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Senate Select Committee on Superannuation

Super Regs II

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CHAPTER 1:

INTRODUCTION

The object of this report is to examine concerns raised about the Superannuation Industry (Supervision) Regulations.

Background

1.1 Pursuant to the *Superannuation Industry (Supervision) Act 1993* (the 'SIS Act') are the Superannuation Industry (Supervision) Regulations, Statutory Rules No. 57 of 1994 (the 'SIS regulations'). These regulations were made on 4 March 1994, gazetted on 11 March 1994, and tabled in the Senate and the House of Representatives on 17 and 22 March 1994, respectively. The SIS regulations were referred to the Senate Select Committee on Superannuation on 16 March 1994. The terms of reference of this inquiry appear at Appendix A.

1.2 The SIS regulations prescribe the standards to apply in relation to an extensive array of issues, including the provision of information for members and other persons, matters associated with public offer entities, the management and trusteeship of superannuation entities, minimum benefits, payment standards (formerly known as preservation standards), contributions and benefit accruals, the financial management of funds, eligible rollover benefits, information to be given to the Insurance and Superannuation Commissioner, pre-1 July 1988 funding credits, and a number of miscellaneous and transitional provisions.

The issues

1.3 Beneficiary investment choice (otherwise known as 'member choice' or 'member investment choice'), the standards for which are prescribed

under SIS regulation 4.02, was the issue which drew the largest response in terms of submissions and evidence given at the hearings. A number of other equally important issues that were raised included the possible impact that the prohibition of charges over assets under SIS regulation 13.14 would have on funds' custodial services; whether partial disability benefits would conflict with the sole purpose test; whether the new preservation requirements should be implemented earlier; whether the age at which a person is deemed to have retired should be lowered; and the controversy surrounding the arrangement between the AWU-FIME and the administrator of the Nationwide Superannuation Fund, the Professional Services Investment Pty Ltd (PSI).

Conduct of the inquiry

1.4 On 24 March 1994, the committee wrote to about 400 persons and organisations on its mailing list. Thirty six written submissions were received. The list of written submissions appears at Appendix C.

1.5 The committee conducted public hearings on 20 and 23 June 1994 in Canberra and heard evidence from AWU-FIME and PSI on 19 September 1994. A list of witnesses who gave evidence at these hearings appears at Appendix D.

Superannuation (Resolution of Complaints) Regulations: Update

1.6 On 29 August 1994, the committee tabled its thirteenth report, *Super Regs I*, on the Superannuation (Resolution of Complaints) Regulations. On the same day, the Senate resolved to disallow these regulations. On 17 October 1994, the Senate rescinded that resolution.

1.7 The Government has stated that a new regulation is to be made which will exempt medical evidence for six months. However, during this period, the Superannuation Complaints Tribunal is 'to evaluate ways of dealing with complaints involving medical evidence'.[1]

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[1] Press Release No. pst19, by the Parliamentary Secretary to the Treasurer, 13 October 1994

1.8 Also on 17 October 1994, Senator Sherry, at Senator Watson's request, said that the Government now favours giving the Tribunal resources and powers to deal with the consideration of medical evidence, and will take steps to ensure that this occurs from the date of expiry of the proposed new exemption regulation.[2]

1.9 On 1 November 1994 the Superannuation (Resolution of Complaints) Regulations (Amendment), Statutory Rules 1994 No. 374, were notified in the *Commonwealth of Australia Gazette.*

1.10 The new Regulation 4 commences on gazettal, 1 November 1994, and ceases six months thereafter. Regulation 4 reads:

> (1) For the purposes of the definition of 'excluded subject matter' in section 3 of the Act, excluded subject matter is matter in relation to which the Tribunal, in dealing with the matter:
>
> (a) would have to undertake the assessment or evaluation of medical evidence, opinion or reports; or
>
> (b) would have to consider, having regard to medical evidence, opinion or reports, the question of a person's incapacity; or
>
> (c) would be likely to have to perform a function mentioned in paragraph (a) or (b).
>
> (2) This regulation ceases to have effect at the end of 6 months after it commences.

1.11 As at 15 November 1994, Statutory Rules 1994 No. 374 had not been tabled.

Acknowledgments

1.12 The committee records its appreciation of the written submissions and oral evidence to this inquiry. In particular, the committee acknowledges the diligence and cooperation of the Insurance and Superannuation Commission (ISC) in resolving a number of issues which were raised in submissions before the hearings were conducted. The committee also expresses its appreciation for the cooperation extended by Brian Scott of

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2 Senate *Hansard*, 17 October 1994, p 1811

Towers Perrin in enabling the committee to use the survey information referred to in this report.

CHAPTER 2:

MEMBER CHOICE

Beneficiary investment choice must be within the investment strategy laid down by the trustee for the fund as a whole.

Introduction

2.1 This chapter examines the issue of members' right to choose funds and the effect of SIS legislation upon funds which offer their beneficiaries choice in how their superannuation money is invested. It also examines the feasibility of mandating the right of beneficiaries to choose investments.

MEMBER CHOICE

2.2 Member choice has two key strands:

- choice of fund membership; and
- members and beneficiaries of funds choosing investment strategies offered by trustees.

Choice of funds

2.3 If a voluntary member of a public offer fund is dissatisfied with the performance of the fund, regardless of the investment strategies on offer, that member is free to move his/her money to another fund, which would necessarily be another public offer fund.

2.4 That freedom of fund choice is not fully available to all members of standard employer-sponsored funds, usually industry funds, frequently because of the conditions imposed by a governing award.

State awards - choice of funds

2.5 However, the committee notes that most states (New South Wales, Victoria, Tasmania and Western Australia) have enacted legislation affecting state awards which allows superannuation payments to be paid into a fund

of the employee's choice, provided the employer agrees. South Australia does not have such legislation but was apparently discussing changes similar to those enacted in New South Wales.[3] The extent to which fund members have taken advantage of these opportunities is unknown to the committee.

Federal awards - choice of funds

2.6 The Department of Industrial Relations (DIR) has previously provided the committee with the results of a survey of major state and federal awards (those covering over 10,000 employees).[4] At the time of the DIR survey, ten major federal awards had been identified in the Australian Bureau of Statistics Award Coverage Survey. Only two of these ten awards did not provide any choice of fund. Of the rest, two allowed the individual employee the choice of funds nominated under the award. Membership of funds in the remaining six awards were generally decided by agreement of the union members or following discussions between employers and unions. (See Table 1.)

2.7 The test case decision handed down on 7 September 1994 by the Australian Industrial Relations Commission (AIRC) about what provision, if any, awards of the AIRC should contain with respect to employee contributions, left the choice of fund provisions intact.[5]

2.8 The recent introduction of enterprise bargaining may have been expected to introduce an extra element of choice for a substantial number of workers. However, the DIR recently advised the committee that as at 13 September 1994, superannuation provisions have been a feature in only 428 of the 2,461 enterprise agreements made, with 332 of those agreements dealing with the issue of choice of fund.[6] Of those 332 agreements, 235 (71%) provided no choice of fund:

- 205 provisions specify one fund only;

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3 *Superfunds*, 'The brave new world of industry super', by Beth Quinlivan, April 1994, p 18

4 Submission No 81 to the committee's original inquiry, sent 1 May 1992

5 Australian Industrial Relations Commission Superannuation Test Case, Melbourne, 7 September 1994, Print No L5100

6 SGCREV Sub No 94

Table 1

AWARD	NO OF EMPLOYEES COVERED	FUND CHOICE	METHOD OF FUND SELECTION
Transport Workers (Superannuation) Award	25,200	One fund	N/A
Insurance Industry Superannuation Award	18,800	One fund	N/A
Printing Industry Superannuation Award 1988	33,800	Two funds: PISF or ARF	Employee
Hotels Resorts and Hospitality Industry Award	24,300	Two funds: HOST-PLUS or existing fund	Employer application - joint working party. To AIRC if no agreement
Textile Industry Award	19,400	Two funds: ARF or existing scheme	Agreed by union members
Timber Industry Award	18,400	Two funds: TISS or existing scheme	Agreed by union members
Motels Award 1989	16,200	Two funds: HOST-PLUS or existing fund	Employer application - joint working party in case of existing scheme. To AIRC if no agreement.
Metal Industry (Superannuation) Award	185,100	Choice of STA, ARF, Tasplan or other (possibly non-industry)	Agreement between employer employees and union; employer choice in some case
Vehicle Industry - Repair Services and Retail	60,000	Multiple	Employee choice
National Building and Construction Industry Award	18,800	Multiple	Disputes over choice referred to AIRC.

Source: Adapted from 'Survey of Major Awards - Superannuation Provisions' prepared supplied by Mr Grant Doxey, Director, Employment Conditions Section, Department of Indu Relations

- 84 agreements provide a choice of two or more funds for superannuation contributions;
- 30 agreements specified the fund in relation to Superannuation Guarantee (SG) contributions; and
- 13 superannuation provisions did not limit payments to any specific fund.

It is possible that the reduced number of employees in any given enterprise agreement, vis-a-vis an award agreement, resulted in restricted choice to facilitate employers' administration of their superannuation obligations.

High Court judgment

2.9 On 1 July 1993, the High Court held that, special circumstances aside, an award cannot require employer superannuation contributions which are made in respect of employees who are not members of a union to be paid into a specified fund.[7] This judgment of the High Court may facilitate some members having a greater choice in nominating their superannuation fund.

Beneficiary investment choice (BIC)

The legislation

2.10 The SIS legislation prescribes the circumstances in which a trustee may be given directions, thereby allowing the beneficiaries of a fund to choose an investment strategy or a combination of strategies offered by the trustee. However, such choices, known as beneficiary investment choices (BIC), **are only possible at the discretion of the trustee.**

2.11 Subsection 52(4) of the SIS Act states that:

> An investment strategy is taken to be in accordance with paragraph (2)(f) [concerning the covenant requiring trustees to formulate and give effect to an investment strategy] even if it provides for a specified beneficiary or a specified class of beneficiaries to give directions to the trustee, where:

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7 *Re Financial Sector Union of Australia; Ex Parte Financial Clinic (Vic) Pty Ltd and Others*, 178 CLR 352

(a) the directions relate to the strategy to be followed by the trustee in relation to the investment of a particular asset or assets of the entity; and

(b) the directions are given in circumstances covered by regulations made for the purposes of this paragraph.

2.12 The regulation made for the purposes of paragraph 52(4)(b) of the Act is SIS regulation 4.02:

REGULATION 4.02 COVENANTS IN GOVERNING RULES OF A SUPERANNUATION ENTITY - BENEFICIARY INVESTMENT CHOICE

4.02(1) [Circumstances in which directions may be given] For the purposes of paragraph 52(4)(b) of the Act, the circumstances in which a direction of the kind referred in that paragraph (other than a subsequent direction of that kind) may be given are:

(a) in the case of a direction by a specified beneficiary who is, or a class of specified beneficiaries each of whom is, a standard employer-sponsored member - the circumstances stated in subregulations (2) and (3); and

(b) in any other case - the circumstances stated in subregulation (2).

4.02(2) [Choice of investment strategies] For the purposes of paragraphs (1)(a) and (b), the following circumstances are stated, namely that:

(a) the trustee gives to the beneficiary, or to each member of the class of beneficiaries, a choice of 2 or more investment strategies from which the beneficiary, may choose a strategy, or combination of strategies; and

(b) the beneficiary, or each member of the class of beneficiaries, is given:

(i) the investment objectives of each of the strategies mentioned in paragraph (a); and

(ii) all information the trustee reasonably believes a person would reasonably need for the purpose of understanding the effect of, and any risk involved in, each of those strategies; and

(c) the beneficiary, or each member of the class of beneficiaries, is fully informed of the range of directions that can be given and the circumstances in which they can be changed; and

(d) the direction is given after compliance with the above paragraphs, and the direction specifies:

(i) which of the strategies or which combination of strategies referred to in paragraph (a) is to be followed in relation to investments of the beneficiary's or class of beneficiaries' interest in the fund; and

(ii) where applicable, matters related to the choice referred to in that paragraph.

