pro quo* should direct investments into particular areas in the national interest;
- compulsory superannuation savings should be used to fund infrastructure or public housing in lieu of public sector financing because government policies will increase the size of superannuation funds at the expense of other financial institutions;
- superannuation funds have shown no interest in voluntarily investing in venture and development capital and should therefore be compelled to do so; and
- Australia is short of capital and therefore superannuation funds should not be allowed to invest overseas rather than in Australian industry.

9.10 IOOF suggested that incentives be offered to superannuation funds which invest in approved areas addressing the needs of new technology, export-oriented industry and public infrastructure. It recommended a new 30/20 rule as a basis for exempting the earnings of superannuation funds from tax.[7]

9.11 In general, however, the superannuation industry is opposed to prescriptive investment guidelines arguing that investment controls for non-prudential reasons will dilute the responsibilities of trustees.[8] In addition, it is argued that prescriptive investment guidelines will reduce returns and increase the riskiness of the investment portfolio.

9.12 A number of reports have recently considered the need for investment controls on superannuation funds.[9] The Government has eschewed non-prudential controls on investments by funds because it is concerned to create a policy environment which

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6 Evidence, p 405.

7 Sub No. 59, p 9.

8 See for example, Sub Nos. 89, 95, 102, 106, 114, 119.

9 See for example The Joint Committee on Foreign Affairs, Defence and Trade, *Australia's Current Account Deficit and Overseas Debt*, 1992; the Report of the Task Force on the Commercialisation of Research *Bringing the Market to Bear on Research*, 1991; and the Industry Commission report, *Availability of Capital*, 1991.

maximises superannuation fund earnings and the ultimate benefits available to fund members.[10] The Treasury submission argued that:

> *... it would clearly be inimical to the Government's policy objectives if investment controls resulted in lower overall retirement incomes.*[11]

9.13 The Treasury submission also noted that:

> *Investment guidelines could also:*
>
> - *run the risk of distorting asset markets and resource allocation with adverse consequences for overall economic efficiency;*
> - *conflict with trustees' obligations to invest in the best interests of their members; and*
> - *leave the Government open to claims for compensation if investments in the prescribed areas performed poorly or failed.*[12]

9.14 Treasury argued that superannuation funds are broadening their investment horizons without government intervention. It advised the Committee that:

> *... as the volume of funds available for investment by superannuation funds increases, market pressures will ensure that this trend continues as trustees and managers strive to maintain competitive investment returns. (By definition, if the rapidly increasing supply of superannuation savings continues to be directed solely to those areas where superannuation funds have traditionally invested, the rate of return on those assets will fall.) ... It is therefore unlikely that, given the flexibility of capital markets, investments offering competitive returns will not be able to attract investment support.*[13]

9.15 Tangible evidence of the broadening of the investment horizons of superannuation funds is provided by the Development Australia Fund (DAF) which is a joint venture of the Australian Chamber of Manufactures, the Australian Council of Trade Unions and AMP. It is a national investment fund available to the trustees of large superannuation funds,with a minimum investment of $500 000.

9.16 The Fund is investment driven, which means that return, security, diversification and the need for a balanced portfolio dictate investment selection. The Committee was advised that, subject to these fundamental criteria, investments are selected so as to benefit Australia by providing capital in areas where it is particularly needed. Such

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10 Prudential Statement on Supervision of Superannuation Industry.

11 Sub No. 195, p 25.

12 *ibid*, p 26.

13 *ibid*.

investments include housing, manufacturing with an emphasis on increasing exports and reducing imports, successful businesses whose growth requires further capital development and some special opportunities uniquely available to the Fund.

9.17 Longer term asset allocation of the DAF is likely to be:

- 40% listed shares
- 30% housing
- 10% business development
- 10% fixed interest
- 5% special opportunities
- 5% cash

Development and Venture Capital

9.18 With regard to development and venture capital, Mr G Grant noted that there are three avenues open to trustees to invest in this asset class:

- debt;
- direct investment in a project or company; and
- indirect investment through a Development Capital Fund.

9.19 Mr Grant observed that the debt method is unattractive to trustees and that:

> *... no credible mechanism seems to be in place to facilitate either of the other options.*[14]

However, the MTIA advised the Committee that the Superannuation Trust of Australia is involved in a specialist investor which concentrates on the bottom 20 per cent of the listed share market.[15]

9.20 Mr Block advised the Committee that the actuaries TPF&C had calculated that 1-3 per cent of total assets could be put in high risk assets to achieve a long term real return.[16] However, he went on to argue that development and venture capital requires specialist managers. He said that in the United States there is not only a professional venture capital market, but highly specialised mutual funds or unit trusts which provide capital for small and medium business. He argued that the:

> *... best way forward ... is to encourage major superannuation funds to set up small venture capital subsidiaries.*[17]

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14 G.A. Grant, *op cit.*

15 Evidence, p 987.

16 Evidence, p 1925.

17 Evidence, p 1925.

9.21 Fitzgerald and Harper noted that in both North America and the United Kingdom, pension funds and life offices can become significant suppliers of capital to specialist intermediaries who are in turn important suppliers of equity funds to small and middle business.[18] They went on to note however, that the top 200 US pension funds, controlling over US$15 trillion, have only about 0.3 per cent of their total portfolios in venture capital and similar funds, but nevertheless provide a substantial part of new capital flows to that area. The longer established UK venture capital and related vehicles account for higher proportions of UK pension fund portfolios – up to several per cent.[19]

9.22 The Committee agrees that development and venture capital vehicles require specialist management but was unable to agree on how development capital vehicles could become part of the capital markets framework.

9.23 The IR&D Board, in its evidence to the Committee suggested that:

> *... the problem is that in Australia we have a very underdeveloped capital market by comparison with the rest of the world ... This market is probably at the cowboy end of the spectrum and because of that there is a great need for it to be nurtured and developed.*[20]

9.24 It went on to argue that:

> *... there is no doubt that a trustee is probably capable of being persuaded, rationally, of the benefits of investment for long term economic development. It is in his interest to do that if he or she has members who believe that too. It is rarely in the interests of a professional funds manager to do that because at the end of the day the funds manager is in the business of managing funds to earn fees, and short term performance is the major marketing tool in selling funds management services ... As far as development capital managers specifically are concerned, I think it would be fair to say that most of the people who have operated in that field in Australia, if they were operating in the US or UK markets, would have made quite a good living because those environments are so much more friendly to venture and development capital investment. In Australia it has been diabolically difficult over the last decade ... [Finally] I would have to say that the lack of adequate management to manage high growth potential businesses is a more serious problem than the lack of skilled and experienced intermediaries.*[21]

9.25 It appears to the Committee that with increased involvement of members in the trustee role, better education of trustees, compulsory preservation of benefits and the

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18 Fitzgerald and Harper, *op cit* p 41.

19 *ibid.*

20 Evidence, p 1965.

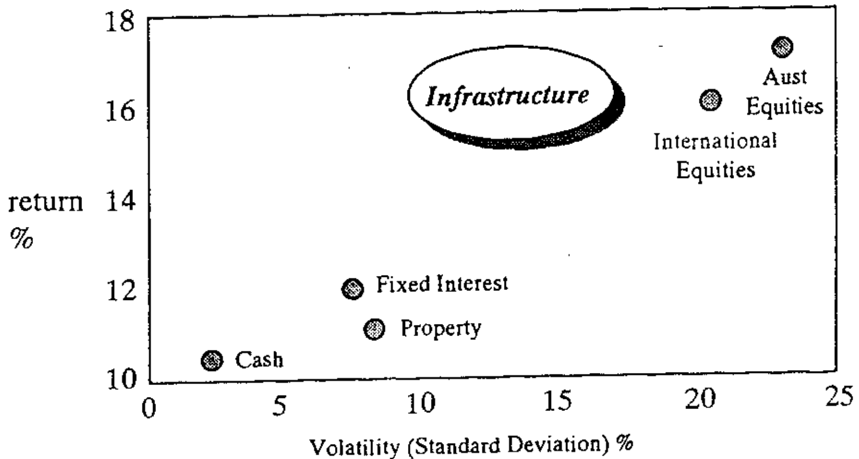
21 Evidence, p 1967.

gradual move towards taking benefits as income streams rather than lump sums, there will be more pressure exerted on the fund management industry to provide vehicles for long-term venture and development capital. In this respect, it is particularly pleasing to note formation of institutional investment in small and medium sized companies with high growth potential such as National Mutual's association with the Advent Group (refer to the Attachment to this chapter).

Infrastructure

9.26 Investment in infrastructure is an another area where calls have been made for compulsory superannuation fund investment. Such investment in infrastructure is necessary for long term economic growth. It is essentially long term and relatively illiquid, and offers trustees the opportunity of matching the funds' liabilities with assets. Figures 9.1 and 9.2 show returns on infrastructure relative to other investment.

Figure 9.1

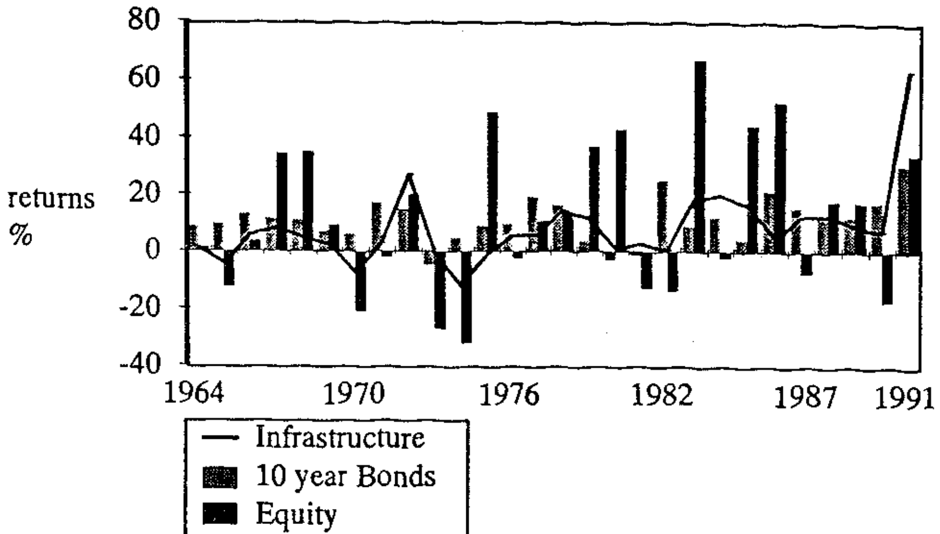


Source: Submission No. 210.

Figure 9.2

Annual Rate of Return

Historic data



Source: Submission No. 210.

9.27 Australian Infrastructure Investment Management (AIIM) advised the Committee that without a specialist fund which could provide management expertise in infrastructure investment, it was unlikely that superannuation funds would invest in infrastructure.[22] However, AIIM also pointed to anomalies in the *Income Tax Assessment Act* (ITAA) which require correction if superannuation funds are to become equity investors in private sector infrastructure projects.[23] AIIM is particularly concerned about application of the public trading trust provisions to the specialist fund which would mean that the income of the fund would be taxed at the corporate rate rather than the concessional superannuation fund rate. Furthermore, it would appear that there are some difficulties with the specialist fund being established as a pooled superannuation trust and that taxation losses accruing to the fund in one project may not be able to be offset against income from other projects.

9.28 Using information provided by AIIM it also appeared to the Committee that infrastructure investment could provide trustees with an asset class that would generate long term rates of return with less volatility than Australian equities. Further details on AIIM are provided in the Attachment to this chapter.

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22 Sub No. 210, p 2.

23 *ibid*, pp 3-4.

> **Recommendation 9.1:**
>
> *Given the attractiveness of infrastructure investment for superannuation funds, the Committee recommends that the anomalies in the Income Tax Assessment Act (ITAA) which discourage investment in infrastructure by superannuation funds be removed.*

Conclusions Regarding Development Capital and Infrastructure Investment

9.29 The Committee agrees with ACOSS that the current taxation system has advantaged housing and superannuation at the expense of infrastructure and industry.[24] Whilst ACOSS was not opposed to prescriptive investment guidelines for non-prudential reasons, it was wary of channelling funds. ACOSS advised the Committee that if the Government tried to direct the form of superannuation fund investment, there are:

> *... some quite difficult questions of definition. ... One of the dangers actually is that the purposes will be chosen because they are easy to define; for example, housing – it is easy to define whether something is housing or not, but not necessarily the appropriate purpose that you want to pursue.*[25]

9.30 An alternative approach is to require funds to disclose their investments in specified categories so that consumers can compare the investment profile of funds and strategies for long term growth. The definitional problems alluded to above are reduced if funds are only required to provide information. This measure would be consistent with the recommendations outlined in Chapters 4 and 8 for trustees to maintain a diversified portfolio and to inform members about the investment strategy of the fund.

> **Recommendation 9.2:**
>
> *The Committee recommends that no investment controls be placed on superannuation funds to compel them to invest in particular areas such as development or venture capital or infrastructure.*
>
> *The Committee further recommends that trustees should have to report to members and to the ISC on investments in new asset classes such as development and venture capital and infrastructure investment.*

9.31 As knowledge of investment strategies and funds management becomes more widespread and sophisticated, the Committee believes that trustees will be prepared to consider sectoral specialists or niche marketers to a far greater degree than is currently the case. There is clearly an onus on financial markets to respond to the need for long term investment strategies to pre-empt any community pressure to introduce prescriptive investment guidelines.

