COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Structure and operation of the superannuation industry

WEDNESDAY, 25 OCTOBER 2006

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 25 October 2006

Members: Senator Chapman *(Chair)*, Ms Burke *(Deputy Chair)*, Senators Brandis, Murray, Sherry and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Mr McArthur

Members in attendance: Senators Chapman, Murray and Sherry and Mr Baker, Mr Bartlett and Ms Burke

Terms of reference for the inquiry:

To inquire into and report on:

The structure and operation of the *Superannuation Industry (Supervision) Act 1993* and the superannuation industry to ensure that it provides an efficient, effective and safe regulatory structure for the management of superannuation funds, with particular reference to:

1. Whether uniform capital requirements should apply to trustees.
2. Whether all trustees should be required to be public companies.
3. The relevance of Australian Prudential Regulation Authority standards.
4. The role of advice in superannuation.
5. The meaning of member investment choice.
6. The responsibility of the trustee in a member investment choice situation.
7. The reasons for the growth in self managed superannuation funds.
8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund.
9. Cost of compliance.
10. The appropriateness of the funding arrangements for prudential regulation.
11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.
12. The meaning of the concepts “not for profit” and “all profits go to members.”
13. Benchmarking Australia against international practice and experience.
14. Level of compensation in the event of theft, fraud and employer insolvency.
15. Any other relevant matters.

WITNESSES

Committee met at 9.07 am

COLLINS, Mr Paul Anthony, Manager, Legal Services, Superpartners Pty Ltd

GULLONE, Mr Frank, Chief Executive Officer, Superpartners Pty Ltd

CHAIRMAN (Senator Chapman)—I declare open this public hearing of the inquiry into superannuation by the Joint Statutory Parliamentary Committee on Corporations and Financial Services. On 30 June 2006 the committee resolved to inquire into the structure and operation of the Superannuation Industry (Supervision) Act 1993 and the superannuation industry to ensure that it provides an efficient, effective and safe regulatory structure for the management of superannuation funds. The inquiry will examine a number of industry-wide trends and sectoral issues and compare Australia with international experience.

I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. This gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudicing themselves. Any act which disadvantages a witness as a result of evidence given to a committee may be treated by the parliament as a contempt. It is also a contempt to give false and misleading evidence to a committee.

I welcome any observers to this public hearing. I now welcome our first witnesses today from Superpartners. The committee prefers that all evidence be given in public, as this is a public hearing. However, if at any time you wish to give evidence in private, you may request an in camera hearing with the committee and we will consider such a request. This committee has before it your submission, which we have numbered 67. Are there any alterations or additions you wish to make to the written submission?

Mr Gullone—No.

CHAIRMAN—In that case, I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Gullone—Good morning. Superpartners is the largest superannuation administrator in the country, with a national presence of over 1,300 staff. The company has been in existence for over 20 years. We look after 5.4 million members and have $53 billion in funds under administration.

The way we see it, the superannuation industry must serve the interests of a sustainable national economy. It must also serve the security and long-term prosperity of members themselves. Everything else, in our opinion, is incidental. For the entities that either influence or operate within the industry, these two main interests must be key considerations. We welcome this inquiry into the structure of the superannuation industry and trust it will lead to positive outcomes for all members of superannuation funds.

Superpartners deals directly with fund members on behalf of our clients. We receive around 3.2 million inquiries each year. This level of interaction with fund members places us in a fairly unique position to comment on what members say is important to them. If I am to sum up their

views, they tend to relate to sustainability, net returns, cost and the lack of understanding of terms and processes. Being able to see issues from the members' perspective is vital to the relevance of the industry and every participant in the superannuation industry.

On this basis, we have submitted recommendations that we believe will enhance the retirement benefits of Australians. In many areas the status quo provides a strong and adequate level of regulation for risk management and transparency. In some areas we argue for simplification and elimination of duplication and unnecessary cost. We have also made recommendations to support the ongoing provision of reliable, value-for-money services that may be incurred during the term of a superannuation account. I thank the joint committee for their interest in our submission and welcome any questions you may have.

CHAIRMAN—In your submission you suggest that the dual licensing arrangements with APRA and ASIC can be sensibly removed by exempting funds from the ASIC licence where a fund confines itself to advice about its own product. Would fund members be adequately protected under such an arrangement?

Mr Gullone—When we get inquiries, for instance from members in relation to the fund or the specific services offered by the fund, we are just stating fact. Information is already provided in written form through fund material and so on. However, the member may require further information such as: what is the latest list of equities in a particular category or has anything changed since that brochure was produced? The level of protection really relates to the underlying business rules and underlying fund rules, and in response to those inquiries we always operate within those rules.

Mr Collins—Protection of the public will be answered by the continued application of the consumer protection legislation against misleading and deceptive conduct. Also it must be noted that the personal advice rules do not apply to Superpartners, so we are not required to give a statement of advice. We are limited to general advice; therefore the rules as to protection of the public in the realm of misleading and deceptive conduct and the like will continue to apply.

What we are saying in our submission is that it is an unnecessary layer of regulation that requires Superpartners, as an administrator, when performing administration services at the instructions of the client fund, to be separately licensed by ASIC and as a general advice licence when it is performing agency functions.

CHAIRMAN—In relation to the terms of reference regarding whether all trustees should be required to be public companies, you argue that they should not. This is the view of a number of the people who have submitted to the inquiry. However, there have also been submissions, even from those who agree with the proposition that they should not be required to be public companies, that they should be subject to the same disclosure requirements as public companies. What is your view on that proposition?

Mr Gullone—It all revolves around the trustees operating to uphold the sole purpose test, and I will not go into that test because everyone is aware of it. The disclosure is adequate, we believe, insofar as the trustee takes on a heightened level of responsibility. Paul can cover this a little bit further if you like, but I think the disclosure is at the appropriate level. The rules that they have to operate within are at a higher level than public companies, so responsibilities are

heightened in comparison to public companies. We think they are adequate as they stand, to be honest.

Mr Collins—The accountability of a fund is quite rigorous, both in the case of new members and existing members. New members must receive a product disclosure statement, which includes fee information as well as all prescribed information in the legislation, and existing members of course receive annual statements, which consist of two parts: fund information following the line by line prescription in the legislation as well as member-specific information about contributions, fees and the like, which again is prescribed line by line in the legislation.

In fact, if one looks at the detailed requirements in regulation 7.9.20 and the like of the Corporations Regulations, it goes into quite an amazing amount of detail required for funds to comply, which is quite different from that applying to public companies.

Mr Gullone—Trustees need to be licensed. They go through the appropriate process of being licensed, which does not happen in a public company environment, so they are scrutinised and looked into by the regulators.

Senator SHERRY—Mr Collins, you were talking about the issue of disclosure in relation to existing members and new members. You may not be familiar with this, but I would be interested to know whether you are. In the case of a member who is in a master trust type bulk purchase arrangement, normally in a corporate environment, when they cease to be an eligible member of the master trust, usually through ceasing employment, and they are transferred into the retail section of the provider, what are the requirements in respect of notification of the member under FSR—if you know? You may not know.

Mr Collins—Off the top of my head, the disclosure requirements for PDS apply to joining a subfund. If your example is that of a subfund, I think that would apply.

Senator SHERRY—Would it require in those circumstances the member's specific authority to be transferred to a subfund?

Mr Collins—A successor fund transfer does not require the member's consent. Apart from a successor fund transfer, I am not sure.

Senator SHERRY—That is fine. Perhaps you could take that on notice, given your expertise.

Mr Collins—Yes, certainly.

Senator SHERRY—Could you have a look at that issue, because I have had it raised with me in another context. It is understandable if you do not know today.

Mr Collins—I will be able to respond to that very promptly, if you wish.

CHAIRMAN—In the context of advice, you discussed the issue of commission based personal advice and challenged the suitability of that. We have received submissions from others that conflicts of interest can be managed through proper disclosure rather than limiting the choice of investors. It has also been suggested that if commission based selling was abandoned,

a lot of low-income earners would not be able to obtain advice, because fee-for-service based advice would be too expensive for them. What is your response to that?

Mr Gullone—As I said in the opening, we deal with in excess of five million accounts and most of our membership—in excess of 90 per cent—are really only interested in the default option. That suits them very well. The performance of the default option in most funds has been excellent, as you may have seen. Starting from that perspective, most members of the funds are well served. If they require advice, then we believe that there should be mechanisms in place for that to be provided and the funds are providing access to low-cost advice based on an hourly rate and not on a commission basis. That is being made available today.

We also believe that, in the event that a cost is incurred for advice, that should be applied against the member account of that superannuation fund. What we are concerned about, though, is the issue of trailing commissions going on and on, in relation to advice that may have been given many years ago, that the member is not benefiting from it and that the advice has no application to the current circumstances of that member. I think there are many avenues that can be explored in terms of either subsidised advice or avenues to more information on particular balanced fund options.

There is also the issue of financial literacy. A lot of members do not have the level of financial literacy required to even accept advice. We believe that there are more avenues for the funds and the government to take on that task.

CHAIRMAN—Mr Baker, did you want to intervene on the same issue?

Mr BAKER—Yesterday the Financial Planning Association's submission raised concerns about the lack of arms-length contractual relationship between industry funds and their service providers. They provided information in regard to industry funds REST and HOSTPLUS, disclosing that 99 per cent of members have invested in their default or balanced options due to the apparent absence of individual advice. You have just stated that that advice was satisfactory for default funds regarding low-income earners. How much advice do you believe would be provided when 99 per cent of those two funds go into a default or balanced fund? One could argue that the default fund was a balanced fund anyway.

Mr Gullone—Yes.

Mr BAKER—You said that there is satisfactory advice out there for default funds and low-income earners.

Mr Gullone—No, I did not say it was advice for them. I said that the default arrangements in many industry funds is adequate for low-income earners, based on their circumstances, and they are performing quite well at the moment. I am not saying that that is advice. I am saying that the default option for members has been quite good for the majority of low-income or members with low balances.

CHAIRMAN—The point that the Financial Planning Association made was that it indicates an absence of advice. Their submission was that, over that period, if members had been taking

advice and investing according to that advice, their returns would have been something of the order of 50 per cent better than that achieved by the default funds.

Mr Gullone—I would like to see the data. But if they had been taking advice from Financial Planning Association members, obviously there would be commissions and other fees attached to it against low account balances. If you extrapolate that out—and presumably the low-income earners cannot afford that advice anyway—taking commissions out and charging additional fees to low-income earners would basically erode their entire retirement savings, or a majority of their retirement savings.

Mr Collins—The question of advice needs to be considered alongside the question of information disclosure. In the case of a default option, the legislation does prescribe information disclosure, as noted in our submission—namely:

The fund must disclose the investment strategy of each investment option, all information needed to understand the risk and the strategy and the range of directions available to the member.

As against the advice, there is also the information disclosure.

Senator SHERRY—In terms of the default investment option, isn't it true that every fund—not just industry funds but corporate funds, retail funds—effectively has a default option?

Mr Gullone—That is right.

Senator SHERRY—And, unless the member actively selects not to be in the default and selects something different from the menu, no matter how they select, they end up in the default option.

Mr Gullone—That is correct.

Senator SHERRY—So it is a common problem to all funds to varying degrees?

Mr Gullone—That is correct.

Senator SHERRY—Would you describe it as a problem?

Mr Collins—Yes. It is also a consequence of the SIS regulations, which prescribe that very structure of a default option.

Mr BAKER—Do you have a concern that 99 per cent are either in a default fund or a balanced fund in those two particular industry funds?

Mr Gullone—Do I have a concern?

Mr BAKER—Yes, as far as the advice. You spoke about returns, and it is very easy to say, 'We've had great returns in the best economic times in the last 10-plus years.'

Mr Gullone—I do not know the specific circumstances of all those members in both of those funds. I cannot talk on behalf of HOSTPLUS, but HOSTPLUS is a client of ours and it is a well-performing, stable fund that has been in existence for a number of years. We get a very high satisfaction rating in responses and feedback from the members of that fund. Based on that, I think in the main the members are satisfied with their investment via HOSTPLUS.

Mr BAKER—Most investment individuals have been satisfied over the last number of years with very good investment returns. But 99 per cent of members in default or balanced funds, moving forward, at a particular stage will need substantial advice. You do not have a concern about that?

Mr Gullone—They are provided with access to financial advice either through HOSTPLUS or through other mechanisms. If they need advice, those avenues are provided. It would be very difficult for the trustee to provide advice to each individual member in any fund. If there are thousands of members in those funds, I could not see it working in practical terms for the trustee to provide individual advice to each individual member and then to sit around providing to that specific member that specific outcome through one fund, because you may need a combination of funds to suit those members.

Mr Collins—I might also point out that the default option does not mean that there is a default of monitoring. The default option, like any other option, under the management and the trustee, must be regularly reviewed and monitored under its statutory investment strategy. The default option is monitored by the trustee board's investment committee on monthly reports, consisting of asset rebalancing on the advice of a professional investment consultant and other fund managers.

Senator MURRAY—Have you done any research? My view is that in most default consequences there is in fact a choice. They have chosen to trust you.

Mr Collins—That is right.

Senator MURRAY—And they have made a choice. It would be interesting to establish whether there are some who have not made that choice, if that makes sense. I think your surveys do not just measure satisfaction, they measure trust. And there is a high level of trust in the industry as a whole.

Mr Gullone—Yes.

Senator SHERRY—On the same issue, isn't it true that in almost every superannuation fund now, whatever the type of fund, there is an investment menu and a default option and, if the member chooses to do so, they can leave that default investment option, whether it is their own decision on reading the returns in the annual report and matching the particular investment to option, or they can choose to get and pay for some advice?

Mr Gullone—That is right.

Senator SHERRY—And it is available to everyone.

Mr Gullone—It is available to all members, yes; it is available to everyone. I must also say that the default option or the balanced option is the option or the category of the funds that is usually compared. When comparing funds, the main comparison is always against that default or balanced option. So the comparison is made a lot easier. In terms of providing advice, if members go in and change their mix, then the comparison point of how their investment has fared or the structure and the risk associated with the investment is more difficult to gauge when comparing that product or that outcome to another outcome.

Mr BARTLETT—Returning to the issue of commission based advice, you make the point that there are serious doubts about the suitability of commission based advice for personal advice. Intuitively, one would think that advisers would be more inclined to direct people towards funds that do pay a commission and I suppose anecdotally there is evidence to support that, but has there been any extensive research done on the extent to which that happens, and, secondly, any research on the difference in the returns for the employee, the superannuant, in terms of commission based funds or commission based investment versus advice that is given on the basis of an up-front fee?

Mr Gullone—I am not sure if there has been any specific work done on comparing commission based advice to non-commission based advice. You would have to get a selection of members that have gone through those two experiences and do that survey. I do know, through independent surveys by companies like Rainmaker and SuperRatings, that members in an industry fund tend to be better off over the longer term and one-third better off in terms of net returns. Also, I think in their submission, Choice stated that close to $1 billion was paid in commissions over the last 12 months or so. If you think about that $1 billion being excluded from the investment account balances in superannuation funds, that is a lot of money that has gone out of the system or gone elsewhere that could have been invested within superannuation funds.

Mr BARTLETT—Equally you could argue, though, that up-front fees would create a substantial amount as well and that that could go back into returns, but obviously people have to pay for advice one way or another.

Mr Gullone—That is right. They have the option of paying for it or going for the default option or doing whatever they think is appropriate.

Mr BARTLETT—It really comes down to whether there is any evidence to suggest that rates of return in net terms are higher or lower under a commission based versus an up-front fees arrangement.

Mr Gullone—I have not seen any specific survey material in that regard.

Mr BARTLETT—Sure. If you do come across anything, if you could find anything, we would appreciate it.

Mr Gullone—Definitely.

Senator SHERRY—Isn't it true that a commission based payment basically has two components, to varying degrees? One is clearly an element for the provision of advice and the

second is, effectively, a reward to the adviser for recommending a particular fund within the parameters of the FSR disclosure and regulation.

Mr Gullone—That is correct, and the latter is usually referred to as a trailing commission of some sort.

Senator SHERRY—Is that the area that causes you greatest concern? What is put to me quite frequently, and has been put in a number of the submissions, is that this is a clear conflict of interest: a reward, based on the old life insurance sales type distribution, that means that a member can end up in a fund that is not necessarily in their best interests but in the best interests of the adviser, because they are being paid for making the recommendation via the commission.

Mr Gullone—That is correct. Some advisers may go for those types of subproducts or subfunds that pay a higher level of commission ongoing as a result, so that may influence the decision-making process for those advisers.

Senator SHERRY—Once a trailing commission is entered into, is there any limitation? Again, I have often had circumstances drawn to my attention where this trail goes on for 10, 20, 30 years.

Mr Gullone—Yes.

Senator SHERRY—Is there a legal ability to terminate it?

Mr Collins—The terms of the commission are set out in the agency agreement between the adviser and its principal. That contains schedules which specify when commission is payable, which consists, as you said, of two parts: new business commission and renewal commission. That schedule contains a proviso that, in the event that a policy is terminated, there is a reversal of the renewal commission. I am speaking from the context of traditional life insurance agency agreements. The continuation of the commission I think is indefinite, dependent on the continuation of the product. As long as the particular product is held, the renewal commission is retained.

That is an issue we raise strongly in pages 22 and 23 of our submission in the context of the acquisition of an interest in a successor fund and the rather oblique nature of the disclosure to members. It suggests that the commission is paid as an adviser fee, suggesting that it is paid on the basis of advice, but, as you have pointed out, the commission is also earned on the basis of persistency—the retention of the product—and as a volume bonus; so the more members the greater the attraction of the commission.

Senator MURRAY—But the solution then has to be considered by the committee. That, to my mind, can only be twofold: either prohibition altogether of a trailing commission or for a specific time period, a maximum time period, which I assume should not exceed 10 years. The purpose of my putting this to you is to ask which solution you propose: that they be prohibited or that they be defined in a term sense.

Mr Collins—We have proposed a third solution, and that is a more targeted disclosure of the commission to members so that the member is informed that there is a commission payable for persistency rather than being misdescribed as a commission paid for advice.

Senator MURRAY—But that does not satisfy the fundamental concern that many customers subject to trailing commissions, even on disclosure, do not understand the consequence. They cannot compute the percentage; they cannot compute the absolute dollar terms; they do not understand the relativities. You are unlikely to be able to address that. The idea that you can educate customers at large is just fanciful. People are not going to ever get around those three issues in the longer term; therefore, I think your solution has real limitations. Whilst I support disclosure, I would suggest to you that you actually need a defined end date, not an indefinite approach. That is really my concern.

Mr Gullone—If I had to pick between the two options you put forward, I would lean towards the prohibition option. It is cleaner and easier to operate under. Disclosure could also be addressed and another arrangement could be put in place for that advice, whether it be an hourly rate or some fixed fee. At the end of the day, it is advice for that person on that day for that particular moment in their investment life, and that could change from week to week or from day to day, depending on the circumstances that that person faces.

Ms BURKE—Have you looked at the ASIC shadow shopper results? That is probably one of the only areas where there has been a bit of study done on this. One of the things that keeps coming through from that is, as Senator Murray says, the lack of information the individual holds and the lack of ability to actually analyse that information. You spoke of 'a comparator'. How do you compare all this information? You do not understand what is in front of you to begin with, so how do you compare it to something else, especially when there seems to be very little disclosure, in this case, about leaving funds and moving funds—what you are leaving behind and what you are going to—leaving aside commissions and fees and all the rest of it. 'What is this fund that I am choosing to leave offering me here and now versus the one that I am being told is the next best thing?' You discover later that the individual has been paid a commission to do that. How do we get to a stage where somebody has the ability to make an informed decision?

Mr Gullone—That is a good question. I have already touched on financial literacy and the low level of financial literacy within the Australian community, particularly as it relates to superannuation. If you look at the regulations and the legislation that is in place for superannuation, it is very difficult for the man or woman in the street to understand. Also the terminology that is used can be different between products. Financial advisers receive training on different aspects of superannuation and other investments and use terminology, so I think we need to go back, whether it is early schooling or whatever, to raise the level of financial literacy within the community and to get down to layman's terms that people understand and can associate with and are used as a standard across all funds, because that will also help the creation of various disclosure statements.

If you look at the product disclosure statements that are in place at the moment which relate to either a fund or a subfund within that fund, they can go for 50-plus pages. You almost have to be a Rhodes scholar to work your way through them. I think there are easier ways of doing that, based on the inquiries that are made to us. We get 2½ million phone calls a year, and with most

of them a lot of time is spent trying to explain what various terms mean. I think we really need to move beyond that, particularly when you consider the length of time that superannuation has been in this country and the way it has evolved. Our view is that we need to look at the layman's terms and see if we can come up with a simplified use of terminology or list of terminology and start the education of financial literacy.

Ms BURKE—The problem we have is that there is a generation who has been given choice now—choice of investment and choice of fund. There is also the flip side, in that there are a whole lot of people who are about to retire and get a lump sum, and they have never had to deal with a bucket load of money before in their lives. The question for us is whether we take some of that burden away from them by saying, 'You can't do things like have trailing commissions, so that you won't be exposed.' If we could legislate commonsense, I think we would all make our lives a lot easier, but we cannot do that. Sometimes we cannot protect individuals from themselves. But what do we do now for those individuals who are faced with those choices now?

Mr Gullone—I think the first step is to simplify the terminology. We do not have to wait another 10 years to do that; we can come up with standard terminology that is easily understood. The second step is to educate people, whether it is in a seminar format or through websites or through other mechanisms, on options that they have for retirement, given a certain set of circumstances. All funds create profiles of members and, given a certain profile and certain age parameters, there are standard outcomes that people can look into and work towards.

Simplify the entire system through the legislation. We can do that now. Standardise the forms that are used amongst all the funds, standardise rollover periods, standardise the way contributions are made. Each fund has its own contribution form, and that complicates it and adds a layer of cost that is unnecessary. The way a contribution form looks in one fund is not a competitive advantage to the way it is designed.

Mr BAKER—Contribution form?

Mr Gullone—I am using that as an example. Each fund has its own layout for a contribution form and its own layout for a benefit form.

Senator MURRAY—Are those the forms that go to employers?

Mr Gullone—They are forms that go to employers or members. All I am saying is that there are plenty of opportunities for us to standardise the way things operate around superannuation funds, thereby acclimatising members to one terminology and the processes that are used to access or get out of a fund. That takes a layer of cost out of it and simplifies the process. It is a bit like a tax return. If we all had different tax return forms, given our circumstances, it would make it a very complex environment. I think there is plenty of opportunity for us to standardise and simplify elements of our superannuation system.

Mr BAKER—Can I go back—the debate has been ongoing—to commission trails et cetera. There are a lot of practices out there that use trails as a form of fee for service. Obviously, the larger the fund the bigger the trail and the greater the need for more sophisticated advice. With smaller funds, going back to what you were saying, it could be argued the advice needs of low-income earners need not be as sophisticated. Isn't that a methodology by which low-income

earners will be in a position to pay for advice via a trail? The obligation for a lower amount going in will be on, say, the planner, if it is an industry fund. Isn't there an argument on both sides? We only hear one side of the argument.

Mr Gullone—Let us again go back to the source of trail. The trail is paid by the product sponsor. The product sponsor gets paid by the fund for promoting that particular fund. Whichever way we want to cut it up, the fund ends up paying for that trail commission, which means lower returns back to the member.

Mr BAKER—You say lower returns.

Mr Gullone—I am saying there is money coming out of the fund to pay for the trail.

Mr BAKER—I am quite interested when I see the advertising on television in relation to industry funds versus retail funds which claim that statistically you will get a higher return from industry funds. On what basis is that calculation made? Is it a balanced fund against a balanced fund? Is it just on cash investments? How high or how low do we go? In relation to share funds, we have all seen the investment options in trusts, whether it is Australian shares, international shares or a mixture of both; a mixture of property, listed and unlisted. The FPA's submission yesterday mentioned 50 per cent higher returns for Australian share funds. Surely that makes your argument quite a lot weaker.

Mr Gullone—We were assuming that they were getting the proper advice. ASIC's shadow shopping survey showed that a lot of people are not getting the proper advice.

Mr BAKER—That is an assumption.

Mr Gullone—It is an assumption, but everything can be regarded as assumptions.

CHAIRMAN—The point was made yesterday by one of our witnesses that, in relation to the shadow shopping advice, if people go to an adviser who is a licensed AMP adviser, quite clearly they are only going to get advice to invest in AMP products, because of the nature of that licence. A lot of the shadow shopping survey probably misunderstood or ignored that fact. Would you accept that?

Mr Gullone—The survey was undertaken by a regulator. I presume the regulator took a holistic view of the market when they undertook the survey. I take the survey results on face value, and that is that they have taken a selection of financial advisers across the entire industry and the outcome of the survey is known. If I were to go to a financial adviser at any company, I would want that financial adviser to review my entire financial position, not just in relation to the product of one particular company. For me, that is a better way to go, because that is why I am going to a financial adviser.

Mr BARTLETT—But don't you think that is covered by the statement of advice requirements anyway?

Mr Gullone—Let us assume that everyone fills out the statement of advice: we saw, through the survey, that not everyone was applying that statement of advice.

Senator SHERRY—But, Mr Gullone, what you are suggesting cannot happen, can it? A planner is constrained by the product list.

Mr Gullone—That is right.

Senator SHERRY—Therefore, in the case of an AMP adviser, they are constrained, in comparison, in a competitive sense to what is on the product list. It was not the case with AMP, but it is certainly the case with most other retail providers. They do not place industry funds on the list. Therefore, there is a legal constraint on the planner offering advice on any other types of funds other than those on the product list which are a retail commission based—usually a commission based; not always—product.

Mr Gullone—That is how we see it.

Mr BARTLETT—How do you respond to the argument that the removal of commission based arrangements and their replacement with an up-front fee for advice—and, presumably, a reasonably substantial up-front fee—would eliminate a lot of low-income earners from being able to afford, and therefore seeking, that advice?

Mr Gullone—If they get charged a trailing commission, they are still paying for that advice.

Mr BARTLETT—Yes, but they are paying for it in a way that they can afford over a longer period of time rather than being required to come up with X hundred dollars to begin with for advice, which at that stage might be unaffordable for them.

Mr Gullone—But we are saying that, if they wanted to pay for the advice, that should appear as a debit within their superannuation account, a one-off hourly rate or some other fixed-fee arrangement, which would come off the superannuation account that they have with the fund.

Mr BARTLETT—That would be an administrative nightmare.

Mr Gullone—Not at all. We can do that right now.

Mr BARTLETT—What of the argument that the compounding effects of that reduced sum would be equivalent to the trailing commission anyway in terms of the net impact?

Mr Gullone—I have not seen the calculation to confirm that.

Senator SHERRY—I understand now what you are suggesting. What you are suggesting is: no commission, fee for service, but the fee can be debited against the member's account.

Mr Gullone—That is right.

Senator SHERRY—Wouldn't the advantage of that be that it is much more competitive? It is easier to understand, because dollar terms are easier than percentages.

Mr Collins—It is transparent.

Senator SHERRY—It is transparent, it is accountable, and therefore more competitive.

Mr Gullone—And they are used to seeing that in a bank statement, which looks very similar. They can see the fee.

Mr BAKER—Who would determine the cost of an hourly rate, or if it is an income protection advice, or if it is a life insurance advice, or if it is a keyman insurance advice? How and who would determine the cost that would be debited?

Mr Gullone—It is a competitive environment. The financial adviser or insurance adviser would say, 'My hourly rate is X and that's what I charge.' People are used to it. They are seeing that now when they use a lawyer or an accountant or some other professional adviser. I think people would see that and say, 'Well, I believe I can get better advice at a lower cost from adviser X in comparison to adviser Y.' I think that should be down to market forces.

Mr Collins—And under the fee disclosure rules, if the fund were to undertake that new scheme of deducting against the client's superannuation account, that is fully disclosable, both to a new member in a product disclosure statement, and to existing members in the annual statement.

Mr BAKER—Would you agree it is law, anyway, whether it is a trailing commission, an up-front charge or an exit charge, that it has to be disclosed now?

Mr Collins—Correct. What I am saying is that if it were the case that a fund undertook that deduction of a fee, then you have that level of disclosure protected by existing legislation.

Senator SHERRY—On the issue of advertising, which has been contentious—I suspect more because of the success of the generic advertising campaign of industry funds—isn't increased advertising a consequence of choice and deregulation and the competition?

Mr Gullone—It is, and it is seen to be not only promotion of those funds but education of members in terms of understanding what the industry funds stand for. It has come about, really, as a result of choice and it has proved to be beneficial, based on anecdotal evidence. Members have a better understanding of what industry funds are about.

Senator SHERRY—We do not live in a Stalinist society where advertising is banned. Whether it works or not, the logic of a competitive environment is that a competitor or a provider has a fundamental right to advertise the benefits of their product.

Mr Gullone—Totally correct, yes.

Senator SHERRY—By way of comparison, do you think it would be reasonable to prohibit credit unions from advertising or promoting their products and services?

Mr Gullone—Not at all.

Senator SHERRY—They are not-for-profit mutuals.

Mr Gullone—They are not for profit, too.

Mr BAKER—They are advertising their better returns. That is the issue that people come to me about. They have a number of concerns, saying, 'Yes, up-front commissions, but there's no disclosure out there of what basis that's determined on.'