...

2.13 **This type of choice which is allowed by the legislation can and should be distinguished from the kind of member-directed investment choice where the trustee *is required* to implement any investment or investment strategy for a member at the direction of that member. The legislation is concerned with existing investment strategy options which a trustee can offer fund members.**

The main concerns about BIC

2.14 The evidence taken by the committee indicated that there is broad support for BIC. However, a number of concerns were expressed about the manner in which BIC would operate under the SIS regime. These concerns merit serious consideration by trustees and the regulator, the ISC.

2.15 Some evidence suggested that BIC be a requirement rather than an option for some or all superannuation funds, either on moral/ethical grounds, or as a means of ensuring that members achieve optimal returns on their superannuation savings investments (under BIC, investment decisions could take into account such factors as the member's age, marital status, gender and financial commitments), or to discourage the establishment of excluded funds which would not be bound by the constraints on BIC in the

legislation.[8] Others expressed concern that SIS regulation 4.02 undermined the basis upon which a number of master funds operate, namely: the right of investors to select and formulate investments that are appropriate to their own preferences and circumstances.[9]

Beneficiaries with limited choice

2.16 The committee considers that the lack of choice available to standard employer-sponsored (compulsory) members of some funds warrants closer examination than has occurred in its previous inquiries into the regulation of superannuation. In contrast, the committee has fewer concerns in this regard about voluntary members of public offer funds (including master trusts) who could become members as an act of personal choice and who, in many cases, are offered the opportunity to select a preferred investment strategy.

2.17 As noted previously, the voluntary members of public offer funds retain the option of transferring their accrued entitlements to other funds if they are dissatisfied with a fund's performance, even though exit fees may be substantial. Such an option may not be available to members of some funds where their membership of a fund is compulsory as a consequence of:

(i) conditions of an award negotiated with the Industrial Relations Commission; or

(ii) the employer's choice of fund into which compulsory superannuation contributions will be paid under the *Superannuation Guarantee (Administration) Act 1992*; or

(iii) agreed conditions of employment.

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8 Howard Pender, Australian Ethical Investment Trust, and Caroline Le Couteur, August Financial Management Limited; Evidence, pp 11-22 and SISREG Sub No 15

Jock Rankin and Judith Towler, Financial Planning Association, Evidence, pp 37-59 and SISREG Sub No 11

Sly & Weigall, Lawyers, SISREG Sub No 13

9 J K Tidswell, SISREG Sub No 3; R E Nixon, Freedom of Choice, SISREG Sub No 4; Don Blyth, Trustee Corporations Association, SISREG Sub No 6

2.18 However, as noted in paragraph 2.5, recently enacted state legislation enables limited mobility for some fund members.

Fund members at risk

2.19 Several factors, especially when taken together, appear to prejudice beneficiaries whose membership of funds is compulsory (standard employer-sponsored members). These factors are:

(i) the general shift from defined benefit funds to accumulation funds, following the introduction of award superannuation and the SG legislation, moved the investment risk in the pre-retirement stage of a beneficiary's career from the employer to the beneficiary;[10]

(ii) employers choose the fund to which the compulsory SG contributions are paid; and

(iii) trustees are protected from liability for poor investment performance where investments have been made in accordance with an investment strategy formulated under the relevant covenant in the SIS Act.[11]

It can be argued that the outcome of these factors operating together is that most standard employer-sponsored members are required to bear the investment risk without having the power to effect the investment outcome. But countering this line of reasoning is the view that the majority of beneficiaries are not in a position to make prudent judgments on superannuation investments. These two arguments need to be carefully assessed.

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10 (i) Financial Planning Association, SISREG Sub No 11

(ii) From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

(iii) David M. Knox, 'A Critique of the Direction of Current Superannuation Developments Using a Simulation Approach'; Colloquium of Superannuation Researchers, University of Melbourne, 8-9 July 1993

11 (i) Financial Planning Association, SISREG Sub No 11
(ii) Subsection 55(5) of the SIS Act 1993

Defined benefit funds

2.20 The Life Insurance Federation of Australia (LIFA) submitted that BIC was inappropriate in the case of defined benefit funds because benefits are not directly related to investment earnings.[12] While this argument has some merit, it could not be extended to all defined benefit funds, as some of these funds have benefits which are supplemented by member generated accumulation components. In respect of this component of a member's superannuation plan, there is a role for an element of member choice.

Advantages of BIC

2.21 The advantages of BIC were perceived to be that:

(i) it allows members to personalise their superannuation investments;

(ii) it allows members to complement their existing superannuation and non-superannuation investments;

(iii) it gives members what they want;

(iv) it would alter the current level of fiduciary responsibilities and obligations of trustees; and

(v) it avoids possible inequities in accumulation schemes by not having to use smoothing and reserving.[13]

Drawbacks of BIC

2.22 However, BIC has some possible drawbacks, namely, the perception that:

(i) overly conservative choices would be made by beneficiaries;

(ii) member benefits would no longer be protected by informed investment decisions made by investment professionals;

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[12] Supplement to SISREG Sub No 17

[13] Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

(iii) generally members are not sufficiently sophisticated to make informed long term investment decisions;

(iv) BIC would interfere with trustees responsibility to protect their members superannuation savings;

(v) increased difficulty of administration would result; and

(vi) the added cost of introducing BIC could not be justified.[14]

Costs

2.23 LIFA estimated that the cost to a fund of introducing BIC into an existing accumulation scheme could be about 10 cents per member per month, plus a $20 charge for switching between options. This estimate took into account costs involving:

- trust deed amendments, processing of BIC requests, and various disclosure requirements;
- the development and implementation of the investment strategies; and
- advice to members.[15]

The estimate assumed that:

(i) the charge would be applied to all members of a fund rather than those who use the service;

(ii) there was no computer enhancement;

(iii) there was no personalised advice;

(iv) the choice was only available on joining and then annually; and

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[14] Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

[15] SISREG Sub No 17, supplementary

(v) there would be a choice of four investment options for existing balances and/or future contributions.

LIFA estimates did not take into account certain investment costs such as buy/sell expenses.[16]

2.24 Where a 'user pays' principle is introduced, the cost per user would be higher. One estimate is that the cost of installing member choice was about $70 to $80 per head, but with little extra cost thereafter.[17] Jacques Martin estimated that based on the US experience (see below), administration costs, if spread across all members, will rise by between 25 to 50 per cent for simple investment choice arrangements.[18] For more complex arrangements, the costs could double.

2.25 While these estimates are approximate, the committee considers that the introduction of BIC into a fund need not be accompanied by substantial costs, particularly if, in the case of industry funds, simple choices are made available.

2.26 The following case study indicates to the committee that if BIC were to be integrated into a new fund's administrative systems from the outset, albeit in its simplest form, it may not add appreciably to the financial burden imposed on a fund and its members.[19]

2.27 Queensland Coal and Oil Shale Mining Industry Superannuation Fund (QCOS) (see paragraph 2.33 below), an industry fund which introduced BIC after the fund was established, found that BIC generated extra costs associated with providing information to members as part of a communication program designed to both inform and educate members of

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16 SISREG Sub No 17, supplementary

17 Estimate attributed to Robert Birnbaum of J P Morgan in Barrie Dunstan's column in the *Financial Review* on 27 July 1994; article titled 'Super fund investment choice still a long way off'

18 SISREG Sub No 32

19 Information supplied by State Street - SISREG Sub No 35

Case Study:

The Australian Superannuation Savings Employment Trust (ASSET), is an industry fund which has been offering simple BIC since it was established (see Appendix E). The trustees charge members of the fund about 85 cents per person per week in administrative fees, which appears to be in a competitive price range for industry funds. As BIC was an integral part of the services administered for the fund, it is not possible to clearly quantify the cost of providing that option. However, it seems that the administrative costs charged to the members of that fund would not be appreciably less if members did not have the option.

the fund into investment choice.[20] Despite this, the fund was proceeding with the program, which was comprehensive in its scope (detailed further at paragraph 2.66 below).

Choosing choice

2.28 The committee considers that in principle it is appropriate for **both** choice of fund and BIC to be available to all members of superannuation funds as it believes this would:

(i) promote competition between funds;

(ii) enhance consumer understanding of superannuation; and

(iii) empower individual members of funds to influence their superannuation arrangements and provide them with an increased sense of ownership of their superannuation balances, thereby assisting them in achieving the objectives of self provision in the Government's retirement incomes policy.

2.29 The committee considers that the advantages to beneficiaries would easily outweigh the disadvantages provided that beneficiaries were more fully

[20] Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

informed and educated to the range and nature of investment opportunities available. These advantages could be enhanced if members were also given some practical information as to how the various investment options could be used to optimise their superannuation entitlements given their individual circumstances and preferences.

2.30 The obvious advantages of BIC increasingly will be embraced by the community and be reflected in market forces which will further its cause. As homogenous investment strategies will be perceived by many members to be inadequate for their individual needs, it is expected that members, and possibly their representatives, who in some funds, act on their behalf, will demand greater choice in the manner in which their money is invested. Similarly, trustees and investment managers of funds would be expected to perceive that they should offer their members choices which would more closely suit their needs.

The current market

2.31 The committee is encouraged to learn that some industry funds are already offering BIC. As noted in the case study, one such fund, ASSET, offers BIC in a simple form, by way of a choice of two portfolios (see Appendix E).[21] One portfolio is market linked, with its attendant risks and designed as a long term investment because of the likely fluctuations in the year to year returns, while the other, designed for older members closer to retirement, consists mainly of capital guaranteed funds or capital stable investment arrangements.

2.32 The committee's attention was drawn to certain terminology used by the industry to describe different types of investment, for example: capital stable, capital guaranteed, and capital secure. Although these terms have very specific meanings within the industry, the distinctions between them are often lost on consumers. The current market can be bewildering for superannuants. The committee therefore calls on industry to ensure that their clients are clearly apprised of these distinctions before they enter investment arrangements. The committee also calls on the regulator, the ISC, to monitor compliance with the requirement that the trustee provide

[21] ASSET employer kit

all the information that a person requires to understand their choice of investment strategy.

2.33 As noted at paragraph 2.27, QCOS also provides BIC.[22] In October 1993, QCOS introduced BIC to members who make voluntary contributions. Of the 10,400 members of the fund, 5,406 are voluntary contributors, of whom 1,113 (21%) elected to make a choice:

> Of those who participated, just over a third chose a mix of investments recommended by trustees according to the age of the member and two-thirds decided to mix and match their own choices from pools of capital guaranteed, balanced and 100 per cent equities. Those who did nothing had their voluntary contributions placed in the capital guaranteed pool, while the mandatory funds which made up the majority were managed in accordance with a member-age schedule.[23]

2.34 One of the largest industry fund administrators is also in the process of promoting BIC for the funds it administers.[24] The committee commends those funds which have taken, and are taking, this very important initiative.

2.35 The simple alternatives offered by ASSET are one end of the spectrum of possibilities which BIC opens to members. At the other end of the spectrum, a sophisticated range of BIC offerings is in the process of being formulated by AMP for public offer employer-sponsored funds - these are the traditional funds where employer contributions are supplemented by employee co-contributions.[25] The AMP plan includes an array of investment options ranging from very conservative capital guaranteed investments, such as short term Australian fixed interest securities, to investments with high levels of exposure to Australian and international

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22 Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

23 Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

24 Barrie Dunstan, 'AMP prepares for super push', *Australian Financial Review*, 25 August 1994

25 Information supplied by AMP on 19 August 1994

shares, in which the investor accepts a high level of volatility in return for the prospect of a high level of real returns associated with long term share investment.