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24 Evidence, p 1371.

25 Evidence, p 1382.

Recommendation 9.3:

The Committee recommends that the issue of directing investment of superannuation moneys be re-examined by an appropriate Senate Committee within three years.

Overseas Investment

9.32 Overseas investment by superannuation funds offers opportunities for portfolio diversification and reducing the volatility of investment returns. It can also have a positive impact on the balance of payments by providing dividends and other income from overseas. However, because of currency risks and higher costs, AMP noted that:

> *... international investments must offer the prospect of superannuation returns if they are to be rationally justified.*[26]

9.33 In aggregate, superannuation funds currently have around 13 per cent invested in overseas assets. Life offices have a similar proportion of their assets invested offshore. However, the level of international investments will vary between funds. AMP told the Committee that it was unlikely that the average level of international investments would be above 30 per cent.[27]

9.34 Most submissions to the Committee argued against prohibition on overseas investment. Jacques Martin was:

> *... bemused by the proposition that overseas investment by Australians can lead to economic disaster when the most powerful economies of the world are the most substantial foreign investors.*[28]

Recommendation 9.4:

The Committee recommends that no special restrictions be placed on superannuation funds investing overseas.

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26 Sub 120, p 20.

27 *ibid.*

28 *op cit*, p 9.

Table 9.2

FUNDS WHOSE ASSETS ARE NOT ALL INDIVIDUAL INSURANCE POLICIES : NUMBER OF FUNDS AND TOTAL INVESTMENTS BY TYPE OF ASSET AND TOTAL INVESTMENTS SIZE – 1986-87

Total Investments Size	Funds	Type of Asset						Total investments
		Public securities	Investments at interest including mortgages	Shares and other equity investments	Real Estate	Insurance policies	All other investments	
$	Number	– $'000 –						
0 to 100 000	78 405	201 433	1 186 701	254 362	45 561	462 128	242 398	2 392 583
100 001 to 200 000	11 828	138 958	781 646	192 308	80 529	283 007	162 294	1 638 742
200 001 to 500 000	6 670	158 870	865 278	222 637	116 574	419 701	207 900	1 990 960
500 001 to 1 000 000	1 838	75 240	370 733	131 360	57 561	452 322	176 461	1 263 677
1 000 001 to 10 000 000	2 043	331 689	773 001	1 212 454	180 008	2 308 572	1 440 677	6 246 401
10 000 001 and over	475	3 461 374	3 157 472	9 956 274	1 756 444	5 102 591	2 589 465	26 023 618
TOTAL	101 259	4 367 564	7 134 831	11 969 395	2 236 677	9 028 321	4 819 195	39 555 982

Note: Funds which did not state total investments at balance date have been treated as having no investments at balance date. They therefore make no contribution to the investment amount totals. Funds which did not provide details of the percentage of investments held in one or more of the investment areas have been treated as having no investments in that area. Where the percentages stated by funds did not total 100 per cent they have been included without modification, except for sampled records which were adjusted.

Source: ISC.

Housing

9.35 The ACTU, the AAPBS and others have suggested that members be able to access their entitlements in superannuation funds for housing. Whilst the details of the schemes vary, the Committee received a number of representations on the broader issue of whether it is desirable for superannuation funds to become involved directly in housing finance.

9.36 The Committee wishes to make it clear that in the following discussion it is distinguishing between individual arrangements between the member and the fund and wholesale arrangements such as the DAF's involvement in low-cost housing in NSW.

9.37 ASFA strode the middle ground on the housing issue noting that:

> *... We have no problem at all with a properly constructed scheme that would enable people to access that for homes. We have a philosophical view that, if you try to use superannuation for too many purposes, you are going to end up dissipating it and it will not achieve the central objective of retirement incomes. But housing is quite clearly different. The Cass report demonstrates very clearly the linkage between home ownership and standard of living in retirement. We do not see that home ownership is inconsistent with the retirement income policy objectives.*[29]

However, ASFA went on to note that whilst it had no in-principle objections:

> *... getting it to work in practice is not easy.*[30]

9.38 LIFA adopted a similar position, noting the administrative complexities of a housing loan arrangement within a superannuation fund, the cost in terms of reduced end benefits and the fact that the time when people will need the money is the time when there is not much money in the fund to borrow against.[31]

9.39 The ACTU told the Committee that there were some administrative and policy issues to be resolved and that:

> *... We do not believe it is necessarily appropriate for members to borrow from the fund as a whole. We have some concern about the proposition that members should be able to borrow from their vested account, because if it is at commercial rates then it is simply providing another form of financing rather than necessarily providing relief, and it is the members borrowing their own money and repaying a rate of interest. It does not relieve the interest payments. There would also be some administrative problems for the funds. They would have to administer a*

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29 Evidence, p 1128.

30 *ibid.*

31 Evidence, p 296.

> *mortgage arrangement. But we have said that we are very supportive of a notion which allows fund members to access their vested superannuation entitlement to put towards the purchase of a house.*[32]

9.40 Westpac advised the Committee that it made sense to allow people to access their superannuation savings in order to fulfil the need to own their own home but that most of the collateral for such a loan is in the property itself.[33]

9.41 The AAPBS outlined their proposed Household Savings Plan (HSP) to the Committee. The HSP:

- would be a savings account which operated as a personal superannuation plan and be subject to the tax rules for superannuation and the OSS Regulations; and
- would permit a percentage of the accumulated funds to be invested as a first or second mortgage for the purpose of buying a first home termed the HSP mortgage.[34]

9.42 The attraction of the plan rests on the current taxation deductibility arrangements for personal contributions by self-employed persons and gainfully occupied persons who do not receive an employer financed benefit other than under an award and the preferential treatment of investment income earned by superannuation funds. Compared to normal savings, the HSP would allow a taxpayer with a 39.25 per cent marginal rate to accumulate 60 per cent more savings over a ten year period and 90 per cent more savings over a 20 year period (assuming annual contributions of $3 000 and interest of 10.5 per cent).[35]

9.43 Mr Mansfield supported the principle of allowing superannuation savings to be used for housing but was concerned about possible distortion in the housing market and equity between members.[36]

9.44 The Committee acknowledges that reliance on rental housing is a significant cause of aged poverty but notes that housing is already significantly advantaged through the taxation system because of the non-taxation of capital gains on owner-occupied housing and imputed rental income. In the time available to it, the Committee has not been able to gather sufficient evidence for it to make specific recommendations on whether superannuation savings should be used for housing. In particular, the Committee is concerned about the effect that such arrangements might have on the retirement benefits accrued by members. The Committee received sufficient evidence for it to conclude the compounding effect of investment income was critical in the accumulation of final

32 Evidence, p 370.

33 Evidence, p 688.

34 Sub No. 148.

35 *ibid.*

36 Evidence, p 1323.

benefits but was not presented with detailed evidence on the effects that a housing loan arrangement might have on final benefits. The Committee intends to report on this issue in its third report.

ATTACHMENT – CHAPTER 9

The Advent Group and National Mutual

The Advent Management Group (AMG) manages development capital funds on behalf of mainly institutional investors. Its expertise is in managing investments in private companies and smaller listed companies. AMG is an autonomous part of the National Mutual Group.

Major shareholders are:

National Mutual Life	53%
Founders and Staff	38%
Colonial Mutual Life	9%

Each company in AMG is the specially established manager of an investment fund:

- Western Pacific Management Company Pty Ltd manages Western Pacific Investment Company Ltd, an unlisted public company, ex-Management Investment Company (MIC), with capital raised of $29.5 million;
- PVM Management Pty Ltd manages Australian Pacific Technology Ltd, a listed ex-MIC which raised $29.5 million;
- Advent Tourism Fund Management Ltd manages Advent Tourism Development Fund, an unlisted non-trading trust which, along with Austin Venture Capital Ltd, provides $10 million for tourism industry investments; and
- Advent Western Pacific Management Pty Ltd manages Advent Western Pacific Ltd, a listed development capital fund which raised $26.5 million.

Australian Infrastructure Fund

Australian Infrastructure Investment Management Limited (AIIM) has been formed as a joint venture between Colonial Mutual Investment Management Limited and Infrastructure Development Corporation Pty Limited. AIIM is in the process of raising approximately $200 million for the Australian Infrastructure Fund (AIF). AIF has been established as Australia's first dedicated infrastructure fund to invest exclusively in Australian infrastructure projects. AIF is structured in the usual form of an investment unit trust.

AIF is seeking funds from a number of major superannuation funds and institutions, which are currently taxed at either 15 per cent or zero per cent tax rates. Current indications are that 55 per cent of unit holders will be superannuation funds and 45 per cent tax exempt institutions. These entities are attracted to the concept of AIF because it provides a vehicle which facilitates diversification of investments in Australian infrastructure and provides access to skilled management expertise in this highly specialised area.

Total funds raised within AMG since its establishment in 1984 are $95.5 million.

AMG is an affiliate of the Advent International Network of development capital companies which covers 18 countries world wide. In this network, AMG maintains direct links with the individual affiliates as well as with the Boston-based central co-ordinating company. The Network manages over $US 1 billion in development capital worldwide.

This Network provides AMG with direct access to experienced people and organisations around the world to:

- help with the due diligence on potential investments, assessing markets and technologies;
- assist Australian companies in which AMG invests to develop their international operations through finding distributors or partners; and
- keeping in touch with relevant international trends/techniques etc. in the management of development capital.

CHAPTER 10

INSTITUTIONAL COMPETITION

10.1 As already noted in this report, the superannuation industry is not homogeneous. This chapter looks at some of the issues arising from competitive neutrality at the institutional level.

Approved Deposit Funds (ADFs) and Deferred Annuities (DAs)

10.2 ADFs and DAs were created in 1983 to receive rollover benefits for members who were unable or did not wish to transfer their superannuation benefits from one fund to another. By rolling over their superannuation benefits into these specialist vehicles, individuals were able to avoid penalty rates of tax on benefits received prior to age 55. Thus they chose to preserve their benefits. At the time, there were no public superannuation funds in existence to receive such funds. The assets of ADFs and DAs have grown from nil in 1983 to $24.5 billion.[1] Of this amount, $9.2 billion is in ADFs.[2] Banks and funds managers dominate the ADF market.

10.3 In its Policy Issues Paper 1991, ASFA identifies four main differences between superannuation funds and ADFs:

- contributions may be accepted by superannuation funds but not by ADFs. ADFs may only receive benefits arising upon termination of employment by way of rollover;

- a benefit which has been rolled over into an ADF, and which is **not** required to be preserved, may be withdrawn at any time. On the other hand, if such an 'unpreserved' benefit is retained in the superannuation fund after termination of employment it may not be withdrawn until some subsequent employment or retirement;

- once a person has retired, benefits must be paid out of a superannuation fund, or a pension may commence to be paid, regardless of age, whereas benefits may remain in an ADF until age 65; and

- on the other hand, provided a person has not retired, benefits may remain in a superannuation fund after age 65, whereas benefits cannot remain in an ADF under any circumstances beyond that age.[3]

10.4 There is no definition of a DA in OSSA. Essentially, it is a life insurance policy which the purchaser can elect to convert into an annuity at some time in the future.

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1 *TPF&C ADF/Annuity League Table* published by Rice·Kachor Research, March 1992/ April 1992.

2 *ibid.*

3 Sub No. 89, p 141.

10.5 ASFA notes that since the introduction of ADFs, compulsory preservation rules have been introduced and extended. The application of these rules will be further extended with the SGL.[4] ASFA advised the Committee that it has become increasingly common for employer-sponsored funds to allow members who terminate their employment to leave the benefits in that fund and that the current differences in rules for ADFs and superannuation funds are:

> *... unnecessary, maybe confusing, and can be iniquitous.*[5]

10.6 ASFA recommends that the differences imposed by legislation between ADFs and superannuation funds be removed.[6]

10.7 IFA also recommended removal of the legislative differences between superannuation and rollover products so that ADF managers could offer investors a wider choice. IFA also suggested that this would be an important part of simplification of superannuation.[7]

10.8 AM Corporation suggested that ADFs were now redundant and that ADFs could be converted into public master trust super funds. It suggested that:

> *... an important consequence ... would be that the existing moneys in ADFs (over $10 billion) could more easily be encouraged to provide income streams.*[8]

10.9 The Commonwealth Bank argued in evidence to the Committee that:

> *.. [the rollover vehicle] is arguably the most important development in superannuation .. since it was introduced in 1984.*[9]

10.10 The Commonwealth Bank suggested that without rollover vehicles, one of two things could happen. Firstly, the money could be spent instead of being preserved for retirement. Secondly, the money could be lost because small amounts would remain in the superannuation fund which people would never claim. The Bank noted that these small amounts are very expensive to administer and that ultimately the cost is borne by the consumer.[10] An advantage of rollover vehicles cited by the Commonwealth Bank was that consumers retain control of their money and have the flexibility to match the

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4 *ibid.*

5 *ibid.*

6 *ibid*, p 143.