Senator SHERRY—But it is permitted within the law, ASIC having made a determination. If someone does not like the advertising, presumably they can go to the Advertising Standards Council. ING advertised with Billy Connolly. I am not sure what Billy Connolly knows about superannuation—I suspect he knows absolutely nothing—but, at the end of the day, it is the right of the provider in a democratic capitalist society to choose the manner in which it promotes its product, within the law.

Mr Gullone—Correct.

Mr BAKER—But they are not promoting greater returns against another company. They are promoting their actual company.

Senator SHERRY—Yes.

Mr BAKER—But they are not saying, 'X returns are better than Y returns.'

Senator SHERRY—What are they promoting, then?

Mr BAKER—Their services.

Senator SHERRY—They are paying Billy Connolly a fortune.

Mr BAKER—They are promoting services.

Senator SHERRY—But how is that going to benefit the member?

CHAIRMAN—The issue that has been raised is whether using the superannuation funds' finances for advertising complies with the sole purpose test. That is the key issue.

Senator SHERRY—ASIC ruled on that.

CHAIRMAN—APRA have put a shot across the bows in relation to the extent to which funds' finances can be used for advertising.

Mr Gullone—I think the advertising has been enormously successful and beneficial to members. Thinking about it, to prohibit that advertising would be like prohibiting advertising in the lead-up to an election by political parties using taxpayers' money.

Mr BARTLETT—Why do you say it has been 'incredibly valuable to member'? Were they your words?

Mr Gullone—Yes, it has been.

Mr BARTLETT—In what way?

Mr Gullone—The questioning and inquiries coming through are at a heightened level, based on anecdotal evidence. Also, there is an increase in roll-ins into industry funds. That has been at a higher level in comparison to previous years, which enables us to spread costs across a wider base and continue to drive costs down. The more members we have within the funds the greater the potential to spread costs.

Mr BARTLETT—Advertising has been successful in attracting members, not necessarily successful in attracting members to funds which would yield them the greatest returns. That is an assumption that the particular fund to which they are attracted as a result of the advertising yields higher returns than alternative funds to which they might have gone.

Ms BURKE—I do not think you can ask someone to answer that question.

Mr BARTLETT—That is not a question, though. It is just a comment.

Ms BURKE—Don't answer that one!

Mr Gullone—I won't.

Mr BARTLETT—It was not a question. It did not need answering; it was rhetorical.

Senator SHERRY—But if there is an argument around advertising, isn't there an argument that if you are going to limit advertising in respect to compulsory superannuation, you ban the lot?

Mr Gullone—Yes, that is right.

Ms BURKE—Therefore banks cannot advertise either.

Senator MURRAY—It is none in or all in.

Ms BURKE—All in or all out.

Mr Gullone—It is either a level playing field or—

Mr BAKER—The issue is not against advertising. The argument is put that there is inducement by stating that one fund returns higher than all the other funds. There is no argument about advertising the benefits of being in a particular company, whether it is MLC, AMP, whether it is Macquarie Bank, but the issue is that the inducement is the higher returns.

Mr Gullone—That is based on independent data by companies such as SuperRatings or Rainmaker. They rank the funds, and reference is made to that analysis undertaken by

independent companies that industry funds have outperformed other types of funds over a period of time.

Senator MURRAY—Mr Gullone, that is the wrong answer, surely. Surely, the right answer is that the ACCC under the Trade Practices Act looks after misleading and false advertising. If you make a false claim, you can be prosecuted for it.

Mr Collins—That is quite correct.

Senator MURRAY—Why are we debating a free market here? I thought we had gone beyond that.

Mr Collins—Comparison advertising is allowed by law, provided it is fair and reasonable. There has to be a reasonable and fair basis. ASIC have made it clear—

Senator MURRAY—It has to be truthful.

Mr Collins—that if that does not happen it will intervene. ASIC did issue a media release in the IFS case and stated that it accepts that funds should be able to explain the benefits to members. I will also add that the advertising is an aspect of fund governance, not only the right in a free society, as adverted to by Senator Sherry. A key component of a fund's management is a retention strategy as part of its business plan. When APRA conduct an on-site review of a fund, the first thing they say is, 'Show us your trust deed and your business plan.' So APRA is quite interested in seeing that a fund, as a matter of prudential management, conducts a strategy to retain and grow its membership.

Mr BAKER—Do you have any processes within industry funds for providing advice?

Mr Gullone—Superpartners does not provide financial advice to members. That is done through other parties and through industry fund services but not directly. We do not have financial planners.

Mr BAKER—The money just goes in and sits there.

Mr Gullone—Yes. We administer the accounts.

CHAIRMAN—You don't make investment decisions?

Mr Gullone—No, not at all.

CHAIRMAN—You are a service provider to the funds?

Mr Gullone—Yes. We do everything other than investment and custodianship.

Mr Collins—To use the terminology in the legislation, we provide general advice as opposed to personal advice. General advice is an issue that we have dealt with in our submission, which we say should be liberated from the confines of an ASIC licence, because if you look at the general advice that we give it is very mundane; member queries about their accounts. We say

that a separate ASIC licence is not justified in the circumstances because we as administrators confine the alleged general advice to information about the 'own product'. There is a valid case, we say, of exempting the ASIC licence when a financial service provider confines advice to its own product.

Senator SHERRY—The point you have raised about FSR requirements, disclosure is a relatively common thread from submissions that mention it. The difficulty of providing it in a cost-effective way, without having to issue 50- to 100-page documents, is a common critique in respect to being able to give general advice and specific advice. Do you have any comments to make on that?

Mr Collins—Yes. We say in our submission that there is no need for an ASIC general advice licence as opposed to personal advice, because it does not take account of a person's own financial objectives, circumstances and needs. In our circumstances of an administrator, carrying out outsourced administration functions and conducting a call centre, we should not have to have an ASIC licence as well as our principal, the client fund, who has an ASIC licence.

Senator SHERRY—This is, I understand, a common concern in all administration for all funds, whether they are retail or industry. There is considerable apprehension about the ability to give what is general advice when someone is on the phone and a staff member has to make a call between specific and general advice, having regard to the legal liability that they could incur.

Mr Collins—Yes. There is a practical side to that. The call centre staff members, of course, are not equipped to answer a question of personal advice and would refer the caller to the financial planning referral. The nature of personal advice is such that it involves quite a detailed analysis of the caller's own financial circumstances, and one can instinctively recognise personal advice in that sense.

Mr BARTLETT—Are you confident, though, that the delineation is clear? I understand the point about definition regarding personal advice versus general advice, but isn't it the case quite often that what is ostensibly general advice is still interpreted by the caller to apply to their particular personal situation; that the advice that is given, without any knowledge of that person's individual circumstances, can still have enough details in terms of alternative investment options to be construed by the caller to lead in a particular direction that might not be the best option for them? Is there an adequate delineation?

Mr Collins—I think there is, because it has the advantage of objectivity. When there is a dispute as to whether the caller was induced by what the call centre told them, the question is objective—namely, did the advice take account of the personal circumstances and objectives?

Mr BARTLETT—It might be objective in terms of a lack of awareness of any particular circumstance of the caller, but it can hardly be argued to be objective in terms of the promotion of one type of investment over another. I have concerns as well that, even in the illustration that you have used, we are talking about someone in a call centre: a person on the other end of a phone offering advice, albeit of a generic or general nature, that can have fairly significant and profound implications in terms of the direction in which someone is pushed. Are there enough safeguards built in there?

Mr Gullone—The call centres typically operate under a scripted arrangement. Depending on the nature of the call, there are various avenues that can be taken. The operators are continually trained on the parameters within which they can provide information to the members calling in, plus we record calls and they are checked by another party within the call centre.

Ms BURKE—These are all inbound calls, aren't they?

Mr Gullone—These are all inbound.

Ms BURKE—There are inquiries coming to you. It is not a marketing service.

Mr Gullone—There is also an outboard call facility which is done by qualified—

Mr BARTLETT—But surely it adds an extra layer of protection for the caller if there is some degree of licensing required for the person sitting at the end of the phone answering those calls?

Mr Gullone—As I said, people in the call centres are still trained. We are saying that the level of licensing is not required when we operate within the confines of that particular fund's rules and that fund's offering.

Mr BARTLETT—But there is a difference, isn't there, between training and qualification leading to licensing?

Mr Gullone—We are saying that the overlicensing is the burden. People are trained in any event to provide information, just product information. They are not providing—or they should not be providing—information about whether someone should move from equities to fixed interest or some other category of member investment choice, unless they are appropriately trained to do that.

Senator SHERRY—Mr Gullone, on the general issue of red tape, compliance, costs et cetera, how would you describe the level of regulation of, in your case, administration of superannuation compared to 10 years ago? Is it greater or less?

Mr Gullone—A lot greater, many times greater; particularly with the two regulators, each having their own layer of regulations and requirements in place. It has increased many times over.

Senator SHERRY—I am a bit puzzled, because I can recall—I think it was in the form of a slogan—that red tape on business was going to be cut by 50 per cent over the last 10 years and it seems, from your experience, that it has actually increased.

Mr Gullone—It has definitely increased, yes.

Mr Collins—Particularly so in product disclosure, Senator, now that product disclosure with FSR applies to all funds. There is an alarming development with the underlying investment disclosure, so that when a fund invests in an underlying investment under the new ASIC rules, the member must receive a PDS of that underlying product as well as the fund PDS.

Senator SHERRY—In terms of this extra regulation, if we contrast it with failure in the superannuation system, I am struggling to recall any significant case of failure of a superannuation fund.

Mr Gullone—There is no significant case, but there are smaller funds that have perhaps fallen over, public offer funds that have fallen over time. If I can give you some other information to confirm that regulations have gone up, just look at the increase in the appointment by funds—and we are included—of compliance related people within their staff complement. It has gone up enormously, over the last 12 months in particular.

Senator SHERRY—Could you give us some numbers? Just take it on notice. Could you also take on notice what are the most frequent inquiries in respect to types of advice that a member seeks. Is it extra contributions? Is it level of death and disability insurance? Is it investment option advice?

Ms BURKE—Or, 'How much is in my account?'

Mr Gullone—I can give you that now, Senator.

Senator SHERRY—Just in terms of time, if you want to provide us with a document; I am not going to question you about it. You have a unique position as a major administrator to give us some idea of what people want advice about as distinct from what a planner may think they want advice about.

Mr Collins—There is a broad summary in our submission. It gives the broad categories at pages 11 and 12.

Mr Gullone—No. 1 is what I categorise as standard administration: change of address, change of circumstances. No. 2 in our experience is financial hardship. People want to access their money or cannot understand why they are paying this amount and want it as soon as possible. No. 3, which we do not respond to, is, 'Should I roll over my money into another fund?' No. 4 is, 'What is superannuation?' That comes back to what I was saying before. The next is co-contribution inquiries, 'How do I access co-contribution?' The last is basic plan details, specifically if they relate to defined benefit plans; information on those plan details.

Senator SHERRY—You issue some DBs, do you?

Mr Gullone—Yes, we do.

Senator MURRAY—I have a question I would like to put on notice.

CHAIRMAN—I still have some questions.

Senator MURRAY—You go first.

CHAIRMAN—One of the issues that has been raised in several of the submissions and was also highlighted in evidence yesterday in Sydney from several of the witnesses—I think the Financial Planning Association raised it, Rainmaker also may have referred to it and IFSA, I

think, in their evidence—is the issue of concern about a lack of arms-length contractual arrangements between industry superannuation funds and their service providers. You are a service provider to industry funds.

Mr Gullone—Yes.

CHAIRMAN—What is your relationship to the industry funds? Are you owned by the industry funds?

Mr Gullone—We are owned by a number of industry funds. Some of those are clients and some are not. Some are ex-clients. We have a contract in place with each client, so it is all at arm's length.

CHAIRMAN—This issue has been raised also in the context of the term of reference relating to the meaning of the terms 'not for profit' and 'all profits go to members'. It was suggested yesterday that there needs to be greater transparency regarding the relationship between industry funds and their service providers; there is a need to drill down to ensure that, in fact, all profits are indeed going to members and are not being, in a sense, creamed-off by related party service providers. What is your view?

Mr Gullone—I can understand where you are coming from. We operate under a very low margin arrangement and that money is reinvested back into the company. The company is owned by industry funds so, in essence, the company is owned by the members of those funds, so they are reaping benefits, assuming the valuation of the company goes up, obviously, as a result of our business dealings.

CHAIRMAN—So you are 100 per cent owned by industry funds?

Mr Gullone—Yes.

CHAIRMAN—I think earlier you referred to Industry Fund Services. What is your relationship with Industry Fund Services?

Mr Gullone—Industry Fund Services acts as a trustee, because of historical reasons, for a number of funds that also have an ownership in Superpartners. We are within the same building, so we interact from that perspective as well. Our board is independent. We have four members on the board. Three of those are independent directors, so we operate as a commercial venture.

CHAIRMAN—They are not directors of any of the super funds that own your—

Mr Gullone—No.

CHAIRMAN—Any further questions?

Senator MURRAY—Just one on notice, I suspect, but I will have to ask you a question first: do you act as a clearing house in the way that that is described?

Mr Gullone—In WA we acted as a clearing house for Westscheme for a period of time, but now that is all done in an alliance with a company called ADP. They act as the clearing house on behalf of employees.

Senator MURRAY—Think about whether you can respond to this—and this is a request, not an obligation. Yesterday I was exploring the issue of mobility and portability. That is rarely facilitated where the fund concerned is actively engaged and helpful in doing that. I have observed that there are some very large private funds—not industry funds so far in my experience—that have developed very sticky procedures designed to switch people off so that they leave their money in, and the consequence is that they retain funds which otherwise might have been moved. When I put this problem across to one of the witnesses, they suggested that people engaged in clearing-house activity would be aware of differences in ways in which funds manage their affairs so that they make it difficult with respect to portability and mobility of funds. I am extremely interested in facilitating that, getting concentration occurring and getting people to sort things, so if you could think about what I have said and come back with a supplementary set of points as to whether you observe any practices which you think indicate the need for a regulator to investigate that area more and make sure that mobility and portability is facilitated.

Mr Gullone—I am happy to do that.

Senator MURRAY—Thank you very much.

CHAIRMAN—I thank both of you for your appearance before the committee and your assistance with our inquiry.

Mr Gullone—Thank you.

[10.16 am]

BECK, Mr Anthony Joseph, Head, Workplace Business, Members Equity Bank

CHAIRMAN—As indicated earlier to our previous witness, the committee prefers that all evidence be taken in public but if at any stage of your evidence you wish to give evidence in private, you may request in camera hearing of the committee and we would consider such a request. We have before us your submission, which we have numbered 64. Are there any changes or alterations you wish to make to the written submissions?

Mr Beck—No changes.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Beck—The Members Equity Bank appreciates the opportunity to make this submission and to speak in support of it this morning. Our submission is more limited by virtue of the fact that we are a bank. We are not a superannuation fund provider as such, so it is more limited. The areas of particular inquiry by the committee we generally left to other more specialised organisations who are perhaps more qualified to comment. Nevertheless, we think this is a matter of very high public importance from a public policy perspective and, because of the characterisation of our ownership and the nature of the financial service industry more generally, we think it is appropriate for Members Equity to speak, but we believe the banking industry should be speaking as well.

Very briefly, Members Equity Bank is probably Australia's most recently licensed bank, receiving our licence in 2001. We are a small bank in terms of the Australian market, being the eighth biggest bank. We have about 1,000 staff and 200,000 customers. Subject to an acquisition that we understand is due to be approved by the regulator, we will have $25 billion funds under management.

The particular interest for our organisation is that we are owned by 40 industry superannuation funds, so we have that ownership connection. Our business model, therefore, is built very directly around understanding the hopes, aspirations and needs of industry fund members and being able to promote and market our banking products to those members. That is our background and that is our interest in this inquiry.

CHAIRMAN—You indicated that you are owned by 40 superannuation funds. Would it be fair to say that the structure of Members Equity is similar to that of credit unions?

Mr Beck—The commonality would be that we describe ourselves as 'an all profits for members organisation'. As opposed to a credit union, there is equity, which is privately held by 40 industry super funds. That would be the distinction between us and most credit unions. The commonality, though, is that all our profits go back to our shareholders, who are the funds, who then distribute it to fund members, so it is an all profits for members model.

CHAIRMAN—One of the issues that has been raised in several of the submissions, and was also raised in evidence yesterday, is in the context of the terms of reference relating to whether all profits go to members and the meaning of 'not for profit'. There is a need to look at the relationship between service providers and superannuation funds, and the extent to which that is arm's length, and the interrelationship between service providers and superannuation funds. Given the particular nature of your structure, would you support a disclosure regime and capital requirements being imposed on Members Equity Bank in a similar way to those which are imposed on credit unions?

Mr Beck—We are regulated by APRA, of course, as an approved deposit-taking institution, so we have to submit to the same capital adequacy requirements as all ADIs, which includes banks and credit unions. That is currently our regulatory regime, with which we comply.

CHAIRMAN—As you said, and I think it is also in your report, you are owned by 40 participating industry superannuation funds. You also say in your submission that you are currently in the process of merging with Industry Fund Services Pty Ltd. As I understand it from the ASIC records, Industry Fund Services currently owns all 4.2 million shares in Members Equity Bank and 600 shares in Industry Fund Services in turn are owned by nine industry super funds. If that is the case, how is it that you say that you are owned by 40 super funds? Is there a reconstruction that has occurred since those records were lodged?

Mr Beck—I will give you a very brief overview of it, but if necessary I will come back with the technical details for the purpose of the inquiry. The way it technically operates, in my description of it, is that IFS acts as a trustee for a trust. That trust beneficially is owned by 40 industry superannuation funds that own all the issued capital in Members Equity Bank. So 40 industry super funds, by virtue of a trust, own Members Equity Bank. IFS is the trustee of that particular trust. That was the pre-existing structure. IFS separately, in its role as trustee, has developed a wholesale-retail funds management capability, including financial planning and a range of other retail investment products, as a separate business. We are merging with that business.

CHAIRMAN—Is the trust a unit trust or a discretionary trust?

Mr Beck—I will take that on notice. There is documentation which, obviously, we have submitted to APRA, as the regulator, which I am happy to provide to the inquiry.

CHAIRMAN—In your annual report you have indicated:

The Board seeks to deliver good corporate governance by guiding and monitoring the affairs of the company.

Are you able to disclose the cross-directorships between Members Equity Bank and the superannuation funds that indirectly own it.

Mr Beck—I assume that our directors are disclosed in our annual report. There are a number of independent directors and a number of directors who have had industry super fund experience and/or connected entities. But at the end of the day, for the bank at least, our regulatory and corporate governance requirements are regulated by APRA. APRA goes through an appropriate process to ensure that all our corporate governance processes—risk management, business

continuity and all of those processes—are appropriate for an ADI and also that our board and our directors are appropriate to serve that purpose.

APRA also requires that there is adequate competency and expertise from the senior management ranks, so they have a process in place which we submit is proper and appropriate to ensure that, from a director level, from an executive management level and through a broad committee structure process, there are adequate procedures in place.

CHAIRMAN—My recollection is that the merger that is occurring between Industry Fund Services and Members Equity Bank was announced about three years ago. It was certainly more than two years ago, yet it still has not been finalised.

Mr Beck—It had a period of gestation, but it has been approved by the shareholders and is just awaiting regulatory approval.

CHAIRMAN—Mr Bernie Fraser and Mr Garry Weaven are members of the board of Members Equity Bank and they are also, I think, members of the board of Industry Fund Services.

Mr Beck—I cannot confirm that, but that may be the case.

CHAIRMAN—In relation to the discussions that have occurred at board level in relation to the merger, there could be a perceived conflict of interest there. Do you know whether they have absented themselves from the discussions?

Mr Beck—Those inquiries are probably best directed to APRA, the regulator. We are submitting the process through all the appropriate regulatory requirements, and APRA will rule on that in due course.

CHAIRMAN—Industry Fund Services is owned, you said, by nine superannuation funds.

Mr Beck—That is my understanding, yes.

CHAIRMAN—It was also partly owned by an organisation called IFS Set Pty Ltd at one stage. I think it had a 25 per cent interest that was then reduced to a 12½ per cent interest.

Mr Beck—That is a question beyond the terms of my submission to this inquiry, so I do not have any comment on that.

CHAIRMAN—Could you take some questions on notice on that?

Mr Beck—I am happy to take any question on notice, of course.

CHAIRMAN—Maybe they should be directed to Industry Fund Services rather than Members Equity Bank.

Senator SHERRY—Although you are the chairman, at the end of the day I have to say I am struggling to see what the relevance of the questions is. Given the status of the witness, if you

want to pursue this line of questioning, having given notice of it, perhaps it would be better to invite someone from IFS or Members Equity Bank who can answer the questions.

CHAIRMAN—That is what I was alluding to. It is the issue that has been raised with us of the arm's length relationships between funds and service providers, which is of concern to some of our submitters, that I wanted to pursue. We could either provide them on notice or request someone from Members Equity or Industry Fund Services to appear before the committee.

Senator SHERRY—Maybe do both.

CHAIRMAN—Yes. Are you happy to accept that?

Mr Beck—Yes.

CHAIRMAN—Thanks.

Ms BURKE—I want to get your opinion on this notion of an arms-length relationship between the various players in the industry funds that other submitters have mentioned, and your comment on the various parties providing advice.

Mr Beck—Perhaps I can comment from two perspectives: Members Equity, as the bank, being owned by the industry super funds, then directly markets. We have direct marketing agreements and these are subject to appropriate scrutiny to ensure that the services we provide meet the funds' expectations and needs, and they are reviewed on a regular basis. From the funds' perspective in terms of the arms-length process, my personal experience as a fund trustee is that I am very conscious that fund trustees are acutely aware of their fiduciary responsibilities and that any agreement or arrangement they enter into is properly assessed and goes through due diligence. Those trustee/board considerations are properly minuted, and we are conscious of that because the regulator does take an interest in those matters. Fundamentally, whilst there are interconnected ownership arrangements, trustees are acutely aware of the sole purpose test, the need to meet that test, their own fiduciary responsibilities and the fact that the regulator regularly audits the decision-making processes of trustees.

CHAIRMAN—With our earlier witness there was some discussion about advertising costs and whether they were a legitimate charge on funds and the like. I note in your submission you say:

> Advertising and promotion is not in contravention of the sole purpose test (except where it has not been primarily to inform and educate existing members, or where it imposes a cost on existing members to attract new members).

It has been argued that advertising to attract new members is a legitimate form of advertising, but I take it from what you are saying that you would be of the view that attracting new members is not a legitimate form of advertising to be a charge to the fund.

Mr Beck—We sought to just summarise the APRA advice in relation to that. We are just indicating that this has been a matter of discussion. The regulator has commented upon it and has issued guidelines. We think those guidelines are appropriate and we endorse those comments.

CHAIRMAN—You are paraphrasing APRA's view there, rather than necessarily your own view?

Mr Beck—Yes, indeed. Hopefully, we have done that accurately, but that is the intention there. APRA has looked into the matter and we think that is appropriate.

Senator MURRAY—Within the boundaries of good prudential regulation, I am a supporter of the superannuation industry becoming fully market based—in other words, operating within a free market concept. One of the consequences of that is that you are likely to move towards a more traditional corporate model, and that affects governance. There has been an interest in whether super funds of all types, not just industry super funds, should be democratised—namely, that the selection of trustees, directors, auditors and so on should be by members through a voting process.

If we take an example of a typical industry fund which might have four employers and four employee representatives, I would assume that giving the members a vote would result in the loss of employer representatives, because employees, well organised through union mechanisms, would marshal the vote and you would end up no longer with an even split; you would probably end up with more union-orientated representation. Do you think it would be a loss to industry funds if employer representatives were lost as a result of democratising the process?

Mr Beck—It is a complex question—many-layered, I suspect—and my answer would be simply along these lines: that in the 20 or so years that industry superannuation has existed, anecdotally at least and from the personal experience of those who participate in those funds and in the governance and as trustees, the resounding strength of the trustee governance is in a couple of areas: firstly, the trustees are acutely conscious of their fiduciary responsibilities and the sole purpose test; and, secondly, trustees from employer associations or unions have been able to cooperate and work together for a common objective, which has been a residual and unique strength for the industry superannuation funds themselves.

Speculating about what might occur if there were a pure democratic process put in place is one issue. My comment, though, is that the track record to this point, with the employer associations and unions cooperating through trustee governance with a shared objective, the sole purpose test and an understanding of the fiduciary responsibilities, has produced governance that I think is exemplary.

Senator MURRAY—You are saying there is no good policy reason to change something which is proven to work both prudentially and in respect to the members?

Mr Beck—Indeed. Again, I am not sure that I can back this up with evidence necessarily, but I am sure the industry superannuation fund movement will be happy to compare its corporate governance record and capability against other models of corporate governance in terms of dedication to the particular cause, the end result, risk management, business continuity issues and disclosure of conflicts—all of those matters. Whatever those tests might be, I think there has been enough experience now over the last two decades to be able to seriously look at what the industry superannuation funds have achieved, the way they have been conducted, the way they have behaved, and to compare that to other models, and I think that that speaks eloquently for the success of this particular model.

Senator MURRAY—Do you think there are any areas in which member participation and direction should and could be improved or lifted?

Mr Beck—The previous discussion highlighted a matter of concern for Members Equity, and that is the question of financial literacy and financial awareness. I think there is a major crisis there. Australia has probably got one of the more complicated financial services regimes. We know that we have one of the lowest levels of financial literacy. There are particular risks that are emerging in the choice environment. I would even submit that the industrial relations environment also complicates and overlays that inherent risk environment at the moment in terms of individual contracts and the risk that puts superannuation to. That is a very high risk environment, we would submit, with low levels of financial literacy. If there is one thing that we are committed to and that we would encourage public policy makers to think about, it is the critical importance of improved financial awareness. That would then, hopefully, promote greater member activism around a whole range of issues: their awareness of their fund and their own personal circumstances.

Senator MURRAY—There are particular fiduciary, but perhaps ethical, issues which arise as a result of contributions being compulsory. What the government has done is freed members from being trapped within unions' funds or within retail funds because choice allows you to vote with your feet, so you can now get out of something which you might be unhappy with. Nevertheless, I assume—I do not know; I assume—that there must be classes of members that want to be more empowered, that might want greater participation. Apart from satisfaction levels to do with people being satisfied with the returns or with administration, have you done any research to establish whether there is any member agitation or need for a greater say in the management and running of their funds?

Mr Beck—Speaking from the bank's perspective, we have not done that research. Beyond that, a large proportion of our 200,000 customer base are members of industry super funds, because they need to qualify for particular products by being a member of an industry super fund or a trade union, and we are not aware of any particular customer feedback. We survey our customers in terms of a range of issues. There is no feedback to us, that we are aware of, about that being a pressing need.

Senator MURRAY—You have heard it said that in the corporate world it is very hard to break into the directors' club. Perhaps it is less hard than it used to be, but there are barriers to entry, to put it into formal language, particularly for women. There is this glass ceiling concept as well. There have long been claims of a lack of independence and of improper relationships between the dominant financial shareholders and directors under their patronage and auditors who are in turn under their patronage. I have not heard that same sort of commentary about super funds, be they retail or industry. Do you have any commentary in that area?

Mr Beck—If we take the history of industry superannuation from 1986 or thereabouts—a 20-year experience—in its very early manifestation, in my submission, it was a vision by the ACTU and other employer associations to provide dignity in retirement for working Australians, because at that time probably only 40 per cent of Australians had access to superannuation.

Senator MURRAY—I know the history. I really want you to tell me whether you think there are barriers to entry to becoming a trustee or a director which are contrary to the interests of

members and whether there are proper rotational possibilities and true independence. Of course, I am aware of the 'fit and proper stuff' and all that. What I am really looking for is: that you get a flow-through of talented and able people and that it does not become club-like.

Mr Beck—I understand that you know the history. My only point was to say there are certain values associated with the industry superannuation fund movement which cannot be devoid from its history. There are certain values that characterise the work, the commitment that people have and the personal commitment they bring to the table. Within the universe of those progressive employer associations, and the trade union movement more generally, there is a universe of people who share those values and who are committed to that objective about dignity in retirement for working Australians, which I would submit indicates there is a talent pool available to meet those needs.

I think there is an issue around the increasing complexity in the compliance and some of the regulatory issues which say there are skills issues, but I think they are met by dedicated training to support that universe of potential trustees or existing trustees.

Senator MURRAY—Thank you, Mr Beck.

Senator SHERRY—You refer to the equal trustee provision. Isn't it also true that that is a feature of superannuation generally?

Mr Beck—The corporate funds also have a similar model—member election—more directly so than the industry super fund model, but that is then counterbalanced with employer nominations.

Senator SHERRY—And public sector funds, I think, operate on the same basis.

Mr Beck—Public sector funds are similar, yes.

Senator SHERRY—You referred to trustees and the increasing complexity of compliance and training requirements. Do you think there is at least some shift towards professional trustees, in the sense of time commitments today compared to 20 years ago, training requirements et cetera? Do you think that is a shift that is occurring?