Attitudes to superannuation which inhibit BIC

2.36 A combination of market forces and changing community expectations may not, on their own, be sufficient to entrench BIC throughout the superannuation industry. BIC, in the absence of steps to educate the community about its benefits, could prove to be:

> a way of guaranteeing members the total right to be wrong.[26]

2.37 Another factor suggested as inhibiting the introduction of BIC is that:

> there was no demonstrated demand for it, except for the top few per cent of people in superannuation.[27]

2.38 The BIC dilemma could well be explained by the widespread confusion which still surrounds the whole issue of superannuation. The Sweeney Report, which was commissioned by the Department of Social Security, published survey data indicating that about 50 per cent of Australians were confused about superannuation and that most did not know how much superannuation they needed to provide for a comfortable retirement.[28] An important message emerging from this report was that a very significant number of people would consider contributing more if they

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[26] Comment by Garry Weaven, executive chairman of Industry Funds Services Pty Ltd, reported by Barrie Dunstan, in 'Member choice a super danger', *Financial Review*, 21 July 1994

[27] Comment by Garry Weaven, executive chairman of Industry Funds Services Pty Ltd, reported by Barrie Dunstan, in 'Member choice a super danger' *Financial Review*

[28] Kalisch and Patterson of the Department of Social Security, 'Australia's Retirement Incomes System: Interactions and Attitudes' presented at the First Annual Colloquium of Superannuation Researchers at the University of Melbourne on 8-9 July 1993

understood more about superannuation. Higher levels of contributions would undoubtedly encourage a higher level of participation in choosing investments most appropriate to individual needs.

The pace of change

2.39 The pace of change in this area of superannuation activity will be influenced by the extent of trustee and beneficiary education. In its sixth report, the committee recommended that the ISC and key superannuation industry groups representing the interests of consumers and providers, combine to develop and implement a five year superannuation consumer education strategy for implementation in early 1994.[29]

2.40 The committee understands that following the Treasurer's Statement of 28 June 1994, a consumer education campaign is to be managed by the Australian Taxation Office, working closely with the ISC, various other government agencies and through a Public Education Focus Group which includes these and a number of other interest groups, including some private sector industry groups.[30] Although BIC was only a very small part of this education strategy, the ISC has recently produced a Superannuation Circular stating its position on this issue.[31] But it is important to note in this regard that ISC Superannuation Circulars are more for consumption by trustees than for fund members.

2.41 It is the committee's expectation, therefore, that BIC should be an integral component of the superannuation education plan of both the ISC and the superannuation industry.

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[29] Recommendation 3.10 of the Sixth Report of the Senate Select Committee on Superannuation titled *Super - Fees, Charges and Commissions*

[30] Michael Monaghan, ATO, Evidence, 23 September 1994, pp 611-612

[31] Superannuation Group, *Superannuation Circular No II.D.1, 'Investment Strategies and Beneficiary Investment Choice'*, September 1994

Recommendation 2.1

The committee recommends that in developing its comprehensive public education campaign on the consumer elements of superannuation, the Government make BIC a component of the forthcoming ATO/ISC campaign.

Beneficiaries who already have the right to choose

2.42 Although BIC has long been a feature of personal superannuation policies and has recently become a major selling point with a number of master funds, several submissions were received expressing concern that SIS regulations 4.02 and 4.09 would restrict the ability of such funds to enable their members to selectively tailor their investment strategies.[32] Included in these concerns was that these regulations will not allow investment strategies to be implemented unless they are formulated before being offered to all members through a prospectus.[33]

2.43 Freedom of Choice Funds Management Limited submitted that subregulation 4.09(2), which requires the trustee of a superannuation entity to formulate and give effect to an investment strategy that has regard to all the circumstances of the entity, is the reverse of their current practice which is to accept the strategy and place the investments as selected.[34] Freedom of Choice maintains that it is not possible for it to formulate and promulgate through its prospectus a range of strategies to suit every new applicant.

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[32] J.K. Tidswell, SISREG Sub No 3

R.E. Nixon, Freedom of Choice Fund Management Limited,SISREG Sub No 4

Don Blyth, Trustee Corporations Association, SISREG Sub No 6

[33] R.E. Nixon, Freedom of Choice Fund Management Limited, SISREG Sub No 4

J.K. Tidswell, SISREG Sub No 3

[34] SISREG Sub No 4

2.44 Another problem raised by Freedom of Choice was an extension of this perceived constraint, that is: a member who decides to replace one investment with another investment is prevented from doing so because under the SIS regulations the participant cannot direct the trustee to replace investments unless it is an investment strategy which has already been formulated by the trustee.[35]

2.45 Tidswell Benefit Consultants and Fund Administrators and the Trustee Corporations Association of Australia raised similar concerns.[36] Freedom of Choice and Tidswell both submitted that many of their subplans would be likely to leave the master trust and establish their own excluded superannuation funds, which are not bound by SIS regulation 4.09, and which would therefore regain direct control over their investment options.

2.46 The Australian Government Actuary commented on this issue:

> ...our experience is that the members of [master trusts with subplans of less than five members] definitely do need prudential protection from the ISC. It has been suggested that the effect of the legislation may be a swing from these master trusts to excluded funds...Some of these very free choice master trusts may break up into their constituent subfunds...In a prudential sense, this is probably a positive move because the separate subfunds will then be separately audited and have separately identified assets, which will deal with one of the major prudential problems that we have detected so far...[37]

2.47 Notwithstanding this line of reasoning, the committee is not troubled by the mode of operation of master trusts which actively formulate individual investment strategies in consultation with members of their subplans, as long as these are consistent with all the circumstances of the fund, particularly with the overall investment strategy formulated for the fund as a whole. The essential ingredient in this process is that the trustee accepts responsibility for the final design and selection of investments. The committee does, however, have concerns that the software used by some

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35 SISREG Sub No 4

36 SISREG Sub Nos 3 and 4

37 Evidence, p 105

master trusts has been inadequate for the task, generating unacceptable delays in administrative processing.

2.48 Although the members of funds most likely to participate in designing and implementing investment strategies would be generally those with substantial investments in superannuation, the committee does not consider that this option should be denied to less affluent fund members. This will become increasingly important as the accrued entitlements of members of funds grow under the SG regime.

Recommendation 2.2

The committee recommends that the ISC review the SIS regulations to ensure that the formulation of an individual investment strategy by a trustee in consultation with a fund beneficiary will not be a breach of operating standards, provided this strategy is consistent with the overall investment strategy that the trustee has formulated for the fund as a whole.

Should a beneficiary be given the right to choose investment strategies?

2.49 Mr Howard Pender, of the Australian Ethical Investment Trust, and Ms Caroline Le Couteur of August Financial Management Limited, submitted, in effect, that standard employer-sponsored members of a fund, who are compelled to join their industry fund or corporate sub-plan, and who have moral or ethical objections to the manner in which a trustee of a fund invested a member's contributions, should be able to exercise some right of choice as to where their money is directed.[38] Such a direction would, amongst other things, be subject to the trustee being satisfied that the proposed investment strategy was suitable for superannuation purposes.

2.50 Ms Judith Towler and Mr Jock Rankin of the Financial Planning Association (FPA) were also in favour of members having the choice of fund and the choice of an investment strategy within funds.[39] The FPA's submission was that individuals would be better off if allowed to make a choice based on their needs, personal circumstances and risk tolerance, with that choice being made within the context of competent and unbiased financial advice.

2.51 In examining the issue of whether or not BIC should be mandated, the committee considered that such a course of action would be premature, if done immediately, for the following reasons:

(i) a concern that one of the cornerstones of SIS, namely, the concept of a single entity, the trustee, taking full responsibility for running the fund, may be undermined;

(ii) at this stage, there appears to be only a small demand for BIC by members of superannuation funds; and

(iii) enhanced community education about superannuation is needed before a mandatory BIC regime is implemented.

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38 Evidence, p 21

39 Evidence, p 45
SISREG Sub No 11

These concerns are discussed in further detail below.

2.52 The committee gained the impression that BIC, while frequently discussed, was not a matter upon which some key superannuation groups have formulated firm policy positions.[40] The absence of publicly stated positions by some of these industry players underscores the impression that although BIC has been allowed under trust law for some considerable time, it is in conceptual and practical terms, in its embryonic stages of development.

The trustee as the sole entity responsible for running a superannuation fund

2.53 This key element to the SIS legislation and its attendant prudential safeguards was recommended by the committee in its first report, *Safeguarding Super.* The committee maintains that trustees should not be forced to, or be able to, avoid responsibility of designing an investment strategy and, ultimately, selecting particular investments. Should this occur, there would be a severe risk of undermining the whole purpose of the SIS legislation, namely, to attain prudential control and security of superannuation assets. This risk would be heightened if individual BIC were to be mandated, and a trustee required to accept an investment strategy or a particular investment preference of any individual member or group of members, regardless of whether or not that investment or investment strategy was certified by an accredited financial adviser as being suitable for superannuation. The basic role of a trustee includes the right to make, and to take full responsibility for, the fundamental evaluation of whether an investment or an investment strategy is suitable for superannuation.

2.54 Nevertheless, the danger to a trustee's responsibility and independence would clearly stem not from BIC per se, regardless of whether

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[40] For example, Australian Institute of Superannuation Trustees; Association of Superannuation Funds of Australia; and the Australian Consumers Association did not give oral evidence on this issue. Of these three organisations, only ASFA forwarded a submission which took a position on this issue, maintaining that it should be '...up to funds as to whether to offer investment choice to members... Member choice should not be compulsory in the current environment.' - SISREG Sub No 28

or not it is mandatory, but from investments and investment strategies being forced upon a trustee.

Demand for BIC

2.55 The results of the symposium held by J.P. Morgan with industry representatives on 19 July 1994 seemed to indicate that BIC would inevitably become a more entrenched feature of the industry.[41] In addition, a survey conducted by Towers Perrin of 139 superannuation funds, revealed that 15 per cent of the funds surveyed already offered BIC, and that a further 50 per cent of the funds surveyed are planning to, or will consider, offering members a choice of investment.[42] Of the remaining 35 per cent of funds that did not intend to offer BIC to their members, over two thirds indicated that pressure from members would make them reconsider their decision not to offer BIC. A smaller but significant proportion indicated that market pressure and a decrease in costs associated with establishing BIC would make them reconsider. Appendix F includes some of the results of the Towers Perrin survey.

2.56 These findings were also reflected at the J.P. Morgan symposium where, although less than one third of the industry representatives at the symposium stated that their funds currently offered BIC, and only about half stated that their funds intended to offer BIC within two years, over two thirds agreed that fund members should have a say in what choices the fund should offer. In addition, nearly three quarters of these representatives agreed that BIC would increase voluntary contributions to the fund while nearly half considered that BIC would increase participation in the fund. Furthermore, nearly two thirds agreed that members of funds are interested in how investment alternatives affect their retirement income.

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41 J.P. Morgan Industry Funds Symposium, Interactive Session Results - Sydney, 19 July 1994

42 Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

The US experience

2.57 In evaluating what appears to be a lack of demand for BIC on the part of members of funds at large, the committee examined the origin of BIC in the USA, where it has become a popular feature of retirement savings plans. Mr Robert Birnbaum, of J.P. Morgan, maintained that the first factor that arose in the US was the shift from defined benefit funds to defined contribution funds (accumulation funds) which were less expensive to fund and operate than traditional pension plans.[43] In addition, employers wished to avoid liability for poor performance. Finally, as their accounts grew, employees, who bore the investment risk in defined contribution plans, demanded control over investments involving their funds.