7 Sub 154, p 9.

8 Sub No. 96, p 5.

9 Evidence, p 822.

10 Evidence, pp 822-823.

investment risk profile with their own needs.[11]

10.11 In its submission, the ISC noted that ADF trust deeds have typically provided for redemption of investments within seven to 30 days of request. Over the past 12-18 months, a small number of ADFs which are substantially invested (80 per cent or more) in unlisted property trusts have been unable to meet the repayment 'upon request' requirement because of the depressed property market and the unprecedented demand for redemption of investments in unlisted property trusts.[12]

10.12 The Attorney-General announced on 23 July 1991 the introduction, with immediate effect, of a standard 12 month notice period for withdrawals from all existing unlisted property trusts. As a result, the ISC has indicated that the Commissioner would exercise his discretion to treat ADFs affected by this announcement as complying funds, given the special circumstances of their inability to repay depositors 'upon request'.[13]

10.13 The ISC noted that:

> *As ADFs are the custodians of retirement income moneys, the arrangements which are put in place, in the longer term, concerning redemption periods, will need to require them to properly match their investments to the 'upon request' requirement. The ISC is liaising with the ASC concerning this matter and will develop proposals to meet this end.*

10.14 The Committee concluded that the existing legislative differences between ADFs and superannuation funds were unnecessary and added a further layer of complexity to a system which is greatly in need of simplification. If ADFs were able to accept contributions, as well as to receive rollover moneys, the Committee believes that the liquidity problems faced by many ADFs could be ameliorated. While recognising that the main institutional beneficiaries of these changes will be banks and funds managers, the Committee considers that this will further enhance competition in the superannuation industry.

Recommendation 10.1:

The Committee recommends that the existing legislative differences between ADFs and superannuation funds be removed.

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11 Evidence, p 823.

12 Sub 151, pp 29-30.

13 *ibid*, p 30.

Bank Account Superannuation

10.15 The Treasury submission noted that the Government's announced commitment to a competitive superannuation industry raised concerns relating to wider institutional access to the superannuation industry and the issue of increased portability of individual superannuation benefits.[14]

10.16 Treasury noted that:

> *... wider institutional access to the superannuation industry is a desirable objective but will require appropriate measures to ensure that the superannuation tax concessions are effectively confined to superannuation and cannot flow through to non-superannuation activities. It will also be vital to ensure that an appropriate prudential framework applies to such institutions.*[15]

10.17 In evidence to the Committee three of the four major banks argued strongly in favour of bank account superannuation.[16] ANZ argued that bank account superannuation will be particularly attractive to farmers and small business employers as well as the self-employed and part-time workers because of its simplicity and security.[17] The ANZ Superannuation Savings Account to be offered by ANZ Life will:

- accept employer and/or employee contributions;
- provide access at any ANZ branch;
- provide standard bank facilities such as statements and inquiries via branches and ATMs;
- be fully vested and fully preserved;
- have a bank account cost structure;
- invest in bank deposits; and
- offer optional life assurance.[18]

10.18 ANZ suggested that bank account superannuation would be:

> *... comparable with capital stable superannuation funds ... It will not be*

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14 Sub No. 195, p 25.

15 *ibid.*

16 The banks were ANZ, CBA and Westpac.

17 Evidence, p 448.

18 *ibid.*

> *seeking to compete with balanced funds which invest in equities and properties because they take more risk in the hope of gaining a reward that is better than a completely safe investment avenue.*[19]

10.19 ANZ argued that bank account superannuation would meet two market segments. The first segment is one which wants:

> *... a safe, stable product with a predictable return.*[20]

10.20 The second segment

> *... wants a catchment facility to satisfy requirements such as the superannuation guarantee levy, whilst the members are sorting out whether they want to invest in a balanced portfolio of shares, equities, fixed interest and so on.*[21]

10.21 The Commonwealth Bank also cited simplicity and security as reasons for the attractiveness of bank account superannuation and suggested another benefit would be that it would provide banks with a pool of funds for banks to on-lend.[22] (See Figure 10.1 for diagram which shows the risk return spectrum.)

10.22 Whilst both ANZ and the Commonwealth Banks emphasised the low risk nature of bank account superannuation, Westpac noted in its evidence to the Committee that passbook type arrangements would widen investor choice and that it is:

> *... entirely possible to construct passbook savings programs that permit the investors to have access to equity type investments.*[23]

10.23 In terms of operation, Westpac suggested that a passbook system would be analogous to an advantage saver product where the investor can make periodic contributions and be advised periodically of interest entitlements.[24]

10.24 The Australian Association of Permanent Building Societies (AAPBS) also argued in favour of passbook savings accounts for superannuation. The AAPBS saw such accounts being linked to housing finance.

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19 Evidence, p 467.

20 *ibid.*

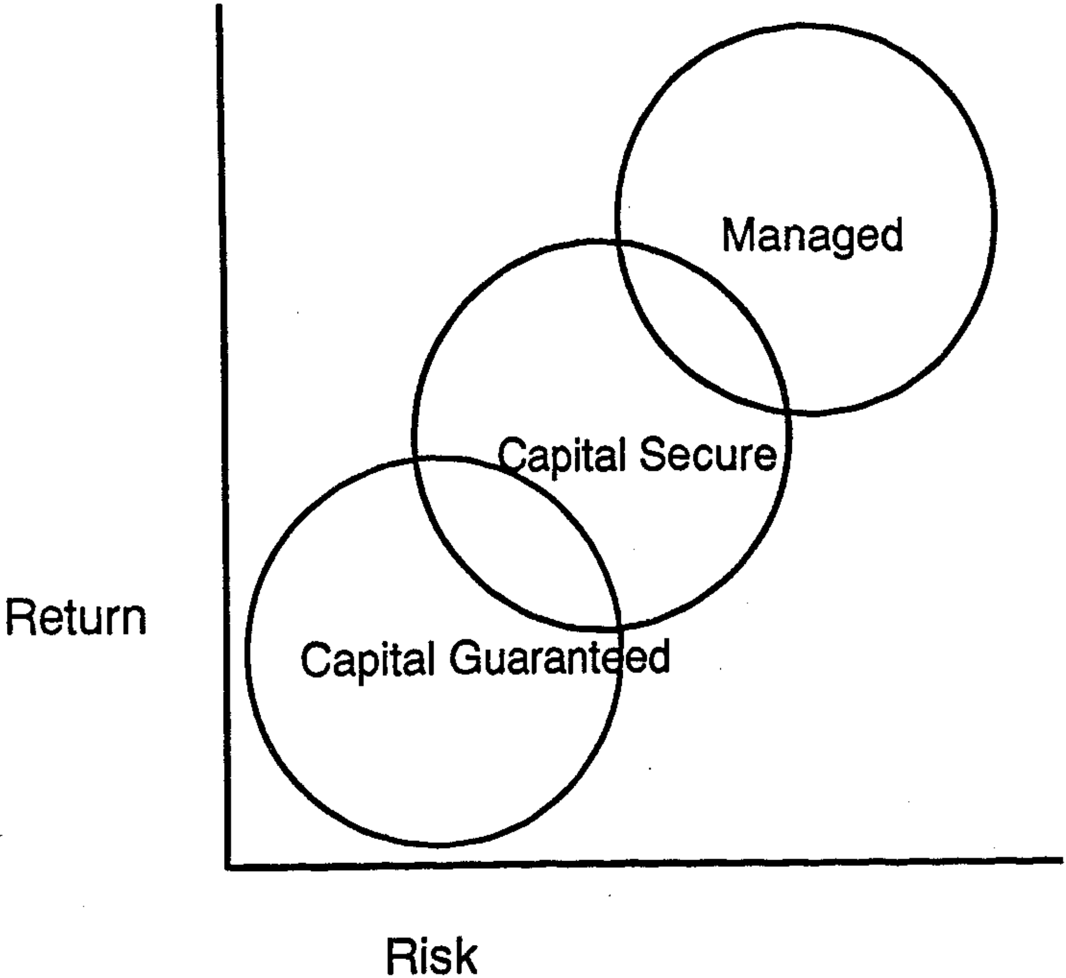
21 *ibid.*

22 Evidence, p 823.

23 Evidence, p 677.

24 Evidence, p 682.

Figure 10.1



Tabled by Commonwealth Bank of Australia at Public Hearings on 19 February 1992.

10.25 Provided that there was a level playing field, National Mutual told the Committee that it had no difficulties with new superannuation providers entering the industry. In particular, National Mutual was concerned that banks would be able to sell directly to the public without the requirement for trust deeds or prospectuses and that those assets would be treated as part of their normal bank deposits.[25]

10.26 AM does not believe that bank account styled Individual Retirement Accounts would work in Australia because:

- people need to be convinced to utilise superannuation (i.e. it needs to be 'sold'; it is not 'bought');
- superannuation saving should be dovetailed into the person's overall financial planning and therefore professional financial advice was generally advisable;
- the performance of dedicated, professional superannuation investment managers far outperforms the returns available on bank accounts. This means that returns on bank account superannuation will be less, with consequent implications for social security expenditure; and
- the level of disclosure required.[26]

10.27 SBC Dominguez Barry, in its evidence to the Committee, argued that investing in cash or fixed interest securities would not achieve the Government's retirement income objectives.[27] The IAA made a similar point in its submission to the inquiry and provided the tables given at the Attachment to this chapter as an illustration.[28]

10.28 It appeared to the Committee that the desirability of banks offering superannuation passbook accounts was closely related to member choice and portability. Consumer groups also saw significant cost advantages over personal superannuation policies offered by life offices.[29] In this context, the Committee notes that the life assurance industry was asked to provide full details of fees and commissions to the Committee and was assured that this information would be treated *in camera*. Despite ample opportunity to do so, the life assurance industry failed to provide the Committee with sufficient information on fees and commissions. The response reinforces the views put by consumer groups and others that the life assurance industry fails to provide sufficient information to enable consumers to make informed choices. The Committee will be making specific recommendations on fees and commission in its third report.

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25 Evidence, p 193.

26 Sub No. 96, p 2.

27 Evidence, p 808.

28 Sub No. 108, p 16.

29 See for example Gillian Moon, Evidence, p 1039.

10.29 Regarding portability, Treasury argued that whilst:

> *... there are cogent arguments for greater portability of superannuation benefits, ... they must be balanced against the administrative problems ... associated with allowing fund members to move their entitlements between funds.*[30]

10.30 Treasury also noted that greater portability had implications for funds' liquidity risks with consequent effects on investment decisions and it pointed to the administrative costs associated with portability.[31] Other witnesses, however, discounted the administration costs associated with member choice, suggesting that technology such as electronic funds transfer could be utilised.[32]

10.31 The arguments against bank account superannuation were generally that this form of investment would not provide an adequate return because it would not have the equity-type investments necessary for long term growth. (See the Attachment at the end of this chapter for the importance of high risk investment.) There was also concern that bank account superannuation could further entrench the focus on short term investment returns.

Table 10.1

IMPACT OF ALTERNATIVE INVESTMENT STRATEGIES ON RETIREMENT BENEFITS

	Risky Strategy		Safe Strategy	
Mean Accumulation ($'000)	571.5		145.4	
Annuity Estimates Replacement	Year 1 Payment ($)	Replacement Rate (%)	Year 1 Payment ($)	Rate (%)
NO ESCALATION				
Single Life	49,800	73.2	12,700	18.6
Joint Life	39,900	58.7	10,200	14.9
2% ESCALATION				
Single Life	41,900	61.6	10,700	15.7
Joint Life	31,800	46.8	8,100	11.9

Source: Submission No. 150, page 14.

10.32 The Committee concluded that while investing in fixed interest securities might be appropriate for someone nearing retirement, it is certainly not appropriate for an individual entering the work force. This was a point pursued vigorously by the University of NSW Superannuation Economics Research Group which argued that customising risk

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30 Sub 195, p 25.

31 *ibid.*

32 Sub Nos 71, 141.

exposure to the age of different contributions should be compulsory.[33] Table 10.1 illustrates the impact of alternative investment strategies on retirement benefits.

10.33 Whilst many submissions spoke in favour of member choice,[34] there was widespread recognition of the administrative problems this could pose for employers and concern that the focus on short term investment returns would be exacerbated.[35] The Queensland Government Superannuation Office advised the Committee that in the United States where there is significant freedom of choice for individuals, the evidence is that:

> *... a significant amount of what otherwise would be superannuation savings ... is being consumed by extensive marketing efforts by various institutions to attract clientele. While from a free market perspective one would be quite comfortable with that if one felt that the people making those choices were making them on an informed basis, the infancy of superannuation in Australia en masse would tend to indicate that people are yet to come to that point, and in fact are relatively unaware of most financial issues, and it will be a considerable time before they are aware.*[36]

10.34 With respect to customised asset allocations, the Queensland Superannuation Office argued that at present people do not have sufficient information that allows them to make a rational choice. As evidence of this phenomenon, the officials pointed to the:

> *... time and effort being spent in trying to communicate with members who in many instances are less than enthusiastic about the prospect of becoming aware of those things.*[37]

Pension and Annuity Providers

10.35 At present only life offices are able to issue complying annuities and some superannuation funds, mainly public sector schemes, provide pensions for their members. A complying pension or annuity is one which:

- is payable for life;
- has no residual capital value; and
- is indexed to the lesser of five per cent and/or the CPI.

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33 Sub No. 150, p 16.

34 See for example ANZ, Rothschilds, County NatWest

35 See for example, Evidence p 56 and p 144.

36 Evidence, p 1173.

37 Evidence, pp 1173-1174.

Recommendation 10.2:

The Committee supports the entry of new entrants into the superannuation industry as this will widen consumer choice and introduce more competition to the industry.

The Committee recommends that cross-subsidisation of the administration costs of bank superannuation products and other banks products be legislatively prohibited under the Banking Act and that this be monitored by the Reserve Bank.