Mr Beck—I think it is a legitimate discussion and I think many trustees are now conscious of the increased commitments in terms of their own skills, awareness, compliance and making judgment calls about their ability to actually perform the role. I think that is a legitimate observation.

Senator SHERRY—Some funds that I am aware of, and this includes corporate funds, have outside independent trustees now, with varying degrees of professional qualifications. Do you think that is an increasing trend?

Mr Beck—Yes, I think that is a fair observation. That is a trend.

Senator SHERRY—Do you think that carries any disadvantage?

Mr Beck—It is probably too early to call. You can see the advantages if people have developed expertise and they have the time and they have dedicated this phase of their lives to becoming expert in superannuation. You can understand why they would bring particular values to trustee governance. Having said that, my own personal experience——not from Members Equity Bank but as a trustee—is that there is a particular value also brought by union and employer association representatives working cooperatively and collectively to meet a common objective.

Senator SHERRY—I know in the retail banking sector there are attempts to cross-sell products. I am referring to superannuation, wealth management, credit cards, insurance—traditional banking services—increasingly trying to sell one product based on the product base of another product. Does Members Equity Bank do that? For example, you obviously have access to superannuation fund members. Do you use that as, effectively, a cross-sell in terms of, say, housing loans? I think there is a credit card product as well, isn't there?

Mr Beck—With our existing customer base, we will cross-sell and cross-promote existing banking products, but it is limited to the service the bank provides. If you are a home loan customer, we may make an offer around a credit card offering, so we do that cross-marketing. I am not sure whether the committee has had submissions from the rest of the banking industry at all, but one of the issues that we are interested in is the highly oligopolistic nature of Australia banking, dominated by the four major banks. The transactional nature of banking is critically important. None of us in this room can operate as a citizen without a transactional banking capability. To the extent that the major banks dominate that through merger and acquisition, we say that provides them with a position to cross-promote and promote their particular preferred financial services regime.

During the course of the nineties all the major banks, rather than develop their own product offerings around superannuation—they tried with the RSA, the retirement savings account, which was spectacularly unsuccessful—acquired fund managers and superannuation providers. ANZ had a joint venture with ING, Westpac with BT and Rothschild, CBA with Colonial, NAB with MLC. So during the course of the nineties they acquired fund management and superannuation services. They then also acquired a large proportion of the financial planning networks, so they now have vertical integration from the advice through to the transactional banking capability, the banking relationship through to superannuation.

All the issues we have spoken about in terms of the nature of advice, sales commissions and disclosure are all relevant but they are also particularly relevant to the major banks, who dominate the financial services market.

Senator SHERRY—You say that the major banks dominate—or banks and their life subsidiaries or associations, in the case of ANZ and ING—but I seem to see increasing levels of competition outside the big four; for example, GE, Virgin and your own bank. Look at the number of players that we have in Australia now compared to, say, 20 years ago. Is it still the case that it is an oligopoly, big four type dominance?

Mr Beck—It depends on the product range. I should be more specific. Transactional banking is really important. We have a range of other entries around credit cards, home loans et cetera, and that is important competition. There is no doubt the market is very competitive. It is just an

observation more than anything else, but the transactional banking capability—access to the payment system—is of critical importance. None of us can operate without that payments capability. To the extent that that is dominated by the four major banks, I think it gives them power and leverage and opportunity which, if not properly disclosed, if not properly accounted for and if consumers are not completely aware of the connection, does raise issues of consumer risk.

Ms BURKE—Would you say that the accusation about being at arm's length that has been fired at the super funds could also be fired at the major banks?

Mr Beck—That is right. If all of us here had a view that we need some financial advice—the first revelation is that we acknowledge that we need financial advice—and if we go out into the main street, it is not obvious to us through the ownership that the large proportion of the network is actually owned by the major banks. It is not branded as such, it is not disclosed as such, and you do inadvertently, without proper disclosure, end up in that limited market, dominated by the major banks.

Ms BURKE—If an individual says, 'I'm looking for financial advice. ING has had this great advertising with Billy Connolly. He's doing all right, so I'll go and check out ING,' would the average person be advised of their relationship with ANZ?

Mr Beck—It gets down to the disclosure issues. Rather than me speculating on that and the previous discussions around that, in terms of the ASIC surveys they disclose, in our view at least, a matter of profound public concern. There just has to be, to the extent that the regulator is saying, through secret shopper exercises, very real concern around lack of disclosure; the concern that sales commissions do influence the nature of advice, to the extent that probably the biggest and largest superannuation company in the financial planning network, AMPFP, were required to give enforceable undertakings, particularly around the notion of superannuation switching. That in itself, I think, indicates the nature of consumer risk that is currently there.

Ms BURKE—Do you think that we need to have greater protection around choice and switching. Certainly the shadow shopper came back and said that one of the greatest faults was the lack of information on the exit fund and what you are actually giving up to go to this new fund. There needs to be greater regulation around that.

Mr Beck—We certainly endorse that, based on the ASIC results and based on previous submissions. I think it has been canvassed in the earlier discussion around the risks associated with sales commissions and the way they operate. The other issue is around SGCs. To the extent that SGCs are a statutory requirement, as Senator Murray indicated before, the fact that you could possibly be drawn into paying a sales commission on a compulsory superannuation contribution is, to us, particularly offensive. That is a statutory requirement. It is part of your remuneration. It has to be paid. The notion that you would somehow have that discounted by a commission is a real issue. So, at the very least, that should be protected from commission. There is obviously complexity around other financial advice.

Senator SHERRY—On that last comment about the complexity of financial advice, if there is a common thread in all of the submissions where it is mentioned it is the difficulty and the costs

of FSR and the disclosure regime. Do you have any specific comments to make on the disclosure regime and requirements as they currently operate?

Mr Beck—For the bank, it gets down to how our FSR requirements go to deposit products. All of our staff are trained in providing general advice around deposit products, and we manage that internally. So, yes, there is additional cost and additional complexity, but we manage that okay. I would be guided by the submissions of other providers. The other worry we would have is that, for the vast majority of people, the financial advice that they require is very basic. For ordinary working Australians, I am not sure that there has been a case made out for the need for complex financial advice.

Senator SHERRY—When you say 'basic advice', what do you mean?

Mr Beck—They probably need to know how to do a family budget, the importance of insurance—general insurance, life insurance and income protection insurance—and the need to get advice about that. They need to understand the importance of paying off a mortgage as opposed to other investments—the net benefit of paying your mortgage off—and they need to understand, in our submission, the difference between industry super and retail super so that they can make an informed choice. At the end of the day, that is probably the basic construct, and it would not take a lot of money or a lot of effort to build a model for, I would suspect, 80 to 90 per cent of working Australians. They could have access to a basic template that would guide them through the system.

Senator SHERRY—I accept that it would be desirable for every Australian to have that. Is it legitimate for it to be paid against superannuation, which is a retirement income product?

Mr Beck—If you go to the sole purpose test, I guess to the extent that you then get advice around super and what sort of fund you should have and to the extent that you wanted advice around MIC, member investment choice, I think that would then be the appropriate way for that advice to be offset against your superannuation account.

Senator SHERRY—Is there not a risk, regardless of the commission versus fee debate, that we end up loading on to a retirement income system all sorts of costs that are not retirement related?

Mr Beck—That is a really legitimate debate. From a trustee point of view and from the existing regulatory regime, Members Equity would have no difficulty with the notion that the sole purpose test is important. It has to relate to the member's retirement income proposition to the extent that it fits within that framework. But if our concern is the broader consumer risk and how we deal with those consumer risks—

Senator SHERRY—Yes, I understand and accept the consumer risk issue. Let me give you an example with income protection insurance. It does worry me—and I have asked APRA about this and they do say that it conforms with the sole purpose test—and I do struggle to accept that unemployment insurance is a part of a retirement income system, or should be part of a retirement income system. Do you have a view on that?

Mr Beck—Very generally, Senator. I think that most trustees are concerned about the welfare of their members, particularly through to retirement. I think we would take the view that traumatic events that interrupt their employment, their earning capability and their ability to contribute to super are matters that bear more directly than indirectly upon the members' end benefits. So, to that extent, we are concerned to provide those products.

Senator SHERRY—The Australian model has a level of death and disability insurance which is compulsory. But, if what you say were true, would it not therefore be a logical argument that income protection also be a compulsory feature of the system? I do not agree with it, but would that not be the logic?

Mr Beck—I can understand that argument. We do not have a particular view on that whether you load into the system specific advice around that and where you charge that. I understand that is the essence of your question.

Senator SHERRY—Yes.

Mr Beck—That is one way to deal with it. The other way is through better information, better education and better financial awareness, so that people are aware that they can take out income protection insurance.

Senator SHERRY—What concerns me—and it is aside from this debate about commissions and fees—is that that is a cost, and a legitimate cost. How it is paid is part of the public debate. But it is a legitimate cost issue, provided it is relevant to superannuation. What really worries me is that you then add on costs of death and disability insurance and costs of income protection. If you add all that together it can have a significant impact on the final retirement payout, can't it?

Mr Beck—I agree. This is well beyond my area of responsibility or professional understanding, but perhaps one way to deal with that is for people to at least be informed that you either do or you do not get advice around such an issue as income protection insurance. You make that choice. Secondly, if you make the choice to seek advice, you could then have the choice of, 'Do you want to pay up-front; do you want to pay a commission; or do you want to have it deducted from your superannuation account?' They can then choose the way in which they pay for that.

Senator SHERRY—It is not covered in your submission, but one of our terms of reference is international comparison. We are getting some data together, but what strikes me about Australia compared to most other retirement schemes—not compulsory but where they exist, as in the UK—is that these add-ons are not a feature of their private pension systems, but they are a feature in Australia. Do you have any general comment to make about that observation?

Mr Beck—The only general comment is, again, from a trustee experience. Trustees are acutely aware of their responsibility to their members. We understand that those forms of insurance are very important options, and we seek to do everything we can to inform members of their rights and responsibilities to properly insure in those circumstances.

Senator SHERRY—Do you have any comment to make about our twin peaks regulatory model, APRA-ASIC, and whether it is an appropriate model or whether a single regulator is a better approach?

Mr Beck—With respect, I would say that that is beyond the remit of our submission. I have read it and I have personal views, but I would not be authorised to speak on behalf of the bank.

CHAIRMAN—As I understand it, Members Equity Bank began life as a home loan organisation funded by the superannuation funds.

Mr Beck—In essence, yes.

CHAIRMAN—Was the reason for that that it was more efficient for the super funds to have a separate organisation which collectively provided that service rather than the individual funds providing a loan mortgage service to members, or are super funds precluded by legislation from providing that service?

Mr Beck—The actual driver was an initiative by Bill Kelty of the ACTU. He was concerned at the gouging by private banks around the price of residential mortgages. So the ACTU approached National Mutual, who established a trust and a fund that the industry super funds invested in for commercial returns. They received a commercial return—a cash plus rate of return—AAA residential backed mortgages, highly secured. They received a competitive return. In return, National Mutual was then able to administer and offer substantially discounted home loans to members of industry super funds.

CHAIRMAN—What was the development from there?

Mr Beck—The development from there was that this exercise became very successful and grew very rapidly. The industry super funds then realised that this was a successful venture in its own right, negotiated a 50 per cent equity in the emerging business with National Mutual at the time and then, by the end of the 1990s, acquired full ownership of the business Members Equity, as it then was. During the period 2000 to 2001, the business became a successful home loan business and sought a banking licence to then offer a range of additional banking products.

CHAIRMAN—Are the home loans provided out of the capital that the industry funds have invested in Members Equity Bank, or do you also take deposits and provide loans from those deposits?

Mr Beck—It is a securitisation process off balance sheet, so the funds invest in a trust and the trust lends against secured mortgages, which are then securitised and on sold in domestic and international equity markets.

CHAIRMAN—So the loans that you can provide are limited by the amount of money that the industry funds have invested. So you do not take deposits like a normal bank?

Mr Beck—We do take deposits, but the home loan lending is off balance sheet. Balance sheet lending funded by the deposit base really goes to personal loans and credit cards.

CHAIRMAN—So the home loans are off balance sheet?

Mr Beck—Yes.

Mr BAKER—What interest rate are they charging at the moment?

Mr Beck—On the home loan?

Mr BAKER—Yes.

Mr Beck—It is 7.24 per cent.

CHAIRMAN—Very competitive! And only members of the relevant superannuation funds are entitled to obtain those loans?

Mr Beck—Yes. We have our nominated rate. The rate we advertise is the same as our comparison rate. There is federal legislation that requires you to load in relevant fees and charges; so you have your nominal rate and your comparison rate.

Senator SHERRY—The comparison rate includes entry fees and all the other bits and pieces.

Mr Beck—Application fees and admin fees, yes. We are probably the only financial institution—and I could be corrected on that—with a nominal rate that is the same as our comparison rate. There are no application fees and there are no admin fees—so it is a very simple, transparent proposition. The fee that you see advertised is the comparison rate and is the rate you pay. To get that rate you have to be a fund of a trade union, a member of a trade union or a member of an industry super fund. If you are not—if it is a public offer proposition—there is an equivalent product but it is 25 basis points higher rate.

Senator MURRAY—I heard you say earlier—though I forget the exact phrase you used—that the big contest is between industry funds and retail funds. In the whole movement towards a market based superannuation industry, I think nomenclature becomes more and more important, because it needs to be intelligible to customers. I do not think customers at large understand industry funds and retail super. Do you think this committee should move towards trying to establish a description which is better based?

Retail funds are effectively just normal corporations which exist to make a profit out of their customers—customers who happen to be superannuants—and the others are mutuals. It does not matter whether they are public sector funds, corporate funds or industry funds. An industry fund is targeted towards a particular demographic. When you boil it down, there are really just three categories—corporates, mutuals and self-managed super funds. Do you think sorting that out and getting better market based terminology would lead to greater understanding and better marketing potential for superannuation or is this just something which will develop naturally?

Mr Beck—I think that would be an important initiative by this committee, if you could work your way through that, because the concern we have is the complexity of the terminology and the jargon that is used. Anything that assists consumer awareness so they can make informed choices is important. The mutuals, as you describe them, probably have a number of key

characteristics—trustee governance, all profits to members and no sales commissions. It might be that there is some sort of criteria that is developed by which those standards are met and a particular fund is characterised as such.

CHAIRMAN—Just help me clarify my understanding of your loan portfolio. When you say the loans are off balance sheet, does that mean you act more as a broker than a provider of loans?

Mr Beck—No. I am not the best person to answer these questions, I am sorry. Most banks do it. The major banks have perhaps a more diversified mix. They have bigger balance sheets and they can do on balance sheet lending.

CHAIRMAN—Most banks would just, in effect, borrow money from depositors and loan it out to borrowers.

Mr Beck—Yes, but they are all now using the process of securitisation. It provides access to larger capital markets to fund the loan book. That is the way I would describe it.

CHAIRMAN—So you arrange loans from, for want of a better term, big lenders as well as your individual—

Mr Beck—Yes. I think I am correct in saying that Members Equity is now one of the largest issuers of securitised paper in certain domestic markets. It is now becoming a global proposition. We now have global investors who understand our business model, our risk profile and our returns and are very pleased to invest and buy the securities we issue. Relative to our peers, our default rate is probably 30 per cent of the default rate of the rest of the industry.

CHAIRMAN—In effect, you aggregate the mortgages and get a big lump of money in to finance those.

Mr Beck—Yes, and then we lend that out again.

Senator SHERRY—Presumably, there are other new entrants in the area of home loans. Aussie Home Loans would be a classic example.

Mr Beck—Similar.

Senator SHERRY—They are not a bank.

Mr Beck—I think Aussie transmogrified over time. They started as a securitiser in their own right and, for whatever reasons, they have now become a broker.

CHAIRMAN—Mr Beck, thanks very much for appearing before the committee. You have been very helpful as far as our inquiry is concerned.

Mr Beck—Thank you.

Proceedings suspended from 11.08 am to 11.21 am

DAVISON, Mr Michael John, Superannuation Policy Adviser, CPA Australia

KELLEHER, Ms Noelle Eileen, Member, Financial Advisory Services Centre of Excellence, CPA Australia

CHAIRMAN—I now welcome the representatives from CPA Australia.

Mr Davison—Thank you for inviting us to appear this morning. CPA Australia is Australia's largest professional body. We represent a diverse range of member interests. We are long-term supporters of super as a retirement savings vehicle and keen advocates for ensuring that all Australians are able to save adequately for their retirement in an environment that is simple, safe and equitable.

The superannuation industry has seen significant changes in the last 20-odd years. We have seen the demise of stand-alone funds, a shift to industry and retail funds, and a rapid growth in self-managed funds. Benefits have also moved from being predominantly defined benefit funds to almost exclusively accumulation benefits. The ability to save for our retirement through super has also improved considerably, as has its flexibility and accessibility. We are also about to see significant change again next year which will further increase the attractiveness of super as a savings vehicle.

In response to these changes, we have seen a significant increase in the regulation of the industry, primarily under the SI(S) Act. Recently we have seen the introduction of the Financial Services Reform Act and only this year the introduction of trustee licensing. Structurally, we believe that the industry is quite sound. The professionalism of trustees has increased significantly and the industry's integrity is maintained by the competition and diversity that exists between the different types of funds. We believe that it is highly regulated and there are many safeguards in place to ensure that members' benefits are protected. Many of the regulatory changes, particularly licensing, are quite recent. We believe that the industry now needs time for the changes to settle in before we can really determine if the industry is structured and operating effectively.

From a retirement savings policy point of view, we have also come a long way, especially in recent years, and the upcoming changes will go a long way to simplifying superannuation. However, we believe that there still is a long way to go before we can say that the system is truly simple and truly equitable. We are happy to expand and go down this path further, if the committee wishes. You have our submission in front of you, so I will not go over our points again. The terms of reference are quite broad, so I do not wish to second-guess the committee and try to focus on any particular issues; instead we will focus on the issues that the committee wishes to. We are happy to answer questions.

CHAIRMAN—Thank you. I note from your submission that you are opposed to the introduction of uniform capital requirements for trustees and also trustees being required to be public companies.

Mr Davison—Yes.

CHAIRMAN—What is your view on trustees being required to abide by the same disclosure requirements as public companies?

Ms Kelleher—In terms of disclosures or what trustees' funds need to do, in theory prima facie maybe they should be doing what the public companies are doing. However, I would ask: how much of those disclosures are going to be relevant for the members and be something that the members can understand? Would we be creating more noise for the members as opposed to clarifying anything that is happening? Part of the reason is that when you look at a public company and see how the shareholder side of it works, as a shareholder of a public company you are investing in the public company. You are not making any choices to do with member investment choice or investment strategies or anything along those lines.

When you look at a super fund, particularly one that has investment choice, what is relevant to the members is not necessarily what is happening to the fund as a whole but what is happening in the various parts of the fund where the members have their money. What is happening in the investment strategy choice that the member has made? If we were going to look at other disclosures et cetera of public companies, relevant for super funds, I think we need to sit back and say, 'From the members' perspective, what part of the fund am I investing in? Do I need to do the disclosures based on the fund as a whole, based on segments of the fund?' et cetera. That is where I think a lot of the noise is going to happen and not necessarily provide better information for members or better information for financial advisers et cetera. It is not even as though we have a whole pool of analysts poring over super fund accounts or PDSs like that you have in public companies. So we need to think about those sorts of things.

Mr Davison—I think the primary issue here is the members' interests, and the members' interests are their investments in the fund. There is quite adequate reporting now, as far as their interests in the fund and how that fund operates. I am not sure what benefit there is in having public reporting of the operation of the trustee, be they corporate or individual trustees, versus the additional cost that it would present, which ultimately would be borne by the members. As Noelle said, it would be another layer of information which may not necessarily be of benefit to them but could certainly confuse the picture somewhat.

Ms Kelleher—The committee should also note that AAS25, which is the accounting standard that applies to super funds, is currently undergoing an extensive revision, and there will be lots of discussion in terms of extra disclosures that should or should not be made by super funds as part of their annual financial statements et cetera. That may be something that could be raised with that review, in terms of looking at public company disclosures and should they be built into the super fund annual reporting.

CHAIRMAN—I note that in your submission you, in effect, support the recommendation that this committee made in relation to regulation 7.1.29 of the financial services legislation reforms, which recommended that accountants, without being licensed as financial advisers, should be able to advise on the structure of superannuation funds, whether they be self-managed, retail or industry funds, rather than just being limited to advising on self-managed funds. In that context, you say in your submission:

Advice on structures per se is integral to the work done by an accountant. Precluding the ability to advise on superannuation structures other than SMSFs may see a proliferation of SMSFs which have been demanded by clients

because of their inability to deal with their accountant and the clients' reluctance to engage another professional to give such advice.

I am just wondering to what extent that is happening because of this sort of artificial exemption—this is a personal view, but it reflects the committee's view in our recommendations—just carving out and being able to advise on whether a self-managed fund is appropriate or not, without being able to compare that with the other alternatives. To what extent is that giving rise to perhaps people going into self-managed funds when other structures might be more suitable, if an accountant could advise on that?

Mr Davison—You have hit the difficulty on the head. Accountants are limited. If a client comes in, they can ask to have a self-managed fund established. The adviser, if he is unlicensed, has no scope to suggest that that is not the most appropriate path and maybe they should consider another type of fund. We do not have hard numbers or evidence as to how big the problem is. It is mainly anecdotal evidence that we get from our members and in discussions with particular members. Members tend to contact us about whether or not something will work, and air their grievances. That is how we hear about the issue.

The focus in the last year to 18 months has been with things like the shadow shopper and ASIC's switching advice survey last year. ASIC has reached a conclusion that you cannot possibly advise on going into a particular type of fund or structure of fund, unless you have considered the fund that they might already be in; whether or not they are actually switching money from that fund. Essentially, the exemption as it stands, of being able to advise on self-managed funds, does not really work at all. ASIC is expecting accountants to consider the other options and yet they are hamstrung to do so.

Senator SHERRY—Is that not the price you pay for being exempted from FSR disclosure?

Ms Kelleher—It is actually the price the individual or the consumer is paying. If I have a client who comes in and says, 'I have $1 million to invest somewhere. What are the structures I have available to me to invest in?' that is typically where they will come from. The question will be, 'How can I invest it?'—not meaning 'Where?' but 'What are the structures I can invest in?' As an accountant, you can talk about the family investment company, the family trust investment trust, your self-managed super fund but you cannot go on and then in theory talk about every other type of super fund, which may be perhaps the most appropriate type of entity structurally for them to invest in.

Senator SHERRY—If your request were granted, it is not clear to me: do you want to be covered by FSR if you had this ability to make the comparison, or do you still want the exemption? It is not clear to me from your submission which is the case.

CHAIRMAN—Extend the exemption, the current exemption.

Mr Davison—We want the exemption extended to cover superannuation structures so it actually works.

CHAIRMAN—As distinct from the investment decisions? Not advice to invest, but just on the alternative structures?

Mr Davison—That is right. The last thing we want is a group of people, albeit our members and accountants, running around giving investment advice.

Senator SHERRY—That is what they are doing, are they not?

Mr Davison—That is not what they should be doing and it is not what we are aiming—

Senator SHERRY—It seems to me that is what they are doing, from everything I have seen. What is the difference between advising on a self-managed super fund and establishing it, and advice on possible investments within it, and any other advice?

Mr Davison—Super is basically a taxation structure. It is the structure of an investment vehicle.

Senator SHERRY—That is true of every super.

Mr Davison—So you should be able to advise on whether a self-managed fund which has a high level of responsibility for the trustee—member, owner, whatever you want to call them—a fair bit of hands-on involvement, a fair bit of potential cost involved, versus an industry fund which is supposedly low cost, versus a retail fund which may give you a lot more options but there may be a cost involved and advice involved, versus staying in your corporate fund.

Senator SHERRY—What is the accountant doing in terms of assisting the trustee of the self-managed super fund that they recommend they set up?

Mr Davison—Once they are established?

Senator SHERRY—Doing nothing?

Ms Kelleher—Once it is established, in terms of you putting your $500,000 or whatever dollars into your self-managed super fund, the accountant cannot provide investment advice in terms of where that money, once it is in the fund, can go.

Senator SHERRY—I know what they cannot do, but what are they doing?

Ms Kelleher—I doubt if they would be doing that, simply because traditionally accountants have not provided investment advice.

Senator SHERRY—I know that. But what are they doing?

Mr Davison—They will assist the trustee with the administration, the accounting, audit tax, setting up income streams potentially, like say an allocated pension, structuring the fund with members, like family et cetera.

Senator SHERRY—Why shouldn't they be covered by FSR?

Mr Davison—We are not saying they should not be covered by FSR; we are saying they should not necessarily be—

CHAIRMAN—They are not covered by FSR now in relation to that.

Senator SHERRY—Yes, we know.

CHAIRMAN—What they are saying is that that exemption should be extended to also being able to advise a client whether an industry fund, a corporate fund, a retail fund or a small APRA fund would be a better structure than an SMF.

Ms Kelleher—It is not actually saying which industry fund—

Senator SHERRY—But that is the job that the planner does at the moment.

Ms Kelleher—Not necessarily.

Ms BURKE—The planners would assert, and they have in their submission, that you should have the exemption taken away and you should be under the same rule as they are because you are fundamentally doing the same job the planner is and you are in competition.

Ms Kelleher—Then what I would be saying is that if we are saying that structural advice to do with superannuation should be covered by FSR, then structural advice to do with whether you should operate via a company, a trust, a partnership, a joint venture et cetera, should all be in there as well, because the difficulty is that we have created a line that says that some structural advice is in FSR and some structural advice is out and from the consumer's perspective, they can come to an accountant and get some advice about structural issues but they cannot get complete structural advice. And if they go to the planners, they can get investment advice but they cannot necessarily get the structural advice that goes with the other side of it.

We have created a problem where a consumer who is after structural advice as to, 'What are all my options?' actually cannot get it from any one source. What I have found with my clients is that a lot of them want to get someone who can sit back and say, 'From an independent perspective, forget about investments or anything along those lines. These are the options that are available to you and these are the structural issues that you need to think about in terms of what needs to be factored into what is going to be right or wrong for you.'

Senator SHERRY—But that is also a major part of—not an exclusive, not the total, but the major part of—the work a planner does at the present time: a comparison of funds.

Ms Kelleher—But do they compare using a company, using a trust, using a partnership?

Senator SHERRY—Sorry, I do not see a clear distinction and I do not think the average punter sees a distinction between this either.

Ms Kelleher—But if you are starting to talk about your investment moneys going into superannuation which is fully preserved, surely some of the discussions have to be that there are options other than superannuation which do not have preservation, which have these other

consequences like, 'If you buy shares in a company, that is your private investment company that is then going to go off and do whatever else.'

Senator SHERRY—But you are wanting the ability to make a comparison between—

Mr Davison—Structures.

Senator SHERRY—I understand that. You want to make a comparison. Say Joe Blow comes to an accountant. At the moment you are confined to an SMSF. You cannot make an active comparison to an industry fund, retail fund or corporate fund.

Mr Davison—Or suggest that they should not do the SMSF.

Senator SHERRY—You want the ability to do that?

Mr Davison—Yes. Not the ability to say, 'You should choose XYZ industry fund over ABC industry fund.'

Senator SHERRY—What do you want, then?

Mr Davison—It is purely to say an industry fund—

CHAIRMAN—Point out the features.

Mr Davison—A typical industry fund would have the features that would suit your needs, or a retail master trust—

Ms Kelleher—But not naming anything—saying, 'A fund of this type could do this.'

Senator SHERRY—But you use the expression 'suit your needs'. Doesn't that mean an examination of the personal circumstance of the individual? It would have to, wouldn't it?

Ms Kelleher—All structural advice requires that.

Senator SHERRY—But, sorry, Mr Davison said 'suit your needs'. A punter comes to you and says, 'What would suit my needs? I'm in an industry fund'—or a public sector fund—'You can examine the SMSF structure for me. What would suit my needs?' What would an accountant have to do? Surely they would have to examine the personal circumstances of the individual?

Mr Davison—Yes, they would.

Senator SHERRY—Yes, and that is advice. What are they going say? 'You're a low-income earner. You need X amount of death and disability insurance. That's available in your industry fund.' You are examining their personal circumstances and you are just going to say, 'I've examined your personal circumstances.' Surely the next step is to make a recommendation?

Mr Davison—It is, and the recommendation would be limited to structure.

Senator SHERRY—I do not see the distinction.

Mr Davison—Senator, the issue we have is that a lot of people still have their primary relationship with their accountant, not their financial planner, if they even have a financial planner. Their accountant is a trusted confidante and adviser. They will go and talk to them about many different business and personal financial issues, issues such as tax.

Senator SHERRY—No argument with that; I accept that is a fact of life.

Mr Davison—Then they will step over the line of, 'I've got 20 grand in my industry fund'—or it might be in their employer fund. 'Is this the best place for it or should I go to an industry fund?' or something like that. The accountant at the moment has to say, 'Sorry, I can't tell you that. Go talk to a financial planner.' From a consumer's point of view, they are either doing nothing, making decisions by themselves without advice—

Senator SHERRY—I am accepting your argument. It would seem to me absurd that an accountant looks at an SMSF structure, as you call it, and cannot examine the existing—if it is a non-SMSF structure. It would be absurd. But doesn't it logically follow that advice will be given in examining the personal circumstances, therefore the accountant should not have an exemption in those circumstances from FSR? It is effectively doing one of the primary tasks that is carried out by a financial planner.