2.58 The extent of member choice in the US is immense. According to statistics quoted by Mr Birnbaum, by 1993 there were nearly US$1.2 trillion invested in defined contribution plans which incorporate member choice, drawing level with the amount invested in defined benefit plans. Mr Birnbaum stated that:

> The growth in the US pension industry over primary savings has really been in the member choice area. It's anticipated by the turn of the century that member choice will be the dominant form of retirement savings in the US...[member choice] plans are enormously popular and enormously visible. People receive statements, they think of it as their money, they see money flowing in both from their own salaries and the company contribution. They see investment growth. They know if they leave their company these things are portable: they can take their money with them. They are very popular benefits. If you look in classified advertisements in newspapers for jobs in the United States, you will very frequently see these plans as the key benefits for attracting employees.[44]

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[43] From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

[44] From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

In Australia

2.59 A salient feature of superannuation plans in the US is that, in the main, membership is voluntary. This, of course, contrasts with the compulsory nature of much fund membership in Australia, generated as it has been by award superannuation and SG contributions, and employment contract arrangements.

2.60 Within Australia, a substantial portion of fund membership is within the large industry funds which are a product of the award superannuation developments of the 1980s. By and large, these funds are defined contribution plans, the members of which, as noted previously, bear the investment risk in relation to the contributions made on their behalf by their employers.

2.61 About a third of the almost 4 million members of 80 or so industry funds which responded to a recent survey are classified as 'inactive' members.[45] This description generally refers to members in relation to whom no contributions have been received for 12 months or more.[46] This is an inhibiting factor which clearly militates against BIC at this stage. Until an effective mechanism is implemented to address the small amounts/inactive members problem, industry funds will find it difficult to have high levels of member participation or choice.

Educating members of superannuation funds

2.62 The low level of participation in industry funds, the ongoing confusion in the minds of the community concerning superannuation, and the complexity of investment decisions in exercising BIC, leads the committee to reiterate that extensive and effective community education needs to be given priority and fully implemented, regardless of whether or not BIC becomes mandated. The committee again notes in this context that greater knowledge of superannuation is likely to lead to significantly higher levels of voluntary contributions by fund members, and that a greater stake

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45 Beth Quinlivan, 'The brave new world of industry super', *Superfunds*, April 1994

46 Ibid

in a fund, particularly a voluntary stake, often leads to greater participation.[47]

2.63 An interesting corollary of an education process leading to greater participation and therefore greater use of BIC opportunities, is that BIC plans themselves may provide educational opportunities because:

> they are visible, people care about them, they watch what happens to them and perhaps this is a chance to educate the...public around financial and economic issues.[48]

2.64 The committee is encouraged to learn that the process of trustee and beneficiary education seems to be gaining substantial momentum in a number of quarters.

2.65 In addition to the recent seminars conducted by J.P. Morgan on the subject of BIC for the benefit of the industry, ASFA intends conducting seminars, surveys and study groups on the issue of BIC.[49]

2.66 The QCOS experience in developing a communication program on BIC is a noteworthy example at the individual fund level. The QCOS program addresses the characteristics of each investment option available to members, the administration requirements for investment choice, and how their investment choice fits in with the fund's investment strategy in the context of superannuation.[50] The fund also distributes a booklet describing its investment strategy, holds meetings of members and their spouses, uses company and union representatives to provide information and issues a quarterly newsletter to all work sites for dissemination to members. In the future, the fund intends providing members with additional investment performance information and more detailed annual reports.

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47 The Sweeney Report, mentioned in paragraph 2.38, refers

48 Robert Birnbaum, from edited transcript of presentation at the J.P. Morgan Industry Funds Symposium in Sydney on 19 July 1994

49 SISREG Sub No 27

50 Greg Bright, *Super Review*, August 1994, 'It's a whole new ball game'

2.67 Another insight into BIC at the fund level was provided by Mr Bob Putnam at the J.P. Morgan Industry Funds Symposium. The CSR Staff Superannuation Fund under Mr Putnam's leadership has been administering BIC since 1983.[51]

2.68 *The committee considers that standard employer-sponsored members of funds should ultimately have the right to choose between investment strategies. It is acknowledged that the introduction of BIC would add to operating costs of existing funds. It is essential that these operating costs should be explicitly identified.*

2.69 *As evidence to the committee (outlined at paragraphs 2.23 to 2.27) suggests that those costs can be reasonably contained, and as market pressure will push administrators into implementing BIC, existing standard employer-sponsored funds with fifty or more members should not be exempted from being required to provide BIC.*

2.70 The committee considers that smaller funds should be exempted from the administrative burden of mandatory BIC unless a future review determines that such an exemption is not an appropriate course of action.

2.71 The committee wishes to encourage a regime which will make BIC mandatory and anticipates that such a requirement could be phased in over, say, five years. This would allow the superannuation industry, with Government assistance, the opportunity to implement appropriate education strategies and sufficient lead time for trustees to reorganise the administrative/technological capacities of their funds.

2.72 The committee notes LIFA's evidence that, if the trustee of any industry fund wanted to offer a particular service involving BIC, then one or more of its (LIFA's) members would be able to accommodate that need.[52]

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51 'Should your fund offer member investment choice?', presented by Bob Putnam, Manager Superannuation, CSR Limited, at the J.P. Morgan Industry Funds Symposium on 19 July 1994 in Melbourne

52 Evidence, p 91

Recommendation 2.3

The committee recommends that the trustees of all standard employer-sponsored funds with fifty or more members (except those defined benefit funds which have no member generated accumulation component) be required to offer beneficiary investment choice to their members in accordance with the provisions of SIS regulation 4.02.

The committee also recommends that this not be introduced before the community education campaign, being conducted by the superannuation industry in conjunction with the ISC and ATO, nor before fund trustees are able to reorganise, as necessary, the administrative/ technological capacities of their funds to ensure the smooth introduction of BIC.

CHAPTER 3:

THE SOLE PURPOSE TEST AND CHARGES OVER ASSETS

Introduction

3.1 This chapter deals with issues arising from the submissions and evidence concerning the sole purpose test (section 62 of the SIS Act) and SIS regulation 13.14 which prevents charges over the assets of funds.

3.2 These issues are:

(i) that SIS regulation 13.14, preventing charges on superannuation assets, be relaxed;[53] and

(ii) the possible conflict between garnishee orders issued under section 1233 of the *Social Security Act 1991* and the sole purpose test.[54]

Charges over the assets of funds

Legislation

3.3 SIS regulation 13.14 states:

> For the purposes of subsections 31(1) and 32(1) of the Act, it is a standard applicable to the operation of regulated superannuation funds and approved deposit funds that, subject to regulation 13.15, the trustee of a fund must not give a charge over, or in relation to, an asset of the fund.

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53 National Australia Bank, SISREG Sub No 5

Arthur Robinson and Hedderwicks, SISREG Sub No 19

54 LIFA, SISREG Sub No 17

3.4 SIS regulation 13.15 states:

> The standards stated in regulations 13.12, 13.13 and 13.14 do not apply to an assignment or charge that is permitted, expressly or by implication, by the Act or these Regulations.

The provision of security against various transactions

I - Derivatives

3.5 Arthur Robinson & Hedderwicks (ARH) submitted that the prohibition against charges over assets, as currently worded, could operate to prevent trustees from entering into agreements with brokers which would enable them to undertake transactions in respect of futures, options and other derivative instruments, both in Australia and overseas.[55] These transactions could be prevented because the 'standard form' agreements upon which these transactions are based require the fund trustees to lodge with brokers an amount of money or securities in a 'collateral account'. These accounts are charged in favour of the broker as security against unfavourable margin calls and can be viewed as a charge over the assets of the fund. ARH stated in their submission that the ISC had advised that the legislation had not been intended to prevent trustees from entering into derivative transactions.

3.6 Notwithstanding that derivatives transactions can be a valuable instrument for managing financial risk, for example, by hedging funds' exposure to currency and other risks, the committee considered that a cautionary note needed to be sounded in the use of these financial products. Although the use of such derivatives to manage financial risk would appear to be perfectly legitimate in the financial management of superannuation funds, overseas experience, particularly in the United States of America, has demonstrated that some derivative transactions have been devised which move beyond this relatively simple function. One example is the volatile, illiquid derivative based on the price of mortgages.[56] Such transactions appear to be approaching the realm of speculative investments for their own

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55 SISREG Sub No 19

56 'Mutual funds' derivatives dilemma', *The Economist*, 3 September 1994,p73

sake, rather than serving any hedging function. They do not appear to be investments appropriate to superannuation, other than within the normal construction of diversified portfolios, with their attendant spectrum of risk profiles.

3.7 The Committee considers that it would be appropriate for this issue to be examined in greater detail, as excessive use of these transactions may well expose superannuation funds, and hence their members' accrued entitlements, to unnecessary risk.

Recommendation 3.1

The committee recommends that the Government review, and if necessary move to limit, the exposure of superannuation entities to certain derivatives transactions.

II - Custodians

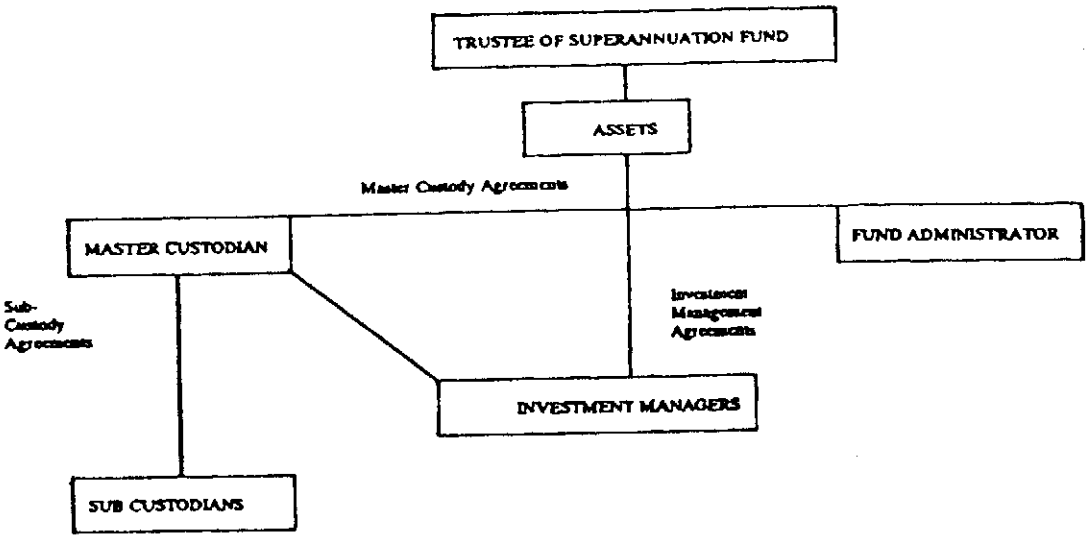
3.8 In a supplementary submission, ARH stressed the importance of custodians, particularly master custodians, within the superannuation industry:

> ...many large superannuation funds engage a master custodian to take responsibility for all of the fund's investment asset administration needs, and to provide clearing and settlement functions, consolidating reporting, "paperwork control" and information regarding rights issues, takeovers and other corporate actions relevant to shares held in the portfolio. Most master custodians also provide valuations, asset performance measurement, accounting, taxation and other related services and some also provide securities lending programs, foreign exchange services, proxy voting, and compliance services.
>
> Where a superannuation fund engages more than one investment manager, difficulties can arise in reconciling differences in reporting methods, keeping track of asset allocations, effecting securities settlement and safekeeping, collecting and reconciling income and other receipts, analysing asset performance and other areas.
>
> ...around 80 Australian superannuation funds have engaged a master custodian. Most of these are superannuation funds with more than $100 million in assets and who use four or more investment managers...

> We further understand from Towers Perrin that capacity among the suppliers of custodian services for the Australian market is not sufficient to meet the present demand. As a result, Towers Perrin has found that client superannuation funds are sometimes unable to enter into custody arrangements with a preferred custodian which has had insufficient capacity to take on a new portfolio within a required time frame.[57]

The place of the master custodian and the sub-custodians in the superannuation fund structure is set out in a diagram provided by ARH and appears at Figure 1.