The Committee further recommends that legislation require consumers to be adequately informed about the implications of a low risk profile for bank account superannuation in terms of retirement benefits, and that the ISC and the industry conduct an education campaign to explain to consumers the importance of risky assets in an investment portfolio.

10.36 The Government introduced changes to the RBL rules in the 1988 Economic Statement to encourage retirees to take their benefits in the form of income streams, but despite this, annuities and pensions remain unpopular because:

- there is a fear of capital loss on premature death;
- there is a desire to bequeath capital assets;
- it is expensive to purchase an adequate lifetime pension; and
- some doubt exists about the life industry's capacity to provide annuities in the future because of the solvency requirements under the LIA.

10.37 Whilst recognising that there are certain taxation impediments to taking superannuation benefits in the form of pensions and annuities (these anomalies will be canvassed in the Committee's third report), the Committee believes that institutional factors may also play a role.

10.38 Mercers advised the Committee that currently a retiree can purchase an annuity or pension in one of three ways:

- taking a lump sum benefit, paying tax and then purchasing an ordinary annuity from a life office;
- transferring the fund benefit direct to a life office to purchase a rollover annuity; or
- receiving a pension from a superannuation fund directly.

10.39 A number of submissions called for funds of sufficient size and financial strength

to be able to provide annuities and pensions directly to retirees.[38] Such funds would be subject to special prudential safeguards. Mercers argued that:

> *... the trustees, in deciding what pension they will provide for a given 'lump sum' do not have the objective of making abnormal profit or paying commissions to agents. As such, the ability of a fund to offer pensions imposes on the large financial institutions providing annuities a genuine and most effective competitive discipline. At the same time, the trustees of a fund should be able to 'transfer' their pension obligations to any financial institution meeting the Government's prudential safeguards. The liquidity that this will inject into the retirement incomes system is both powerful and effective – as is evident overseas.*[39]

10.40 The IFA advised the Committee that:

> *... the current need for a company to hold an insurance licence in order to operate in the annuity market is not seen by IFA members as a competitively neutral position. While it may be argued that the reserves provisions of the Life Insurance Act ensure that the money to pay annuities will always be there, IFA believes that its members should be able to satisfy criteria without the need to hold an insurance licence.*[40]

10.41 The IFA went on to argue that growth in the annuity/pension market will be delayed until the public develops an acceptance of, or is forced to accept, pensions in lieu of lump sums. Under current arrangements it argued that most of the growth would accrue to the life offices[41] even though the investment and administrative skills needed to manage annuity type products already exist amongst IFA's membership.

Recommendation 10.3:

The Committee recommends that the annuity market be opened up to firms of sufficient size and financial strength. Such funds would be required to meet special solvency and reporting requirements as evidence of their ability to provide indexed income streams.

10.42 In December 1991, the average amount of annual income that could be purchased with $100 000 from three major Australian life offices was $6 923.[42] (This was based on male age 65, spouse age 60, indexation of five per cent per annum, 85 per cent reversion to spouse and ten year guarantee period.)

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38 See for example Sub Nos 136, 79, 59, 154.

39 Sub No. 79, p 8.

40 Sub No. 154, p 7.

41 *ibid.*

42 Supplementary submission to Sub No. 95, p 1.

10.43 One of the reasons that the cost of life-time annuities is prohibitive is the solvency requirements on life companies in the LIA. Life companies are required to discount their liabilities at a rate no higher than 12 per cent. SBC Dominguez Barry estimated that:

> *... if the existing solvency requirements for life annuities remain unchanged and assuming an average capital requirement of $11 for every $100 invested in a pension based on [certain] assumptions, this would require capital of $15 to $21 billion to support this level of life pension.*[43]

10.44 SBC Dominguez Barry went on to note that:

> *... those managers of superannuation funds that have limited access to capital are arguing quite strongly for the need for more flexibility in product design.*[44]

10.45 Mr Newman told the Committee that the issues that needed to be addressed in developing an innovative, complying annuity market were:

- setting competitive annuity prices, consistent with sound underwriting;
- within the constraints of a capital-guaranteed fund, determining investment policies that realistically hedge against inflation;
- establishing adequate contingency reserves;
- setting upper indexation limits (if any);
- developing deferred annuity options reflecting occupational rather than select mortality – both for groups and individuals – and penalties for early withdrawals;
- financing new business strains under an LIA minimum standard (if any);
- developing participating CPI indexed annuities, which would distribute investment profits derived before disinvestment of purchase price becomes significant;
- developing CPI indexed annuities backed by investment linked funds;
- whether purchase prices of annuities should be based on a medical assessment of the annuitants (life insurance in reverse!) and whether there is a sound basis for the development of an impaired lives annuity market, including total and

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43 Mr R Barry, Report to the Committee for the Economic Development of Australia, 10 December 1991. The assumptions were that the:

> *private sector must fund a pension that provides 30 per cent of AWE for 30 per cent of the retired population in the year 2000. The pension would be indexed at 5 per cent per annum and the return on the fund (discount rate) would be 8.5 per cent.*

permanent disablement with a reasonable prospective of longevity.[45]

10.46 The Committee also noted evidence of the Women's Economic Think Tank that women are severely disadvantaged by the current pricing of annuities because of their longevity and their generally smaller superannuation benefits.[46]

10.47 One of the products referred to by the industry as meeting consumer needs for more flexibility than provided by complying annuities, is the allocated pension. An allocated pension is a pension:

> *... where the member has his own account against which the pension payments are debited and to which any investment earnings are credited. The pension will continue until the death of the pensioner, or until the account is exhausted. When the member dies, any balance remaining in the account is paid to a designated beneficiary as a [taxable] lump sum payment, or is applied to secure further pension payments to a surviving spouse. Part or all of the pension may be selected by the member. Current providers of allocated pensions have, however, set self-regulatory guidelines such as maximum and minimum pension levels.*[47]

10.48 ASFA suggested to the Committee that allocated pensions:

> *... could play a vital role in overcoming the lump sum mentality and in encouraging benefits to be taken in pension or annuity form.*[48]

10.49 AM told the Committee that:

> *... the allocated pension is a natural extension of the allocated [defined contribution] type of super fund, but there is a need for a consistent set of rules as the major providers of allocated pensions have received a range of slightly different approvals to their self regulatory approaches.*[49]

10.50 The allocated pension has become extremely popular as shown by the four main national providers capturing 11 per cent of the Retirement Income Stream market in 1990/91. The following table shows the breakdown:

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44 *ibid.*

Table 10.2

RETIREMENT INCOME STREAM MARKET

Year Ended 30 June 1991

	$M	%	Number Pensioners
Cashback Pensions*	107	11	897
Lifetime Annuities#	432	43	6 980
Term Annuities#	464	46	10 370
Totals	1 003	100	18 247

* based on AM LifeTrack, Bains, Connelly & Temple, Le Fort
\# based on Solomon & Associates, Consulting Actuaries Report

Source: AM Corporation Sub No. 96.

10.51 SBC Dominguez Barry noted that if the Government allows a more flexible scheme such as allocated pensions, it runs the risk that retirees will revert back to it for the aged pension.[50]

10.52 The ASFA Working Party on Superannuation Pensions has recommended that regulations should be introduced for allocated pensions which cover such issues as:

- periodicity of pension payments;
- minimum and maximum pension payment;
- the right to partial or full commutability;
- the tax on the commuted amount ;
- eligibility criteria should be consistent with deferred annuities and annuities;
- prudential standards;
- disclosure; and
- treatment under social security income and assets test consistent with annuities.[51]

10.53 The Alexander Consulting Group provided the Committee with details of Retirement Income Savings Accounts (RISAs). This is a variant of the allocated pension. A consumer guide to this type of retirement income is given at Appendix 3 of this report.

10.54 As Table 10.2 illustrates, the major annuity market in Australia is term-certain annuities. IFA advised the Committee that:

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45 Sub No. 3, *op cit*, p 17.

46 Sub No. 126, p 9.

... from a financial institution's view point, term-certain annuities have the same characteristics and risk as securities such as debentures.[52]

10.55 The IFA noted that unit trust arrangements, including ADFs, currently cannot retain rollover moneys for beneficiaries past the age of 65 and they are therefore precluded from offering a term-certain annuity for retirees. IFA recommended that a level of solvency reserves should be established for institutions capable of offering term-certain annuities and the unit trust managers able to meet this criterion should be able to offer term-certain annuities.[53]

10.56 The Committee was attracted to this recommendation as it would introduce a further element of competition in the annuity market. This would encourage retirees with relatively small ETPs to take their benefits as income stream.

Recommendation 10.4:

The Committee recommends that the Government introduce legislation to regulate the provision of allocated pensions and other flexible retirement income products as soon as possible.

The Committee further recommends that unit trust arrangements meeting solvency and reporting requirements be allowed to offer term-certain annuities.

The Committee notes that if the Government does not address broader socio-economic issues in this context, such as the preservation age, there could be a substantial cost to revenue from such arrangements.

52 *op cit*, p 8.

53 *ibid.*

ATTACHMENT – CHAPTER 10

LONG-TERM INVESTMENT RETURNS – SUPERANNUATION FUNDS

RATE OF INCREASE (% PER ANNUM) IN:

PERIOD COVERED	G	S	O	P	Total	AWE	CPI	Real Return
5 years ended:								
30 June 1977	1.3	0.9	6.6	11.8	3.9	15.3	12.4	-9.9
30 June 1978	6.2	3.8	8.9	11.6	6.9	15.5	13.2	-7.4
30 June 1979	9.5	15.4	12.4	12.5	13.2	13.8	12.2	-0.5
30 June 1980	8.2	29.6	14.1	15.5	18.7	10.8	10.9	7.1
30 June 1981	8.2	26.7	12.8	17.5	17.8	10.7	10.2	6.4
30 June 1982	8.2	18.7	12.9	17.6	15.5	11.1	9.5	4.0
30 June 1983	8.8	23.7	13.9	18.4	17.6	11.4	9.9	5.6
30 June 1984	12.2	19.9	14.9	19.7	17.7	11.3	9.7	5.8
30 June 1985	14.0	12.2	15.3	18.9	14.8	10.7	8.5	3.7
30 June 1986	16.0	16.6	16.2	17.3	17.6	9.2	8.3	7.7
30 June 1987	17.0	34.2	16.8	19.9	24.9	7.7	8.1	16.0
30 June 1988	16.1	23.7	14.8	18.0	19.5	6.6	7.2	12.1
30 June 1989	13.4	24.5	14.2	15.4	18.6	6.6	7.3	11.3
10 years ended:								
30 June 1977	3.5	6.6	7.1	-	6.5	11.9	8.2	-3.0
30 June 1978	4.8	4.2	7.8	-	6.3	12.3	8.8	-5.3
30 June 1979	5.1	5.1	8.3	-	6.8	12.4	9.4	-5.0
30 June 1980	5.9	12.2	9.3	-	10.5	12.5	10.1	-1.8
30 June 1981	5.9	15.0	9.9	14.1	12.0	12.7	10.6	-0.6
30 June 1982	4.7	9.5	9.7	14.7	9.6	13.2	11.0	-3.2
30 June 1983	7.5	13.3	11.4	15.0	12.2	13.4	11.5	-1.1
30 June 1984	10.9	17.6	13.7	16.1	15.4	12.5	10.9	2.6
30 June 1985	11.0	20.6	14.7	17.2	16.7	10.7	9.7	5.4
30 June 1986	12.0	21.6	14.5	17.4	17.7	9.9	9.2	7.1
30 June 1987	12.5	26.2	14.8	18.7	20.1	9.4	8.8	9.8
30 June 1988	12.4	23.7	14.3	18.2	18.5	9.0	8.6	8.7
30 June 1989	12.8	22.2	14.6	17.5	18.1	8.9	8.5	8.4
15 years ended:								
30 June 1977	3.9	8.5	-	-	6.0	9.0	6.2	-1.5
30 June 1978	4.5	8.4	-	-	8.2	10.2	6.8	-1.8
30 June 1979	4.5	8.7	-	-	8.3	10.4	7.3	-1.9
30 June 1980	4.7	14.7	8.2	-	11.3	10.5	7.7	0.7
30 June 1981	5.0	15.3	8.9	-	11.8	11.1	8.1	0.6
30 June 1982	5.0	11.8	9.0	-	10.8	11.6	8.7	-0.7
30 June 1983	6.1	10.3	9.8	-	10.0	12.0	9.2	-1.8
30 June 1984	7.4	9.8	10.4	-	10.3	12.0	9.5	-1.5
30 June 1985	8.5	12.2	11.3	-	11.9	11.9	9.6	0.0
30 June 1986	9.2	15.5	12.0	15.1	13.8	11.6	9.8	2.0
30 June 1987	8.7	17.1	12.0	16.4	14.5	11.3	10.0	2.9
30 June 1988	10.3	16.6	12.5	16.0	14.5	11.1	10.1	3.1
30 June 1989	11.7	19.9	13.9	15.8	16.5	10.5	9.7	5.4

RATE OF INCREASE (% PER ANNUM) IN:

PERIOD COVERED	G	S	O	P	Real Total	AWE	CPI	Return
20 years ended:								
30 June 1982	4.9	11.0	-	-	9.8	10.0	7.0	-0.2
30 June 1983	5.6	12.1	-	-	10.5	10.5	7.6	0.0
30 June 1984	6.4	11.4	-	-	10.5	10.6	7.9	-0.1
30 June 1985	7.0	14.1	9.9	-	12.1	10.6	7.9	1.4
30 June 1986	7.7	15.6	10.6	-	13.3	10.6	8.2	2.4
30 June 1987	7.9	17.1	10.9	-	14.2	10.6	8.5	3.3
30 June 1988	8.5	13.5	11.0	-	12.3	10.6	8.7	1.5
30 June 1989	8.9	13.3	11.4	-	12.3	10.6	9.0	1.5
25 years ended:								
30 June 1987	7.2	15.3	-	-	12.7	9.6	7.2	2.8
30 June 1988	7.6	14.3	-	-	12.3	9.7	7.5	2.4
30 June 1989	7.8	13.9	-	-	12.1	9.8	7.8	2.1

NOTES: The figures for G (government securities), S (shares), O (other securities) and P (property) sector performance as well as Total fund performance have been derived where possible from the average rates of return of funds participating in the IMS survey up to 1987 and the TPF&C survey subsequently.