Mr Davison—One of the shortcomings of the FSR legislation is the link of advice to product and that whenever you are giving advice on any sort of investment, it is deemed a product, so advice on a super fund, be it industry versus self-managed fund et cetera, is viewed in the same way as advice on AMP versus BT versus Commonwealth Bank, or whatever.

Senator MURRAY—But that is false, if I may say so. Surely if you said to a person, 'You should invest in property,' and then he says, 'What property?' and you say, 'Oh no, you've got to choose'—commercial, residential and so on—by saying he should invest in property rather than in shares, you are giving advice. If you say to somebody, 'You should be in an industry fund,' and he says, 'What industry fund?' and you say, 'Oh well, I can't give you that,' you have already directed him in a particular direction.

Ms Kelleher—I do not think you would have someone saying, 'I think you should invest in an industry fund.' Ideally, what we need is a situation where an accountant can say, 'Here are all the features of the different types of funds that are out there. We don't think that a self-managed super fund is appropriate for you because you don't want to take over the administration' or 'take over the trustee responsibilities' or 'you're so disorganised with all your ordinary life, there's no way you're going to cope with a self-managed super fund. But I can give you information about these other types of funds so that you can then have a bit of understanding as to what they are, and then you can go and talk to a planner and ask which one you should go in.' So it is not 'You should be in an industry fund' or 'You should be in a corporate fund' or 'You should be in a retail fund' or 'in a small APRA fund'. It is 'Here are all the features about them. You think about what you think is important for you,' et cetera, 'and go and talk to a planner about what your options are in terms of getting into the detail with all this stuff.'

Senator SHERRY—But isn't this adding just another layer of complexity? You go to the accountant for your tax return or whatever, you get into a discussion about super, and they can say, 'Look, show us your industry fund' or 'your retail fund documents', and they make an assessment. They are not giving advice, of course; they are making an assessment. And then you are referred off to a planner. It seems to me we are getting two sets of advice in the equation, rather than one.

Mr Davison—But it may have given the client a benefit or a better understanding of where they are going than if they had not got any advice.

Senator SHERRY—What you are suggesting is that an accountant should become an overarching clearing house for a planner.

Mr Davison—No, not at all.

Senator SHERRY—That seems to be where it is leading.

CHAIRMAN—I do not think you are excluding the capacity of the individual to go to the planner direct.

Mr Davison—No.

CHAIRMAN—You are more talking about someone who has an ongoing relationship with an accountant, aren't you, rather than someone coming in off the street and saying, 'Advise me'?

Mr Davison—Exactly. The bottom line is that accountants who want to give financial advice should be licensed, the same as everyone else. They should be a licensed financial planner, who happens to be an accountant. The aim of the exemption—and we have asked to try and get it extended to make it work properly—is to cover those accountants who, as part of their day to day accounting business, come across clients asking questions which at the moment are crossing that line into advice.

Senator MURRAY—Is this a real problem? If I go to my accountant and say, 'I want to set up a self-managed superannuation fund,' and he says, 'I don't think you should,' that is what happens.

Ms Kelleher—Yes, but then if you say to your accountant, 'What other options have I got?'—

Senator MURRAY—Then he says—

Ms Kelleher—'Go and talk to your planner.'

Senator MURRAY—'If you're thinking about super, your other options are corporate funds or industry funds or retail funds.' That is what happens. There is no problem. No regulator has come back to the parliament and said, 'Gee, there's a real problem out there. Customers are coming and complaining that an accountant said to them, "Don't open a super fund," and when they asked him what the alternatives were, he said, "A corporate fund or a retail." There is not a problem.

Mr Davison—The difficulty is that legally they are not allowed to do that. The shadow shopping survey that ASIC did last year or early this year came to the conclusion that, whilst the overall strategic advice was generally given well, often people were crossing the line and giving advice they should not be, so they are breaking the law, but then when they talked to the clients about it, something like 80 per cent of them were happy with the advice they were getting.

Senator SHERRY—And that was pretty frightening, in my view. The fact is, they got spun a yarn and were mis-sold—

Mr Davison—They were happy.

Senator SHERRY—The overwhelming majority did not know they had been conned, frankly. That is a pretty worrying outcome.

Mr Davison—I think what the ASIC shadow shopper showed was that the quality of strategic advice is reasonably good but people are stepping over that line.

CHAIRMAN—This is from accountants or from planners?

Mr Davison—They talk generally. They talk about unlicensed advisers and, whilst it did not target accountants specifically, it includes them in the group. People were stepping over that legal boundary.

Senator SHERRY—Planners can advise on SMSFs, can't they?

Mr Davison—Yes.

Senator SHERRY—This is where I find your request, frankly, a bit beyond the pale. It seems to me you want the best of all worlds: the exemption to continue but to be able to generate more work to the disadvantage of planners. I am not one who has a lot of sympathy for some planners, I have to say, but it just seems to me that surely we should have a level playing field of regulation and requirement and licensing. If people want to be involved in superannuation advice on structures or not, we should have a level playing field of regulation.

Mr Davison—I totally agree. Like I said, our view is that accountants who want to give financial advice should be licensed. The aim of the exemption is to cover those situations where they are getting caught up inadvertently in the requirements of FSR while going about their normal day to day business.

CHAIRMAN—Where it is, in effect, incidental to their main role.

Mr Davison—I try to avoid that word, but it is catching the incidental advice.

Senator SHERRY—But if it is incidental, if someone comes to the accountant and the accountant wants to talk to them about SMSFs, if that is part of the business—and I suspect it is a growing part of the business for accountants, looking at the data on SMSFs—I still cannot see why they are exempt from the FSR requirements.

Mr Davison—In that example they should be licensed, I totally agree. Those who are specialising will have licences. It is the corner accountant who has business clients—small local businesses—with whom they have had a 10-year, 20-year relationship. We get calls from these members, who say, 'I've got a business client. I do his tax. I do his books. He's asked me for super advice. What can I say?' and the answer is, 'Well, you can't,' and they are loath to send him off to the financial planner down the road.

CHAIRMAN—But if what Senator Sherry was suggesting were to be the case, in effect would virtually every accountant have to become FSR licensed?

Ms Kelleher—Yes, in theory. If you go to your tax adviser to talk to them about making a superannuation contribution, the tax adviser cannot say to you that superannuation is more tax-effective than investing elsewhere, because that comes in under FSRA licensing requirements.

Mr BARTLETT—As it should.

Ms Kelleher—If you are giving pure tax advice in terms of the tax-effectiveness of investing in a bank account versus investing in something that you are going to get a tax deduction for, then I do not know necessarily if it should. It should have disclaimers around it in terms of preservation rules and all those sorts of things, but there will be tax advisers who are actually breaching the FSRA licensing requirements because they will be talking about the tax-effectiveness of superannuation. Anything that you say that could be seen as an inducement or that could be used by an individual to make a decision regarding how they may or may not spend their money is caught by the licensing requirements. So we are in a situation where you cannot, as a tax adviser even, talk about superannuation being tax effective in terms of deductibility issues et cetera.

Senator SHERRY—Do we have any data on both the number of funds and the assets contained in SMSFs that are accountant-advised on the structure as distinct from planner-advised?

Mr Davison—No distinctive numbers. The nature of the self-managed fund market is that it is fairly individual and difficult to measure. We did research on self-managed funds two years ago. We surveyed advice providers and service providers—accountants, financial planners et cetera—and we surveyed fund owners and trustees, so we got an indication of where the relationship was held. We can certainly get those numbers to the committee.

Senator SHERRY—That would be useful.

Mr Davison—I cannot recall them off the top of my head. We do have them from a survey point of view, but there is no definitive data on the industry as a whole.

Senator SHERRY—Accountants are obviously professionally qualified, but they do not charge commissions. Some planners seem to have to charge commissions, so why don't accountants?

Mr Davison—I will not go into whether planners have to or not, because that is probably their argument. From an accountant's point of view, traditionally they have structured their business around fees, and you pay fees for a particular service.

CHAIRMAN—They are not selling a product.

Senator SHERRY—Accountants are doing well, aren't they? If accountants can survive by charging fees, why can't planners?

Ms Kelleher—If you look at an accountant's business, where historically and culturally it is fee for service, where superannuation has just been part of their service or part of the work that they have done for their clients, no accountant would necessarily even keep details of: 'My company work is X per cent of my business, my trust work is Y per cent of my business and my super fund is one per cent or 50 per cent of my business,' or whatever. I do not think you could necessarily get to a point of being able to identify the income of an accountant relating to fee-for-service super versus a planner, where—

Senator SHERRY—No, the general observation that accountants are fee for service is correct, is it not?

Ms Kelleher—Absolutely.

Senator SHERRY—You come along, you spend the time and you will be charged whatever the accountant's rate is on a fee-for-service basis. Why can't planners do the same thing?

Mr Davison—I think that structurally, yes, they should be able to do that, and we are seeing more of the financial planning industry move towards a fee for service. From what I have seen in the press, there is a real polarity between commission versus fee for service, and I think the issue really is how the adviser is remunerated for the advice they give and that that is properly disclosed to the client. The issue is: 'As an adviser, I am providing you with advice and it is going to cost you X. How do you want to pay me?' Then it comes down to an up-front fee for service or using a commission structure as a payment collection method.

Mr BARTLETT—How do you respond to the argument that an up-front fee-for-service approach would disenfranchise lower income earners with less means?

Mr Davison—That is a real difficulty. People on lower incomes, people just starting out in the workforce and younger people just paying SG are not going to be able to afford paying up-front for financial advice they may need to obtain. If anything, the FSR regime has made advice a lot more expensive and difficult to obtain. Anecdotal feedback we get from our members is that, if a young person who had, say, $20,000 in superannuation walked in off the street, they could not afford to give them advice because they could not recover the cost. The issue is not so much that fee for service will not work or that commissions are bad. In that situation, commission is a reasonable avenue or vehicle to recover the cost of the advice, as long as it is properly disclosed and directly linked to the advice.

Mr BARTLETT—Are you saying that for that sort of person you have just described—the low-income earner—a commission based approach would be more affordable for them, therefore they would be more likely to seek advice?

Mr Davison—I think it would probably remove a barrier to advice, yes. The issue is where we see ongoing commission—like trail commission, which goes forever, essentially—and whether or not that is linked to advice that may be received for that commission.

CHAIRMAN—You may not be able to answer this question, not being a planner yourself, but on the surface of what you have said, it would seem therefore that, for those financial planners who are remunerated by commission, their higher net worth clients are in fact subsidising the time they devote to the lower net worth clients, because if the up-front fee is too much for a lower net worth individual to pay, one assumes that the amount of money they are investing would not attract a significant commission related to the time factor, so there must be an element of cross-subsidisation there.

Mr Davison—I am not close enough to answer that definitively, but certainly anecdotally what I have heard from planners and from our members who are planners is that there is a lot of cross-subsidisation going on in the industry.

CHAIRMAN—So lower net worth people are gaining a benefit from higher net worth people.

Ms Kelleher—Ideally, what you want to see is that consumers are given a choice to pay an up-front fee or to pay a commission that somehow equates to the value of whatever the up-front fee is. Once low-income people realise there is a fee, it does not matter how it is paid, they may baulk at having the advice because they see it as a cost. They may be able to go and scrape the money up by asking their parents or whatever to help them out for the initial bit. It is where they are not given a choice or it is all hidden that the real issues start. If someone gets all of their remuneration 100 per cent by commissions, I think, 'Hang on, something is not quite right here,' because of cross-subsidisations. Are they really doing that amount of work for all of their clients that actually adds to the fee for service that they would otherwise have received?

Senator SHERRY—But isn't commission composed of two elements, to varying degrees—the advice and the selling of the product? Commission is not all advice, is it? It is a reward paid, in part, to the seller for recommending that particular brand. That is part of the commission.

Ms Kelleher—And you would hope that part of the commission potentially would be rebated back to the client or offset against whatever.

Senator SHERRY—Yes, that is the theory.

Ms Kelleher—That is the theory.

Senator SHERRY—How often does it happen in practice?

Mr Davison—Historically, that was definitely how it worked. There is much greater transparency in the industry now than there was in the past—in the funds management and advice industries.

Senator SHERRY—How? People cannot read the FSR disclosure documents. It is all there, it is all disclosed, but nobody can read it and understand it.

Mr Davison—That is a good point.

Senator SHERRY—That is why you wanted exemption under FSR, isn't it?

Ms Kelleher—No.

Mr Davison—In theory, there is greater disclosure. I think there has also been pressure on the industry to ensure that there is a greater link between advice and the commissions that are paid. As Noelle said, there is a much greater element of rebating commissions nowadays than there was five years ago.

Senator SHERRY—Is there? Is that true? Can you give me some data on that? I have asked planners—not at these hearings—what is the level of negotiation down of the commission. Give me the data.

Mr Davison—I think you would have to talk to IFSA about that.

Senator SHERRY—Yes, that is right, but you made a claim which, frankly, I have not been able to find any evidence of.

Mr Davison—I have talked to planners in a personal capacity, I have talked to planners in the industry, I have talked to planners who are our members, and the majority talk about fee relief, the fees being rebated.

Senator SHERRY—It would be great for them to share that information with us. I would be interested to see just how many are actually doing it. I want to come back to your earlier comment about fee for service. Presumably on the logic of your argument—that fee for service can be a barrier to advice—accountants are having to turn away low- and middle-income earners because they cannot afford an accountant's fee for service to do the tax return. Is that a problem?

Ms Kelleher—Depending on who the individual wants to do their work then, yes, it can. It is like driving a car: you might want to drive the Mercedes or the Saabs or whatever. If you can only afford to drive the Vee Dub or ride the motorbike, that is what happens. The issue is not so much the methodology of the payment being a barrier but people being prepared to pay the dollars that have to be paid for the advice or the work that they want to have done.

CHAIRMAN—I do not want to take anyone's name in vain, but you are distinguishing between an HR Block type of tax advice and some detailed tax planning advice that you might get and the relative time that is devoted to that.

Ms Kelleher—Yes, and the way that things are structured. The fees are structured because there is high turnover, limited time. Salary and wage group certificates are nice and easy—over and done with in an hour max; only see them once a year; get a refund cheque—versus someone who has not only their salary and wage but might have a little bit of investment income or whatever that is far more complicated. That extends your needs. Then depending on what the

client is after, if they are starting to talk about estate planning and all those sorts of things, then they need a different type of service and need to shop around to find someone who is going to give them what they want for the fees that they can afford.

Senator MURRAY—I think with much of the stuff, particularly with middle and lower income people, we are off on the wrong track. I do not think that personal financial advice is realistically possible, and what you want most of all is generic universal advice, such as government programs which inform people of co-contributions or reputable industry analysis which is publicly available which says, 'This is an investment giving you a better return than the other if you put your super in it.' My own feeling is that we need to be realistic about what people can afford. If you want quality financial planning advice, you have got to pay for it. You cannot get it cheaply.

Ms Kelleher—Yes. The issue is, though, that the people who need that advice the most are actually the low- and middle-income people, because the people who are high-income—this is not always right—generally are a bit more savvy than the low- and middle-income people.

Senator SHERRY—Do you think that was true with Westpoint?

Ms Kelleher—Hindsight is always wonderful.

Senator SHERRY—But on the evidence available, that is not true.

Ms Kelleher—It is not true. You almost get to a point where you say: are the high-income, high-net-worth individuals the ones to get all the advice they want, and everybody else, well, tough luck, we are not going to work towards having a system that is going to improve your lot in life by simply making some fairly easy decisions that give you more guidance on perhaps some things that you had not even thought about.

Senator MURRAY—Let me give you the alternative: when governments and nations decided that everybody should get proper health care, they made very costly services available at public expense. That is how that happened. It is not possible for quality medical care to be paid for individually. I think it is the same with quality financial advice. We are not going to get to a situation where it is going to be paid for at public cost, except generically, with wonderful government programs telling you about co-contributions, for instance.

To me, the question to people like you who represent a highly reputable profession in which people have trust and which, by and large, produces good service, is: how can you take away unnecessary compliance costs? How can you make a service which has to cost money at least as affordable as possible? The propositions that you are putting to us need, in my view, to be from that perspective; not some kind of myth that accountants are ever going to be able to service low-income customers, because you cannot.

Ms Kelleher—That is not what we are saying. Typically, clients of accountants will be middle- to high-income individuals, as opposed to low-income individuals. When you start looking at some of the barriers to the affordability of advice for low-income earners, when you start looking at some of the documentation requirements et cetera that need to be filled in—from an FSRA perspective and the quantity of the paper in the advice that does not necessarily add

anything—they are the sorts of things that add to the cost: instead of something being a one- or two-hour job it could turn out to be a one- or two-day job. They are the sorts of things that need to be looked at in terms of trying to make things more affordable for low-income individuals, bearing in mind that, at the same time, you do not want to end up with the situation where you are only collecting half the information.

Senator MURRAY—But, you see, we have got to come back to then a basic point at which the accountant enters. One of those issues is which stage should you put people into self-managed superannuation funds. That leads us to the question: what should be the cut-off point? At present the cut-off point is regarded, I think, as $200,000. Below that you should not be in them. To me, the question for accountants who might be tempted to put people into those things when they should not be in them is: do you think that there should be an automatic annual lifting of the level below which you cannot put somebody into a self-managed superannuation fund?

Mr Davison—I would like to hold off on that question for a minute and come back to your previous comments about giving advice. I agree that the great difficulty is getting advice to the lower income end or to people who can least afford it. That is where things like the Financial Literacy Foundation and the work they are doing will address that over the longer term, and we are working quite closely with the foundation to get their material out. We are also setting up programs where our members will go out and do free public seminars, and even looking at how we can do pro bono advice, on a cost basis, to try and deliver advice to that low end.

One of the big issues of getting what you call 'generic advice' out is the difficulty that the funds face with doing that. They want to be able to get generic advice out to groups of members, or all their members, and their view is that to be able to do that in the FSR environment they basically have to be licensed to do so, and then there is the cost and compliance involved in doing so. It is definitely ASIC's view that if you are giving any sort of generic advice—which is not crossing the line into personal advice—you should still be licensed. That is creating another barrier for the funds to provide that low-cost advice to those people who need it. The self-managed fund issue, and the limit—

Senator SHERRY—There is no statutory limit.

Mr Davison—No, there is no statutory limit. In our publications we agree with the $200,000 limit only insofar as it is a reasonable dollar amount—that, if you were to look at a self-managed fund purely on a cost basis compared to, say, a retail fund, you would probably have to invest that sort of money to start getting ahead cost wise. We are just putting the finishing touches to a document, a guided statement for our members, which we will be distributing in the next month or so, outlining advice around self-managed funds and talking about that dollar guide.

The issue really about establishing a self-managed fund is not so much how much money you have but it is the purpose you are establishing it for. People need to have a strict purpose for it. If you are just doing it for cost or because you think you can do better than a fund manager, you really need to think long and hard about what your alternatives are instead of just jumping into it.

Funds may be established for business, in conjunction with your small business, when there is the exemption for holding assets, for holding business real property et cetera. Funds can legitimately operate quite effectively for amounts less than $200,000, and for good reason, for

good purposes, so we certainly would not want to see any sort of statutory limit. I do not think it would work, and we certainly would not want to see it. I see that number just as a guide for the average person who has the barbecue discussion on the weekend about self-managed funds being the latest fad and thinks he can just go out and get one. I certainly do not think there should be a line as to when and where you can get one.

Senator SHERRY—But if you do not have a line, you move to the danger of the accusation—and I do not know if it is true ever or partly or occasionally—that the accountants who set up SMSFs know that invariably the client will stay with them and they will earn annual fees from a statutory requirement, the fiduciary requirement, that trustees have to keep a set of books, have an annual report and financial statements produced, have a strategic plan produced, and have it audited, so there is two to three grand's worth of fees available to the accountant; so the accountant has an incentive to set up something which will produce them a long-term return.

Ms Kelleher—But in regard to those fees, you have to remember, too, that the accountant cannot audit books that he has put together because he would be in breach of the independence requirements both from the accounting profession and the SIS requirements perspective. They cannot audit their own work. They should not be providing the investment strategy et cetera for the fund, because they are not licensed. Really, the only fees that a fund must have or must incur are the APRA licensing fee or the SIS return component of the return, which is $45, to go up to $150, and the audit fee. The client has got complete control over everything else.

It is not so much having a dollar limit that people need to understand when they are setting up a self-managed fund. It is: how do you work out what your break-even point is going to be? What expenses are you going to incur in your fund? Is it your SIS return, your audit fee? Are you going to use an accountant to do your accounting work? Are you going to use an accountant to do your tax return? Have you got an investment adviser for the planning side of things? What are the other costs that you have in the fund? What sort of rate of return is acceptable for you? And, from there, you work out what the break-even point is. Is it $200,000? Is it $1 million?

Senator SHERRY—Surely the accountant would advise the client on what the typical costs are going to be.

Mr Davison—I agree, and I think if you are establishing a fund with $50,000 in it and your accountant—or your financial planner, for that matter, because they can both advise in establishing one—was charging you $3,000, $4,000 plus, you would hope that the client would be questioning the benefit and the value of that.

Senator MURRAY—One of the terms of reference of this inquiry is to account for the rapid growth in self-managed superannuation funds, and one of the sets of anecdotes that we receive, and probably you receive, is twofold. Firstly, it is a popular concept, a barbecue concept, that people get control of their own funds and can determine their own destiny, which appeals to anybody, low income to high income. It is an appealing concept. Secondly, of course, it is in the interests of the accountants to set these things up; there is a nice little earner available there. The issue I come back to you with is that there are only two mechanisms, it seems to me, which you could apply to control that, if that were true—and I have not seen the research or any empirical study which validates the remarks I have just made—but the two would be either that all accountants should become licensed under FSR so that there is a normal process of disclosure

and so on through there, or that you set up some kind of sophisticated barrier which is like a level below which SMSFs could not be formed. The difficulty with the proposition I have just put to you is that it is based on anecdote. There is no empirical research available to qualify the situation.

Mr Davison—I mentioned research before. We researched on self-managed funds two years ago, and it suggested to us that, more often than not, self-managed funds were bought as opposed to sold, and that people were coming and requesting self-managed funds.

Senator MURRAY—That cannot be true if you get an absolute increase in number, if there has been an actual increase in the number.

Mr Davison—You are asking for empirical evidence. This is the survey evidence we have, which is from accountants, financial planners and, more importantly, from the fund owners.

Senator SHERRY—Can you send that to the committee?

Mr Davison—Yes, I will forward a copy through to the secretary.

Senator SHERRY—On this issue of data—and I actually have raised this with the ATO on a couple of occasions—APRA publish their quarterly statistics, which I am sure you would have seen, and there is data in there on self-managed super funds, but it is very limited compared to the detailed data on other sectors in the superannuation industry. Wouldn't it be useful if the ATO did a representative sampling of data in this area so that at least we have some hard evidence to operate from?

Mr Davison—To be fair to the tax office, in the past they have gathered quite detailed data on a more informal basis. They used to present it to the Annual Colloquium of Superannuation Researchers. This year, I represent CPA on the Superannuation Consultative Committee, which is an industry liaison group with the tax office. The committee has had quite detailed discussions with the tax office about getting more data out, presenting more data to the industry, to government et cetera, making it publicly available, and we have gone through the process of—

Senator SHERRY—Yes, but conceptually we have presentation of what I think is pretty good data on the various sectors of the super industry from APRA. Obviously APRA do not regulate the self-managed super fund sector. It seems to me logical and in the interests of a well-informed debate that we should have a similar or the same set of data in respect to self-managed super funds.

Mr Davison—I totally agree. That would be very valuable to us.

Ms Kelleher—Yes.

Mr Davison—And my understanding from the tax office is that we are moving towards that in the not-too-distant future.

Ms BURKE—I suppose that is the next question: should the ATO continue to manage the self-managed funds? The growth of them is sort of telling us—and others have submitted—that

really it has got to the stage where it is beyond the ATO to be managing these funds and that they should be moved and regulated somewhere else.

Mr Davison—I will not say I am an expert on the history of the regulation, but the regulation of self-managed funds was moved to the tax office because it was deemed too hard for the ISC.

Ms BURKE—APRA.

Mr Davison—Or APRA.

Ms BURKE—APRA was ISC. Yes, I know.

Senator SHERRY—I have to say, frankly, that the ATO do not seem to have done a much better job.

Ms Kelleher—That was the next comment.

Mr Davison—We deal with the tax office quite regularly. I certainly would not say they are doing a bad job in regulating self-managed funds. It is a difficult area because there are so many of them, and there are always resource and expenditure issues in doing so, but in the circumstances they have done a pretty good job. They certainly did a lot in the early days, from an educative point of view, with the material they put out. They put out some first-class education material and they are putting in place some pretty sophisticated programs for review and audit of funds to try and police them. It will be interesting to see where we go with the increase in the levy of self-managed funds from next year and how that translates to the ATO's policing powers.

Ms Kelleher—The issue of self-managed funds growing, in itself is not bad. I think the issue is trying to get to is why it is happening and whether it is happening for the right reasons versus it is happening for the wrong reasons, The tax office data will be useful, but it will not tell us why these things are happening and why they are not happening. That is one thing that, as an industry, we all have to work around. At the same time, we have to remember that people have had super now since 1992 and there are a lot of people who had non-compulsory super way before that and certainly have a lot more in their super balances now than potentially what they would ever have had. Over the years, whenever the investment markets have gone down, I have always seen an increase in the number of people saying, 'Well, I want my own excluded fund or self-managed fund because, if I'm going to lose my money, I want to be the person who's responsible for it.' They get upset when they are paying money to someone who is supposedly the expert, who then loses their money.

I was at a self-managed super fund trustee meeting last night and, in discussions, it came up that I was going to be here this morning. They were talking about why they actually set up their self-managed super funds and control and taking over the responsibility was part of it and, 'I want to be the person responsible for losing my money.' But they also raised concerns about the level of fees in some of the other products that are out there, and that there is no incentive for the other product provider to perform well: they get their money, regardless of whether the performance has gone up or gone down.

Senator SHERRY—They are still paying commission?

Ms Kelleher—They are still paying commission or paying a percentage of their assets. There is no win-win for the individual in terms of, 'My fees are going to be less if the returns go down,' or whatever. There was also concern about the level of churn in the assets held by a lot of the other entities. They see super as being a long-term strategy and, 'If I hold it for 10 years and deal with the CGT over that 10-year period of time and if I go into pension mode I can get the CGT tax-free, whereas if I'm in some of the other products I've actually got churned and I'm bearing the CGT from year in, year out, even though I've got this long-term investment.' They want transparency in terms of actually understanding what's happening in the other funds that they were in. They did not feel that they had a good grip on how their money was being dealt with and looked after and all the rest of it, whereas with their self-managed super fund, because they are the bunnies who are responsible, they feel that they have a finger on exactly what is happening.

Senator MURRAY—Ms Kelleher, we as legislators and governments have to decide where the appropriate intervention should be. My own instinct is that citizens, residents, need to be given the freedom of choice to choose how their financial affairs should be managed. So then our requirement as legislators and governments comes back to ensuring that they are protected from unwarranted risk, which is prudential regulation and proper licensing of those who give advice. If the accounting profession is the principal profession to which people go for managing their own super because of the self-managed superannuation fund phenomenon, then to my mind you are moving towards a circumstance where accountants would need to be licensed as a whole to give advice.

Let me just complete the argument. If that is to occur, that can only be done on one of two bases, because it is not their principal business: it can either be done through making disclosure less onerous than it is at present—and there is a lot of discussion about that; reducing the requirements for statements of advice and product disclosure statements so that it is more focused, more targeted, less onerous, less voluminous—or introducing a second-tier licence which is a more basic licence and a more limited licence, a less voluminous licence, for the accounting profession.

Ms Kelleher—I do not think that the growth in self-managed funds is primarily due to accountants. I think you will find that a lot of it is due to planners—

Senator SHERRY—Yes, I think that is a fair comment.

Ms Kelleher—who actually are getting two layers of fees potentially: one for setting up the self-managed fund and then the second for the managed products that the self-managed fund is investing in.

Senator SHERRY—If you look at the detail of at least what is available on Westpoint and the commission driven selling and the problems that occurred there, it was overwhelmingly planner driven, not accountant driven.

Ms Kelleher—I do not think you can say that self-managed funds are growing because accountants are advising on them and they are the ones that are setting them up. I think that is grossly unfair.

Senator MURRAY—Sorry, but that is not what I said. I said that people are attracted to them, and when they are attracted to them they go to them they go to their accountants and say, 'I'm attracted to SMSF. Will you put me into one?'

Ms Kelleher—No. More often than not you will find that the people using accountants to set them up are clients who already have an established relationship with the accountant who looks after their other business affairs, and anybody else who has not been using the accountant will basically have received a recommendation or whatever from the financial planner to set up the self-managed fund.

Senator SHERRY—Part of this which has not been touched on, one of the poorly examined stories in this, is the decline of defined benefit funds.

Ms Kelleher—Yes.