Figure 1:
The Place of Custodians in a Superannuation Fund



57 SISREG Sub No 19, supplementary

3.9 ARH submitted that master custody agreements put to trustees invariably contain provisions that a charge be granted to the custodian to cover claims for payment of fees and expenses, and that these charges are required for two reasons:

(i) such a charge is customary within the custodianship industry to protect custodians from occasional substantial exposures resulting from their payment of registration fees, transaction charges, production fees, script exchange fees and the like which enable them to discharge their obligations to effect settlements; and

(ii) sub-custodians engaged by master custodians (to deal with local settlements and transactions et cetera especially in other countries) generally request charges to cover their own exposure.

3.10 The National Australia Bank's Custodian Services (NAB) expressed very similar concerns over regulation 13.14, asserting that:

> The undoubted interests of fund members in unencumbered, ungeared portfolios must be balanced against the bona fide interest of service providers to the fund or trustees in being remunerated for their services and reimbursed for expenses incurred in good faith. Protection of such interests is specifically provided in comparable regulations in other jurisdictions.[58]

The other jurisdictions referred to by the NAB include the USA, Canada, the UK and Hong Kong. The NAB submits that:

> the prudential standard applicable to Australian superannuation entities should equate to that applying in comparable jurisdictions, ie fees, costs and expenses attributable to the safe keeping or administration of fund assets should be exempted from any prohibition against encumbering fund assets.[59]

3.11 Roger Nairn of NAB reiterated that there were a number of transactions which are normal administrative management matters for which a supplier would expect to be covered, for example, on short term borrowings where fees in advance are required. Other examples given

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[58] SISREG Sub No 5

[59] SISREG Sub No 5

included within-the-day facilities to support trading activities, and forward foreign exchange dealing facilities which create obligations and which are provided against the general financial strength of the fund.[60]

3.12 The fundamental point made by NAB was that a range of transactions, which are normal to the operation of a fund, including bona fide investment activities by funds, may be severely impeded with little consequential benefit to members and trustees if regulation 13.14 prohibition was applied literally. This would also be the case if regulation 13.14 applied to fees which are payable for the safe custody and administration of fund assets. In some major jurisdictions, such fees appear to be exempt from prohibitions upon rights, charges, liens, pledges, security interest or any other encumbrances.

Possible Consequences

3.13 A possible scenario postulated by Mr Nairn was that if service providers were denied exemptions from the prohibition they would:

> ...almost certainly seek to minimise their exposures by not permitting borrowing, requiring fees in advance, the establishment of slush funds for the payment of incidental costs and expenses and/or refuse to meet such expenses until finances to cover are provided by the fund.[61]

3.14 ARH similarly submitted that it would be reasonable to expect that custodians who are asked to provide the usual range of services without the usual security will consider:

- whether fees charged to Australian superannuation fund clients need to be increased to take account of the higher level of risk (we understand that some custodians have already increased fees);

- whether trustees should be required to permit the custodian to keep liquid funds available to the extent required to enable a custodian and sub-custodians to meet transaction and other costs "up front" (with corresponding effects on the fund's rate of return);

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60 Evidence, pp 60-65

61 SISREG Sub No 5

- whether their own insurance arrangements are affected by the absence of security in respect of Australian superannuation fund portfolios, with consequential pressures on costs;

- whether, in the absence of security, custody agreements need to include stronger indemnities and other provisions aimed at strengthening the custodian's position;

- whether other jurisdictions offer business opportunities which should be pursued ahead of those available in the Australian market.[62]

Other Matters

3.15 In its supplementary submission, NAB sought to address concerns raised by the committee that the prohibition of charges over assets in relation to custodians serves as a means of enforcing rigorous control of expenditure by the custodian, thereby preventing abuse of power or the claiming of unauthorised expenditure.[63]

3.16 NAB submitted that the exemption sought in relation to custody of a fund's assets would not of itself create charges over assets, but simply provides a fund with more room to manoeuvre in negotiating investment activities.[64] NAB also maintained that allowing such exemptions would benefit members as well as custodians because many types of investments, risk management techniques, facilities and services which may well have been closed to an investor if security of the obligations involved cannot be given, would remain available. In addition, NAB submitted that custodians have no power to encourage prudence in investment as, by its nature, custody of assets occurs after the investment has been made.

3.17 The committee acknowledged the difficulties in evaluating an area of considerable financial and legal complexity. The committee understands that the prohibition in the SIS Act upon borrowings by superannuation entities did not extend to many debts and other liabilities incurred by funds

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62 SISREG Sub No 19, supplementary

63 Evidence, p 62

64 SISREG Sub No 5, supplementary

in the normal conduct of their business, for example: reimbursement of fees and advances, within-the-day settlement of transactions, and 'standard form' agreements with brokers and daily running expenses. The committee also understands that the ISC intends, in due course, to issue a Superannuation Circular to clarify this issue.

3.18 It seemed inconsistent that a range of routine transactions which incur debts and other liabilities and which are not prohibited under the anti-borrowing rules should be prevented by the operation of regulation 13.14. Given that debts and other liabilities would often only be able to be incurred upon provision of a security, in this case, the assets of a fund, the committee believes that it would be appropriate for the ISC to re-examine regulation 13.14. *But the committee wishes to reiterate its statements in previous reports on the need for a prudential regime which provides the utmost protection for superannuation funds. In particular, the committee considers that custodians should not be given the status of a preferred creditor, nor should any charge over assets exercised by a custodian significantly exceed the amount required to cover expenses outlaid by the custodian or apply at all in respect of custodian's fees.*[65]

3.19 NAB also submitted that similar problems may be associated with some conditions being drafted by the ISC for the purposes of subsection 26(3) of the SIS Act. These conditions will include the provisions which must be included in any agreement between the trustee and a custodian of assets of superannuation entities. The committee considers that the importance of proper custodial and other financial services for superannuation entities, and their possible impact on members' benefits, should not be underestimated.

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[65] Arthur Robinson & Hedderwick, SISREG Sub No 19, supplementary

Recommendation 3.2

The committee recommends:

(i) that, within the context of a clear need for a strong prudential supervision regime for superannuation funds, the Government review the operation of SIS regulation 13.14 to establish whether it unnecessarily constrains legitimate investment activities of superannuation entities;

(ii) that if any such unnecessary constraints are identified, they be remedied, after consultation with the major providers of financial services to superannuation entities, through appropriate amendments to the legislation; and

(iii) that the ISC publish an explanation of this review in a Superannuation Circular.

The sole purpose test and garnishee orders under the *Social Security Act 1991*

3.20 LIFA submitted that section 1233 of the *Social Security Act 1991*, which enables the Department of Social Security to serve garnishee notices on debtors, has been used by that Department to gain access to accrued entitlements of members of superannuation funds.[66] LIFA submitted that a trustee who obeyed such a notice would be in breach of:

- section 62 of the SIS Act, the 'sole purpose test', which prescribes the timing of benefit delivery and the persons to whom benefits become payable;

- SIS regulation 6.22, which limits the cashing of benefits in regulated superannuation funds in favour of persons other than members; and

[66] SISREG Sub No 17

- SIS regulations 13.12, 13.13, and 13.14, which prevent a trustee from recognising an assignment of a superannuation interest of a member or beneficiary, or from giving a charge over minimum benefits, preserved benefits, non-commutable income streams, or an asset of a fund.

3.21 A breach of these provisions can subject a trustee to monetary penalties or imprisonment. [67]

3.22 The committee notes that this issue has also arisen in considerations involving the recovery of outstanding money following bankruptcy proceedings, as well as recovery of unpaid tax. The committee understands that measures are being implemented to make the necessary changes to the SIS Act and the Bankruptcy Act which will allow the assignment of superannuation entitlements which exceed a member's RBL. In a supplementary submission, the ISC has advised that it has taken the view that superannuation assets should not be accessible by garnishee orders and other claims for indebtedness, particularly for preserved benefits.[68]

3.23 The issues involving conflicts between the SIS sole purpose test and associated SIS legislation on the one hand, and the service of garnishee orders from the Department of Social Security as well as recovery of unpaid tax by the Australian Tax Office on the other hand, appear to fall within a common category. The committee expects that these issues will be resolved through consultation with the appropriate organisations.

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[67] (i) Part 21 of the Act provides for certain criminal consequences of contravening or of being involved in a contravention of subsection 62 (1) of the Act.

(ii) SIS Regulations 6.22, 13.12, 13.13 and 13.14 prescribe standards under one or more of Sections 31, 32 and 33 of the Act, intentional or reckless contravention of which is punishable on conviction by a fine

[68] SISREG Sub No 20, supplementary

Recommendation 3.3

The committee recommends that, consistent with the policy of limiting recovery of Commonwealth debts from the members' superannuation accounts to those amounts which exceed RBL levels, the Government review and reconcile any conflict arising between:

(i) the SIS legislation; and

(ii) the tax and social security legislation which enables recovery of money.

CHAPTER 4:

THE REMAINING REGULATIONS

Introduction

4.1 This chapter addresses the following submissions and evidence brought to the committee's attention during the inquiry:

(i) that the definitions of 'member' and 'beneficiary' in the SIS Act and SIS regulations be clarified;[69]

(ii) that various disclosure requirements be changed;[70]

(iii) that the number of members of 'excluded funds' (currently less than 5) be enlarged or that funds with non-arms length members receive different treatment under SIS;[71]

(iv) that old life policies be convertible into superannuation policies;[72]

(v) that the age at which retirement can be presumed when a person has ceased gainful employment be reduced from 60 to 55;[73]

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69 LIFA, SISREG Sub No 17; Evidence, p 86

70 ANZ Funds Management, SISREG Sub No 7
Office of the Cabinet, Queensland, SISREG Sub No 10
Financial Planning Association of Australia, SISREG Sub No 11
LIFA, SISREG Sub No 17
Permanent Trustee Company, SISREG Sub No 24

71 Howard V Smith and Associates Pty Ltd, SISREG Sub No 12
G&E Foti Enterprises Pty Ltd, SISREG Sub No 18

72 Chris Hanson, SISREG Sub No 9

73 LIFA, SISREG Sub No 17

(vi) that the preservation of benefits arising out of SG contributions and the changes to the preservation rules take effect from 1 July 1995;[74]

(vii) problems with the pension and annuity standards;[75]

(viii) various technical amendments;[76] and

(ix) concerns about the possibility of retirement being inappropriately enforced on a member of a fund on medical grounds.[77]

4.2 The committee also acknowledges the receipt of submissions from the following persons. Mr J. M. Kelberg expressed concern with the manner in which the Shell Superannuation Fund repatriated surplus to the Shell Company.[78] Mr Bryce Jarrett submitted that a system be introduced enabling lump sum superannuation payments to be directly invested as venture capital.[79]

4.3 Prior to the hearings, the ISC resolved issues relating to a submission from the Bus and Coach Association that the 'approved trustee' requirements for industry funds with self employed members should be relaxed.[80] Also resolved was the problem of whether 'excluded funds'

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74 LIFA, SISREG Sub No 17

75 LIFA, SISREG Sub No 17

76 ANZ Funds Management, SISREG Sub No 7
Office of the Cabinet, Queensland, SISREG Sub No 10

77 SISREG Sub No 27

78 SISREG Sub No 21

79 SISREG Sub No 25

80 Issue raised in SISREG Sub No 2 from the Bus and Coach Association; its resolution foreshadowed by ISC Information Statement No 4 of 20 June 1994 in which the ISC announced that certain public offer funds will be temporarily exempted from the requirement to have an 'approved trustee' under SIS

should be exempted from the requirements imposed on public offer funds, raised in a submission by Self Management Retirement Systems Pty Ltd.[81]

Definition of 'member' and 'beneficiary'

Definition of 'member'

4.4 SIS regulation 1.03 defines a 'member' to mean:

> (a) ...
>
> (b) in relation to a regulated superannuation fund - a member of the fund;

The definition of 'member' in Part 2 of the SIS regulations, which prescribes the standards applying to the provision of information to members and others, includes pensioners and deferred beneficiaries.