Where figures for each sector performance were unavailable from these surveys, they were obtained from the average performance of the appropriate units in the No 2 Statutory Funds of the AMP society and National Mutual.

For some early years, figures were obtained from Stock Exchange Indices and Commonwealth bond yields.

The Total fund performance statistics for periods prior to 1 July 1970 were based on a model fund with the following investment proportions:

– 30% G, 15% O, 55% S where statistics were available for G, O and S sectors only.
– 40% G, 60% S where statistics were available for G and S sectors only.

ASW is average weekly total earnings for males as published by the Australian Bureau of Statistics.

CPI is the Consumer Price Index eight capitals figure for All Groups published by the Australian Bureau of Statistics.

Real Return is equal to the ratio of the rate of Total investment return to the rate of increase in AWE.

Source: *Superfunds*, June 1990, pp 21-22.

CHAPTER 11

DISPUTE RESOLUTION MECHANISMS

The Perceived Need

11.1 The substantial increase in the membership of superannuation schemes consequent upon the introduction of award superannuation, combined with the legal and taxation complexities surrounding the subject, will create a large pool of contributors with very little, or no, background knowledge of many of the principles involved. The large, and increasing, balances standing to the credit of members will, over time, become the major avenue of individual savings apart from home ownership. The fact that, in some circumstances, entitlements may be determined at the discretion of fund trustees adds to the already fertile ground for misunderstanding and disputation.

11.2 Some of the matters which may not be readily understood are:

- the charging to individual accounts of administration fees, contributions tax and insurance premiums;
- the failure in some instances to disclose all fees and commissions;
- the charges levied on the early cancellation of some policies;
- the methods of dealing with broken periods of service;
- the frequent provisions requiring trustees to allocate benefits between conflicting parties, for example, former and current spouses of deceased members, or between other dependants;
- the differences between defined benefit and defined contribution schemes, in particular, the consequences of major changes in asset values;
- the meaning and significance of technical terms such as vesting, preservation, reasonable benefits and the various types of annuity currently available; and
- medical problems, such as total and permanent disability and eligibility for life insurance.

11.3 All of the foregoing relate to the entitlements of individual members, but differences of a broader, more general character may arise over matters such as the election of trustees, investment policies, the alteration of trust deeds and the degree of employer influence over trustees. The difficulties may, in part, be the product of an environment in which the rights of members are limited and the providers of superannuation products have overwhelming power which, under the present regulatory regime, is difficult to question or challenge.

11.4 In August last year, the Treasurer stated that:

> *The Government considers that consumers should have an appropriate forum to settle any disputes between themselves and the superannuation funds. To this end, the Government will be working with industry participants to develop a suitable low-cost dispute resolution mechanism. Such a mechanism should raise consumers' confidence in the superannuation industry and increase their willingness to invest in superannuation.*[1]

11.5 The predominant view put to the Committee was that there was a need for the establishment of such a mechanism which was independent of the fund manager concerned and which avoided the courts as far as possible. Among the organisations taking this view were the ACTU, MTIA, Jacques Martin, Clayton Utz, LIFA, the principal accounting bodies, the TPC and organisations representing pensioners and consumers.[2]

11.6 Nevertheless, the Committee noted that there was very little quantitative evidence as to the actual extent of disputation, that is, how many disputes occurred each year, what the issues were, how they were resolved and at what cost. The Committee was therefore unable to gain any idea of the scale of the problem and had some difficulty in devising an appropriate solution.

11.7 A significant minority of witnesses held that no new arrangements were called for. MMBW felt that the nature and structure of trustee bodies provided for adequate review. Reliance on the courts discouraged frivolous claims while providing for the resolution of serious claims. An outside authority would be costly and might become a de facto regulator by making determinations which reflected its own thinking.[3] ACM also felt that dispute resolution was a matter for internal arrangement by each fund.[4] ANZ opposed the establishment of any new mechanism, expressing the view that most disputes could be defused by allowing greater freedom of choice so that members could 'vote with their feet'.[5]

11.8 On balance, the Committee concluded that, notwithstanding the paucity of factual evidence as to the extent of the problem, several considerations dictated that the establishment of an external review mechanism, within the compliance framework of OSSA, was highly desirable:

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1 The Hon John Kerin, MP; *Review of Supervisory Framework for the Superannuation Industry*, Press Release No. 73; Canberra, 20 August 1992.

2 Sub Nos. 106, pp 20, 24; Sub No. 55, p 17; Sub No. 90, p 16; Sub No. 20, p 2; Sub No. 114, pp 49-51; Sub No. 119, p 15; Sub No. 145, p 12; Sub No. 125, pp 21-22; 139, p 9.

3 Sub No. 66, Section 10.

4 Sub No. 95, p 16.

5 Sub No. 73, p 6.

- superannuation was already compulsory for a large section of the community and it was government policy that all employees should be covered. The Government therefore had a duty to ensure that members' rights were protected;

- it was highly desirable that justice should not only be done but should also be seen to be done;

- the cost of litigation was so high that it offered no real rights to members;

- the ability to vote with one's feet offered no comfort to, for example, dependants of deceased employees who might be denied access to benefits or to members who might suffer heavy losses on withdrawal from a fund; and

- the factors set out in Paragraph 11.2 above make it highly probable that there will be a sharp increase in disputation in the next few years.

Possible Models

Banking Industry Ombudsman

11.9 In 1990, the Australian banks, with the exception of two banks operating only in single States, combined to establish an independent ombudsman with power to deal with claims up to $100 000.[6] The procedures to be followed in the resolution of disputes comprise the following:

- the customer and the bank must endeavour to reach agreement;

- if the parties are deadlocked, the ombudsman may call a conference and act as a mediator.

- as a last resort, the ombudsman arbitrates the dispute; and

- the decision is binding on the bank if accepted by the customer.

11.10 The Ombudsman is appointed by, and answerable to, a council comprising three former bankers, three consumer representatives nominated in conjunction with the Commonwealth Minister for Consumer Affairs and an independent Chairman, currently Sir Ninian Stephen. The scheme is financed and administered by the banks, acting through a board on which the Reserve Bank is represented.

11.11 Every bank branch has literature describing the service and the ombudsman's staff is independent of the banks. The Ombudsman produces an annual report which is available to the public.

11.12 In 1991-92, the Ombudsman estimated that the office would receive 50 000 telephone inquiries and 5 000 written complaints.

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6 Evidence, pp 1975-79.

The LIFA Scheme

11.13 LIFA has recently established a formal disputes resolution procedure with the following components:

- an Industry Code of Practice for dealing with inquiries and complaints. The main elements of the Code are the nomination by each company of a senior officer to whom all complaints are referred, the entry of every complaint on a register and the establishment of time limits for the acknowledgment of, and decision on, each dispute;
- the establishment within the LIFA secretariat of an inquiry and complaints service charged with the provision of advice and assistance and which also carries out a conciliation role between the parties;
- a three-member Complaints Review Committee which arbitrates disputes not settled at the company or LIFA level. The members are chosen by the Insurance Industry Complaints Council (see below), LIFA and the Commonwealth Minister for Justice and Consumer Affairs, who nominates a consumer representative. The Committee's decisions are binding on the companies, but not the complainants; and
- The Insurance Industry Complaints Council, which oversees the whole complaints process, but cannot overturn Committee decisions. The Council is chaired by a former federal Attorney-General and has two industry and two consumer representatives.

11.14 The arrangements are fully funded by the companies, but both the Committee and the Council are required to report publicly each year.[7]

11.15 AFCO was highly critical of the LIFA scheme, 'primarily because of the lack of independence and the lack of accessibility'.[8] Any complaints body would need to be 'as fully independent of industry as possible' and to have 'strong consumer involvement in the management of the process'.[9] It regarded the banking industry ombudsman as the 'best possible alternative that we can obtain at the moment'.[10]

11.16 In the Committee's view, however, the two mechanisms have much more in common than is implied in the AFCO criticisms. Both are wholly industry financed but, in each case, the industry has gone to considerable lengths to obtain consumer representation on the controlling bodies, with ministerial involvement in their choice. Both require genuine attempts by the parties to reach agreement prior to arbitration and both schemes include provision for publishing annual reports.

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7 Sub No. 114, pp 45 - 49.

8 Evidence, p 1941.

9 *ibid*, pp 1942, 1944.

10 Ibid, p 1944.

State Insurance Office - Victoria

11.17 The Victorian State Insurance Office has established its own 'ombudsman' - the Consumer Appeals Centre, with power to make determinations up to $400 000.[11]

11.18 A major part of the Centre's activities is the provision of information and advice, since poor communication has been found to be the major cause of complaints.

11.19 Nearly all complaints are resolved by conciliation, with senior company officers participating. Only one complaint in every 200 proceeds to arbitration.

The Law Reform Commission's Proposal

11.20 In its report *Collective Investments - Superannuation*the Law Reform Commission proposed the establishment of two separate schemes - an advisory service and a dispute resolution service.[12]

11.21 The advisory service would be established within the ISC and would be responsible for the provision of educational material and the conduct of a general information service. It would advise fund members on their rights and should establish a panel of conciliators to assist in resolving disputes.

11.22 The report recommended that all funds should establish their own internal dispute resolution mechanisms and that all members and prospective members be fully informed of their existence.

11.23 The report also recommended the establishment of an external dispute resolution mechanism wholly financed by the Commonwealth, on the grounds that it would be part of a scheme to implement Commonwealth policy. Disputes would be determined by a panel independent of government, the schemes and the regulator. The panel would be selected by the minister from names submitted by interested parties.

11.24 The report expressed the view that the panel should not be able to decide issues on their merits but should confine itself to deciding whether the trustees had properly applied the provisions of the relevant laws or deeds, that is, whether they had taken all relevant material, and no irrelevant material, into account and whether they had acted in good faith. Bona fide decisions of trustees, exercising their discretion properly, should not be interfered with.

State Government Schemes

11.25 Most superannuation schemed operated by State governments give members the right, if dissatisfied with decisions of the superannuation board or trustees, to appeal to outside tribunals, such as the industrial commissions, an ombudsman or the courts. The external review bodies are able to reconsider the full merits of cases, not merely the

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11 Sub No 135.

12 Law Reform Commission, Report No 59, pp 185 - 196.

propriety of the procedures.[13]

Commercial Arbitration

11.26 Mr N Renton suggested to the Committee that the commercial arbitration system offered a suitable alternative to dispute resolution through the courts.[14] While there may be merit in this proposal, the Committee believes, in the absence of evidence to the contrary, that a specialist body is more likely to develop the expertise necessary to build up the required degree of public confidence.

The ASFA Proposal

11.27 ASFA, while questioning the need for an external dispute resolution mechanism in the absence of any 'rigorous statistical or other evidence', has drawn up a proposal for such a scheme.[15] The main features of the proposal are:

- every fund should nominate an officer to whom complaints may be referred;
- a member should have the right to have the matter reviewed by the trustees;
- these procedures should be advised to fund members on joining and annually; and
- an external, statute-based review panel, supported by a secretariat within the ISC should be established. The panel would comprise experienced fund trustees drawn from government, employer and union nominees. The panel, and a 'high-profile' chairman, would be appointed by the Minister.

11.28 The mechanism should deal with disputes over individual rights and the conduct of a fund as a whole. The panels should be limited to reviewing the bona fides of the processes, not the merits of the cases before them. Decisions should be in writing and binding on all parties. Some user contribution toward the expenses of the mechanism would be appropriate.

11.29 The ASFA proposal states that in the interests of simplicity and economy, funds with access to the LIFA scheme and the State government reviewing processes should be exempt from the proposed mechanism.

Dispute Minimisation and Resolution

11.30 The Committee endorses the view, expressed by many witnesses, that the better informed members of superannuation funds become, the less will be the likelihood of misunderstanding and disputation. Funds should be encouraged to produce their own explanatory literature, setting out in the simplest terms how they operate and the rights

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13 ASFA, Supp. Sub No 89, p 3.

14 Evidence, p 142.

15 Supp Sub No 89.

and obligations of members.

11.31 But there is also a need for general educational material outlining the nature of superannuation itself, the various types of schemes in operation, the taxation implications and the technical terms used. The Committee believes that the Government has the responsibility to produce such material.

> *Recommendation 11.1:*
>
> *The Committee recommends that the ISC produce simply worded, descriptive literature on superannuation, suitable for distribution to all existing and prospective fund members through the individual funds.*

Internal Review

11.32 The Committee recognises the desirability of encouraging the internal resolution of disputes on grounds of simplicity, speed and economy. Experience with the mechanisms described above indicates that the great bulk of disputes are amenable to resolution in this way. In the Committee's view, the procedures should be formalised, made compulsory and publicised.