Senator SHERRY—For this group of people, a DB is no longer available. They have, overwhelmingly, all been shut. You touched on the issue of the increase in the regulatory fee. The May budget announcements did not have any reference, that I can recall, to risk in the SMF sector or the cost of regulation or, indeed, the fee. Is that a correct recollection?

Ms Kelleher—That is very correct. There was nothing in the budget about SMSFs.

Senator SHERRY—That is what I thought, and yet in the final announcements there were actually, I think, a couple of pages added—a new section—identifying regulatory risk factors in respect to SMFs and a tripling of the fee. Were you consulted on that at all?

Mr Davison—The short answer, no. As with most of the super simplification announcement, that was done in secrecy, and the first that the industry knew about it, including ourselves, was when we saw the budget announcement and then the subsequent September finalisation.

Senator SHERRY—Yes, I understand.

Mr Davison—In that September finalisation, the material on self-managed funds, including the fee increase, that was the first we had seen of it, heard of it; no discussions.

CHAIRMAN—You had discussions about the other refinements, though, didn't you?

Mr Davison—Through the consultation period, yes, that is right. Subsequent to that, the focus has been on the main parts of the package, and we are yet to discuss with Treasury where the self-managed fund provisions have come from.

Senator SHERRY—You had no idea, because it was not in the original plan.

Mr Davison—No, we do not know where it came from.

Ms Kelleher—We do not even know, with the increased levy, what we are going to get for it. That is a lot of money for the tax office but there has been no indication of how it is going to be sent or, 'This is the value you as a self-managed fund are going to get from this money'—be it more visits from the tax office or better information available on the ATO website or anything. We have no idea how it is going to be spent.

Senator SHERRY—The only light that I can perhaps throw on all of this is that when I was questioning the ATO about their lack of vigilance in respect to Westpoint, one of the officers replied that they were only receiving a $46 regulatory fee; they did not use the words, but what could be expected, given that level of regulatory fee? So it seemed to me to be an indication that they were headed off for an increase, which has appeared.

Ms Kelleher—Yes. The issue is, though, whether the regulator's role is to regulate SIS compliance versus regulate whether people are making good or bad investment decisions. I would suggest that, from the regulator's perspective, they should not be concerned about whether you have made the wrong or right decision. They should be concerned about the process that got you to that decision: did you get appropriate advice or whatever, and whether it complies with the SIS legislation. That goes for be it APRA or the ATO.

Senator SHERRY—I agree with that. The tax office's job is to regulate existing laws and regulations around SMFs. It is pretty apparent to me, I have to say, from the Westpoint exercise, they have not been doing too good a job of it. It was largely planner driven; I accept it had little to do with accountants. But they have not even looked at, at least the last time I asked in the May estimates, the circumstances around these planners recommending SMSFs for Westpoint investment entities. They have not even looked at it yet. Frankly, they should have; given the circumstances.

Mr Davison—I would suggest that investing in Westpoint or not as a self-managed fund and whether it was appropriate is probably outside the ATO's regulatory powers, as far as SIS is concerned.

Ms Kelleher—That is really an ASIC issue.

Mr Davison—That is an ASIC question as to whether whoever has given them advice has given them the appropriate advice as far as Westpoint is concerned.

Senator SHERRY—What about the prudent person test?

Ms Kelleher—The tax office's responsibility would link to whether the investment is in accordance with the investment strategy of the fund. They do not have to make an opinion as to whether it is a good or bad investment strategy.

Senator SHERRY—No, I understand that.

Ms Kelleher—So is it in accordance with the investment strategy and then, from a sole purpose perspective, were the transactions or was the investment made with the intention of improving the retirement benefits?

Senator SHERRY—My concern with the ATO's approach in the case of Westpoint is that they have not yet even examined this issue in the context of the Westpoint entities. It seems to me that where you have a case of that nature, which attracted a lot of publicity, then the regulator should go to those entities and the planners involved and at least examine what went on. They have not done that yet.

Ms Kelleher—From the tax office perspective, they do not have that information. They do not know what individual investments the super funds have, apart from knowing the tax agent and the auditor. They do not know the adviser.

Senator SHERRY—I know that. The point I make is this: Westpoint collapse occurred. The tax office became aware of it. ASIC had informed them as to the planners involved. Certainly as at May, the tax office had not gone to examine those arrangements. It would seem to me logical, in a case of that nature and seriousness, the tax office would go and look at those to see what happened in respect to those self-managed super funds, where it does have power and responsibility. It has not happened at all. They have done nothing.

Mr Davison—I do not think we can really comment on whether the tax office should have touched that one or not, although I would think that their—

Senator MURRAY—Sorry. There is a direct question which arises to you, and that is this issue of the twin peaks, APRA and ASIC. In fact, there are triple peaks with the ATO. My view is that the ATO is an administrator, not a regulator at all. It just does not regulate in the sense that we know it. Do you think SMSFs should be taken away from the tax office and given to either ASIC or APRA to run?

Ms Kelleher—They came from APRA to start off with.

Senator MURRAY—Yes, I know.

Ms Kelleher—ASIC is not necessarily doing a good job regulating FSRA stuff, and I dread the self-managed funds necessarily going across to the ASIC side.

Senator MURRAY—Do you agree that ATO behaves more as an administrator than a regulator in a classic sense?

Mr Davison—The difficult thing is that the tax office is the revenue collector. They are the administrator, so it is out of left field to a certain extent that they have now been given the responsibility to regulate a particular industry or part of an industry. I suspect it has been quite a cultural shift for the ATO to do that. Having dealt with them for a number of years in relation to self-managed funds and their oversight, I could not say that they are doing a bad job and I could not say that there is any strong reason why it should be taken away from them and that one of the other regulators would do a better job.

Ms Kelleher—In some respects, the question becomes: should the superannuation responsibilities of APRA and ASIC be combined?

Senator SHERRY—Yes.

Ms Kelleher—There is a lot of confusion as to exactly who is doing what.

Senator MURRAY—If you go in that direction, surely all super has to be with one regulator, which means it comes out of ATO—

Ms Kelleher—If you go way back to the early eighties, the ATO used to regulate all super funds. They used to do the whole lot. The superannuation then came out of the ATO into the ISC, as it then was. The ISC had all the funds until we ended up with the excluded fund category being split between small APRA funds into the self-managed fund arena, which then went back into the tax office. That begs the question: should we have a superannuation regulator that deals with the whole lot? If you have a superannuation regulator that is responsible for the non-self-managed super funds and the self-managed super funds, I think you will end up with the same issue of: can they still do the whole lot together?

When you look at whether the tax office is doing a good job, what are we expecting the good job to be? Are we expecting them to find that there is a whole lot of non-complying self-managed super funds out there or are we expecting them to be out there auditing to give funds a green tick or a red cross, depending on how they are going? What are we looking for? If the first option is that the tax office should be fining all of these bad self-managed super funds, I do not think that is the right answer because the majority of people setting up self-managed super funds, particularly when you look at it from the individual's perspective, are out there trying to do the right thing. They are not necessarily getting it right all the time but they are out there trying to bona fide provide for their retirement benefits. It is when you get people involved with the early release of retirement benefit schemes et cetera that the self-managed super funds get tainted with the bad news, when it is the advisers that are causing the issues for the self-managed super funds. When we look at whether the tax office is doing a good job or a bad job, we need to decide what it is that actually identifies the good job or the bad job.

Senator MURRAY—Which is why I describe them as an administrator rather than a regulator. Surely the aspect of a regulator we are concerned with in this inquiry is on the prudential side of things. If you look at APRA and ASIC, using the law and their discretionary powers, they attempt to structure and react to circumstances where risk can be better managed. I basically view individuals running their own financial affairs as equivalent to the business judgment rule. They are entitled to make bad decisions, frankly, as long as it is in good faith. So that is not the issue for me. The issue for me is whether governance is appropriate and you have a proper prudential environment.

I do not think we can talk about the amalgamation of APRA and ASIC's superannuation responsibilities without throwing the ATO in there. It is equivalent to corporations. ATO runs corporations from one direction, because it is making sure they pay taxes, and the other direction is for ASIC to take. Back to my question to you: regardless of whether it will work perfectly or not, surely if we are to consider an amalgamation of regulators, they must all be under one, not just ASIC and APRA under one.

Mr Davison—Coming back to your original question, I do not think the ATO is doing a bad job in the current environment where we have three regulators. We have issues with the interaction between APRA and the tax office, in that they are regulating the same piece of law and yet their interpretations are often quite different, and the level of communication and

consultation does not always appear to be as high as it should be. In an ideal situation, if we were able to start again, yes, we would certainly support the concept of having one regulator for the whole industry. I imagine that that regulator would probably be separated in its functions somehow as to which parts of the market it focuses on, but I agree that we should have one regulator. The two main issues we see are the different interpretations of SIS between the tax office and APRA and the duplication in requirements and information gathering between APRA and ASIC.

A good example is: we had Australian finance services licensing two or three years ago and we have just gone through the two-year transition period for trustee licensing under APRA. There were a lot of the same questions and a lot of the same requirements, although perhaps couched a bit differently. The trustees had to jump through the same hoops again, providing the information to APRA, when a lot of it could have been shared in the first place. Because we have that separation, we end up with a lot of duplication. There does not seem to be as much cooperation between the three regulators as there could be. Obviously, we would end up with size problems, but that would probably address a lot of the issues we are seeing.

Senator SHERRY—A single financial services regulator is now the majority world model, isn't it?

Mr Davison—I cannot talk definitively in relation to the whole world, but certainly major markets like the UK have a single regulator.

Senator SHERRY—We will do some research on the internet but the trend seems to be towards a single financial services regulator, for a whole variety of reasons in different jurisdictions.

Mr Davison—There were some good reasons for realigning the regulations as we did in the late nineties, but that has also created a lot of problems, so I am not sure that we have actually benefited.

CHAIRMAN—I understand the single regulator in the UK has a lot of problems too because of the structure

Mr Davison—True.

CHAIRMAN—One of my questions follows on from the question about the fee increase for self-managed funds administration, and I note that you in your submission argue that the fee for small APRA funds is too high, and that may have been a contributing factor to people moving more to SMFs than small APRA funds. Given that the fee for SMFs is now up to $150, would it be appropriate to reduce the small APRA fund fee to $150?

Mr Davison—Small APRA funds are appropriate vehicles for people who want that sort of small fund structure and want the control but do not necessarily want to take on the responsibilities that come with being your own trustee, so it makes a lot of sense to be able to outsource that responsibility to an approved trustee in the SAF environment, but the major barrier has been the additional cost. So we may have seen people taking on the extra risk of

running their self-managed funds themselves, whether they are suitably equipped to or not, purely because of the cost.

Bringing the fee down or realigning the fees so that the decisions as to which structure you use are based on which suits your needs best, as opposed to the fee you pay, would make a lot of sense. Considering that APRA is regulating the approved trustee, or the licensee nowadays, the majority of the fee probably should be between the trustee and APRA. As a member setting up your own fund, there should not be any cost difference between self-managed funds and SAFs.

CHAIRMAN—The trustee pays a fee as well, don't they?

Mr Davison—They pay as well, yes. Given that APRA is regulating the trustee and the trustee is already wearing that cost, I am not quite sure why we have to have that additional cost in the funds.

CHAIRMAN—Returning briefly to the issue of the exemption of accountants from the FSR—not dealing with the substance of the issue but the mechanics—since this committee made a recommendation, which was basically in accord with what you have been arguing today, have you had any discussions with Treasury or response from Treasury on the issue? If so, what has that been?

Mr Davison—We have had pretty much ongoing discussions with ASIC as to how the current exemption works and with Treasury and the minister's office as to how to make it work better. Initially it was: what is their response to this committee's recommendations? We are in the middle of discussions with Treasury at the moment on how to make it work, and the options that are being canvassed include broadening the exemption so it does work and shoring up the concept of a recognised accountant to whom the exemption applies.

We have had discussions about how we can improve the educational requirements of our members—perhaps with some sort of compulsion around that—so that they would have a similar level of education requirement as a financial planner would, without necessarily having to go through the cost et cetera of being licensed. That would basically mean that all of our public practitioners would be covered for incidental advice, as we discussed before. If we broaden the exemption for these recognised accountants who are suitably qualified and they are giving incidental financial advice in their day to day operations, they are not falling outside of the requirements of FSR, which is essentially what is happening now.

The second option that has been canvassed is the idea of mini licensing, which I think Senator Murray touched on before. There is potential for that to work, but again it does not pick up incidental advice and how that is covered. Discussions are ongoing with Treasury. We had a meeting with them last week, and we are continuing to go with it.

CHAIRMAN—With regard to the issue of whether all trustees should be required to be public companies and also the issue of the meaning of 'not for profit' and whether all profits go to members in relation to superannuation funds, I note that you, like many, have recommended that there should not be any requirement for a public company structure. What certainly came out in discussions yesterday at our hearings in Sydney was that there were several who believed, like you, that trustees should not be required to be public companies but they should be subject

to exactly the same disclosure requirements as public companies in terms of related party transactions, trustee remuneration and the like. That also goes to the not-for-profit issue in terms of the relationship between superannuation funds and some of the organisations providing services to those superannuation funds. What is the view of the CPA on those issues?

Mr Davison—I think the biggest issue is disclosure. As far as disclosing related parties and trustee remuneration et cetera, I was of the understanding that that is already in the fund reporting in the annual report.

Ms Kelleher—It is in the financial statements. The super funds et cetera pick up all of the normal accounting standards that would apply to any other entity plus whatever is in AAS25. So the related party disclosures, the remuneration issues and all those sorts of things are sitting in the financial statements for the super funds, which do not necessarily get sent in full to the members but the members are told in the annual report that they can request the full set. So the information primarily is there. In theory, disclosure is good, but a lot of disclosure can create unnecessary noise, and it is a question of whether the noise is going to add any value or whether the disclosure is going to add any value or is it just going to add noise?

CHAIRMAN—You also advocate removing the 10 per cent rule for tax deductibility of personal contributions so that everyone has equal flexibility in determining the tax treatment on their contributions. Could you perhaps enlarge on that? What are the issues there?

Mr Davison—A couple of the primary issues have always been with the self-employed. The 10 per cent rule is an arbitrary number. If less than 10 per cent of your income relates to employment, then you are deemed to be self-employed and able to claim tax deductions for your super contributions.

Senator MURRAY—Is that under the tax law?

Ms Kelleher—Yes.

Mr Davison—Yes.

CHAIRMAN—You are saying that, if you have got more than 10 per cent from employment, you can't?

Mr Davison—That is right. You are deemed to be an employee.

Senator MURRAY—The reason I asked that question is that I wanted to know whether it fell under personal services income legislation—alienation legislation—or the usual income tax law?

Mr Davison—No, it is the usual tax law.

Ms Kelleher—It is the usual tax stuff.

Mr Davison—The old tax act.

Senator MURRAY—Thank you.

Mr Davison—There are two issues that we have seen: one is that the workplace has changed considerably and we see a lot of people who are now in casual employment or contracting and who are, essentially, self-employed. But they might pick up a contract with someone and they are treated as an employee for tax purposes, and income from that contract might push them over the 10 per cent rule. They lose their ability to claim a deduction on personal contributions but at the same time, because it is more of a casual relationship on a contract basis, they may not have access to anything above the compulsory SG contributions, they may not be able to salary sacrifice et cetera, and they tend to be at a disadvantage compared with the employed.

The other reason we are suggesting removal of the 10 per cent rule is that, if you are employed and in a situation where you can salary sacrifice and hence take your super contributions out of your pre-tax income, that is essentially having the same effect as if you claim a deduction. If you are in that situation, you have an advantage over an employee who cannot salary sacrifice. That is raised as an issue in the super simplification package. We have an uneven playing field to a certain extent as far as who can claim a deduction on their contributions, depending on their personal circumstances.

Now that we have the new super package coming in where we are limiting taxable contributions to $50,000 per year per person—per employer—we now have the situation where we could remove this limit on deductions so that anyone can choose to make contributions pre- or post-tax and claim a deduction, and yet the deduction has a limit of $50,000. It creates an uneven playing field. We have already seen a precedent, in that the government is going to allow the self-employed to choose whether their contributions will count towards the co-contribution, so essentially you can choose to claim a deduction or do it after tax and maybe qualify for the co-contribution. It is adding to a simple understanding of how the system works. It is definitely going to help people put more money into their retirement savings, which cannot be a bad thing, but it is really an equity issue as well, to create that level playing field.

CHAIRMAN—What you are saying is that the same rules should apply to everyone, irrespective of the source of their income?

Mr Davison—Irrespective of your source of income or how you pay your contributions, you should have a choice as to how your contributions are treated from a tax point of view.

Ms Kelleher—The reason why going into the new regime it will work to remove the self-employed or the 10 per cent test is because the tax concessions linked to the deductible contributions are actually the tax that's being borne over the cap, which is the individual's choice as to whether they want to be paying the 45 per cent tax on their excess contributions over the cap as opposed to there being deduction limits at the employer end or the individual end.

If we do not get rid of the 10 per cent rule, what is happening is that we are saying, 'Employees, you can put in $50,000 a year, no problems, provided your employer will let you salary sacrifice up to the $50,000'—and there are still a lot of employers out there who do not allow salary sacrifice. For a self-employed person, unless you are really purely self-employed, you just cannot get to that $50,000 figure at all, unless you have got a user of your services who will actually let you salary sacrifice above or contract sacrifice above the SG rate. It would be a way of removing that discrimination at the start, because of the $50,000 cap that is controlling the tax on the contributions going into the fund.

Senator MURRAY—Have you made that submission on the superannuation proposals to Treasury?

Mr Davison—We made that suggestion during the consultation period. We made two submissions to Treasury and that was in our second submission.

Senator MURRAY—You have not written about it in great detail here.

Mr Davison—No, we have not written about it in great detail because we saw the focus of this committee's inquiry as being—

Senator MURRAY—But just for good order, could we have a copy of your submission to Treasury as well?

Mr Davison—I will forward that to the secretary.

Ms Kelleher—It is something that we are including in our pre-budget submission as well. It is an ongoing issue, as we see it.

Senator SHERRY—Likewise, if you have other details on the other issues that you have raised there already in some form—

Mr Davison—I have got a bit of a list of things to send you.

CHAIRMAN—There being no further questions, thank you for your appearance before the committee. You have certainly assisted our inquiry with your responses to our questions.

Proceedings suspended from 1.00 pm to 1.39 pm

KNOX, Mr David Montgomery, Principal, Mercer Human Resource Consulting Pty Ltd

WARD, Mr John, Principal and Manager, Mercer Human Resource Consulting Pty Ltd

CHAIRMAN—I welcome Mr David Knox and Mr John Ward from Mercer Human Resource Consulting Pty Ltd. As this is a public inquiry the committee prefers that all evidence be given in public, but if at any stage of your evidence you wish to give evidence in private, you may request an in-camera hearing of the committee and we would consider such a request. The committee has before it your submission, which we have numbered 65. Are there changes or alterations you wish to make to the written submission?

Mr Knox—No.

CHAIRMAN—I now invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Knox—First, thank you very much for the opportunity to appear before the committee; we do welcome that. I thought it might be useful to give a little bit of background as to who Mercer is, and therefore in what capacity we are appearing. The operations of Mercer encompass the full spectrum of the Australian superannuation industry, including a master trust that has more than $10 billion in it, a trustee company that acts as trustee for a number of other superannuation entities, administration services for a significant number of corporate funds, a clearing house for employer contributions in our fund of choice environment, Mercer Wealth Solutions which provides financial advice to individuals, Mercer Investment Consulting which provides investment advice to super funds, and we are also the largest employer of actuaries in the country, and offer actuarial services to the private and public sector. It may be of interest that we offer actuarial services to the parliamentary fund as well as the Future Fund.

Senator SHERRY—There are no questions on that.

Mr Knox—In our opening remarks, I will briefly consider the first two terms of reference, concerning capital and public companies, and then my colleague, John Ward, will comment on issues relating to advice, compliance costs and funding for prudential regulation. Naturally, we would then be very happy to talk about any other matters the committee would like to consider.

The first term of reference relates to whether uniform capital requirements should apply to trustees. Our answer to that is a strong no. Notwithstanding our negative response, we do recognise that each super fund must adopt a strong risk management process and strategy. That is obviously important for the ongoing confidence of fund members and the Australian community. However, it must be recognised that there are various ways for funds to manage risk as well as to mitigate the potential costs from adverse events that will occur from time to time.

In thinking about capital, we wish to highlight the really important difference between capital and reserves. Capital within the prudential framework is a requirement and must always be there. However, within a superannuation context, we believe that reserves built up over several years have the potential to provide a buffer against the financial consequences of any adverse events.

Such reserves can be used when needed and rebuilt over a period of time. In essence, reserves represent a much more flexible and appropriate framework for super funds than capital.

In respect of the second term of reference, we do not believe that all trustees should be public companies. Further, we do not believe that such an arrangement would improve the safety or governance of Australian super funds. Rather, we believe that the existing prudential framework under APRA's licensing process is sufficient for these purposes. I will now hand over to John to make some further comments.

Mr Ward—Over the years I have presented to a number of parliamentary inquiries into superannuation. One of my regular themes has been the complexity of the legislation. Over the years, the complexities have increased further. Whilst the changes announced in this year's budget are promising and will hopefully simplify the taxation aspects, there is an increasing need to simplify the other regulatory requirements—in particular, Corporations Law and the Superannuation Industry (Supervision) Act. I agree with the intent of most of this legislation. Greater protection for members and more appropriate disclosure are to be encouraged. However, I am particularly critical of two aspects. First, the legislation is overly complex, ambiguous and anomalous. The worst examples are generally the more recent legislation such as Corporations Law. Not only does it use terminology that is generally not used in a superannuation context, but also it is like wading through a maze. There is the act, the regulations, amending regulations; some of the regulations amend the act. If it is not in the regulations, it might be in one of the many schedules of the regulations.

Once you have waded through all of that, you then have to check whether there is an ASIC policy statement or class order that may override the regulations. In some cases we have legislation that is written so ambiguously that the various regulators cannot even agree on what the legislation means. In other cases it is the inconsistencies in the legislation that are a problem. For example, breaches of the legislation have to be reported to both APRA and ASIC; however, only material breaches have to be reported to ASIC, whilst all breaches have to be reported to APRA.

My second area of criticism is that some of the legislative requirements appear to have gone too far. This creates problems such as product disclosure statements that are overly long and unlikely to be read, let alone understood; an increase in the cost of providing advice to individuals leading to situations where people who need some minor level of advice being unable to obtain it for a realistic fee; superannuation fund members being provided with less useful advice and less advice than previously by their trustee; increases in the cost of providing advice to large companies because they must be treated as retail clients; the likelihood that some trustees will have to remove certain investment options currently offered because it will be totally impractical to comply with new disclosure requirements applying from 1 July next year. Legislation designed to protect may actually be having the opposite effect in some cases. We need clear, concise and effective legislation. At the present time, we are a long way from that. A significant revision of both the SI(S) Act and the Corporations Law to make them more consistent, easier to understand and to better fit the environment of 2007 is required.

Finally, I will make a brief comment on the funding of prudential regulation. With the decline in the number of funds, APRA levies have risen considerably. In our view, with superannuation being compulsory and designed to reduce the long-term social security costs to government, we

believe that there are strong arguments for the regulators to be funded totally from consolidated revenue.

CHAIRMAN—Thank you very much. In relation to your response to the issues of whether superannuation trustees should be required to be public companies and the issue of capital, one of the issues that has been raised by way of suggestion from several witnesses —and I think it is fair to say that your view reflects that of the majority of witnesses we have heard so far that there should not be a public company requirement on trustees—is that the same disclosure requirements that apply to public companies should apply to superannuation funds. What is your view with regard to that proposition?

Mr Ward—I am not convinced that additional disclosure would do anything more than add further costs.

Mr Knox—I think the important thing is to disclose to members a number of features of super funds, including their governance, but I am not sure that that is exactly the same as what is required for public companies today. We do need to disclose to members how the funds are governed and be as transparent as possible on that, but that is not quite the same as the disclosures being the same as public companies.

CHAIRMAN—One of the concerns regards the terms 'not-for-profit' and 'all profits go to members'. While that may be the case at the fund level, what about the extent to which service providers might be profit-making organisations and might have relationships with the funds—for example, there might be related party transactions? Some of the evidence we have had indicates that there is not sufficient drilling down, if you like, into some of those relationships to determine exactly whether the fees that are being charged by such service providers are reasonable.

Mr Ward—I think we made similar comments to that in our submission. I am not sure whether you are trying to link that to the public company requirement, because I am not sure how that comes out in greater disclosure if trustees were forced to have the same reporting requirements as public companies.

CHAIRMAN—The CPA, a previous witness, thought there was related party disclosure requirements and the like, but some of our earlier witnesses did not seem to think that was happening. What is your understanding in terms of those issues?

Mr Ward—I would not have a problem if trustees were required to disclose some of their related parties, where that impacts on the particular fund. I am just concerned that, if we go too far down the track in treating trustees as public companies, there are a lot of unnecessary additional costs that would not necessarily relate to an improvement in disclosure that is relevant to members.

CHAIRMAN—In relation to advice, you want the definition of retail client amended to exclude large employers. Can you perhaps expand on the purpose and the consequences of that?

Mr Ward—By treating an employer as a retail client, it effectively means that any advice given to a retail client has to be done as a statement of advice, taking into account the full

circumstances of the client, et cetera. In many cases we are providing advice to the trustee. Generally, subject to size, the trustee is treated as a wholesale client. In many cases, though, in a corporate fund situation, the trustee might be expected to be passing that advice to the employer, in which case we have to treat the advice to the trustee as a statement of advice, in effect, because of the secondary advice provisions. It means that we have more detailed disclosure and higher costs in providing advice where that advice may end up with the employer.

In many cases, the person with whom we are dealing at the employer may also be a director of the trustee. The person with whom we are dealing at the employer may also have significant assets in their own right, and could be treated as a wholesale investor. So, if we were providing advice to the individual at the company, we may be able to treat him as a wholesale client if he has his trustee hat on; with his employer hat on, no matter how big the employer, we have to treat him as a retail client. It just increases the compliance costs of rewriting your advice in a way that meets the requirements for advising a retail client.

Mr Knox—It really does not add any value, and in many respects, if you think of those three situations that John has outlined—the employer, the trustee and the individual—the employer is the largest of the entities, and that is the one we have to treat as retail, whereas we may be able to treat the trustee and the individual as wholesale clients. There is an inconsistency that just adds costs as compliance requirements to providers.

Mr Ward—For other types of financial services, employers are treated as wholesale clients. Superannuation is the odd one out.

CHAIRMAN—You also draw attention to what you see as the incompatibility between APRA's approach to trustees in the context of member choice, and the relative responsibilities of members and trustees for investment decisions. You have recommended that circular II.D.1 should be revised to recognise the reality that trustees cannot be aware of the total circumstances of members, and that trustees must take information available on all options. Any investment choice made by a member under member investment choices ultimately is the member's decision. Where do you actually think the dividing line is between what the trustee should be responsible for and what the member should be responsible for?

Mr Knox—John may wish to add some comments, but I would look at it from this angle. The trustee has a responsibility to disclose and make it as transparent as possible for the member. There is a responsibility of the trustees for disclosure. As a member I may choose a particular investment option that may be, to pick an extreme case, 100 per cent in emerging markets. Because I am in this fund with a particular purpose of exposure to emerging markets that I cannot get elsewhere, why should I not have that opportunity, as far as this fund is concerned, that investment would not be balanced or diversified? Within my own portfolio, it may well be quite diversified, but the trustee is not in a position to know my overall portfolio. To put simply, within a member investment choice context, if we are going to give members that responsibility, certainly we have to educate; certainly we have to make it as transparent as possible the risks associated with them. If we do that properly, members should have the opportunity to make that decision and stand by it.

Mr Ward—We are in a choice environment. Members can choose their own fund. It seems anomalous that, whilst a member can choose his own fund, he cannot choose his own

investment. In many cases, members have chosen a particular investment strategy on the advice of their own financial planner; yet here we have APRA saying it is inappropriate for that advice to be followed in a superannuation fund.

CHAIRMAN—You draw attention to several areas in the financial services and Corporations Law where you say that the disclosure requirements are poorly designed and there is inconsistent legislation, and you recommend that the Corporations Act and associated regulations should be re-written so that they can be more easily understood. I thought that was the whole aim of CLERP, to simplify the Corporations Law.

Mr Ward—The intention was to simplify it.

CHAIRMAN—Are you saying that CLERP has not achieved its goal?

Mr Ward—I do not think we would be alone.

Senator SHERRY—You are certainly not. That is a common thread through every submission.

Mr Ward—The Corporations Law is just unintelligible.

CHAIRMAN—So CLERP has actually made it worse than it was—

Mr Ward—Far worse.

CHAIRMAN—notwithstanding the great efforts of this committee, which I think in almost every instance of CLERP legislation has recommended that it not be as complex or as intrusive as the government has intended each time.

Mr Ward—Again, we are not saying that the intention is wrong. The concept is right; it is just that the manner of putting the intention into words in the act and the regulations has been done in such a way that nobody can understand it.

CHAIRMAN—Has it got away from what was supposed to be a principles-based scheme to too much of black letter law—if not by legislation, by the associated regulations?

Mr Ward—Yes.