4.5 LIFA submitted that the definition of 'member' in SIS regulation 1.03:

> does not actually provide any meaning of who constitutes a member of a superannuation fund;[82]

and that it was:

> imperative that a substantive definition of member is given in relation to a superannuation fund which overrides any trust deed requirements in relation to the fund in this regard.[83]

4.6 LIFA did not support their submission on this matter except to suggest that the definition be redrafted along the following lines:

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81 Issue raised in SISREG Sub No 16 by Self Management Retirement Systems Pty Ltd; its resolution was also foreshadowed in ISC Information Statement No. 4 of 20 June 1994 in which the ISC announced that 'excluded funds' which met certain requirements will not be considered to be public offer funds

82 SISREG Sub No 17

83 SISREG Sub No 17

> a person who has been accepted by the trustees as a member of the fund and in respect of whom the trustees have not fully discharged their liability to pay the person a benefit or benefits[84]

The committee notes that such an amendment would more or less bring the definition in line with the expanded definition in Part 2 of the SIS regulations.

4.7 The committee considers that small funds could be disadvantaged if the current definition was amended in this way, as the inclusion of pensioners and/or deferred beneficiaries into the main definition could in many cases inflate the numbers of members in such a fund beyond two key thresholds.

4.8 The first was the threshold of 4 members which constitutes an excluded superannuation fund, and which is not subject to some of the more onerous provisions of the SIS legislation.

4.9 The second was the threshold of 49 members, which is the maximum number of members which may be in a non-public offer fund after 1 July 1995 to which the alternative agreed representation rules can apply (that is: as an alternative to basic equal representation rule which requires equal numbers of employer representatives and member representatives amongst the trustees, a corporate trustee can be appointed following nomination by agreement between the majority of the members of the fund and the employer(s) of the members).

4.10 These thresholds do not affect funds with 50 or more members. It would appear that as the requirements under the regulations for trustees of funds to disclose information to members already included pensioners and deferred beneficiaries, the principal impact of the inclusion of these beneficiaries within the definition of 'member' would be in the areas of notifying members in case of a repatriation of surplus to employers, and equal representation of employers and members on trust boards.

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[84] SISREG Sub No 17

4.11 The committee sees no reason why pensioners and beneficiaries of superannuation funds should not be members, with the attendant rights of member representation. It seems anomalous that:

(i) funds are required to provide the same information to pensioners and deferred beneficiaries that they are required to offer 'active' members;

(ii) funds are empowered to offer beneficiaries (including pensioners and deferred beneficiaries) choice in the manner in which their money is invested; and

(iii) funds have an obligation to pay certain pensioners and deferred beneficiaries;

but under the current SIS regime, these pensioners and deferred beneficiaries are not considered to be members.

4.12 The thresholds issue referred to in paragraphs 4.8 and 4.9 could perhaps be addressed by allowing excluded funds and funds with less than 50 'members', as currently defined, to continue to be considered to come under the thresholds for the purposes associated with those thresholds.

Recommendation 4.1

The committee recommends that the Government review the definition of a 'member' of a regulated superannuation fund under SIS with a view to including those persons who are pensioners or deferred beneficiaries of such a fund.

Definition of 'beneficiary'

4.13 The definition of 'beneficiary' in subsection 10(1) of the SIS Act states that:

> **"beneficiary"**, in relation to a fund, scheme or trust, means a person (whether described in the governing rules as a member, a depositor or otherwise) who has a beneficial interest in the fund, scheme or trust and includes, in relation to a superannuation fund, a member of the fund despite the express references in this Act to members of such funds.

4.14 LIFA submitted that the definition of 'beneficiary' was inadequate, as it was insufficiently broad to include a number of categories of persons who would have a legitimate interest in decisions made by trustees.[85] Of the examples provided by LIFA, one was a dependant of a member in respect of whom the trustees have not or will not exercise their discretion as to the distribution of a death benefit (and hence is not a beneficiary as defined in the Act for the purposes of being able to lodge a complaint with a fund, and hence the Superannuation Complaints Tribunal, because s/he does not have a beneficial interest in the fund until the trustee has exercised its discretion in that person's favour).

4.15 The committee considers that the SIS legislation should be applied fairly and, to this extent, considers it appropriate to ensure that the Superannuation Complaints Tribunal be empowered to hear the legitimate complaints of persons affected by trustees' decisions.

Recommendation 4.2

The committee recommends that the Government amends any inconsistencies in the definition of 'beneficiary' in the SIS legislation to allow full access to:

(i) the internal complaints mechanisms within superannuation funds; and

(ii) the Superannuation Complaints Tribunal.

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[85] SISREG Sub No 17

Disclosure requirements for superannuation entities

4.16 A number of submissions were received raising concerns about the various requirements to disclose and forward information:

(i) Permanent Trustee Company Limited submitted that the requirement for audit certificates in relation to employer-sponsored public offer funds to be given to trustees within four months is unnecessarily burdensome. A six month requirement was suggested.[86]

(ii) LIFA expressed concerns about the benefit illustration requirements in a forthcoming ISC Determination which is being drafted by the ISC pursuant to section 159 of the SIS Act in relation to prospective beneficiaries other than standard employer-sponsored members.[87] LIFA submitted that the requirement in the SIS regulations to report contributions arrears to members, as well as the action that the trustees had taken or were proposing to undertake to have the contributions paid, should be amended in the light of industry fund experience which makes accurate information in this context difficult to report.

(iii) The Financial Planning Association suggested that the SIS regulations be amended to compel employer-sponsored superannuation funds to meet the same disclosure requirements as applying to public offer funds, and for employer-sponsored members to receive information that was sufficient for them to make informed decisions.[88]

(iv) The Queensland Office of the Cabinet expressed concerns at the difficulty some funds will encounter in complying with some of the disclosure requirements in the SIS regulations. For example, the requirement for a fund to provide certain information to a member

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[86] SISREG Sub No 24

[87] SISREG Sub No 17

[88] SISREG Sub No 11

who is exiting a fund within one month of ceasing membership may be difficult to comply with if the fund does not have all available information to process benefit details. Another concern was that eligible rollover funds may not be able to supply the Insurance and Superannuation Commissioner with all the information required under the SIS regulations as some information may not be held by the fund transferring the information.[89]

(v) ANZ Funds Management requested that the SIS regulations which require a trustee to quantify in a report to a member the amount of benefits which must be preserved, be amended to make it clear that the amount referred to in the report should be the amount preservable under the governing rules of the fund, if that amount is higher than the amount preservable under the regulations.[90]

4.17 In addition, the committee noted that Noel Davis had recently commented in the print media that there was an anomaly in the SIS legislation relating to disclosure.[91] He commented that trustees are not required to provide a prospectus to standard employer-sponsored members of a fund that is not a public offer fund, but are required to provide a prospectus to standard employer-sponsored members of a fund that is a public offer fund. The committee notes that under the SIS legislation, the requirement for prospectuses has been replaced by the requirement to provide certain information to prospective members.

4.18 While the majority of these concerns amount to possible 'housekeeping' amendments, the level of information to be provided to standard employer-sponsored members will need to be upgraded once BIC has become an entrenched feature of standard employer-sponsored funds, and members of these funds take a more active interest in their participation in superannuation.

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89 SISREG Sub No 10

90 SISREG Sub No 7

91 Australian Superannuation Law Bulletin Editorial, (1994) 6 SLB 29

Recommendation 4.3

The committee recommends that:

(i) the Government examine the concerns expressed to the committee about the various disclosure requirements and take appropriate action; and

(ii) consistent with any policy to implement BIC initiatives, the Government review and upgrade the provisions in the SIS legislation, prescribing the amount of information to be provided to standard employer-sponsored members.

Small and excluded superannuation funds

4.19 The SIS Act defines an excluded superannuation fund as a superannuation fund:

> of which there are fewer than five members.[92]

4.20 Howard Smith & Associates submitted that the definition of 'excluded superannuation fund' should be amended to allow funds with up to 9 members or to allow family members to join without depriving a fund of its 'excluded' status. This reflects their concern that:

> Over the years we have seen an increase of family members being introduced into the fund and when children marry, it is increasingly becoming a problem for in-laws to be admitted to these funds. The cost of establishing a second fund is in many instances prohibitive.[93]

4.21 Mr Cosimo Foti of G. & E. Foti Enterprises expressed similar concerns, namely that:

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92 Subsection 10(1) of the SIS Act 1993

93 SISREG Sub No 12

> because my parents had three children instead of only two, ...our superannuation fund must adhere to the same reporting requirements as AMP and National Mutual.[94]

4.22 The committee noted that the SIS legislation exempted excluded superannuation funds from some of the more onerous requirements of the SIS Act and SIS regulations. In addition, the committee noted that the ISC had released an Information Bulletin on 20 June 1994 announcing that excluded funds which met certain requirements will not be considered to be public offer funds and will not therefore be required to have an 'approved trustee' under SIS or to meet public offer disclosure rules.

4.23 Moreover, subsection 18(7) of the SIS Act enables the Insurance and Superannuation Commissioner to declare a fund not to be a public offer fund, which enables family funds such as the ones described above to be exempted from many public offer obligations.

4.24 However, there appear to be a substantial array of rules under SIS which exempt excluded funds, but do not exempt small funds, for example:

- the requirement that a trustee give each new member of a fund an extensive inventory of information, including statements of how fees, charges and administrative or other operational costs are attributed, either directly or indirectly, to members;[95]

- an operating standard which requires the trustee of a fund to formulate and give effect to an investment strategy;[96]

- the prohibition of trustees acquiring the assets of members or their relatives;[97]

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94 SISREG Sub No 18

95 SIS regulation 2.16

96 SIS regulation 4.09

97 Section 66 of the SIS Act

- equal representation and alternative agreed representation requirements;[98]
- the restrictions on the appointment of investment managers and custodians;[99]
- payment of surplus amounts to employer-sponsors;[100]
- various duties of trustees and investment managers of superannuation entities, including the need to establish internal complaints mechanisms;[101]
- various requirements in relation to auditing of fund accounts and the lodgment of annual returns;[102]
- trustees not being subject to direction, and exercises of discretion by persons other than trustees;[103] and
- amendments of governing rules;[104]

4.25 The committee did not see that an exemption from many or all of these requirements for a fund such as the kind described in paragraphs 4.19 and 4.20 would prejudice the SIS legislation.

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98 Part 9 and section 107 of the SIS Act

99 Part 15 of the SIS Act

100 Section 117 of the SIS Act

101 Part 12 of the SIS Act

102 For example: SIS regulations, 1.04(2), 8.03 and 11.02

103 Sections 58 and 59 of the SIS Act

104 Section 60 of the SIS Act

Recommendation 4.4

The committee recommends that the Government examine the rules imposed under the SIS legislation upon small non-excluded superannuation funds consisting of non-arms length membership, with the aim of introducing flexibility into the requirements.

Presumed age of retirement

4.26 The SIS regulations enable a person aged 60 or more to gain access to that person's preserved benefits once s/he has ceased an employment arrangement (for example, through resignation, retirement, retrenchment, redundancy or on medical grounds).[105] The SIS regulations also enable a person aged 55 or over to gain access to the preserved benefits if s/he has similarly ceased employment and the trustee is reasonably satisfied that the person has, in effect, retired.