> *Recommendation 11.2:*
>
> *The Committee recommends that, as a matter of high priority, the OSS Regulations be amended to require that, as a condition of compliance, each fund should:*
>
> - *develop and publish its policies relating to dispute resolution;*
> - *nominate a person or persons to whom queries and complaints should be addressed;*
> - *undertake that, if that person cannot resolve the matter, it will be referred to the trustees, who should be required to make a decision within 90 days of referral to them and to provide reasons for that decision in writing; and*
> - *notify full particulars of these procedures to members on entry and annually thereafter.*

> *Recommendation 11.3:*
>
> *The Committee further recommends that these provisions should be fully implemented within two years of their promulgation and that the ISC should monitor their introduction and operation.*

External Review

11.33 There will always remain a hard core of disputes that cannot be satisfactorily resolved internally. The only external avenue currently available to most members is through the courts - a costly, time-consuming and often distressing process.

11.34 The Committee therefore believes that decisions of trustees should be subject to external review and considered a range of options to give effect to this view.

11.35 A statutory body could be established by the Commonwealth along the lines of other quasi-judicial authorities, such as the Administrative Appeals Tribunal, the Commonwealth Ombudsman or the Human Rights Commissioner. Alternatively, the authority could be established by the industry, with government participation in some form.

11.36 The former would have the advantage of visible independence, but would run the risk of bringing into being a formal bureaucratic structure, involving the probability of high costs, delays and unnecessary formality.

11.37 The Committee prefers the approach adopted by LIFA and the banks and proposed by ASFA, whereby the review authority is established by the industry but the Minister appoints the arbitrators from names submitted by representatives of all interested parties. A joint management body could be established with similar representation. As the recent and prospective growth in superannuation is a key objective of government policy, the Committee believes that it is reasonable for the Government to bear at least half of the costs to be incurred.

11.38 While ASFA, in the interests of economy and simplicity, proposed that disputes involving superannuation should continue to be dealt with under the existing LIFA and State government procedures, the Committee believes that, as far as possible, all types of superannuation should be dealt with by a single authority. Accordingly, the LIFA mechanism, beyond the conciliation point, should no longer be involved with superannuation disputes. Constitutional limitations would probably require that participation by the States would be optional. Existing arrangements operating in non-participating States would remain undisturbed.

11.39 The reviewing authority could comprise one person acting alone, as with the banking ombudsman, a bench of say three, as employed by LIFA and as proposed by the ALRC, or one or more selected from a wider panel, as proposed by ASFA. A further refinement could be a permanent presiding member, or ombudsman, possibly with legal qualifications, sitting with two other members, chosen from an expert panel of persons experienced in the administration of superannuation.

11.40 The Committee is attracted to the latter structure, as it combines the benefits of continuity, which a single ombudsman would bring, with the wider range of views and experience which the panel of experts - for example, major fund trustees and professional fund administrators - would bring.

11.41 A matter of considerable importance is the scope of the authority's powers of review. As noted above, the powers proposed by both the ALRC and ASFA would not extend to a reconsideration of the merits of the disputes, but merely to the propriety of the procedures used and the relevance and completeness of the material considered, as is the current position of the courts.

11.42 The State tribunals, on the other hand, have unrestricted powers of review and are able to place themselves in the position of the trustees and exercise their own discretion as if they were the trustees.

11.43 In the Committee's view, the strict limitation of the role to procedural propriety and relevance of evidence would provide an adequate review mechanism. The proposed codification of trust law principles and duties of trustees set out in Chapter 4 will provide for a range of penalties enforceable against trustees if there is a breach of fiduciary duty. In addition, the rights of members will be clearly identified in the legislation and the ISC will be able to protect members' interests and to take action against trustees.

11.44 In cases where the matters in dispute concern the individual rights and entitlements of members, decisions of the authority should be final. In matters that concern fund policy and the interests of members in general, the authority should have the power to report the circumstances to the ISC, with any recommendations it sees fit. The Committee expects that the ISC would comment on all such reports, and any action taken on them, in its Annual Reports.

Recommendation 11.4:

The Committee recommends the establishment by legislation of an external disputes resolution mechanism, at the earliest practicable date, with the following features:

- *a management board comprising nominees of the Commonwealth and participating state governments, industry bodies and representatives of the unions, women's and consumer groups;*
- *a review authority chaired by an ombudsman, who would sit with two other members drawn from a panel of fund trustees and other people with appropriate experience. The ombudsman and panel members would be appointed by the Minister from names submitted by the board;*
- *staff and supporting facilities arranged by the board and financed equally by participating governments and industry groups;*
- *the functions of the existing superannuation review mechanisms conducted by LIFA and the participating states to be transferred to the new authority;*
- *the authority should not have power to review cases on their merits but should be confined to ensuring that the trustees' powers have been exercised properly and that all relevant evidence has been considered;*
- *decisions of the authority would be final and binding on all parties; and*
- *the ombudsman and the management board should publish annual reports.*

MINORITY REPORT ON CHAPTER 9 – INVESTMENT BY SUPERANNUATION FUNDS – SENATOR KERNOT:

The first part of recommendation 9.2 states:

> *The committee recommends that no investment controls be placed on superannuation funds to compel them to invest in particular areas such as development or venture capital or infrastructure.*

The assumptions underlying this recommendation are that :

- the investment choices made by superannuation fund trustees and their fund managers are superior in all circumstances to any mandated investment policies;
- superannuation funds having been given massive commercial advantages against other institutions in competing for savings, should then be able to invest purely as they see fit, without any regard to the welfare of the nation and the economy; and
- superannuation funds are not an integral part of the economy, but exist in a vacuum which involves only the maximisation of monetary returns irrespective of the effects of such a policy on the Australian economy.

This recommendation and the assumptions underlying it are not supported by the Australian Democrats.

Fund management is a specialised function. There is no doubt that the decentralisation of investment management throughout the economy has some benefits in terms of risk diversification and in terms of producing a competitive fund management market. Professional fund managers employ sophisticated investment strategies and techniques. Notwithstanding this, recent experience has shown that private fund managers can also deliver poor returns to members. This is particularly so for funds which have large commercial property holdings at the moment.

Added to this have been the very conservative investment strategies pursued by many funds during the 80's, especially the concentration of investment in capital-guaranteed products.

The second argument goes to the core of the legitimacy of the concessional taxation treatment of superannuation. The Parliament has decided that superannuation is important to national welfare and as such it encourages savings in this form. Without this concessional treatment it is certain that assets in superannuation funds would be greatly below what they are today.

The tax expenditure involved in this concession is approximately $3.5 billion and is by far the largest granted by the Federal Government. This is expected to grow. This means that the public incurs an opportunity cost of public expenditure equal to $3.5 billion every year. Certainly fund members benefit from this system, but does the public get value out of this foregone revenue?

The third point is perhaps the most important. It is argued by the industry that their duty is to maximise the returns to members and that there will be losses if any interference takes place. This ignores the possibility of greater returns from investments in Australian firms because of higher levels of general economic activity which arise from increased local investment. Increased local employment will also obviously lead to increased total membership of superannuation funds.

What we are dealing with is a massive part of national savings. Why is it so unreasonable that there is some regulation by the Government to try to ensure that not only are individuals assisted to enjoy a higher level of retirement income, but also that Australian businesses are assisted?

SPECIFIC AREA – DEVELOPMENT CAPITAL

The venture and development capital sector has long been perceived as weak in Australia. Various governments have identified the need for patient equity investment in Australian businesses and have introduced measures to try to address the inadequate supply of such capital.

Moreover, the financial market has not reached a state of maturity which will ensure that funds are automatically channelled into this vital area of investment. In this regard, the evidence given by Mr D Hanley of the Industry Research and Development Board (IRDB) is most instructive:

> *The problem is that in Australia we have a very underdeveloped capital market by comparison with the rest of the world. I have had to plead for money in all of the markets. This market is probably at the cowboy end of the spectrum, and because of that there is a great need for it to be nurtured and developed. People talk about the market as if it were a real market – it is not. It is controlled by a whole series of interests that I do not think are present in some of the larger and more liquid markets available overseas. We should not compare ourselves with New York, we certainly should not compare ourselves with London and probably, thank God, we are not the same as Tokyo.*[1]

The Australian Industry Development Corporation (AIDC) is a public institution created to assist developing businesses. AIDC is a specialist manager in this area and has operated successfully.

The Management and Investment Company (MIC) scheme, which provided generous 'up-front' taxation concessions for venture capital investments, was severely affected by the flight to quality which occurred after the 1987 stock market crash and has now been terminated.

Evidence given to the Committee shows that the problem of lack of development capital is still unaddressed. Given the long term nature of compulsorily preserved benefits,

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1 Evidence, p 1965.

superannuation funds are the ideal patient capital providers; superannuation is also the Government's chosen growth area in national savings, and as such should provide more of the capital for the future growth of Australian industry.

The major capital market failure is in the area of the commercialisation of research. This is particularly tragic for Australia, as we now acknowledge the need to diversify out of commodity-based trade and into higher value sectors. Yet we see our research effort continually acquired by foreign investors with a longer term investment horizon. The Gene Shears technology was one recent high profile example of the continuation of this disturbing trend.

Belatedly, the Government has announced the creation of the Australian Technology Group (ATG) to specifically address this market failure. However, there is great uncertainty as to whether it will be able to find private sector investors to match the $30 million in equity. This is a ludicrous situation, addressed by the same old solution: 'wait for the market to provide'. Australia has been waiting for too long, it cannot afford to wait any longer.

The second Government initiative in this area is the Pooled Development Fund (PDF) proposal currently before the Parliament. This involves the creation of special entities to invest in small and medium sized firms. These will be taxed at 30 per cent instead of 39 per cent. As such, PDFs are not attractive to superannuation funds, although they might be attractive to other institutions and to some individuals.

A far simpler way would be to mandate that a small proportion of superannuation fund assets (one per cent) be diverted into a National Development Fund. This fund will provide capital to ATG and to PDFs and will be used to develop Australian industry. In addition, the fund would ensure that there is always a sum of money available to ensure that vital technology does not become controlled by foreign interests.

What must be remembered is that the long term interests of superannuation fund members are enhanced by, and largely dependent upon, a healthy Australian economy.

The Committee has recommended (Recommendation 9.3) that, as usual, the Parliament should ignore the problem and re-examine the matter later. This is simply not good enough. Both Senator Button and Mr Keating have previously stated that the Government was not impressed by the performance of the superannuation sector in this area, yet they have shown little inclination to be pro-active.

Mr Dennis Hanley, the retired chairman of the IRDB and current Board member of Memtec Ltd, gave evidence to the Committee that the short-term nature of the reporting of investment performance will always work against the provision of development capital:

> *In my opinion, nothing is going to happen in the present environment unless some form of compulsion starts the ball rolling.*[2]

2 Evidence, p 1959.

The Prime Minister has been very keen to urge us to integrate more fully into Asia. Why does not the Government learn from the successful economies? Much of the recent gains of the Asian region have come about because there has been a plentiful supply of cheap capital.

Alternative Recommendation 9.2 (Senator Kernot)

That a National Development Fund (NDF) be established with one per cent of the assets of superannuation funds, the money to be invested in the Australian Technology Group and to provide patient development capital for small and medium size Australian firms.

The performance of the NDF, and the general development capital market, should be reviewed after 10 years to see if the sector has developed enough to disband the NDF or whether the mandatory centralised fund is still necessary.

OVERSEAS INVESTMENT

Recommendation 9.4 states:

> *The Committee recommends that no special restrictions be placed on superannuation funds investing overseas.*

There is no doubt that there are good reasons for superannuation funds investing overseas. The motivation is obviously the return which a particular investment is expected to yield and the broader question of portfolio diversification.

However, there are other effects of offshore investment which must also be taken into account. Foreign investment of Australian savings achieves the export of jobs to the actual destination of the investment.

Under the current system trustees must think solely of the welfare of their members. As such they are prevented by law from considering the national interest. Parliaments are charged with the responsibility of promoting the national interest. This conflict of interest in policy direction must be resolved.

There is no question that job creating investment in Australia increases national welfare and provides health, welfare and social benefits in excess of the direct monetary benefits to the employees concerned. This benefit must not be ignored by this Parliament.

I accept that it is neither feasible nor desirable to ban offshore investment by superannuation funds entirely. However, the Committee has adopted a completely hands-off approach which could theoretically lead to the investment of the total assets of the superannuation industry offshore.

The assets of superannuation funds benefit from taxation concessions. If these are then invested overseas, employment and taxation benefits accrue to the other country at the expense of Australian taxpayers. Did we learn anything from the corporate failures of the 1980s?