Mr Knox—In the same vein, within the Corporations Law and elsewhere, there are often bits of legislation related to superannuation in different sections. In one sense, principles-based legislation will say, 'Within a multifaceted financial services operation, let's make sure the principles are the same for banking, insurance, super, et cetera.' But we live within a functional world, and if you are a super administrator, you want to administer a super fund. It is much better to have most of that legislation within the one spot, without its being spread over several sections, if you like.

CHAIRMAN—Have you raised these issues with Treasury, and if so, what has been the response?

Mr Knox—We have not raised them directly. We thought this was a good opportunity here.

Senator MURRAY—Is there a particular area that you would put as a priority or highlight above all else?

Mr Ward—I think it is a general comment across all of the parts of the Corporations Law that impact on super.

Senator MURRAY—When you reply like that, and we are dealing with Treasury, they might just shrug their shoulders and say it is all too hard; whereas if you are able to say to us, 'This is the worst area,' and we as a committee can focus on that, then at least we might make some progress. Perhaps you could come back to us.

Mr Ward—The biggest problems would relate to disclosure, either in product disclosure statements or periodic statements to members. They are the main aspects that are covered by Corporations Law. There are other inconsistencies in there, which I guess are more minor; for example, a trustee company has to report changes in directors. There are different requirements in reporting those under the Corporations Law to ASIC than there are in reporting them to APRA under the SIS legislation. The timing requirements are different. It would not take much to make the two reporting requirements consistent. Likewise, it would not take much to make the two reporting requirements on breaching the SI(S) Act and the Corporations Law consistent between the SI(S) Act and the Corporations Law.

Senator MURRAY—I am interrupting the Chairman's questioning, but could I ask you to drop us a note and give us the precise sections to which you are referring, so that we can be particular in our own commentary?

Mr Ward—Yes.

Senator MURRAY—Thank you.

Mr Knox—I think perhaps more generally we make the comment that the SI(S) Act is, of course, an older piece of legislation than the Corporations Law, and the super industry has changed significantly since the SI(S) Act was introduced. Parts of the SI(S) Act have been excised over time. When the SI(S) Act was introduced, it was a fairly good piece of legislation and comprehensive. It no longer has that comprehensive nature because we have had other bits of legislation and the super industry has changed with fund choice, et cetera. I think there is a good argument that the SI(S) Act, as a whole, needs to be reviewed and revisited, taking into account what has happened since the SI(S) Act was promulgated.

Mr Ward—One example of that would be when the SI(S) Act was introduced, there were almost no sub-funds, yet in 2006 we have many wholesale master trusts which are made up of hundreds of different sub-funds. the SI(S) Act really does not cope very well with the sub-fund concept. It is more looking at the fund as a whole level whereas these sub-funds are actually really autonomous little funds under the main umbrella.

CHAIRMAN—You comment in relation to advertising that it should be able to be met from the funds subject to appropriate disclosure and product disclosure statements and periodic

statements. Do you have any concerns that advertising by some segments of the superannuation industry is not consistent with the requirements of the sole purpose test? Do you think APRA is currently adequately regulating this matter?

Mr Ward—In our view, funds have to obtain new members to remain viable. How do you obtain new members? You can do it in a number of ways. You can advertise, you can pay salesmen commissions to attract new members, or you can pay employees to go out on a salary basis and recruit new members. If you are going to ban one, should you ban all three? We find it very difficult to see how you can effectively stop one segment of the industry from attracting members in a particular way. What is important is to make sure that any advertising is done in a proper manner and is not misleading.

Mr Knox—I think we need to recognise that the super industry has been through a significant structural change, and yet that is still happening. The number of funds in the industry is still diminishing. We are suggesting that within five to 10 years, the top 10 funds will represent perhaps 40 per cent of the industry, if you exclude the public sector and the self-managed super funds. They will be major financial services players, whether they are an industry fund, a bank or some other player. All of those players will have a brand. That brand is important, and it will be advertised in a variety of ways, whether it be through a sales force, direct advertising, or on the internet, et cetera. Member information is important. We live in a competitive environment. Those funds will compete with one another in all sorts of ways. I think that is a fact of life that is part of fund choice. We need to recognise that.

Senator SHERRY—With respect to the issue of capital requirements in a little more detail—and it is unusual in financial services that superannuation has a statutory protection in the event of theft and fraud, but it exists—given that we are overwhelmingly a DC system where the member carries the risk on investment rate of return, why would you need any capital? If we do, where would you need it?

Mr Knox—I did not use the term, but the sorts of risks I am talking about are generally called operational risks. Operational risks can occur from any number of sources, both internal—mistakes, errors by members or the staff—and external events, either from government or elsewhere. These operational events have an impact on the fund. The big impacts come very occasionally and are often unpredictable. If you have an impact on the fund and that cost for whatever it might be is one per cent of assets, so your crediting return or investment return down here is reduced by one per cent, in a competitive market, that will hurt you, and it will hurt all the members in that fund.

Therefore, we are suggesting that, in those events, it is preferable for a fund to consider not making it mandatory but to consider establishing a reserve built up over a series of years by perhaps point one of a per cent a year, so that, when these events come, they actually do not hurt that group of members but the risk is shared to some extent by those members. Otherwise, you face the possibility that, if an adverse event occurs, that is publicised, the brand is tarnished, and the other members in that fund are then hurt by a run on the fund by people leaving that fund through an event that is an operational risk event. We think it is part of a strategy that the fund needs to look at to actually manage those sorts of events. You can insure some of them; and some of them you can mitigate by using an outsource provider, but some of these events will

happen from time to time. We think it is part of that risk management process for a fund to consider establishing a reserve.

Senator SHERRY—Given that, would we not be best to examine where these events have actually occurred to date to get some evidence about what would be required, if indeed it was to be imposed—and I do agree with you that it should not be—what would be an indicative figure that should be reserved or put away by a fund if that event occurs?

Mr Knox—That is a very good question. Some of that work has been done in the banking sector where, with respect to operational risks under the Basel requirements, they are now looking at capital issues. As I say, we are not supporting capital here but we are supporting the reserve. How big should be the reserve is a very good question. Our view is that the reserve diminishes as a proportion of the fund as the fund gets bigger, because some of these adverse events have a fixed cost nature to them. If I were to give you an example, if the government were to introduce a major piece of legislation that required a major system change to the computer system that would have an impact for the next 10 years, that may cost the fund millions and millions of dollars. Is it fair that that group of members who happened to be members in that year that the system had to be introduced, copped the consequences? Or would it in fact be better to have a reserve that enabled that cost to be spread out over a period of years?

Senator SHERRY—As I understand it, your very clear view is that it should be a reserve allocated from the funds over time?

Mr Knox—Correct; over time. It is not from the shareholders. Therefore, whether it is an industry fund, a corporate fund or another type of fund, the circumstances and operations of the particular fund need to be considered. If they are doing some in-house administration, for instance, they bear some risks that they may not bear if it were outsourced because they might be able to pass that risk on to the outsource provider.

Senator SHERRY—Very briefly, I want to come to a couple of issues relating to disclosure—and I do agree with the comments about the mess of disclosure and its unreadability. There was an exchange with the Chairman about principle versus black letter law. Is not one of the problems in respect of the disclosure regime that we do not have black letter law; it is principle-based, and therefore the disclosure documents invariably have to pass the legal test—and this is not a criticism of lawyers—which involves ensuring that every possible consideration and caveat is placed in the documents, hence their length?

Mr Ward—I agree. I think there is some of that. I think there is also too much black letter law. It is a combination of the two problems. Some parts of the legislation, for example, required you to use particular words in your product disclosure statement or your periodic statement. In some cases, those words do not make sense in the context of that particular fund, but you still have to use those words. That is part of the black letter law problem.

Senator SHERRY—At least in some areas of advice such as death and disability insurance advice or level of additional contributions, would we not be better off with standard form disclosure documentation that is simple and concise?

Mr Ward—Again, I can see some merit in some standard forms in some circumstances. We are talking at the moment about a standard form for portability transfers.

Senator SHERRY—Yes, that is right. We have a standard form for choice of fund.

Mr Ward—We have a standard form for choice of fund. Even when you look at the standard choice of fund form, it does not make sense in the way some organisations have operated. There is the portability standard form, which we have not seen yet, as it has not been developed yet. For example, funds have set up over the past different ways of verifying that somebody who contacts them is actually the member that they say they are. I think it will be very difficult to come up with a standard portability form that appropriately picks up the relevant identification and verification details that the fund will need to actually verify that that member is who they say they are. All funds have different systems at the moment that have been developed over 20, 30, or 40 years. They are not all the same. If we were starting from scratch on day one, it would be a lot easier as everybody could set up the same systems.

Senator SHERRY—Going to a related issue of disclosure, there is a reference to relevant—and I am pleased that word is in there—limited advice. Is not giving limited advice at the moment particularly difficult under FSR?

Mr Ward—Yes. That is what we are arguing; that there should be some greater flexibility. Somebody may come along and say, 'I've got $4,000 in this fund and I've $1,000 in this fund; what should I do?' If they go to a financial adviser, he will charge them $700 minimum to say, 'Yes, I think you should put it all in that fund,' by the time he goes through and analyses all of the person's individual circumstances, which he is required to do. You cannot get it too far wrong if you have $4,000 in one fund and $1,000 in another. The client just wants a five-minute piece of advice to verify that what he is planning on doing makes sense. He does not want to spend $700.

Senator SHERRY—I agree with you, and you should not be able to go far wrong, but the shadow shopping exercise certainly showed a few do go wrong, intentionally.

Mr Knox—I think that is absolutely right, but the problem is because this minimal amount of advice is not easy to get nor affordable, the financial planners turn you away because it is not in their best interests. A lot of individuals therefore rely on the advice down at the pub or over the side fence. That is not good advice, by and large.

Senator SHERRY—Just on this issue, as a matter of principle, should we not be minimising the need for advice in the system?

Mr Knox—We are certainly encouraging people to take on more responsibility, and therefore, yes.

Senator SHERRY—If a person does not want to make decisions, why should they be required to make decisions? Surely in the way we have default investment, we should have default decisions made so that a member does not have to make a decision unless they actively choose to make a decision.

Mr Knox—Is that not the current arrangement with choice of fund?

Senator SHERRY—It is not. Let me give you an example—lost superannuation accounts. Why should a member have to go and get advice about what to do? Why should it not be done automatically? In the proposed changes in the UK, there will be no advice allowed; it will just not happen. Everything will be done by default, and the member can select, actively if they choose to; but the protections, if you like, and the decisions are default decisions unless the member chooses otherwise.

Senator MURRAY—It is an opt in, not an opt out model.

Mr Knox—Yes.

Ms BURKE—Is that why most people find super attractive—because somebody else takes all the decisions for them in lots of respects? For example, 'My money's sitting there with a whole lot of other people looking after it, and I don't need to worry.'

Mr Knox—Correct. Part of the success of the superannuation guarantee it that we have had the nine per cent put in where a lot of people would not have saved otherwise. You are absolutely right. I think we do need to make that process easier. When somebody has three or four funds, and says, 'I want to bring them all together; which fund should I go to?' a piece of advice is needed there. I think that advice is not currently being given because it is too hard to get, too expensive, and the financial planners are not interested.

Ms BURKE—In your best case scenario, who can give that? Who can provide that advice?

Mr Knox—One alternative would a financial planner, but make it very clear that it is not a full piece of financial advice. It is like, what does insurance mean? Does this fund offer insurance? It is a more contained piece of advice, and the appropriate disclosure is, 'I am not doing a full financial statement of advice to you; instead your scope of job was, "Which fund of these three should I merge into?" I have looked at these three funds, which has taken me an hour, because they are all on my database; I will charge you $50 for it, or $100, but not $700.'

Senator SHERRY—Would it not be generally true that, for most members, the types of advice they need are consolidating account, level of death and disability insurance, extra contributions, and probably investment choice? Therefore, there is no need for a significant group of members to get advice on everything every year.

Mr Knox—True.

Senator SHERRY—Our system does not cater well at the moment for that?

Mr Ward—At the moment they do not need to get advice either. They do not have to get advice. They can make their own decisions, although many people are scared of making their own decisions without getting advice, because the whole system is so complex.

Mr Knox—The source of advice they previously relied on—if you like, the HR department in the company—now cannot give it. Who do I go to? I go to the HR manager, the super manager,

who says, 'Well actually I can't tell you what to do,' and therefore the employee is left high and dry and they have to go back to the office or factory, wherever they are working, and ask somebody else who asks somebody else.

Senator SHERRY—That is certainly true in what was formerly a DB employer corporate dominated environment. It is much more difficult in a compulsory defined contribution environment where, in reality, for many of the new members, that is, those in the last 20 years, in many industry sectors it would simply be impractical to go to the employer, even if it were permitted.

Mr Knox—That is true but, even if I am joining a new employer, that new employer has a different default fund from the fund I am currently in. The question is then, 'Here's our default fund.' The new employee says, 'I don't know whether I like that one or this one; what do I do?' Maybe this employer has a little bit of extra insurance, and this is particularly relevant for me or not relevant for me. Whenever I am changing employment, I have a decision to make as to whether I stay with the old fund or move across. It is not easy to get that simple advice.

Mr BARTLETT—Which is the least worst of the options? Is it the default option? Is it to allow HR managers, accountants, or whatever, to give a limited amount of advice in structural terms, or is it to talk to your mates at the pub or seek advice from your family? Which is the least worst of those options?

Mr Knox—We are suggesting that provision be made so that, under appropriate constraints, people are able to give limited advice within superannuation, within the constraints as Senator Sherry has outlined on the three or four areas that are fundamental to a super fund. We are not talking here about financial planning advice for retirement or something of this nature, which is more complicated, but, 'Tell me about equities, tell me about bonds, tell me about insurance and what are the advantages of insurance in a group scheme versus my taking it outside?' I think we would be better off if those sorts of what I will call vanilla type issues are more readily available.

Ms BURKE—Is it not some of the problem that financial advisors who are linked to products are going more commission-based? We think, 'I am going to walk through the door and see you and ask for 15 minutes of your time, and I am happy to pay for you to give me that advice.' There is actually nobody who is actually offering that sort of service as you see it at the moment, that sort of limited scope advice. If you were going to say to someone, 'Go and get some limited advice,' who would you actually send them to now?

Mr Ward—At the moment they cannot provide that limited advice.

Ms BURKE—I know, but, even so, a financial planner would say, 'I'm not doing it because there is no commission attached'. There are very few out there that operate—

Mr Ward—A financial planner can charge a fee of $100 or $200 for his hour's conversation. That is not a problem.

Mr Knox—I relate to one of our financial planners who is not commission based but is on fee-for-service. He had one of these guys come to him with $5,000 here and $10,000 there, and John just said, 'I'm not going to give you any advice because it's going to cost you more to get

the advice that I can offer you than it's worth.' It was one of those situations where John made, in my view, the professional decision and said to the guy, 'It's not worth me talking to you after five minutes because it's going to cost you more than it's worth.'

Ms BURKE—Because I am going to ask you all these details about it.

Mr Knox—We have to spend an hour to help me get to know you, et cetera.

Mr Ward—I would also be concerned, as you were suggesting, Senator Sherry, if somebody is in two funds where one of the amounts is automatically transferred to the new fund. I do see some problems in that. The member may not have or may not be able to get any insurance in the new fund, and if you automatically pick up his old fund and transfer that out, he may lose insurance in that fund. There are some dangers in that sort of approach as well.

Senator SHERRY—I accept that there are some conceptual issues, but I do not think they are insuperable. If a person has a lost account, and they have been lost for two years by definition, they will not be covered by insurance.

Mr Ward—In many cases they are not.

Senator SHERRY—In most cases, but at some point in time, with 5.2 million lost accounts and $8 billion in lost money, and it is going north every year, there has to be an effective solution, because it is not happening at the moment. As to the issue of advertising, we do not live in a Stalinist or Marxist society, fortunately, but from the figures I have seen there has been a general increase in advertising levels after the introduction of choice of fund. Is that not in one sense inevitable, that advertising was going to increase? It is an outcome, if you like, of fund choice, and that should not come as a particular surprise to people.

Mr Knox—I would agree. I think advertising has increased, but I would put it more broadly within financial awareness. I think financial awareness and financial literacy generally has improved within the community over the last 10 or 15 years. If financial awareness has increased, then the advertising actually has more impact because more people are aware of super. We all know that people's awareness of their super increases as their balance hits a particular threshold. When your balance is $5,000, it is a used car, if that, and I am not very interested. When my balance hits half my salary, or whatever the threshold happens to be, I have more traction. Therefore, from the fund's point of view, there is more impact from advertising as there is more value in it. So, yes, you are right, Senator Sherry, that fund choice has increased advertising, but as the industry has become bigger, then there is more traction from the advertising as well. If you expressed it as a percentage of the overall assets in the super industry, I am not sure there would be much of an increase if you looked at it now compared with five or 10 years ago, because clearly the industry is much bigger. I have not done that number.

Senator SHERRY—If you look back 10 years, would you describe the level of regulation today compared to 10 years ago as significantly greater?

Mr Ward—It is certainly significantly greater. I am not saying that is all bad. I am sure there was a need for greater regulation on disclosure. Some of the safety in super legislation, you would have to say, will increase the security of members' benefits. Trustees are taking much

more care now on making sure they do a full and proper job. Yes, there is a lot more regulation; most of it is good. It could be written a lot more effectively, and a lot of the old stuff is may be not necessary anymore.

Senator MURRAY—At a practical level with respect to regulation, one of the things we could recommend, of course, is that the regulation that is operating through legislative instruments automatically include a sunset provision, which would force a periodical review. Is that something you would support? Do you understand what I mean by that?

Mr Ward—I missed some of the words in the middle.

Senator MURRAY—As you know, primary legislation is your act and delegated legislation is regulation. That is different, of course, to guidance notes and so on. Most regulation is a legislative instrument. It is subject to disallowance in parliament and it is written to amplify or explain or make more apparent the act's intention. As far as I am aware, much of what you complain about might be picked up in regulation, which is a legislative instrument. If they do not have a finite date, they are indefinite until such time as repealed, like an act, unless that has a defined date. One of the devices you can introduce to ensure that it is periodically rewritten and re-evaluated or reviewed is to insert sunset dates. That is what I am saying—in other words, so that the process is automatic.

Mr Ward—I guess I have not thought of that sort of approach before. Where some of the problem aspects that might not be apparent when the regulations are first put out but in practice as you work through them they become very difficult to operate under, certainly it would be useful for a sunset date to provide the facility to review those so that it can iron out some of the wrinkles.

Senator MURRAY—Perhaps in that regard, if you have time and the opportunity, if you could drop us a note and say, 'The following regulations are those which upset us most', we might have a look at that.

Mr Knox—I think I understand where you are coming to, Senator Murray. We need to recognise that superannuation is long term and that processes and structures need to be set up for 10, 20, 30 years.

Senator MURRAY—Although regulations mostly cover process rather than policy intent.

Mr Knox—True, but processes feed their way into systems that super funds require to pay benefits and calculate benefits and so forth. I can see the advantage of sunset clauses, but a cautionary note as I think about it, we just need to be aware that we do not want to disrupt the long-term nature of super savings and put any uncertainty there.

Senator MURRAY—A sunset clause does not mean the regulation would end; it just means they have to issue a new one. What you are asking for is it to be better written, as I understood it. You said the regulation is good but it is badly written. Is that right?

Mr Knox—Yes.

Senator MURRAY—The other area I wanted to discuss quickly with you is portability. You mentioned the fact that even so-called common forms are unintelligible in parts, and a facetious thought went through my mind. The design of some forms in some companies, I think, has a nefarious purpose. I am a fan of portability and of concentration, with the care and caution you need to attach to some of that. I think some of the superannuation funds are making it administratively difficult for individuals to consolidate with respect to portability. The result of that is some of them, having tried, just give up, and then the money is left in that fund. You said earlier in your opening remarks to us that you were a clearing house. Can you confirm whether, in your experience, you think that some funds are being unnecessarily administratively difficult in order to keep their sticky fingers on other people's money for longer than might otherwise occur?

Mr Ward—I do not have any personal experience of that, and I am not sure that David does either. The clearinghouse really only picks up contributions from employers and then distributes them to the fund nominated by the particular employee. It does not really assist in the portability type question. Most of the funds that we administer are corporate funds. Virtually all, if not all, of those funds I would say are quite happy for the members to take their money as quickly as they can. Once they get their portability request, 'Let's process it as quickly as we can because we don't want to forget it, we don't want to be caught by missing the deadline and so on. Let's do it now.' I am not saying that the problem to which you have alluded is not present in other organisations, but I have not personally seen any real evidence of it.

Senator MURRAY—I must say to you that I have personally had a look at a mix of about 12 to 15 industry, retail and corporate funds, and nearly all of them were exemplars of propriety. It happened easily. But there was one very large, very well known one who definitely designs their processes to put you off and to hang on to their money. I will not name and shame them yet, because I need more empirical evidence, but I smell a big, big rat out there and I want to know if anyone else has smelt it.

Mr Ward—If I look at a corporate fund, in the past all of the information flow has been from the employer. The employer tells the trustee that Joe Bloggs has left service; you need to pay him his benefit. There is the verification. The trustee is dealing directly with the employer. Under portability, the employer is kept out of the equation. The employee contacts the trustee. In the past, funds did not have any real way of identifying an individual member because their verification process was through the employer. They have to set up systems to enable them to recognise and verify that you are who you say you are.

Senator MURRAY—But if in my experience you find that 13 out of the 15 do not have a real problem in dealing with the employee, but one out of 15, a very large one, does, that big rat is firmly in my sights, I might say.

Mr Knox—As John said, I certainly have not had that experience either. I have heard that it has happened on occasions where particular institutions are a little bit slow, shall we say, or recalcitrant in processing the benefit. On occasions, that can be because the appropriate information has not been provided.

Senator MURRAY—Yes, but that is a convenient excuse if it is raised in such a way. Let me recount to you quickly a story from yesterday. The witness said that 6,000 people had made a co-

contribution and did not have TFNs. They took the 6,000 sample, went back to those 6,000 by email, by letter and by phone, to get them to put in their TFNs because otherwise they do not get the co-contribution benefit. Only 2,000 responded. The lesson is that employee relationships and the ability to get information out of them is limited. I am saying to you as corporates, you want to hang on to other people's money, and it is not helping them move it. They know that if they put enough impediments, people will just give up and the money stays. This is a classic corporate activity. It happens all over the world. Companies develop systems to ensure that they get a bit of cash flow through paying people late or whatever. It is well known in the business world. I am saying that it is happening in portability with respect to forms and the way in which people operate. My question is: do you have personal experience, and if you do not have personal experience, do you think it is the sort of area that a regulator should start to just have a look at?

Mr Ward—From what I have seen, it is not widespread. If it is occurring, it is something on which the regulator should take action. But where you have regulations that say you have 90 days, it is a little bit hard for the regulator to come down and say, 'Hang on, you have taken 78 days; that's too long.'

Senator MURRAY—No, you still do not understand the point I have made to you. It is not that it does not happen within the 90 days; it is the way in which the forms are sent back and the onus on the employee is so great that it never happens at all. They give up on portability; they give up on consolidation. It is not the 90-day period.

Mr Knox—In that context, a more uniform portability form should provide some assistance because all the required information should be on that form. Then the fund has 90 days or what will be 30 days to turn it around.

Mr Ward—That form can be designed in a way that does actually validate who that member is.

Mr Knox—The only other point I would make is that if the fund is a market-related fund, and a defined contribution fund, if that money stays there for an extra 20, 30 or 50 days, then of course it should get the investment earnings over that period. If that does not happen, clearly something is wrong. I do take your point that, where portability is difficult for the member to do, then in fact an institution may be putting up unnecessary barriers for that to happen.

Senator MURRAY—That particular un-named one is putting up unnecessary barriers, and some way or other I will nail them.

Mr Ward—I thought your comment was interesting that one particular fund wrote to 6,000 members asking for their TFNs, and only 2,000 came back.

Senator MURRAY—It was fascinating.

Mr Ward—That does not surprise me.

Senator MURRAY—It was really in their interests, as you know, to return.

Mr Ward—We have had similar experiences. What is a concern with the proposed changes from 1 July next year is that funds will need to get members' TFNs. We will have exactly that problem. Funds will write out to members; ads will appear on TV, but the TFNs will not come back. Even though it is in their interest, 4,000 out of 6,000 will not send back their TFNs, and that will create very complex problems under the new tax scenario from 1 July next year.

Senator MURRAY—Let me ask you a quick question, because I am worried about the time. The ATO does matching, but it does not advise the super fund that it has done the matching and therefore does not tell the super fund, 'Here's the TFN number that you're missing.' To my mind, if an action is beneficial to the person concerned and is confined to just one area, there is no privacy consideration. To my mind, the ATO should be instructed to advise super funds of the TFN numbers where they have done a matching. Would you support that approach?

Mr Ward—We would support that, and I would even go further and say that the employers should be forced to pass on the TFN where the employer has it.

Senator MURRAY—How would you force them?

Mr Ward—You would change the tax act to make it a requirement.

Senator MURRAY—How would you force them?

Mr Ward—How would you enforce it?

Senator MURRAY—That is the difficulty. If you say to an employer, 'You must do something,' you must have a means to be able to assess whether they have done it; you must find a means to enforce it; and you must have a penalty if they do not do it. That gets into tricky areas.

Mr Ward—On the other hand, we have legislation in the SI(S) Act that is inconsistent with the legislation in the tax act, and we have employers who want to provide their fund with the TFN but they cannot because to do so would breach the SI(S) Act.

Senator MURRAY—Perhaps when you drop us that note, you can add that to it.

Mr Knox—It is getting longer. I think there is a framework whereby an employer who provides an superannuation guarantee contribution to a fund can pass on the TFN at the date of the first contribution. That would need a change of legislation, but it is a fairly straightforward process. Then the fund has the TFN.

Mr Ward—But we have a bigger problem; we need to pick up the TFNs for the existing employees as well. That will be the bigger problem.

CHAIRMAN—As there are no further questions, I thank you both very much for your appearance before the committee and for your assistance with our inquiries.

[2.42 pm]

COOGAN, Mr David, Treasurer, Board of Directors, Australian Institute of Superannuation Trustees

McLAUGHLIN, Ms Peta-Gai, Manager, Legal and Compliance, Australian Institute of Superannuation Trustees

REYNOLDS, Ms Fiona, Director, Australian Institute of Superannuation Trustees

RYAN, Ms Susan Maree, President, Board of Directors, Australian Institute of Superannuation Trustees

CHAIRMAN—I welcome the witnesses from the Australian Institute of Superannuation Trustees. The committee prefers all evidence be taken in public, but if at any stage of your evidence you wish to give evidence in private, you may request an in-camera hearing of the committee and we would consider such a request. We have before us your submission that we have numbered 79. Are there any alterations or additions you wish to make to the written submission?

Ms Ryan—There are no alterations or amendments.

CHAIRMAN—In that case, I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Ms Ryan—Thank you, Chairman, and committee members. On behalf of our members, the trustees of representative super funds, we are very pleased to have this opportunity to discuss our submission with you. The AIST has been in existence for about 12 years. It was developed as a professional development support body for trustees of funds. Our main activities are professional development, training and information. In general, our mission is to ensure that trustees are able to understand legislation and regulations, and are able to run the funds in the interests of their members. We value the opportunity of having this discussion with your committee, as we did the many discussions we had with the Senate select committee on superannuation, which worked very effectively for many years.

I would like to explain to you how an AIST submission comes into existence. We consult our members—about 600 trustees of representative super funds—and we advise them that the submission will be prepared. We ask them for their views on major matters and matters that they would like us to emphasise. We survey them as to specific issues. Usually, when we have a draft of our submission, we send that out again to members and ask them for comments and suggestions for inclusion. So, when we finalise our submission, it does represent the views of our 600 or so trustee members.

In relation to the inquiry, it is the view of AIST that we have a very robust and effective regulatory system. The superannuation arrangements, particularly following the introduction of compulsory superannuation in 1992, have proved to be very fruitful indeed for members of

funds and for the Australian economy. We do not see that there are major problems in the regulatory arrangements for superannuation funds. We have also participated in the very many changes that government and parliament have initiated in recent years, most of which have had the effect of strengthening the regulatory and prudential effectiveness of superannuation. We have addressed each of the committee's terms of reference, but in some cases we believe that the current arrangements are operating effectively and we are not advocating change.

Because it is our role to make sure the trustees are aware of all legislative and regulatory changes, and are able to implement them in the interests of their members, we are not fans of change for the sake of change. Where we see a shortcoming in the system, of course we would like to see change, and we are happy to talk to you about that. But where arrangements are operating effectively, of course we would say, 'Let us keep those arrangements and focus on the areas that require change.'

As to the terms of reference, we certainly support the simplification of superannuation, as does I think every person who has ever looked at the system. Of the matters that have been brought before us, we would say that there is a big defect in relation to advice, particularly in relation to the performance of financial advisors. We discuss that at length in our submission and we make some proposals as to how that defect could be remedied in the interests of members of super funds. We also have concerns about the way in which self-managed super funds operate. We believe that there is a case for further regulation there, and again, we have gone into some detail as to why we think that and how that could take place. We do see it as a weakness in the current global arrangements for superannuation. In terms of new initiatives, it is our view that we are now at a stage where every dollar that a person earns should attract the nine per cent superannuation payment, not just dollars over $450 a month. Again, we explain why we have that view.