4.27 LIFA submitted that the age where retirement is presumed in such circumstances should be lowered to age 55 because for trustees:

> to continue to need to satisfy themselves that a person who resigns from employment from age 55 to 59 is retiring, unnecessarily adds another layer of complexity to the process of paying benefits.[106]

4.28 The committee accepted LIFA's assertion that the current requirement adds an unnecessary layer of complexity to the process of paying benefits. The committee also considered that lowering the age of presumed retirement should also eliminate any administrative costs associated with the need for trustees to investigate a person's employment circumstances and to attempt to verify what are often subjective motivations on the part of fund members. The requirement for trustees to evaluate the employment circumstances of beneficiaries in the age 55 to 59 bracket

105 SIS regulation 6.01 (7)

106 SISREG Sub No 17

would, in any case, disappear once preservation to age 60 became universal by the year 2025.

Recommendation 4.5

The committee recommends that the Government review SIS subregulation 6.01(7), which relates to the presumed age of retirement, to ensure that it is consistent with its overall policy on preservation.

Preservation rules

4.29 LIFA also submitted that, in the interests of simplicity, benefits arising out of SG contributions and the new preservation rules which have been included in Part 6 of the SIS regulations should commence from a common date.[107] LIFA suggested delaying the preservation of SG contributions until the 1996 calender year (in line with the Part 6 requirements for preservation generally), or to bring the date of effect of Part 6 forward to 1 July 1995 and to also commence preservation of SG benefits from that date.

4.30 The committee is unable to endorse these suggestions because the preservation date for SG contributions has already been deferred twice, from 1 July 1992 and 1 July 1993 to 1 July 1994. Further deferrals would significantly reduce the amounts of benefits preservable until members' retirements, an important plank in retirement income policy. Although this may be offset under the second option by bringing forward the preservation requirements from 1996 to 1995, the committee does not consider that any further changes to the preservation rules can be justified.

Pension and annuity standards

4.31 The committee agrees with LIFA's submission that the pension and annuity standards which were recently copied into the SIS regulations from

[107] SISREG Sub No 17

the Occupational Superannuation Standards (OSS) regulations are incomplete, in particular in relation to the tax treatment of commutations of allocated pensions and annuities.[108] Currently, the regulations prescribe upper and lower limits on the amounts of benefits that can be paid in relation to allocated income streams in any given year of income. Although commutations above the upper limit are specifically allowed under the standards, the Government has not as yet finalised the rules governing the tax treatment of such commutations.

4.32 It is a matter of some considerable concern to the committee that important rules concerning allocated pensions and annuities have not yet been completed, particularly in light of the popularity of such products. The committee is concerned that this delay will generate a policy, virtually by default, that may result in unduly generous tax treatment of commutations on allocated income streams.

4.33 The committee understands that the ISC is conducting a review of the pension and annuity standards. Nevertheless, the issue involving the tax treatment of commutation of allocated pensions and annuities has been outstanding since the standards were promulgated in the OSS regulations in late 1992.

Recommendation 4.6

The committee recommends that the Government remove uncertainty surrounding the tax treatment of commutations of allocated pensions and annuities by expeditiously finalising the rules governing the tax treatment of commutations of these benefits.

[108] LIFA SISREG Sub No 17

Inappropriate retirement on medical grounds

4.34 Dr G.J. Acton, of Seaview Downs in South Australia, expressed concerned about the accountability of trustees who inappropriately retired members on medical grounds as totally and permanently incapacitated (T&PI), reviewed those members a short time later and reduced their benefits following a determination that the person concerned was no longer T&PI.[109] Dr Acton expressed a concern that he had not been able to have his case determined by an independent tribunal such as the recently established Superannuation Complaints Tribunal (the Tribunal).

Other matters

4.35 ANZ Funds Management and the Queensland Office of the Cabinet raised a number of issues of a technical nature, the latter expressing concerns about whether partial disability pensions were allowed under SIS, and whether the prohibition of liens over benefits was wider than intended.[110] Mr Chris Hanson, of Hawthorn in Victoria, was concerned that a whole-of-life insurance plan which he had taken out in 1972 could not now be converted into a superannuation policy because of the changes in the rules concerning superannuation since that time.[111]

4.36 The committee considers that it would be appropriate to refer these matters to the ISC for review, and if possible, resolution.

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[109] SISREG Sub No 27

[110] SISREG Subs Nos 7 and 10, respectively

[111] SISREG Sub No 9

CHAPTER 5:

AWU-FIME

Background

5.1 On 13 July 1994, *The Australian* published an article titled 'Union gets 20pc of super fund as management fee'. The following day, the same newspaper followed this up with another article: 'ABA denounces union-super pact'.[112]

5.2 This issue provoked some discussion in the committee during its hearing on 13 July 1994. It also provided an opportunity for the committee to seek the views of other industry players on the arrangement that had been entered into by the AWU/FIME Amalgamated Union and the administrators of the Nationwide Superannuation Fund (NSF), Professional Services Investment Pty Ltd (PSI).[113] That arrangement involves twenty per cent of the 73 cent administration fee levied by the NSF and received by PSI being paid to the AWU-FIME by the PSI as a contractual obligation to cover some of the costs incurred by the union in marketing the fund.[114]

The sole purpose test

5.3 One of the committee's concerns about the arrangement between the AWU-FIME and the PSI was the question of whether there had been a breach of the sole purpose test under either the Occupational Superannuation Standards Act 1987 or the SIS Act, given that part of the

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[112] See Appendix G

[113] Namely, David Goodear and David Vernon of Jacques Martin Industry, who expressed opposition to the arrangement - Evidence, pp 139-141, 13 July 1994

[114] AWU/FIME, SISREG Sub No 29
Steve Harrison, Evidence, p 486, 19 September 1994

administration fees reimbursed to the union had been used in providing scholarships to members of the union.[115]

5.4 Evidence given by Steve Harrison of the AWU/FIME and Michael Tyler, Chairman of PSI, to the committee on 19 September 1994 denied any breach of the sole purpose test.[116] A letter from Paul Elliott, the Parliamentary Secretary to the Treasurer, published by the committee on 23 September 1994, supports this assertion. The ISC had provided Mr Elliott with information following a meeting between the ISC, the AWU-FIME, the trustees of NSF, and PSI. Mr Elliott's letter stated:

> * The agreement is between PSI and FIMEE, rather than between NSF and FIMEE, and it relates to the subcontracting of administration and promotional services to FIMEE. Although the trustees of NSF were aware of the agreement, they were not a party to it and were not concerned by it.
>
> * The administration fee earned by FIMEE is a commercial arrangement made on an arm's length basis...
>
> * The link between union scholarships and the fee derived by FIMEE ...has nothing to do with arrangements between NSF and PSI and is not a concern to either NSF or the ISC because the arrangement with FIMEE is on commercial terms.
>
> * ...
>
> On the basis of the information and documentary evidence provided by NSF and FIMEE, the fees earned by FIMEE, and the linking of union scholarships and other benefits for union members, in return for services provided by FIMEE is not seen as inappropriate or a threat to the retirement incomes of NSF members.[117](original emphasis)

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115 Information concerning use of reimbursement provided by AWU-FIME, SISREG Sub No 29

116 Evidence, p 497, 19 September 1994

117 SISREG Sub No 31

Conclusion

5.5 Mr Elliott's letter referred to 'many factual inaccuracies' in the article by *The Australian*. The committee expresses the hope that such inaccuracies would in future be kept to a minimum to enable a climate of reasoned debate and discussion. The whole field of superannuation and retirement income policy is fraught with enough complications without the issue being further complicated by such misreporting.

5.6 In any event, the committee notes that this matter has raised some consternation in the superannuation industry, and understands that it is currently under examination by the ISC.

APPENDIX A:

TERMS OF REFERENCE

16 March 1994

That, without prejudice to any inquiry or report that may be made by the Standing Committee on Regulations and Ordinances, the following regulations be referred to the Senate Select Committee on Superannuation for inquiry and report on or before the last sitting day in November 1994:

(a) Superannuation Industry (Supervision) Regulations (Statutory Rules 1994 No. 57); and

(b) Superannuation (Resolution of Complaints) Regulations (Statutory Rules 1994 No. 56).

APPENDIX B:

LIST OF COMMITTEE REPORTS AND PAPERS

Super System Survey - A Background Paper on Retirement Income Arrangements in Twenty-one Countries (December 1991)

Papers relating to the Byrnwood Ltd, WA Superannuation Scheme (March 1992) Interim Report on Fees, Charges and Commissions in the Life Insurance Industry (June 1992)

First Report of the Senate Select Committee on Superannuation - *Safeguarding Super* - the Regulation of Superannuation (June 1992)

Second Report of the Senate Select Committee on Superannuation - *Super Guarantee Bills* (June 1992)

Super Charges - An Issues Paper on Fees, Commissions, Charges and Disclosure in the Superannuation Industry (August 1992)

Third Report of the Senate Select Committee on Superannuation - *Super and the Financial System* (October 1992)

Proceedings of the Super Consumer Seminar, 4 November 1992 - (4 November 1992)

Fourth Report of the Senate Select Committee on Superannuation - *Super - Fiscal and Social Links* (December 1992)

Fifth Report of the Senate Select Committee on Superannuation - *Super Supervisory Levy* (May 1993)

Sixth Report of the Senate Select Committee on Superannuation - *Super - Fees, Charges and Commissions* (June 1993)

Seventh Report of the Senate Select Committee on Superannuation - *Super Inquiry Overview* (June 1993)

Eighth Report of the Senate Select Committee on Superannuation - *Inquiry into the Queensland Professional Officers Association Superannuation Fund* (August 1993)

Ninth Report of the Senate Select Committee on Superannuation - *Super Supervision Bills* (October 1993)

Tenth Report of the Senate Select Committee on Superannuation - *Super Complaints Tribunal* (December 1993)

Eleventh Report of the Senate Select Committee on Superannuation - *Privilege Matter Involving Mr Kevin Lindeberg and Mr Des O'Neill* (December 1993)

A Preliminary Paper Prepared by the Senate Select Committee on Superannuation for the Minister for Social Security, *Options for Allocated Pensions Within the Retirement Incomes System* (March 1994)

Twelfth Report of the Senate Select Committee on Superannuation - *Super for Housing* (May 1994)

Thirteenth Report of the Senate Select Committee on Superannuation - *Super Regs I* (August 1994)

Fourteenth Report of the Senate Select Committee on Superannuation - *Super Regs II* (November 1994)

APPENDIX C:

LIST OF WRITTEN SUBMISSIONS

No 1	Australian Consumers' Association (ACA)
No 2	Bus and Coach Association
No 3	Tidswell Benefit Consultants and Fund Administrators
No 4	Freedom of Choice Fund Management Ltd
No 5	National Australia Bank
No 6	Trustee Corporations Association of Australia
No 7	ANZ Funds Management
No 8	Australian Federation of Consumer Organizations Inc. (AFCO)
No 9	Chris Hanson
No 10	Office of the Cabinet, Queensland
No 11	Financial Planning Association of Australia (FPA)
No 12	Howard V Smith & Associates Pty. Ltd.
No 13	Sly & Weigall
No 14	Attorney-General's Department
No 15	August Financial Management Limited
No 16	Self Management Retirement Systems Pty Ltd

No 17 Life Insurance Federation of Australia Incorporated (LIFA)

No 18 G. & E. Foti Enterprises Pty. Ltd.