There must be a repudiation of the pursuit of the level playing field; it is a naive and atavistic experiment. I therefore recommend that:

Alternative Recommendation 9.4 (Senator Kernot)

- *an absolute limit of 20% of assets of a superannuation fund be allowed to be invested offshore; and*
- *the Parliament introduce a tax regime which is preferential to investments in Australia, rather than the absurd policy of capital export neutrality which has been another legacy of the 1980s.*

APPENDIX 1

SENATE SELECT COMMITTEE ON SUPERANNUATION

SUBMISSIONS

No. 1 Gynn, W J
No. 2 Fisher F
No. 3 Newman, C A
No. 4 The Liquor Trades Union
No. 5 Perry, K F
No. 6 Walsh, A
No. 7 Buildings Union Superannuation
No. 8 N E Renton & Associates
No. 9 Serendip Publications
No. 10 InterData Pty Ltd
No. 11 Not a submission
No. 12 Trau, Dr J
No. 13 McJannet, D
No. 14 Davies, D
No. 15 Garrett, P R
No. 16 Samson, S W
No. 17 Schwarz, D
No. 18 Restuccia, V
No. 19 Downs, B
No. 20 Clayton Utz
No. 21 Adams, G
No. 22 Lucas, J M
No. 23 Cartledge, O
No. 24 Hearn, G
No. 25 Foley, E
No. 26 Civil Service Association of WA
No. 27 E S Owens & Co
No. 28 Independent Schools Superannuation Trust
No. 29 Burns, W G
No. 30 **In camera**
No. 31 ACT Council of Social Service Inc
No. 32 Hughes, D
No. 33 Shell Superannuation Rights Committee
No. 34 Australian Salaried Medical Officer
No. 35 Australian Council of Social Service
No. 36 Belshaw, W J
No. 37 Smith, B
No. 38 Boffa, G
No. 39 Arthur Andersen & Co
No. 40 Williams, T
No. 41 Prudential Life Underwriters Association (NSW)
No. 42 Nipper, M R G and Weeks, P L
No. 43 Prudential Assurance Company Ltd

No. 44 Retired Associate Members' Branch Public Service Association of NSW
No. 45 Myuna Pty Ltd
No. 46 du Cros, N
No. 47 Fisk, B
No. 48 Trustee Companies Association
No. 49 Australian Lifewriters Association
No. 50 Australian Small Business Association
No. 51 Long, P D
No. 52 Knox, Professor D
No. 53 Tribunal on Homosexuals and Discrimination
No. 54 Chamen, P
No. 55 Metal Trades Industry Association of Australia
No. 56 National Association of Nursing Homes & Private Hospitals Inc
No. 57 Duesburys
No. 58 Morgan Stockbroking Ltd
No. 59 IOOF Australia
No. 60 Non-Government Schools Superannuation Fund
No. 61 The Alexander Consulting Group
No. 62 Metal Manufacturers Limited
No. 63 National Australia Bank
No. 64 Women's Action Alliance (Australia)
No. 65 Chamber of Commerce & Industry of WA
No. 66 MMBW Employees' Superannuation Fund
No. 67 Yann, R N
No. 68 Secondary Colleges Staff Association
No. 69 Ulverstone Chamber of Commerce
No. 70 Belshaw, M
No. 71 Wilson, The Hon Ian, MP
No. 72 Crouch, W G
No. 73 ANZ Bank
No. 74 Independent Insurance & Superannuation Agencies
No. 75 Cooley, L M
No. 76 Australian Finance Conference
No. 77 Northern Territory Superannuation Office
No. 78 Lee, W A
No. 79 Mercer Campbell Cook & Knight Inc
No. 80 Noble Lowndes
No. 81 Department of Industrial Relations (ACT)
No. 82 Klumpes, Dr P J M
No. 83 National Farmers Federation
No. 84 WA Government Employees Superannuation Board
No. 85 Australian Government Employees Superannuation Trust
No. 86 Smith, A W J
No. 87 Turner, M
No. 88 White, B
No. 89 The Association of Superannuation Funds of Australia Ltd
No. 90 Jacques Martin
No. 91 CSA Consulting Group
No. 92 Mansfield, G

No. 93 Civic Securities Pty Ltd
No. 94 Australian Retirement Fund
No. 95 Australian Chamber of Manufactures
No. 96 AM Corporation Ltd
No. 97 The Taxpayers' Association of Tasmania
No. 98 County NatWest
No. 99 **In camera**
No. 100 National Mutual
No. 101 Chifley Superannuation Services
No. 102 Commonwealth Funds Management Ltd
No. 103 Coles Myer Ltd
No. 104 National Association of Personnel Consultants Ltd
No. 105 Bankers Trust Australia Limited
No. 106 Australian Council of Trade Unions
No. 107 Attorney-General's Department
No. 108 The Institute of Actuaries of Australia
No. 109 Retirement Benefits Office
No. 110 The Motor Inn & Motel Association of Australia
No. 111 Langley-Bates, D
No. 112 NSW Farmers' Association
No. 113 MTAA Superannuation Fund
No. 114 Life Insurance Federation of Australia Inc
No. 115 Minister for Productivity and Labour Relations, WA
No. 117 Metway Corporation
No. 118 NSW Minister for Industrial Relations
No. 119 Australian Society of CPAs
No. 120 AMP
No. 121 Hanson, Mr J H
No. 122 Minister of Transport, Correctional Services, Finance
No. 123 Moon, G
No. 124 The Taxation Institute of Australia
No. 125 Australian Pensioners & Superannuants Federation and Combined Pensioners & Superannuants Association of NSW
No. 126 Women's Economic Think Tank
No. 127 Department of Social Security
No. 128 Director-General, Office of the Cabinet – Queensland Government
No. 129 Davey & Associates
No. 130 Women's Electoral Lobby Australia Inc
No. 131 de Visser, L
No. 132 Westpac Banking Corporation
No. 133 Griffin, P
No. 134 Australian International Pilots Association
No. 135 SIO Consumer Appeals Centre
No. 136 Australian Friendly Societies Association
No. 137 Whittimore-Hull, J
No. 138 Trades and Labor Council of Western Australia
No. 139 Australian Federation of Consumer Organisations
No. 140 Victorian Automobile Chamber of Commerce
No. 141 Rothschild Australia Asset Management Limited

No. 142 Federated Ironworkers' Association of Australia
No. 143 Jacques Martin - Reply to Tasmanian Taxpayers
No. 144 National Association of Nursing Homes & Private Hospitals Inc
No. 145 Trade Practices Commission
No. 146 Shell Australia Contributory Pension Fund
No. 147 Smith, Dr G F
No. 148 Australian Association of Permanent Building Societies
No. 149 Docker, A R
No. 150 University of NSW Superannuation Economics Research Group
No. 151 Insurance and Superannuation Commission
No. 152 Department of Community Services & Health
No. 153 Crawford, G J
No. 154 Investment Funds Association of Australia Limited
No. 155 Australian Taxation Office, Commissioner of Taxation
No. 156 Langfield-Smith, I
No. 157 Health Employees Superannuation Trust Australia
No. 158 National Mutual - Nexis Proprietary Limited
No. 159 Weijers, A J
No. 160 Foster, W
No. 161 Gierczycki, L M
No. 162 Ramakrishnan, H
No. 163 Permanent Trustee Company Limited
No. 164 Industry Research and Development Board
No. 165 HEST Australia Ltd
No. 166 The Shell Superannuation Rights Committee
No. 167 Shell Australia Contributory Pension Fund
No. 168 Unity Action Group for Retired Persons
No. 169 Crome, I
No. 170 Campbell, B G
No. 171 Knight, Dr J
No. 172 Australian Council on Smoking and Health
No. 173 Commonwealth Bank of Australia
No. 174 Clothier, D P
No. 175 Australian Government Employees Superannuation Trust
No. 176 **In camera**
No. 177 Selstay Pty Ltd
No. 178 J G Mulhallen & Sons (Vic) Pty Ltd
No. 179 Armstrong, W J
No. 180 Rutter, A
No. 181 The Australian Workers' Union
No. 182 Sly and Weigall
No. 183 **In camera**
No. 184 **In camera**
No. 185 SA Employers' Federation
No. 186 Australian Securities Commission
No. 187 Grey, P
No. 188 Pacific Industrial Investments
No. 189 CIG Employees' Superannuation Fund
No. 190 Reserve Bank

No. 191 Aitkin, J
No. 192 Harrower E
No. 193 Grace E
No. 194 University of Melbourne
No. 195 The Treasury
No. 196 SBC Dominguez Barry Ltd
No. 197 Financial Planning Association of Australia
No. 198 CIFC
No. 199 Australian Eagle Superannuation
No. 200 Ellis, M
No. 201 Moore, E J
No. 202 Morley, B
No. 203 Tindal, B
No. 204 Shell Australia Limited
No. 205 Treasury, Tasmania
No. 206 Mathews, S R
No. 207 **In camera**
No. 208 Human Rights and Equal Opportunity Commission
No. 209 **In Camera**
No. 210 Colonial Mutual Investment Management
No. 211 Pollard, D
No. 212 Advance Bank

APPENDIX 2
WITNESSES WHO APPEARED BEFORE THE COMMITTEE

WITNESS/ADDRESS	Date of Appearance
IOOF Australia	10 February 1992, MELBOURNE
Actuarial Consultant, Tribunal Working Group	21 February 1992, SYDNEY
Alexander Consulting Gruop Ltd	19 February 1992, SYDNEY
AM Corporation Limited	18 February 1992, SYDNEY
AMEV Life Assurance	10 April 1992, CANBERRA
Association of Superannuation Funds of Australia	21 February 1992, SYDNEY
Association of Superannuation Funds of Australia	18 February 1992, SYDNEY
Attorney-General's Department	24 February 1992, CANBERRA
Australian Society of Chartered Public Accountants	20 February 1992, SYDNEY
Australian International Pilots Association	19 February 1992, SYDNEY
Australian Pensioners Superannuants Federation	18 February 1992, SYDNEY
Australian Council of Social Service	6 March 1992, CANBERRA
Australian Small Business Association, NSW Division	19 February 1992, SYDNEY
Australian Finance Conference	20 February 1992, SYDNEY
Australian Securities Commission	6 March 1992, CANBERRA
Australian Lifewriters Association	10 April 1992, CANBERRA
Australian Federation of Business and Professional Women	25 March 1992, CANBERRA
Australian Federation of Consumer Organisations	10 April 1992, CANBERRA
Australian Banking Ombudsman	10 April 1992, CANBERRA
Australian Taxation Office	15 April 1992, CANBERRA
Australian Friendly Societies Association	25 March 1992, CANBERRA
Australian Council on Smoking and Health	10 March 1992, PERTH
Australian Association of Permanent Building Societies	6 March 1992, CANBERRA
Australian Workers Union	9 March 1992, ADELAIDE
Australian Retirement Fund Pty Ltd	11 February 1992, MELBOURNE
Bankers Trust Australia Ltd	19 February 1992, SYDNEY
Dr Owen Cartledge	6 March 1992, CANBERRA
Chamber of Commerce and Industry	10 March 1992, PERTH
Chifley Superannuation Services	18 February 1992, SYDNEY
Civil Service Association of WA Inc.	10 March 1992, PERTH
Clayton Utz Solicitors	18 February 1992, SYDNEY
Combined Pensioners and Superannuants of NSW Inc.	18 February 1992, SYDNEY
Superannuation Financial Services	

Commonwealth Bank of Australia	19 February 1992, SYDNEY
Commonwealth Funds Management Limited	6 March 1992, CANBERRA
Commonwealth Funds Management Limited	6 March 1992, CANBERRA
Mrs Lorna Cooley	13 February 1992, HOBART
County NatWest Australia Investment Management	10 February 1992, MELBOURNE
Mr Gary Crawford	10 March 1992, PERTH
Mr John Dermody	6 March 1992, CANBERRA
Federation of Industrial, Mechanical and Engineering Employees Comalco	13 February 1992, HOBART
Mr John Foley	1 April 1992, CANBERRA
Former Redundant Employees from West Australian Newspapers	10 March 1992, PERTH
Actuary, Godwins Australia Pty Ltd, and Consultant Metal Trades Industry Association of Australia	20 February 1992, SYDNEY
Government Employees Superannuation Board	10 March 1992, PERTH
Professor Robert Gregory	10 April 1992, CANBERRA
Mr Denis Hanley	10 April 1992, CANBERRA
Mr Graeme Hearn	10 March 1992, PERTH
Health, Housing and Community Services, Department of	10 April 1992, CANBERRA
HEST Australia Ltd	9 March 1992, ADELAIDE
Host-Plus	9 March 1992, ADELAIDE
Independent Schools Superannuation Trust	9 March 1992, ADELAIDE
Industrial Relations, Department of	25 March 1992, CANBERRA
Institute of Chartered Accountants in Australia	20 February 1992, SYDNEY
Institute of Actuaries of Australia	10 February 1992, MELBOURNE
Insurance and Superannuation Commission	30 March 1992, CANBERRA
Investment Funds Association of Australia Ltd	10 April 1992, CANBERRA
Associate Professor David Knox	19 February 1992, SYDNEY
Mr Ian Langfield-Smith	10 February 1992, MELBOURNE
Mr William Lee	21 February 1992, BRISBANE
Life Insurance Federation of Australia	11 February 1992, MELBOURNE
Lifewriters Association	10 April 1992, CANBERRA
Liquor Trades Union	9 March 1992, ADELAIDE
Mr Julian Lucas	11 February 1992, MELBOURNE
Mr Garth Mansfield	6 March 1992, CANBERRA
Mercer Campbell Cook & Knight	10 February 1992, MELBOURNE
MMBW Employees Superannuation Fund	11 February 1992, MELBOURNE
Ms Gillian Moon	20 February 1992, SYDNEY
Motor Trades Association of Australia	10 April 1992, CANBERRA
Industry Superannuation Fund Pty Ltd	10 April 1992, CANBERRA