You have our submission both in summary form and the detailed submission, so we are happy to attempt to answer any questions the committee might have for us.

CHAIRMAN—Thank you, Ms Ryan. We appreciate your opening statement. In relation to promotional advertising, which you regard as a legitimate expense of the fund, the Financial Planning Association has recommended that the full cost of advertising by a fund should be disclosed to members where the cost is borne directly by the fund. What is your view on that proposal from the FPA, and to what extent, if any, is disclosure currently occurring in the industry?

Ms Ryan—We would believe that that information is available to members should they wish to seek it. The funds' accounts will always specify amounts spent on advertising, and any member of the fund is entitled to that information. I might ask David Coogan to expand on that matter.

Mr Coogan—Obviously fund members receive an annual report from the fund. In those annual reports are abridged accounts. All members, and employers for that matter, can seek a copy of, I guess, the audited accounts of an individual fund. Those funds have a lot more detail to comply with generally accepted accounting standards and that provide most of the disclosures to which you earlier referred from a public company point of view. They do not pick up the stock exchange type disclosures; they pick up all the accounting standard disclosures that provide a lot

more detail in terms of the various expenses of a particular fund. Some do go to that extra extent of breaking out all of the administration costs, which would include, in some funds, advertising. But obviously, as has been mentioned earlier by some of the earlier speakers, there are different forms of advertising. You can have a lot of salary and wage costs sitting in particular funds where those people are effectively promoting the fund out in the field. Some will be caught under salaries and wages, and some will be caught directly under advertising costs. It will vary from fund to fund.

CHAIRMAN—In a sense, a related issue that has been raised is whether trustees should be corporations. I think your view is consistent with many of the views that we have received that it is inappropriate to require trustees to be corporations. What has been suggested in that context, and also in the context of concerns raised about the lack of arm's length in contractual relationships between industry funds and some of their service providers, is that the disclosure requirements applying to corporations should apply to superannuation funds as well. What is your view on that?

Ms Ryan—As you have identified, it is certainly our view that we see no need to mandate all trustees to become corporations. Some have. The structure for a particular fund is best determined by the trustees, and there is a variety of structures, all of which are fairly effective. As to relationships with service providers, every fund must have a service provider contract with whoever is providing that contract. In the recent APRA licensing process, which we have all been through for the first time, there was a great deal of interest and scrutiny of ways in which service provider contracts are regulated by the trustee board and can be prudentially regulated by APRA. I would not see any particular shortcoming in prudential regulation of service providers by any super funds that are following the current rules.

Ms Reynolds—In funds' annual reports, they do set out all of their main service providers. If the fund has that as an investment as well, that is shown in their investments. In your financial service guide, if you have part ownership, you also have to set out that aside. I do not think that it is right that people are saying that those things are not already done. I think they are.

Mr Coogan—Also, there is full disclosure on related party transactions in the audited accounts of every fund, to which every member has access. That is a requirement of the law from an accounting standard point of view. Members can get access to that if they so choose. It is no different from a public company.

CHAIRMAN—One of the service providers is Industry Fund Services, which I think is owned by about 40 of the funds. I think about 40 funds each have a shareholding?

Ms Ryan—Certainly it is owned by a range of industry funds. I am not sure of the absolute number.

Ms Reynolds—I am not sure of the absolute number either.

Ms Ryan—We can provide that to you subsequently. Certainly a number of large industry funds do own that company, yes.

CHAIRMAN—Do funds put out to tender the provision of services?

Ms Ryan—Yes.

CHAIRMAN—Given that those funds own that service provider, is there a bias towards that service provider in providing its services?

Mr Coogan—Yes. It is fair to say across the whole industry, whether it is industry funds or for-profit funds, not that I like using those sorts of terminologies. As Susan outlined earlier, there is an outsourcing standard as one of the requirements of APRA's licensing, and in those outsourcing standards, it does not matter what type of fund you are, you need to set out the procedures for reviewing and monitoring all services providers. It really applies to both areas of the market, and it is up to the trustees to work their way through that as they see fit.

Some trustees will put out to tender; they will have a tendering policy across their different service providers and set out a program for all service providers over a period of time. Others, given the nature of the service and because they have done benchmarking to satisfy themselves that they are getting the right service at the right sort of market rates, that they are not out of the market, they may choose not to go to tender as such.

Ms McLaughlin—As part of the APRA RSE licensing program, APRA required that funds give copies of all of the material outsourced service provider contracts to them to review. The process required them to be in writing and to cover off, as David Coogan said, on a number of very stringent elements that did go to arm's length relationships. Also, APRA required that they turned their mind to whether or not they were arm's length at that stage before granting the licences.

Ms Reynolds—People bring up IFS but, taking AMP as an example, if AMP has a master trust superannuation arrangement but also uses AMP's investment arm and also uses AMP's separate administration company, are these things arm's length as well?

CHAIRMAN—The same disclosure should certainly apply in this instance. The same governance arrangements should certainly apply.

Ms Reynolds—Yes, but there often seems to be a focus just on one section of the superannuation industry in these things.

Senator SHERRY—Given their current performance, they might be better using IFS.

Ms Reynolds—Yes.

CHAIRMAN—Given that part of your role is educating trustees, it has been suggested that there needs to be a raising of the bar in terms of the fit and proper person test for trustees. What is your view on that?

Ms Ryan—Oh, Chairman, how much harder can it get?

CHAIRMAN—I am just asking what has been asked of me.

Ms Ryan—There has been over the years a lot of discussion about fit and proper, but all of that discussion was crystallised by APRA in the requirements they set out for the achievement of a licence. Trustees now have to provide an enormous amount of information about themselves initially, including an Australian Federal Police check. All of that had to be provided for all trustees in order for us to obtain a licence. I chair a corporate superannuation fund, and at every meeting, every trustee director has to confirm that they have not breached the fit and proper requirements in any way. There is a very high bar.

We also now document all of the professional education we undertake. We have to provide that to APRA, as well as how many courses we do. Of course, we are very pleased if people choose to do our courses, but they may do the Association of Superannuation Funds of Australia, ASFA, courses or they may do securities education courses. I think we now have a much higher level of examination of the trustees' capacities than do directors of public companies. I cannot imagine what else we could do to convince the regulator that we are fit and proper to do the task we have undertaken.

Ms Reynolds—The fit and proper standards also have not been really in all that long. I am sure that APRA will review them once they have been in place for a bit longer to see if they think that there is any need for change. But as Susan said, at this stage, the fit and proper requirements are higher than those of a company director, and they are higher requirements than any other industry that has fit and proper standards.

Mr Coogan—A lot of fund trustees have looked at the composition of their boards and the competency of individual board members across the whole board in particular areas. Where there are I guess perceived weaknesses, they have looked for independent directors in some cases to fill some of those gaps.

CHAIRMAN—What is the role of the trustees in the funds' investment decisions? Do they get actively involved in investment decision or do they leave that to the chief executive and the senior officers of the fund or does it vary between funds?

Ms Ryan—The system of law requires, and APRA has made it clear again and again, that the trustees retain the fiduciary responsibility for the overall success of the performance of the fund. While you can outsource functions according to now very strict documentation requirements, you can never outsource your fiduciary responsibility. Even where a fund has an investment committee—and a large fund these days may have internal investment experts on staff—the decisions have to be taken by the trustee board, and the trustee board retains the responsibility. So yes, trustees do get very much involved, although of course they seek expert advice, external and internal, in formulating investment strategy and revising it from time to time.

Mr Coogan—I think it would be fair to say that a large majority of the trustees' time has focused on the investment area. Obviously, the whole compliance and risk management area is taking up an increased amount of time, but the primary focus of all funds is really to deliver good investment returns.

Ms BURKE—Related to that, has member investment choice made that more complicated for trustees and how they deal with it?

Ms Ryan—I would say yes, because the fund provides the investment choices. In developing those investment choices there is enormous amount of research by the trustees with their advisors on how many choices to offer and whether to add choices. Even with the default fund, which is usually the balanced choice, a lot of effort goes into ensuring that the investment underpinnings of that choice are the best possible. We live in a turbulent global economy so as things change, trustees need to revisit their asset allocation and they need to ensure that all of the investment choices have the right combination of elements in them. While you will see a pattern across big funds as to how they do this sort of thing, there is no precise formula. Each trustee board needs to make sure that they have the best possible asset allocation and within the choices, the choices that are going to benefit their members. So, yes, by providing investment choice, which most big funds do—but are not required to do—we have certainly taken more work on board for the trustees.

Ms BURKE—As to the notion of an individual going to a financial planner to get their own personal advice and then going to the trustees and saying, 'This is what I want, because my advisors told me,' the other submissions have make comments about how that works into what trustees do and how they take that advice and how they handle that.

Mr Coogan—The fund trustees survey their members. They take feedback through call centres and different things. If they are getting feedback that there are not enough investment options or there are too many, then they reconsider the break up of their investment options.

Ms Ryan—The financial planner has no fiduciary responsibility for the client. That is one of our concerns. The financial planner might say, 'You should do this, this and this,' whereas the trustee retains the fiduciary responsibility for the successful performance of the fund for every member. Although these days the trustee board would inform members that they are entitled to go and get their own private advice, that does not detract from the fiduciary responsibility of the trustee. We have all care and responsibility; financial planners do not.

Ms Reynolds—The experience in, I think, nearly all funds is that member investment choice take-up rates have been very low, so most people—a far greater majority—stay in that balanced or default fund.

Senator SHERRY—That effectively may be an active choice.

Ms Reynolds—Yes, it may be an active choice.

Mr BARTLETT—Ms Ryan, you said that large funds have investment experts on staff?

Ms Ryan—Yes.

Mr BARTLETT—What about smaller funds, how do they make their investment decisions?

Ms Ryan—They would outsource. There are a whole range of investment advisors.

Mr BARTLETT—Outsource their other investment advisors?

Ms Ryan—Investment advisors.

Mr BARTLETT—Who are charging commission?

Ms Ryan—They are charging fees.

Mr BARTLETT—Most of the outsourcing would be on a fee-for-service basis rather than a commission basis?

Ms Ryan—Definitely, yes.

Mr Coogan—When a trustee is outsourcing their investment management role, they are generally doing it through an asset consultant and they are paid on a fee-for-service basis rather than a commission basis.

Mr BARTLETT—How substantial a fee would that be?

Mr Coogan—It depends on the size of the fund. If it is a small corporate fund it could be $50,000 to $100,000 per year for attending meetings and helping the trustee. For a large fund, it could be hundreds of thousands or even into the millions of dollars.

Mr BARTLETT—There is a fee-for-service payment there. How much analysis is there of the decisions made by those consultants? Do they in fact then recommend investments that involve a commission?

Mr Coogan—Our understanding is no; otherwise they would be jeopardising their position in the market.

Mr BARTLETT—Are they precluded from that? Is there anything in the legislation—

Mr Coogan—No, I do not think there is, provided that they disclose any fees that they are receiving in that fashion.

Mr BARTLETT—Is it possible a member of your association who could be on a consultancy fee-for-service basis, could allocate the investment decisions to a consultant who is making decisions to invest in a range of products, some of which might yield a commission to that consultant?

Mr Coogan—We would be surprised if that would be the case, but it is not impossible.

Mr BARTLETT—It is not impossible? That is interesting given your very strong recommendation on the prohibition of commissions.

Ms Ryan—Commissions we know are being charged to the detriment of members of funds.

Mr BARTLETT—There is a difference between whether they are known or not known?

Ms Ryan—I am interested that David, who has relationships with many funds, has not heard of it. I have never heard of it. The providing of investment advice is a very competitive business.

All of the investment managers from around the world come here and set up shop and try to get mandates from super funds, because we have such a large aggregation of super funds needing investment management. They charge quite high fees for service but they are very well aware that if a trustee board is dissatisfied with the service and believes that the fee is too high, there are plenty of other people from whom to choose. It is quite a competitive situation. If we became aware that an investment manager was offloading some of their fees to a commission—it is hard to see why they would do that it terms of their own business interest—we would certainly examine it and we would form a view on it. I doubt that we would form a favourable view.

Mr Coogan—That is right. I think that one of the key things that these advisors are doing is really supporting the trustee through the investment management process. In the last five or 10 years a lot of funds have been moving towards investing directly in the market rather than through fund managers.

Mr BARTLETT—So they can appoint their own fund managers?

Mr Coogan—Their own experts. That is all part of the choice of fund environment in terms of delivering competitive returns to members in the industry in the community.

Ms McLaughlin—Those asset consultants who are providing the fee-for-services to those superannuation fund trustees are required to have their own Australian Financial Services licence to provide that consulting advice. In accordance with that AFSL, they are required to comply with the ASIC's conflicts of interest policy and the Corporations Law, which has quite stringent disclosure and management issues that relate to conflicts of interest.

Mr BARTLETT—Disclosure is the critical point.

Ms McLaughlin—Not so much disclosure, but the management and avoidance of those conflicts of interest where they cannot just be disclosed. ASIC have come out quite strongly on this with their policy statement, saying that disclosure may not be enough in some sorts of situations with that conflict. That situation that you have described indicates to me that that would be a fundamental conflict.

If an asset consultant were receiving commissions from an investment fund manager and then recommending them to a particular trustee over another fund manager because they would be getting a commission on it, there would be no way that a disclosure would be enough to avoid that conflict of interest, in my opinion. I would think that those requirements that apply to each of those asset consultants and experts that are advising trustee boards would have to comply with the conflict of interest regime that is implemented in the corporations act, or they would lose their licence.

Mr BARTLETT—Thank you.

Senator SHERRY—AIST represents trustees in retail, public sector, industry, corporate?

Ms Ryan—Trustees of not-for-profit funds; equal representation trustee boards.

Senator SHERRY—That is corporate, industry and private sector?

Ms Ryan—Corporate, public sector and industry.

Senator SHERRY—To come back to the earlier conversation, do you know of commission-based practice in the wholesale investment area? I will get to retail in a moment.

Mr Coogan—No.

Senator SHERRY—Based on the earlier conversation?

Ms Ryan—No, I am not aware of that

Senator SHERRY—Do you believe that a fund—any fund, and I would include in this the AMPs, the AXAs and the INGs of the world—would be willing to have the fee structures around their contractually negotiated wholesale arrangements made publicly available?

Mr Coogan—From a wholesale point of view they effectively are, but not at a retail level.

Senator SHERRY—Let's just stay at the wholesale level at the moment. All the superannuation funds in Australia would have contractual relations in terms of the investment—the moneys they place in a whole range of areas—whether it be through an intermediary or through direct advice from fund advisors and investment advisors that they have in-house or have purchased externally. My understanding is those contractual arrangements are not publicly available.

Mr Coogan—What I meant in respect of 'publicly available' is through the wholesale market. Large funds that we represent know what those wholesale rates are. Retailers obviously are a part of those numbers but wholesale, as such, is not really disclosed.

Senator SHERRY—Given the earlier conversation, we have not had any reference to this area in any of the submissions. Whether or not there is any malpractice, there does not seem to be an issue with anyone—including the Financial Planning Association, which has have made a range of allegations.

Ms Ryan—We addressed the terms of reference as best we could. We are not aware of this being an issue. Issues do emerge.

Senator SHERRY—I am not either. My understanding is that our arrangements in Australia in the wholesale area are broadly similar to every other country in the world. It is an international market.

Ms Ryan—I would think so, yes.

Senator SHERRY—Turning to the retail area and your critique of commission-based selling, distribution and advice: do you think it would be useful if, where a commission is paid—supposedly for advice—there were a clear distinction made between commission paid for sale of a product as distinct from the provision of advice? It seems to me that a commission payment is effectively for two basic purposes: one, clear advice—you gather information and provide advice based on that specific information; two, the selling of product. Yet there is no distinction made in

our disclosure arrangements at the moment in respect of two types, to varying degrees, of commission-based payment in Australia.

Ms Ryan—It is the confusion of those two elements that causes us concern and causes members to lose money. A member might think they are buying advice from a financial planner but they are in fact buying products. This goes for the whole ASIC shadow shopping report—whether people are getting appropriate advice and so forth. Our response has been to say: 'Let's restructure the industry. Why can't financial planners start to work on a fee-for-services basis like accountants or other professionals do.'

Senator SHERRY—My suggestion about a clear separation of commission for advice, which is based on the gathering of specific information versus the disclosure of commission for what is a product sale. Do you think that would be useful?

Ms Ryan—Theoretically it has some attractions but, in practice, I think it would be very hard to do given the size of the sector and the numbers of people who would be seeking and giving advice. We are very concerned with the extent of poor advice being given at the moment. For that reason, we would rather go to a completely new structure where financial advisors get their qualifications and operate as accountants do.

Ms BURKE—We have had to retrofit the market. There were financial advisors out there pre-super who were genuinely attached to a company or licensed to provide a product—generally insurance products. Then super came along and nobody seem to fill the void of providing financial advice as opposed to product advice. We do not seem to have somebody who has come along and said: 'I'm here. I'm setting up shop. You walk in the door, I'll map you out, I'll charge you a fee and then go off and get whatever product I think. I have mapped out all the products, compared them for you.' Nobody has gone down that line yet.

Ms Ryan—Very few, because the alternative of continuing to sell AMP products, for example—as they have been recently put on warning, I will name them—it was easier to just say, 'Here, buy these products.' Banks have done it, big insurance companies have done it. I think you are quite right: the development of an independent advisory function has not really taken off. We would like it to take off.

Some funds now employ financial advice experts and make those people available to their members. It might be that their first consultation is free—that is a service the fund offers—and then subsequent consultations would be on a fee-for-service basis, an hourly rate all known and all disclosed. That is the beginning of an independent advisory profession. It is the old selling of products segued into financial advice without a proper consideration. That is why we would like to see the parliament, perhaps your own committee, Chairman, examine this matter and develop a regulatory structure for a new kind of financial advisory sector.

CHAIRMAN—What is your response to the view that has been expressed in some of the submissions—indeed in some of the evidence that we have taken over the last couple of days—that moving to a full fee-for-service approach to advice would, in effect, disenfranchise lower income earners because they could not afford the fees that would be required to be charged to cover the time involved in providing that service? Indeed, it has been acknowledged by at least a couple of the witnesses in the last couple of days that there is probably a means of remuneration

cross-subsidisation of low-income earners by higher net worth individuals through the commission because of the relative proportions they pay through commissions.

Ms Ryan—It would be an outlay that people do not currently have but, if the financial advisory sector developed its rates of charging fairly, it would not be necessary for a low-income person to take very expensive advice—because they do not have a lot of assets about which to be advised. Your previous witness, Mr David Knox, or his colleague, pointed out that a lot of people do not need a lot of complicated advice; they just need to know it is better for most people to have all their bits and pieces of super in one fund, to always look at insurance cover, to always look at cost, to look at the website and to make sure they can understand the annual report. There are some basic things that really should not be an expense to point out to people.

Senator SHERRY—Is that provision of limited advice, as it is referred to, easily compatible with the current FSR disclosure regime on a cost effective basis?

Ms Ryan—I would say yes.

Mr Coogan—I think there is experience out there that it was costing a lot of money for low-income earners. Other simplified forms of limited advice were provided through some of the funds at a lower cost. That advice focused on what the member needs to know and provided some direction to the member on particular areas. Some of the call centres have financial planners who provide limited financial advice.

Senator SHERRY—On the issue of fee for service and fee for different types of advice; as with lawyers and accountants, are there indicative fee levels for particular types of advice in the planning industry? I am not aware of any.

Mr Coogan—No, I think it ranges quite a lot in the financial planning network, which is obviously very big. The accounting profession are moving towards fee for service. There are also funds that have employed people on a salary basis rather than necessarily on a commission basis. There are some funds that do have a mix.

Ms Reynolds—The issue with the commission is not just about the cost of the payment; it is about the conflicts that arise with commissions. That is why we need the fee for service. ASIC's first shadow shopping exercise a few years ago heard terrible things about the conflicts that had arisen because of commissions. Even though the financial planning industry undertook that they would clean up their act, their latest survey showed a small improvement but, as ASIC said, there is a long way to go. I do not know how you can get around this issue of conflict of interest with commissions. That is the issue, not the fee.

Senator SHERRY—That was my next issue. My view is that commissions are a conflict of interest. It seems to be very clear that it must be, given it contains a significant element of 'sell'. It is frequently argued to us that protection of consumers can be covered off by disclosure; you disclose all these commissions and fees and therefore the consumer is protected because they are informed. Do you accept that disclosure in itself—particularly the current regime of disclosure—protects consumers?

Ms Reynolds—No, because people will not read all of the documentation that they are given, which is usually quite a number of pages long. I work in the financial services industry. I got something for a home loan recently and they gave me three booklets to read. I tossed them in the tray to read later. I did not read them. I do not know if they are in plain English.

Senator SHERRY—The criticism of almost every submission is about the length of documentation and that it is unreadable, not simple et cetera. I accept that. Let us assume that you could get to the point where you had a significantly simplified FSR regime disclosure document that was simple, standard and easy to read. Would that provide sufficient protection for consumers against mis-selling on the basis of commission?

Ms Reynolds—I do not think so. As I said before, where there is commission, no matter what, there will always be conflicts of interest. I want to go back to your point about separating out commission for advice and commission for actually selling the product. We should not only go halfway; we should go all the way and get rid of commissions. It is outrageous that, on a nine per cent compulsory contribution, every Australian worker has to pay—that someone can sell someone that product and get a trailing commission on it. They did not have to actively go out and seek this. It is law.

Senator SHERRY—I am not sure of this: where there is a commission disclosed, does the current disclosure FSR regime require a fee disclosure as well? That would be the effective fee equivalent of a commission-based payment. Is that required under FSR?

Ms Reynolds—In the statement of advice that a financial advisor would give a client, they are required to identify any kickbacks or commissions that they would receive for recommending that product. But, when you are talking about a statement of advice that might be 15, 20 or 40 pages long, that could be hidden very effectively. It may be in there, but they may not be reading it.

Senator SHERRY—I just want to be clear on this: you get the product disclosure statement, and there might be a 0.5 per cent trail commission. Does the current FSR require that to be shown as a dollar fee as well?

Ms Reynolds—Yes, that is correct. There is dollar disclosure.

Senator SHERRY—They will both be there. The other argument that I often hear is that individuals can dial down the commission. Is there any available data as to the number of individuals who have successfully been able to dial down a commission? I have not seen any.

Ms Ryan—I do not think we would have it. Because our members in general are very concerned about commissions and are from funds that will not use commissions sales people, it is not data that would readily come our way however, it might be something though on which the committee could commission a research project.

Senator SHERRY—Perhaps I could ask a retail fund to provide it to us. In terms of the theory of competition, it would be interesting to know effectively how dial down works. Perhaps you could give me your view on this: if we had a situation where the law required dial-up, as distinct from dial-down, do you think that would make a difference to the negotiating power of

an individual with a planner? In other words, you have to start with the cost of the product and then work your way up.

Ms Ryan—Negotiate?

Senator SHERRY—Yes. At the moment, the commission is there and the individuals have to say to the planner, 'Look, I want to dial down by 0.3 or 0.4 or whatever.' If the starting point is zero and they then have to negotiate the commission or the fee on top of the cost of the product, do you think that would make a difference?

Ms Ryan—I think that it would create a lot of worried constituents for you, Senator.

Senator SHERRY—Which constituents?

Ms Ryan—I meant 'colleagues'. I do not think we should be placing further burdens of complexity on members of the Australian workforce who are required to save for their superannuation. That is why we are going for this fee for service where, if you need a bit of basic advice, it might cost you $500. You get that and, if you think you need some more advice, it might cost you another $500. We would think we would be doing your constituents—members of our funds—a service by going that route, rather than negotiating around very complex percentages and timetables. It is the problem with disclosure now—a lot of information is disclosed but, as Fiona said, it is not absorbed by the person it is supposed to be helping.

Senator SHERRY—Effectively your argument is that, in respect of fees, particularly commissions, even if it were simplified, disclosure in itself is not sufficient; it requires some regulation.

Ms Ryan—Correct, that sums up our position.

Ms Reynolds—Some of our members have raised with us the issue of whether someone would be able to access money from their superannuation account, with prices around it and limitations on how often you could do this. Also, if people were able to get more basic information from their superannuation fund without all of the regulations around that—other people have talked about this while I have been here—they should be able to get that simple piece of advice from their fund. Because of regulations around their licence, they are not allowed to give someone that simple piece of information.

Mr BARTLETT—You recommend it be allowed that they can give that basic piece of information?

Ms Reynolds—Yes, I think there should be some very basic information that superannuation funds should be able to talk to their members about.

Ms BURKE—Is that we should be educating the public and telling them: 'Having three super funds will not give you the best rate of return, you should roll them all in. Here is some very basic information that you should be able to go and read, theoretically, about the various funds and what they return, so you can actually make that informed choice yourself; but here is the education to allow you to do that.'

Ms Reynolds—Sure, but I think within the regulations there is a very fine line between education and advice. Funds are very hesitant about where that line is and about crossing over it.

Mr BARTLETT—Could it be argued then, that if those regulations allowed a little bit more latitude in terms of giving basic structural advice, that that might obviate the need for some people to have to pay a fee-for-service to financial advisors or planners to access that sort of information? That would therefore overcome at least part of the problem of a fee-for-service regime in which low-income earners would be disenfranchised because they would not be able to afford that advice.

Ms Reynolds—I think so. Obviously the people at the fund would have to have the correct education, qualifications et cetera to answer these questions.

Mr BARTLETT—Some sort of licensing arrangement would still be required?

Ms Reynolds—Yes.

Mr Coogan—I think the real difficulty for members is comparing one fund to another at the end of the day. It is about how we simplify the information so that members are in a better position to make objective comparisons from one fund to another.

Ms BURKE—Wasn't part of the last shadow shopper criticism about changing funds that most advisors were not giving a description of the fund you were leaving, the exit fund, compared to the entry fund? They were saying, 'This is you-beaut,' but they did not actually tell you that you were leaving behind something that might have been better. It is obviously not in their interests; they will not get commission if you do not change funds. Some of that information needs to be removed from people who are acting on a commission basis, because it is not in their financial interest not to swap funds.

Mr Coogan—That is right. It is a complex area but if we could come up with some templates that simply said, 'From an investment point of view, for the default option in this fund, the net return to the member was X over one, three and five years.' You obviously cannot predict the future. The same could be done with costs and insurance. If you come up with something as simple as possible, at least it would give members a better chance of making a comparison.

Senator SHERRY—On this issue of the theory of economic competition and people competing; is there any data available on whether or not the average fund member who seeks financial planning advice goes to four or five different planners, obtains the documentation, sits down and in a rational and informed way and selects the best material that is presented to them? That is the way economic competition is supposed to work, as I understood it.

Ms Ryan—Anecdotally, we would say that that does not happen. What happens is someone says to their colleague or their friend: 'Who do you go to? What are they like?' or they go to their bowling club or their golf club where there is a financial planner. I think that is how people get the advice. It is out of recognition that people will not go through all those processes that the funds that are big enough to do this have started to hire in-house financial advice experts and are making them available in a very fair and transparent way to their members.

Senator SHERRY—Putting aside the issue of fees versus commissions for one moment; it raises the question: should the cost of any financial advice be permitted to be debited against a superannuation fund? Should any death and disability insurance be permitted in the system? Should any salary continuance insurance be permitted in the system? Why do we have costs that are not central to the core provision of retirement income added to our system and why is that allowed in any way, shape or form?

CHAIRMAN—I would add advertising to that too.

Senator SHERRY—I would add advertising to it as well.

Ms Ryan—They are allowed. Currently, offering those services is legal and those services are acceptable within the sole purpose test of the Superannuation Industry (Supervision) Act 1993.

Senator SHERRY—I know they are allowed, but should they be?

CHAIRMAN—There are a lot of things allowed in the SI(S) Act which you say should not be.

Ms Ryan—In the particular cases that you have mentioned, there is a relationship between your salary continuance insurance, your disability insurance and your retirement income. If there were no disability insurance or salary continuance allowed, if you became ill and dropped out—

Senator SHERRY—That is why we have Medicare.

Ms Ryan—But Medicare does not pay for your living costs.

Senator SHERRY—One of our terms of reference is international comparison. In the UK, where new soft compulsions have come in, no forms of insurance are permitted at all—no advice, no death and disability. It is a retirement income de facto compulsory defined contribution system. These issues simply do not occur because they will not be allowed in the first place.

Ms Reynolds—But within Australia, the majority of working Australians would only have a form of insurance because they have it through their superannuation fund. If they do not have it through their superannuation fund and they have to pay retail prices for it, most people are probably not likely to have insurance. I know medical expenses et cetera would be covered by Medicare, and there are rules around workers compensation, but I think people should have some level of insurance.

Senator SHERRY—Clearly that comes at a cost to the ultimate retirement income, doesn't it? Where do we draw the line? A lot of people do not have private health insurance. It seems to me that the logic of the argument is we would allow private health insurance premiums to be paid out of superannuation contributions.

