

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

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.

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 (xxv) – 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

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.

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.

¹⁵ Sub No 79, App. 5, p 3.

¹⁶ Evidence, p 311.

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