No 19 Arthur Robinson & Hedderwicks

No 20 Insurance and Superannuation Commission (ISC)

No 21 Mr J. M. Kelberg

No 22 Administrative Review Council (ARC)

No 23 Superannuation Trust of Australia (STA)

No 24 Permanent Trustee Company Limited

No 25 Mr Bryce Jarrett

No 26 Maurice Blackburn and Co., Barristers and Solicitors

No 27 Dr J.G. Acton

No 28 Association of Superannuation Funds of Australia Limited (ASFA)

No 29 The AWU-FIME Amalgamated Union

No 30 In camera

No 31 Parliamentary Secretary to the Treasurer

No 32 Jacques Martin Industry

No 33 COMSUPER

No 34 Construction + Building Unions Superannuation (C + BUS)

No 35 State Street Australia Limited

No 36 Senate Standing Committee on Regulations and Ordinances

APPENDIX D:

LIST OF WITNESSES AT PUBLIC HEARINGS

CANBERRA, 20 JUNE 1994

Ms Caroline Le Couteur, Director, August Financial Management Ltd

Mr Robert Drake, Senior Policy Officer, Australian Consumers Association

Mr Robert Gunning, Adviser, Bus and Coach Association

Mr Roger Nairn, General Manager, Custodian Services Division, National Australia Bank Ltd

Mr Howard Pender, Director, Management Co., Australian Ethical Investment Trust

Mr Ronald J Rankin, Chief Executive Officer, Financial Planning Association of Australia

Mr Trevor J Thomas, Assistant Commissioner, Review Branch, Insurance and Superannuation Commission

Ms Judith N Towler, Member, Legislative and Regulatory Committee, Financial Planning Association of Australia

Mr Michael B White, Executive Director, Disabled Peoples International (Australia) Ltd

CANBERRA, 23 JUNE 1994

Mr Darren Davis, Assistant Manager, Operations, Life Insurance Federation of Australia

Mr Donald B Duval, Australian Government Actuary and First Assistant Commissioner, Policy, Legal and Actuarial, Insurance and Superannuation Commission

Ms Prudence Ford, Director, Federal Bureau of Consumer Affairs, Attorney-General's Department

Mrs Wendy Robinson, Director, Review and Legislation Section, Insurance and Superannuation Commission

Mr Kenneth Robinson, Member, Superannuation Committee, Life Insurance Federation of Australia

Ms Dusanka Sabic, Acting Assistant Secretary, Consumer Policy Branch, Federal Bureau of Consumer Affairs

Mr Trevor John Thomas, Assistant Commissioner, Review Branch, Insurance and Superannuation Commission

Mr Tim Williams, Member, Superannuation Committee, Life Insurance Federation of Australia

CANBERRA, 19 SEPTEMBER 1994

Mr Stephen Harrison, National Secretary, AWU-FIME

Mr Graham Poole, Director, PSI Superannuation Management Pty Ltd

Mr Michael Tyler, Chairman of Board, PSI Superannuation Management Pty Ltd

APPENDIX E:

ASSET PORTFOLIOS FOR BIC

INVESTMENTS [118]

How are the contributions invested?

You have the choice as to how your money is invested as follows:

Portfolio 1 - is a market-linked investment arrangement where the investments are spread over a wide spectrum of investment products.

These would include Australian and overseas shares, property, Government bonds and liquid investments such as cash. The rates of return may vary substantially from year to year depending on the performance of the various investment sectors. This portfolio should be viewed as a long-term investment.

Portfolio 2 - investments are mainly in life office capital-guaranteed funds or capital stable investment arrangements. This portfolio is designed for high security and stable returns. Members who are close to retirement may be more comfortable with Portfolio 2.

You may vary your investment twice at any time during the year ending 30 June without an additional charge. You will be fully informed on a regular basis of the status of your investments.

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118 Source: Australian Superannuation Savings Employment Trust (ASSET): Employer Kit - ASSET Member Booklet *Working Hard for your Retirement* (extract)

APPENDIX F:

SELECTED RESULTS OF SURVEY ON BENEFICIARY INVESTMENT CHOICE [119]

I - Number of superannuation funds surveyed: 139

IIA - Size of funds surveyed (number of members)

Fewer than 500 members	61 (44%)
500 - 5000 members	52 (37%)
Over 5000 members	26 (19%)

IIB - Size of funds surveyed (size of assets)

less than $10m in assets	45 (32%)
$10m to $100m in assets	65 (47%)
more than $100m in assets	29 (21%)

TABLE 1: Funds and BIC

	Defined Contribution Funds	Defined Benefit Funds	Combination of both	Total
Now offer choice	13 (23%)	2 (5%)	6 (13%)	21 (15%)
Will/may offer choice	32 (57%)	15 (41%)	23 (50%)	70 (50%)
Will/may not offer choice	11 (20%)	20 (54%)	17 (37%)	48 (35%)
Total	56 (100%)	37 (100%)	46 (100%)	139 (100%)

119 Source: Selected from Towers Perrin's '*Results of survey on member investment choice*', May 1994 - courtesy of Brian Scott, Towers Perrin

APPENDIX F (Continued)

TABLE 2:
Which Issues are Important in Determining Availability of BIC?

Issue	% of respondent funds who already offer BIC who considered issue important*	% of respondent funds who will/may offer BIC who considered issue important*
Age of the member	53 (78)	61 (77)
Family circumstances	35 (33)	50 (36)
Financial position of the members	32 (45)	57 (50)
Size of the member's account balance	32 (45)	51 (48)
Member's position in the organisation	24 (25)	24 (21)
Length of service	24 (25)	40 (31)

* The number shown in brackets is the percentage of the first number who thought that the issue was **very** important

TABLE 3: Who Should Choose?*

	respondent funds who offer BIC	respondent funds who may/will offer BIC
Members must choose	13 (62%)	57 (81%)
Members can decline to choose	8 (38%)	13 (19%)
Total	21 (100%)	70 (100%)

* Of the two industry funds known by the committee to offer BIC, both feature default options for members not exercising investment choice

APPENDIX G:

ARTICLE IN *'THE AUSTRALIAN'* OF 13 JULY 1994

2 THE AUSTRALIAN Wednesday July 13 1994 – 2

Union gets 20pc of super fund as management fee

By industrial correspondent EWIN HANNAN

ONE of the nation's largest unions has secured approval for a deal that allows it 20 per cent of the gross income of a superannuation fund as a management fee.

The Industrial Relations Commission approved the deal following an application by the Australian Workers Union-Federation of Industrial, Manufacturing and Engineering Employees, despite the objections of rival unions.

Commissioner Errol Hodder ruled Nationwide Superannuation Fund could be the approved superannuation fund for employees at Comsteel Newcastle and ANI Arnall.

In an arrangement believed to be unique, 20 per cent of the fees received by the NSF administrators are remitted to the AWU-FIMEE.

The Automotive, Food, Metals and Engineering Union told the commission the NSF was not a true industry fund with its board of management on the union's side comprised exclusively of representatives of the AWU-FIMEE.

The AFMEU said the NSF was the only industry fund that remitted any money to union or employer board members.

According to NSF financial records, the administration expenses were $133,382 for 1992-93 financial year. This means the AWU-FIMEE would have received $26,676 over the 12 months.

The NSF is estimated to have about 10,800 members working for 701 employers. The administration company, PSI Superannuation Management, gave evidence the NSF was enrolling 500 new members and 30 employers each month in all States except Western Australia.

The AFMEU told the commission that given this "spectacular growth", it was apparent the AWU-FIMEE was positioned to reap a substantial financial benefit from the proliferation of the NSF.

"If the commission allows this application, the AFMEU submits it will be sending a signal to the parties involved in superannuation that the pursuit of narrow and sectional interests is acceptable," the AFMEU said.

Unions and employers might then withdraw from industry superannuation funds and set up funds for the dual purposes of raising union and employer revenues, and providing benefits for members.

"Intense competition may then follow and it would not be unrealistic to foresee widespread industrial confrontation in the area of superannuation," the AFMEU said.

The Construction, Forestry, Mining and Energy Union, in also rejecting the application, expressed concern that the main motivation for the promotion of the fund was the "direct pecuniary interest that FIMEE has by virtue of the administration fee".

In promotional pamphlets to AWU-FIMEE members, the NSF says the money received by the union would result in lower membership fees and improved services.

The AWU-FIMEE says the funds will be used to provide scholarships and other services to members and families.

In his decision, Commissioner Hodder said the 20 per cent arrangement did not give him cause for concern.

However, he said he would be concerned if potential new members were not aware of all the circumstances before they agreed their 3 per cent superannuation entitlement should be paid into the fund.

APPENDIX H:

LETTER FROM HON. PAUL ELLIOTT, MP

SISREG-31 (23.9.94)
PARLIAMENTARY SECRETARY TO THE TREASURER
Contact: The Hon. Paul Elliott, MP
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The Hon. Paul Elliott, MP

PARLIAMENTARY SECRETARY
TO THE TREASURER

PARLIAMENT HOUSE
CANBERRA ACT 2600

Publish - now see SS Regn
Sec.
23/9/94

RECEIVED
23 SEP 1994
SENATE SELECT
COMMITTEE ON
SUPERANNUATION

Senator John Watson
Chair
Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

Dear Senator Watson

Thank you for your letters of 19 July 1994 to the Treasurer and to the Insurance and Superannuation Commissioner in which you expressed concern over an arrangement (reported in *The Australian*, 13 July 1994) involving the Australian Workers Union-Federation of Industrial, Manufacturing, and Engineering Employees (AWU-FIMEE), the Nationwide Superannuation Fund (NSF) and NSF's administrator, PSI Superannuation Management (PSI). The article reported that AWU-FIMEE received 20% of the administrative charges paid by the NSF to PSI as a commission.

In order to fully address your concerns, and in order to clarify conflicting statements within the article, ISC officers met with the trustees of NSF, along with officials from the administrator and FIMEE.

The ISC has provided me with the information that follows. In the course of those discussions, it was ascertained that the article contained many factual inaccuracies.

A brief summary of the arrangement is as follows:

- The agreement is between PSI and FIMEE, rather than between the NSF and FIMEE, and it relates to subcontracting of administration and promotional services to FIMEE. Although the trustees of NSF were aware of the agreement, they were not a party to it and were not concerned by it.

- The administration fee earned by FIMEE is a commercial arrangement made on an arm's length basis. The existence of a financial benefit for FIMEE was disclosed to NSF members in material accompanying the application form to join NSF. This material also contained a declaration of interest by one of the member representative trustees, an employee of FIMEE on the basis that FIMEE receives a financial benefit for the promotion of NSF.

- The link between union scholarships and the fee derived by FIMEE was made to assuage possible fears of union members that union officials would personally derive a benefit from the services provided by the union. This link has nothing to do with arrangements between NSF and PSI and is not a concern to either NSF or the ISC because the arrangement with FIMEE is on commercial terms.

- The Industrial Relations Commission (IRC) did not "approve" the arrangement as was alleged in *The Australian* article. The arrangement was in fact raised in argument by unions in competition with FIMEE, in the process of the IRC hearing an application for an amendment to certain awards so that members could have some freedom of choice in relation to the superannuation fund that their award contributions would be directed to.

On the basis of the information and documentary evidence provided by NSF and FIMEE, the fees earned by FIMEE, and the linking of union scholarships and other benefits for union members, in return for services provided by FIMEE is not seen as inappropriate or a threat to the retirement incomes of NSF members.

As a final point, the article also gave the impression that the arrangement with FIMEE was "unique". While such an arrangement with a union may well be unusual, there is nothing unusual about administrators entering into agreements with third parties for promotion of a particular superannuation fund. Such agreements are acceptable provided they are conducted on a commercial basis and provided there is adequate disclosure to superannuation fund members where such disclosure is appropriate (for example, as in this case, where there is a connection between a third party and the superannuation fund).

The SIS legislation requires that all transactions entered into by a trustee or an investment manager of a superannuation fund be on an arm's length basis (commercial terms) and disclosure of commissions is required in certain circumstances. In light of this case, ISC staff are currently investigating whether an amendment to the disclosure requirements would be appropriate.

If you or other members of the Select Committee on Superannuation have any further concerns on this, or related matters, please do not hesitate to contact me.

Yours sincerely

Paul Elliott