Motor Inn, Motel and Accommodation Association	20 February 1992, SYDNEY
Mr Clifford Newman	18 February 1992, SYDNEY
Myuna Pty Ltd	10 March 1992, PERTH
National Mutual Life Association of Australia	11 February 1992, MELBOURNE
National Mutual Life Association	1 April 1992, CANBERRA
National Superannuation Group, Arthur Andersen & Co.	21 February 1992, BRISBANE
National Association of Nursing Homes and Private Hospitals Inc.	19 February 1992, SYDNEY
National Farmers Federation	6 March 1992, CANBERRA
New South Wales Superannuation Office	19 February 1992, SYDNEY
Nexis Pty Ltd	13 February 1992, HOBART
Noble Lowndes Superannuation Consultants Ltd	11 February 1992, MELBOURNE
Occupational Health and Safety Training Unit Trades and Labor Council of Western Australia	10 March 1992, PERTH
Productivity and Labour Relations, Department of	10 March 1992, PERTH
Provident Fund, Comalco	13 February 1992, HOBART
Prudential Life Underwriters (NSW)	19 February 1992, SYDNEY
Prudential Assurance Co. Ltd	20 February 1992, SYDNEY
Public Service Association of New South Wales	20 February 1992, SYDNEY
Queensland Government Superannuation Office	21 February 1992, BRISBANE
Mr Nicholas Renton	10 February 1992, MELBOURNE
Reserve Bank of Australia	10 April 1992, CANBERRA
Retail, Commonwealth Bank of Australia	19 February 1992, SYDNEY
Retirement Benefits Office	6 March 1992, CANBERRA
Rothschild Australia Asset Management Limited	10 February 1992, MELBOURNE
Mr Siegfried Samson	13 February 1992, HOBART
SBC Dominguez Barry Limited	19 February 1992, SYDNEY
SBC Dominguez Barry Ltd	10 April 1992, CANBERRA
School of Economics, University of NSW	20 February 1992, SYDNEY
Shell Australia Contributory Pension Fund	18 February 1992, SYDNEY
Shell Superannuation Rights Committee	18 February 1992, SYDNEY
Social Security, Department of	4 March 1992, CANBERRA
South Australian Superannuation Fund Investment Trust	9 March 1992, ADELAIDE
South Australian Treasury	9 March 1992, ADELAIDE
South Australian Employers Federation Inc.	9 March 1992, ADELAIDE
Superannuation Office, NT Government	10 March 1992, PERTH
Taxation Institute of Australia	20 February 1992, SYDNEY
Taxpayers Association of Tasmania	13 February 1992, HOBART
Trade Practices Commission, the Commissioner	4 March 1992, CANBERRA

Dr Jerry Trau	18 February 1992, SYDNEY
Treasury, Department of the	15 April 1992, CANBERRA
Trustee Companies Association of Australia	11 February 1992, MELBOURNE
Mrs Margaret Turner	13 February 1992, HOBART
Victorian Automobile Chamber of Commerce	11 February 1992, MELBOURNE
Westpac Banking Corporation	18 February 1992, SYDNEY
Mrs Beverley White	13 February 1992, HOBART
Mr Trevor Williams	9 March 1992, ADELAIDE
Honourable Ian Wilson, MP	9 March 1992, ADELAIDE
Women's Action Alliance	10 February 1992, MELBOURNE
Women's Economic Think Tank	20 February 1992, SYDNEY
Women's Electoral Lobby, Australia	25 March 1992, CANBERRA

APPENDIX 3

Source: The Alexander Consulting Group

RETIREMENT INCOME STREAM ACCOUNT (RISA)

Q1 What is RISA?

A A RISA is an arrangement for a retired person to have his money managed for him. It is hoped that widows will soon be able to utilise the facility.

Q2 How does RISA work?

A Exactly the same as an investment account. Your investment is the opening balance. The account is credited with investment income on the balance remaining from time to time. The account is debited with your drawings and with the manager's charges.

Q3 Who can issue RISAs?

A Life insurance companies and other financial institutions approved by the ISC. To be approved, a financial institution must prove experience in investment management and its suitability to manage individuals' savings for retirement.

Q4 What types of investment are available to me if I purchase a RISA?

A Most RISAs will be invested in tax-free balanced portfolios with wide discretion for the managers to invest in any kind of investment. These portfolios, with significant share and property investments at most times, are expected to have the best 'growth' features over the long term and to provide the best protection against inflation. There is no reason why capital-stable or capital-guaranteed investment mediums, or a mixture of types of investment, cannot be used provided the investment managers have tax-free facilities.

Q5 Lots of organisations will manage my money for me, including unit trusts. What is different about RISA?

The essential differences from other money arrangements are firstly, that RISA meets Government requirements for payment of a retired income and secondly, because it is part of the approved retirement income system, there are significant taxation advantages.

Q6 What are the Government requirements?

A The fundamental requirement is that you must make regular drawings of specified amounts from your account. The drawings which you must make are related to your age and to the balance remaining in your account.

Q7 Why do minimum drawings depend on age?

A The idea is to enable a RISA investor to spread his income over the rest of his life. So younger investors might not be required to draw even the income earned. Drawings are required because the purpose of the system is to provide retirement incomes.

Q8 You referred to 'younger' investors. Can anyone buy a RISA?

A At the present time, RISAs are only available to retiring members of superannuation funds. Later, it is hoped that anyone who wishes to buy an immediate retirement income stream will be able to buy a RISA in just the same way as anyone can buy an immediate annuity. However, the 'market' is expected to be

- retired persons who have lump sum superannuation money or personal savings which need to be transformed into an income stream

- widows and disabled persons who receive lump sum superannuation.

Q9 What is the scale of minimum drawings?

A The balance held 3 months before the beginning of a financial year (or the amount invested where the person made his investment after that date) is divided by a factor, as follows, to give the minimum quarterly rate of drawing during that financial year.

	Age last b'day on 1 July	Factor	Age last b'day on 1 July	Factor	Age last b'day on 1 July	Factor
Up to & incl	55	22.0	63	16.0	71	12.0
	56	19.5	64	15.5	72	11.5
	57	19.0	65	15.0	73	11.0
	58	18.5	66	14.5	74	10.5
	59	18.0	67	14.0	75	10.0
	60	17.5	68	13.5	76	9.5
	61	17.0	69	13.0	77	9.0
	62	16.5	70	12.5	78	8.5
					79 or more	8.0

Q10 How do I know how much I must draw?

A Your manager will issue you a quarterly statement. When your March statement is issued he will tell you not only the balance standing to your credit but how much you must draw from the next 1 July. He will automatically pay the minimum unless you have nominated a larger amount.

Q11 How frequently will payments be made?
A Monthly. Lump sums can be drawn at any time. Tax will be deducted from both regular drawings and lump sums.

Q12 Are there any maximum drawings?
A No, but remember that all drawings other than the return of your undeducted purchase price are taxed as income. So if you draw too much in one year, you may increase the rate of tax on all of your income, including your regular drawings. Most RISA holders will draw only what they need for regular income needs and use the lump sum facility for special capital requirements.

Conserve capital, maximise the income credited to your account and protect your old age!

Q13 You said there are taxation advantages. If drawings are taxable, what are the advantages?
A The first advantage is that your investment suffers no tax at all while it is in your RISA account. It is a significant advantage to pay tax only on what you draw and not on what you earn. This increases dramatically the 'compounding ' power of your savings.

Q14 You said that this is the first advantage. Are there others?
A The other very significant advantage concerns the undeducted purchase price.

Q15 The undeducted purchase price. What is that?
A This is the amount invested which has not qualified for a taxation deduction, ordinary savings for example. A superannuation benefit on which tax has been paid becomes 'ordinary' money and like personal savings invested in a RISA (or annuity) is an undeducted purchase price.

If a superannuation benefit is rolled over before tax, the pre 1 July 1983 component and, usually, the employee's personal contributions made on and after 1 July 1983 are an undeducted purchase price.

Q16 What then is the advantage attaching to the undeducted purchase price?
A No tax is payable on the undeducted purchase price component of drawings. All other drawings are taxed as income. The undeducted purchase price component is determined by a formula which produces relatively large tax free components early on and smaller ones later.

Q17 That should make the minimum drawings go further in the years following retirement when travel and other activity are popular. Are there any other taxation factors?

A Yes, indeed. If you roll your super over before tax, the post 30 June 1983 component earns a 15% tax rebate.

Q18 That all sounds complicated.

A It isn't really. The manager records your undeducted purchase price and tells you on each statement how much has been drawn and how much remains to be drawn. He will also tell you how much of your credit is post 30 June 1983 super money and the rebate earned.

Remember that if you paid the tax on your super and then invest in a RISA (or an annuity) you will not be entitled to a post 30 June 1983 component rebate.

Q19 What happens if I invest my money in a market linked RISA and the market crashes?

A You simply ride it out. Because you will normally draw only a very small proportion of your balance at any one time, you will ride out all the ups and downs of the market. Your credit follows the experience line of the manager. It is sure to bounce up after a decline in prices and similarly to be 'cut down to size' after a boom. Your long term drawing capacity will follow the manager's underlying trend line.

The important action to be avoided is cashing out in a downturn. The ISC will be considering whether a maximum should be imposed on lump sum drawings to stop RISA holders from 'shooting themselves in the foot' by pulling out when the market is down.

Q20 Can I top-up my RISA with additional investments?

A Not after you have commenced drawings except by adding any roll over which you may have kept in an Approved Deposit Fund. However, the final rules may authorise the payment of lump sum contributions at any time.

Q21 What are the advantages of a RISA over an annuity?

A There are several advantages

- the ability to leave one's undrawn capital to heirs (this has special significance to many people who have a lump sum option at retirement, particularly where the member or his spouse is in poor or indifferent health)
- protection against inflation through participation in a mixed trust under experienced management

- flexibility in income with the opportunity to blend into social security
- retention in a very real sense of the 'ownership' of one's savings (The ability is there to change managers but, as a general rule, this would not be a frequent occurrence.) The ability to withdraw even one's full balance is provided but is seldom exercised.

Q22 What are the advantages of a life annuity over a RISA?

A A life annuity continues at its contractual level however long the annuitant or annuitants live. A RISA could fall away and would fall away rapidly if drawings significantly exceed earnings.

It is possible to buy a fully indexed annuity at the present time. Although the income is low relative to capital, initially, this is the only means of ensuring that real income is maintained. The supply of such annuities is likely to be limited and when inflation is expected to rise they probably will not be available at all.

Q23 Speaking of income relative to capital, annuities seem to be a good deal, don't you think?

A Annuities effected in the high interest rate era provide a very good income stream. New annuities are not nearly so good. Annuities reflect for their whole life, the economic conditions prevailing at the time of purchase.

Annuities and RISA's are alternatives. It is a matter of weighing up the pros and cons of each.

The average rate of return on a RISA should be better than on an annuity because the manager is not constrained by guarantees as is the issuer or an annuity.

The long livers may do well out of annuities. Those who live a short period transfer some of their capital to the long livers.

Some people will be happy to lock-in their income through an annuity and will be content to accept that on death after expiry of the term certain (if any) there will be no residual payment available to children. The residual payment on death during the term certain declines quite rapidly.

Whilst annuities are generally unsatisfactory at the present time, RISAs present the opportunity to buy in at relatively low prices because of the depressed share and property markets.

Q24 I have only a modest lump sum. The annuity is really very small. Is a RISA any better?

A Yes. You can draw your RISA at a rate sufficient for you or live on and then move to social security. Better still, your adviser will work out a drawing plan to

blend your RISA income with social security. You can 'fine tune' your program as you go along or make a major change e.g. drawing it down more rapidly or slowing the drawings to a minimum to best suit your changing circumstances. Family circumstances can change quite dramatically after retirement. Misfortune does befall some families. (Dad had a good super but he bought an annuity. We have four kiddies still at school since Tom's illness it has all been uphill and will stay that way.)

Q25 I am not 65 yet. When should I buy my RISA? I have some personal savings, my Company super and super from a previous job rolling up in an ADF.

A Your RISA commences when you retire but you can retain your ADF credits and roll them into your RISA later (but not after age 65 of course).

Q26 If I have a lot of money in my super, is there anything special to watch out for?

AS As a general rule, it is not a good idea to accumulate your super over the lump sum reasonable benefit limit (RBL) unless you can go a long way over and, hopefully, approach the pension RBL.

If you go over your lump sum RBL the choices are

- pay tax at your marginal rate on the excess
- take at least half your lump sum as what is called a complying pension. This has the effect of reducing the lump sum subject to concessional taxation treatment.

At the present time, only an indexed, non commutable life annuity is a complying pension.

Hence, if your super rubs up against your lump sum RBL it is generally a good idea to retire, transfer it to a RISA and start drawings.

It is important to consult your adviser. There are choices to be made and unfortunately it is the case that very few people can make an informed decision without guidance.

Q27 Why does switching to a RISA avoid the excess benefits problems?

A Once you are in a RISA it doesn't matter how much you earn, it will accumulate tax-free. Of course, the more you earn, the greater your drawings must be.

Q28 What happens if I die?

A The balance standing to your credit is payable. A spouse can continue to draw income under the RISA, as before but the minimum drawings are adjusted for the spouse's age.

Q29 What is the taxation position if the balance is paid as a lump sum?

A Any undrawn undeducted purchase price is payable tax free. The remainder is taxable but subject to rebate where applicable.

Q30 To whom is the balance payable?

A Typical superannuation trust provisions apply. The Trustee has a discretion to pay one or more dependants or the legal personal representative of the deceased.