Ms Ryan—I do not know that we are in a situation where we have to be caught up in a logical extension of services that are offered. These services have been offered, they have developed. As Fiona said, they have provided something that is not otherwise available to people. If anyone has

ever tried to get income maintenance insurance as a private individual, it is extraordinarily difficult.

Senator SHERRY—I accept that.

Ms Ryan—I think that at this stage we would say the benefits outweigh the fact that there is some erosion of retirement income.

Senator SHERRY—Even in bulk purchase superannuation of income protection, my understanding is that, although not compulsory in most funds, it is costly election for insurance purposes, it is certainly greater than death and disability insurance.

Mr Coogan—We recognise that it is a cost but I do not think it is a significant cost. I think we have to look at the benefit as well, as has been outlined, if there is cause to make a claim on that insurance that is of benefit to the member and their family if a death is involved.

Senator SHERRY—My central contention is whether or not a retirement income system should be paying for this. We could argue that a lot of people are underinsured for their house insurance, therefore the provision of house insurance bulk purchase, which would be cheaper through a superannuation fund, should be permitted. It is pretty catastrophic if your house burns down and it is not insured, and it certainly affects your retirement income because you will not have anywhere to live.

Mr Coogan—This has evolved from the defined benefit fund scheme in the private and public sector.

Senator SHERRY—I am just expressing a general concern beyond the issue of fees, commissions, advice and insurance about where we should be drawing the line in terms of costs being added to the system.

Ms Ryan—Let us not forget that there is quite a strong correlation between employment, superannuation and the benefits of having salary continuance insurance or death and disability insurance. If you cannot work, you then do not get super. That is where the insurance and those sorts of benefits kick in. However, if you follow your argument through, it would mean that benefits like an ill-health benefit or a temporary incapacity benefit that a super fund might pay to members would not be payable or relevant. Some funds provide those benefits. But that is not for retirement purposes. On the proposition that insurance should be excluded from coming out of the superannuation accounts because it reduces the retirement income, we would firmly put the view that the benefits of things like insurance and salary continuance to ordinary Australians, and every Australian that has superannuation, far outweigh the reduction of that retirement benefit.

Senator SHERRY—In summary, if I advanced a policy position that every form of deduction from superannuation should be prohibited in law, it would be a particularly unpopular policy position with the entire superannuation industry.

Ms Ryan—I think so. We do not want to ditch things that are working in the interests of our members; we only want to ditch or change things that are not. At this stage we would not unravel the particular benefits you have enumerated.

Senator MURRAY—There is an important point of principle, isn't there? Insurances of this kind are not legislated. The only thing that is compulsory is the superannuation guarantee. Therefore, if it is not legislated and the retirement funds choose to continue with it, members who wish can opt out of those funds and go to funds that do not have those benefits or they can choose to stay. It does lead us to what I would call a market based approach where the providers of superannuation are entitled to attach whatever product benefits they want to their package. I would not in fact limit it to anything. If to attract members to your fund, you would consider it worthwhile to offer household, car, fire insurance, whatever other things you wish, I think it is in the interest of a market based approach that you are entitled to add on extras. Providing you have genuine choice or portability, the members are able to decide whether they go to other funds which might have a higher return because they have lower add-on costs. Is that not a market based model?

Ms Ryan—I would not like to see funds going to an all out department store-like competition for the things they are offering.

Senator SHERRY—Why?

Ms Ryan—Because the core task of looking after the contributions, investing them and complying with all the laws and regulations is such an important task that I would not like to see the resources of superannuation funds diverted to offering things that are available elsewhere in the market. If you want car insurance, there are plenty of people offering car insurance. The reason we would like to see the current benefits maintained is that they were not readily available. Income maintenance for low income people at a dollar a week or something, is not readily available outside of the super fund. It has developed; at the beginning it may not have been part of the plan. APRA keeps a very close eye on the sole purpose test. We believe these services are part of that. I would not like to see a free-for-all where super funds dissipated time and effort on finding all sorts of extras.

Senator MURRAY—If you adopt your approach, others are entitled to argue, 'All right, then you cannot advertise, because we think that's wrong.' What you want is a managed product which is not fully market based which allows certain things to continue and certain other things not to continue. There are those who argue that if you going to have a managed environment they are entitled to stop you advertising, for instance.

Ms Ryan—I am not sure I follow your argument, Senator. Certainly we do not have a completely market based approach; we have compulsory superannuation.

Senator MURRAY—Advertising reduces members benefits. Why should it not be prohibited?

Ms McLaughlin—Can I just clarify: in relation to extra benefits that are provided through a superannuation product, any extra benefit that is given to members must comply with the sole purpose test under the SI(S) Act. The sole purpose test is one of the biggest safeguards in our

superannuation system today. The benefit must be for members or for their beneficiaries for the sole purpose of their retirement. That is why things like death and disability insurance, income protection, ill-health benefits and so on have actually been allowed and permitted by Australian Prudential Regulation Authority and in accordance with the SI(S) Act, because it is in the sole purpose of what providing superannuation is all about. Those extra things that relate to house insurance or car insurance are not consistent with that sole purpose test.

Senator MURRAY—Why not?

Ms McLaughlin—Because they are not for—

Senator MURRAY—Has anyone ever asked the regulator that question?

Ms McLaughlin—Yes.

Ms Ryan—ASIC have.

Senator MURRAY—I take Senator Sherry's point. I actually think that if someone's house burns down when they are 58 and it is uninsured, it genuinely does affect their retirement. The point I am trying to make is that providing something falls within the broad regulations. I believe that funds should be entitled to provide whatever services they wish, including household insurance. If you do not go to that market based model, you are not allowing full choice—you are not allowing people to decide whether they want funds with or without insurances. There is nothing in the sole purpose test that says you have to have income assistance insurance. As soon as you start to say, 'It's okay to have income assistance insurance and not house insurance,' you then give credibility to those who argue, 'It's not a market based model; we're entitled to say to you that you can't advertise.'

Ms Ryan—As I advised the committee at the opening of our discussion, our position is that we are generally in agreement with the regulatory structure that has developed over the last 12 to 15 years. We are not arguing for a completely different system; we are not arguing that we should go directly to the marketplace. We believe that the compulsory system brings many benefits to Australians and to the Australian economy. Because it is compulsory, a lot of regulation is required and we cooperate with the regulation. The purpose of our existence is to ensure that our trustees know how to cooperate with the regulation. We are not looking to completely abandon a regulatory structure and have a complete free-for-all—that is not really our position. Others may have that view, but our view is that if benefits have developed within the system—permitted and supervised by APRA as Peta-Gai has pointed out—and are serving a purpose, we should keep going. We are not saying that the whole system needs to be changed so that your super fund provides everything you might ever need. Our position is that we basically think that the system is working very well. We only argue for change where we see a real defect. We do not see the absence of car insurance in your super fund as a defect, so we do not advocate it.

Senator SHERRY—In your comments on employer insolvency, you recommended a couple of changes in terms of monthly contributions.

Ms Ryan—Monthly contributions.

Senator SHERRY—A number of the submissions have recommended that GEERS, the government employee entitlements protection scheme, should cover what is a statutory entitlement in the event of employer insolvency. Do you have a view on non-payment of super?

Ms Ryan—We really have not discussed that issue for a long time. We believe that monthly payments would reduce a lot of the problems caused.

Senator SHERRY—It would.

Ms Ryan—That is our position. We have not looked at another body coming in to fund what is an employer obligation. All we want to do is make sure the rules facilitate the employer meeting their obligations.

CHAIRMAN—Returning to the issue of commissions, your opposition to commission based advice, I assume, is consistent with the industry wide advertising campaign that industry funds do not pay commissions?

Ms Ryan—We have industry fund trustees as members of our association, so we are familiar with their position and with their advertising program. We think it has been a very constructive exercise in letting people know how they can exercise choice of fund to their own advantage. I think Fiona wanted to say something.

Ms Reynolds—I was just going to say that we have always had this view. We had this view before superannuation funds were advertising; our view has not changed because of that.

Ms Ryan—On commission.

Ms Reynolds—On commissions, no.

CHAIRMAN—Given the misleading nature of that advertising, what is your attitude?

Ms Reynolds—What misleading nature?

CHAIRMAN—It has come to light that in fact some funds are paying commissions—Health Super, for one.

Ms Ryan—Is Health Super a funder of those advertisements? Is it a participant?

Mr Coogan—Not that I am aware of.

Ms Reynolds—We are not aware of exactly which funds are involved in the advertising campaign. I assume that if it is not correct, the regulators would look at it and do something about it.

Ms Ryan—I would remind you that when the ads started, because some competitors of industry funds complained, ASIC jumped in and required the ads to be adjusted to put in the qualification that should the fee structure change over a working life then obviously the outcomes would change. From that, I think you can be assured that ASIC and APRA are both

very alert to the contents of the advertisements and are very quick to act should they think anything is going wrong.

CHAIRMAN—When this issue was raised with IFS chief executive, Garry Weaven, he was quoted as saying, 'We're quite happy for it to be taken as a broad brush understanding of these funds, because if there are one or two exceptions it doesn't change the message.' What is your attitude to that response as a body that is advising trustees?

Senator SHERRY—Maybe we should put that to Garry Weaven.

CHAIRMAN—No. This is a body that advises trustees of these funds who are responsible for their advertising campaigns.

Mr Coogan—To be fair, there are a few industry funds that pay commissions, but they are not the ones involved in the advertising about which you are talking about. That is our understanding.

CHAIRMAN—But this is an industry-wide advertising campaign.

Ms Reynolds—No, there were a number of funds who collectively, under the industry fund banner, did the advertising campaign. There are many other funds who also consider themselves to be industry funds who are not part of the advertising campaign.

CHAIRMAN—Do you think it is acceptable just to dismiss this as a broad brush approach? Given the stringent approach that has been adopted for financial planners by ASIC with regard to the shadow-shopping exercise and other issues, do you think ASIC would accept as an excuse from them, 'This is just my broad brush approach to advice'?

Ms Reynolds—Not knowing the whole context of what Garry Weaven is taking about, I do not think we would want to comment. As Senator Sherry said, it is probably best to put that comment to Garry so he can put it in context.

Senator SHERRY—I do not think he will be reluctant to appear.

Ms Reynolds—No, I am sure he not.

CHAIRMAN—I do not think he has made a submission.

Senator SHERRY—I move that we invite Garry Weaven along. We are very happy to have him.

Ms Ryan—I am sure you will find it very instructive, because he is really a very important person in the whole industry funds movement. Generally speaking—

CHAIRMAN—Some people think he is too important.

Ms Ryan—if a person is trying to exercise choice of fund and they realise they have been paying very, very high trailing commissions and they see an advertisement that says, 'There are

some funds that don't have these commissions and have lower fees,' they then need to go off and identify a particular fund, look at it and decide whether they want to join it. I think the general message is constructive and helpful.

Mr Coogan—I think the other point to make is that some of the for-profit funds, if I can put it that way, have been looking at fee-for-service rather than commissions and they have gone public on that. It is no different to what we were talking about before regarding industry funds.

CHAIRMAN—Again it gets back to what Senator Murray was saying. The issue is a market driven approach as against a mandated approach. I think that you are advocating a mandated approach. Are you saying that commissions be banned?

Ms Ryan—Yes, we are.

CHAIRMAN—Thanks to all of you for your appearance before the committee and for your assistance with our inquiry.

[4.00 pm]

ANDERSON, Mr Barry, Company Secretary, Equipsuper Pty Ltd

BURNS, Mr Robin, Chief Executive Officer, Equipsuper Pty Ltd

LUI, Ms Cynthia, Corporate Lawyer, Equipsuper Pty Ltd

CHAIRMAN—I welcome the representatives from Equipsuper. The committee prefers that all evidence be taken in public, but if at any stage of your evidence you wish to give evidence in camera or in private, the committee would consider such a request. We have before us your submission, which we have numbered 30. Are there any alterations or additions you wish to make to the written submission?

Mr Burns—No thank you.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Burns—I will just set the scene and say a little bit about Equipsuper as a fund. It is probably best described as a multiemployer corporate fund. The fund has been in existence since 1939, originally as the State Electricity Commission of Victoria in-house corporate fund. With the privatisation of the utility sector in Victoria some years ago, the fund opened up to other employers including the Gas and Fuel Corporation. Over the last 10 years it has been open to any employer who wishes to participate in it. We have competed in the corporate outsourcing market for new business.

There is a significant defined benefit element to Equipsuper; almost 50 per cent of the assets we manage support defined benefit liabilities for a number of our employers. We manage approximately $3.8 billion on behalf of 40,000 members and about 500 employers who participate in the fund.

We are often called an industry fund because of our background and our profit-for-member status. In addition, our governance structure is slightly different in that directors make their way onto our board through a different structure to that of the typical industry fund, and our competition is much more typical of the commercially motivated corporate master trusts that are very active in the corporate market.

On behalf of Equipsuper, I would like to thank you for the opportunity to appear today and speak to you. Our written submission contained a number of matters, some of more significant conceptual impact that others, but I will refer only to a few of our more specific or detailed points. Before I do, I would like to state that, in our view, Australian governments have put in place over recent years a sound and well regulated superannuation regime. There is no doubt that the changes that will take effect on 1 July 2007 will in due course ensure that superannuation becomes the preferred long-term savings vehicle for many Australians. The continual development of this regime has meant that the industry has experienced frequent and very

significant regulatory change. The introduction of the FSR regime and the APRA licensing requirements resulting from the safety in super inquiry are two examples of this. We do of course recognise the need for regular review and inquiry, but we also think it is important that the industry be permitted to refocus on improving services to members rather than on implementing further complex legislation changes.

In this context, we would also point out that observed in our members and participating employers is an apparent scepticism regarding the frequent changes to the superannuation regime. This colours their perception of the long-term value of super and probably affords the government of the day less popular credit for positive changes than may actually be deserved. It is important, therefore, to focus on those changes that we think will permit superannuation providers to improve efficiency and cost effectiveness. In the main, we believe that any further immediate changes required would be minor.

In the limited time that we have, we will raise some of the specific issues addressed in our submission in more detail. Defined benefits comprise a very significant part of our business. Although the number of open defined benefits schemes is rapidly declining, the amount of assets still held in defined benefit schemes are substantial and will remain for some years. The cost and complexity of administering defined benefits schemes often appear to be overlooked by legislators as the focus is on accumulation style accounts. Inevitably, considerable time and effort have been required to seek further clarification or exemptions from regulators to deal with defined benefit specific issues.

We would like to comment on the SIS Act. The government has introduced several initiatives that affect superannuation, but we do not believe that the SIS Act has kept up with those changes. As our first example, I mentioned the restrictions imposed by the sole purpose test. We believe that regulated superannuation funds should be permitted to offer products other than superannuation to members provided those products generally support the government's overall retirement income policy. As a specific example, the sole purpose test currently prohibits superannuation funds from offering insurance against total and permanent disability to members who have never participated in the workforce. We recently approached APRA for an exemption on this, but have been limited to offering this insurance cover to members who have previously been employed. We think that the nexus between superannuation and employment has weakened over time. For example, a spouse may now hold a superannuation account despite never having participated in the workforce. However, that same spouse is not able to buy total and permanent disablement cover. We think there are clearly good public policy reasons why such a product should be permitted to be offered to such members, especially when the member is willing to fund the cost of the cover and insurers are willing to accept the risk.

Another feature of the sole purpose test, which we believe should be considered for review, is the restriction placed on an individual's ability to deduct the cost of financial advice from their superannuation account. If a member approaches a financial planner seeking advice on retirement planning, the planner is required to consider both the member's superannuation and non-superannuation assets. However, superannuation funds are currently permitted to deduct from the member's account only the cost of that part of the advice which relates to superannuation affairs, which clearly complicates the whole process. As up-front fees paid out of normal taxed income are not always a viable option for many members, particularly those whose only financial assets or savings are in a super fund, we believe that the costs of broader

retirement or financial planning advice should be permitted to be deducted from a member's fund account. This would give members another option on how to pay for financial planning and potentially help lessen the need for trailing commissions.

As a final example of the SI(S) Act not keeping up with other areas of government policy, we believe that the equal representation rule which currently applies to employer sponsored and some public offer funds should be reconsidered in light of the fit and proper requirement which now applies under the new APRA licensing regime. Unlike most other public offer funds, the directors of Equipsuper are elected by participating employers and members, except for the chairman, who is appointed as an independent director. We believe that all superannuation fund members should have appropriate and expert representation. However, the current application of the equal representation rule limits the pool of experienced directors. The SI(S) Act envisages the appointment of a single independent director, and we submit that legislation should be amended to permit the appointment of more independent directors without the need to seek the regulator's approval. That concludes our opening comments. We welcome any questions from the members of the committee on these comments, our submission or the views of the superannuation regime in general.

CHAIRMAN—Thank you, Mr Burns. Can I just clarify the way in which Equipsuper operates? You are a public offer fund and you are a multi-employer fund. As I understand it, you are not limited to one industry segment. As a point of comparison, the MTAA super fund provides principally for employees in the motor trades—

Mr Burns—That is true. Our background tends to come from the Victorian utilities industry, but for a number of years now we have been open to employers from any industry. We have had employers join us from other states and from a very wide range of industries, from white collar all the way through to blue collar.

CHAIRMAN—In that context, how are your trustees appointed? Again, if you go to the MTAA, half of their trustees are appointed by the industry body that relates to the motor industry and half are appointed by the union that relates to that industry. If you are a multi-industry body, how does the trustee appointment system work?

Mr Burns—All of our directors are elected. There are four directors elected by the members every three years and each member gets to vote in that process. There are four directors elected by participating employers and all employers get to vote in that process, with a vote for every member that they have in the fund. Those appointments are all for three years. All the stakeholders in the fund effectively have a say in who represents them in the overall governance. Between them, those eight elected directors select and appoint an independent chairman.

CHAIRMAN—How many members do you have in your fund?

Mr Burns—About 40,000.

CHAIRMAN—It is not large.

Mr Burns—It is not a big fund in members.

CHAIRMAN—No. It has been raised in the last couple of days whether it is feasible to democratise industry funds. I suppose some funds have hundreds of thousands if not millions of members, which would make the logistics a lot more difficult than with just 40,000. Do you not find the cost of administering the elections prohibitive? Obviously if you are a smaller fund the proportion of costs of administering elections is going to be as large as it might be for a larger fund which has more resources.

Mr Burns—We are certainly starting to find that the cost is becoming a factor. We have an election about to take place over the next few weeks for member directors for which one of our objectives is to get as high a turnout as possible. Some cost is associated with encouraging members to actually take their opportunity to have a say in the governance of the fund.

Mr Anderson—The cost will be around $2 to $3 per member. A large part of that is mailing 40,000 members.

Senator MURRAY—How many of the 40,000 members actually vote?

Mr Anderson—The number has been declining. At the last election three years ago, 4,000 members voted and that was about 18 per cent of the membership at the time. The membership base has grown substantially. We are hoping that by advertising the election more in our newsletters more people will vote, because we think that if the number drops substantially below 18 per cent you may have to question whether this is an appropriate way for selecting the directors of the trustee company.

CHAIRMAN—Can you give some more detail on why you believe it is important for financial planning firms to disclose the name of any associated product provider in material provided to customers? To what extent does this happen currently?

Mr Burns—We think that clarity and transparency are key issues in ensuring that people who obtain financial planning advice understand what it is that they are paying for. We do not have any philosophical objection to commission as such, so long as people who obtain financial planning advice think that they are getting value for money and understand what it is that they are paying for through that channel. There is a very common analogy used in financial planning advice, which is that of someone buying a car who walks into a motor dealership with the name of the manufacturer in big letters on the front of the dealership. That person clearly understands that there is a significantly high probability that they will come out of that dealership with a car from that manufacturer, be it a Ford, a Holden or a Mitsubishi.

There are many financial planning networks that are owned by substantial listed entities and other companies, and the motivation for owning these networks or dealerships is basically product distribution. They are sales channels. Often they will ultimately report to someone within the organisation whose title is head of, or general manager of, distribution. They are distribution channels and there is a reason for owning them. We think that although you may be able to find the link in the fine print, it is often difficult to pinpoint, even when you know what you are looking for.

Senator MURRAY—Mr Burns, yesterday I asked about nomenclature for financial planners; that in fact the nomenclature for them should include their status in ways which are understood

by consumers. I have not got a final view of it, but it might say franchisee or dealer if you are directly related to one company. It might say financial planner or agent if you are an agent for, say, three or four companies. I have asked a number of witnesses to come back with some views on a way in which people are more easily able to identify whether financial planners are a tied house, independent or whatever when looking at directories or shopping for financial planners.

Mr Burns—In response to the original question, we would regard it as a fairly small but simple step that if someone walked into a particular financial planning dealership, network or branch, they understood that it was clearly linked with a major brand name that they would recognise. Obviously there are structural issues with the financial planning industry in terms of independence of advice. There are many excellent financial planners out there doing a very good job indeed for people, but as we have seen from the shadow shopping exercises, that may not be universal. Clearly, in the minds of many consumers, there is a view that they are getting independent advice because they are going to a particular shop or brand, if you like, not understanding that there is a significant probability or potential that they will in fact come out with a product that is owned by the ultimate owner of that network or dealership. We have suggested that as a fairly simple and easy step to take that would at least help to identify in consumers' minds that if I come out of this place with product ABC, I understand why that is likely to be the case.

CHAIRMAN—This issue of fee-for-service versus commission has featured large in some of the evidence today and a little bit yesterday. Correct me if I am wrong, but my understanding is that the requirement on a financial planner is to provide advice in relation to a product that is appropriate. It does not have to be the best product available for that person. Is that correct? Is there a distinction between those two?

Mr Burns—I think there is clearly a distinction. Most if not all financial planners work from an approved product list. In order to get onto the approved product list, the product must meet certain criteria and go through a research process that says, 'Yes, this is an appropriate product for most of the people who will come to us.' Clearly, owning the body that creates the approved product list is a particularly useful way of ensuring that your own products achieve sales targets or are distributed widely. Certainly, you would like to think that financial planners will in all cases recommend the best product, but that may not be immediately apparent from the circumstances or the information that is provided. In most cases, the best that you could hope for is that the consumer will be recommended what appears to be the best product at that time and is appropriate for them. What is the best product is not always going to be entirely clear.

CHAIRMAN—If that requirement was changed from appropriate to best, would that result in any improvement in advice, or is that an unworkable definition?

Mr Burns—Perhaps you are not asking the right people. I am sympathetic with the financial planning industry as there are probably 10,000 products in which people can invest, and any financial planner has to be able to select some products. That implies that there has got to be a filtering process of some sort and the approved product lists are one way of doing that. The people who draw up the list have a challenge in evaluating all 10,000 products. If the approved product list is drawn up without bias then the products that are on that list should be very good, if not the best.

Senator SHERRY—Can I challenge you on that in the context of superannuation? I accept there are thousands of non-superannuation products and there is a valid argument for a product list. Given the context of superannuation, where we now have only 300 registered entities as a consequence of licensing, is a product list anticompetitive in a sense? Presumably a planner can now access the APRA database, examine the entrails—if we want to use that description—of any licensed superannuation fund in this country and examine the essential details from which to make a recommendation. Given that, would it not be better to do away with the product list in the context of superannuation?

Mr Burns—I think approved product lists originated for a number of reasons. One of them was undoubtedly regarding risk and compliance management, to make sure that affiliated planners were only selling products with which the ownership entity was happy. I think a clear reason was to make the planner's life easier and to cut out a lot of the work that would be required to go through that list of 300 super funds on a regular or frequent basis. Obviously, they could not do that for every customer that came in because it would be a very costly exercise. We would not regard the use of an approved product list as such as being necessarily a bad thing at all. Controlling the composition of the approved product list is always going to be a critical part of the process and how those lists are compiled is possibly one of the great unexamined parts of the industry.

Mr Anderson—The deputy chair raised the shadow shopping issue, where financial planners did not really look at the fund out of which the member was potentially coming. In the circumstances you are talking about, clearly if that particular fund was not on the approved product list, the financial planner should do some work to determine whether it is the appropriate fund for the member to stay in rather than move on. That is a slightly different set of circumstances to the one that you originally proposed: that there are 300 and the financial planner should evaluate all of those 300 funds and form a view as to whether they are appropriate or not.

Senator SHERRY—But I can go to the internet and access all these 300 funds now. Despite some possibly spurious claims in the past, you can identify quite readily the essential features on which to make a recommendation. I can do it; I do not see why a financial planner cannot do it. You are perhaps not the right people to take this issue up. But I suspect, given the evidence that ASIC have given us on this, there is some change in the wind on approved product lists.

CHAIRMAN—Am I correct in reading your submission that you undertake direct investment rather than investing in managed funds?

Mr Burns—Yes we do both. We have an internal investment team as well as external managers.

CHAIRMAN—Do members of your fund have a menu from which to select within the fund or do they simply invest the money in the fund?

Mr Burns—They have a menu to select from, which includes a range asset allocation options and specific asset category options, but all of those options are multimanager. In other words, every member who invests in the fund is getting a proportionate share of both the internal team's portfolios and external managers' portfolios as well. Our internal team—

Mr Anderson—Except for one product which is our SRI product, which has only a single fund manager.

Mr Burns—The internal team is effectively run on exactly the same basis in effect as if it were an external investment manager. Our asset consultant interviews the internal team, assesses their performance and tracks them against their performance objectives and benchmarks over long periods of time. We have a very firm regime over it.

Ms BURKE—Are you doing both defined and accumulative benefits under that regime too?

Mr Burns—Yes we are.

CHAIRMAN—Does that differ from other industry funds? Do other industry funds do much direct investment or are they mostly investing in managed funds?

Mr Burns—I think historically most of them have probably done external investment, but I believe that over the last few years there is a trend to have chief investment officers and some investment capacity in-house. There are a number of industry funds that have large internal investment teams but actually manage no money internally. There are a range of solutions and approaches out there.

CHAIRMAN—What do their investment teams do?

Mr Burns—They manage the external managers.

CHAIRMAN—They manage the managers!

Mr Burns—You are talking about very large funds which use possibly over 100 external managers across the world. It is a significant task.

CHAIRMAN—I note also that you are proposing that the sole purpose test be expanded. The particular example you gave was allowing disability and death insurance for people who have not previously been employed. I notice that APRA eventually allowed you to introduce that, but only for people who had been previously employed—is that correct?

Mr Anderson—Yes.

CHAIRMAN—Are there any other areas apart from that to which you would see the sole purpose test being extended? I do not know whether you want to pick up the issues that Senator Murray raised. I do not know if you were here when he was raising some other areas that he thought might be appropriate within the sole purpose test.

Mr Anderson—Yes, I did hear Senator Murray's and also Senator Sherry's comments about what is in and what is out. Moving aside the philosophical question, if the government said it was appropriate for something to be within its retirement incomes policy, our initial view as a fund would be to offer that product. That would effectively reflect our competitive position in the market. I accept the view of Senator Sherry that some of the things that are offered, such as

death and disability cover, perhaps should not be offered. It would certainly make life a lot easier for a lot of super funds if they were not offered.

CHAIRMAN—Can I just interpose there. From what Senator Sherry said, a lot of funds are offering death and disability cover.

Mr Burns—Yes.

CHAIRMAN—Given that, what was your difficulty in getting this approved—the fact that you wanted it to cover people who had not been employed?

Mr Anderson—Can I just go back one step. Usually, whether somebody is totally and permanently disabled is determined by whether in fact they can work. For somebody who has not worked, how do you determine that they are totally and permanently disabled? The products that are being offered by the insurers are: can these people undertake activities of daily living and so on? The initial approach to APRA was asking if we could offer this product to anybody. That was initially declined. On review, APRA then said it could be offered to people who had been employed at some time in their life. That is a question that we have to ask anybody—

CHAIRMAN—That was a little more relaxed than what perhaps others are offering, which is currently employed people.

Mr Burns—Yes. Could I just add one other thing.

CHAIRMAN—Yes.

Mr Anderson—There is a long history in superannuation; we have been a fund since 1931. Initially the benefits that were offered were defined benefits in the form of a pension. The structure of the pension was to make provision for somebody's family when they died or became disabled. If in fact you were starting afresh in the present market, you would perhaps adopt Senator Sherry's approach and say, 'Those things shouldn't be there,' but they are there at the moment.

Senator MURRAY—Providing you fall within the sole purpose test and providing you have true mobility and real portability, not notional portability—and I stress that area, so that people can choose between a fully serviced fund, if you want to call it that, and a no-frills fund or whatever they want—my view is funds should be free to devise products which might have all these insurances that fall within the expanded sole purpose test, as you have done, or they might have none. I do not think it is up to the legislator to say anything else but that there shall be a sole purpose test, which is that their retirement benefit should be there.

Mr Anderson—I am not sure how to respond to that, Senator Murray. Certainly the government has an interest in this in that it has put in place a compulsory superannuation regime. I am not sure whether it should be solely left to the market.

Senator MURRAY—Except that the government has not chosen to prohibit the insurances that are common. Those insurances have been deemed by the regulator to fall within the sole purpose test. I am not challenging the sole purpose test idea; I am simply saying that if under

that test the major retirement asset for a self-funded retiree is their house then having house insurance may well fall within that. It is not up to people to artificially constrain things that may be decided by the sole purpose test. Providing you have got genuine portability, people can choose not to have a fund with that and therefore potentially have lower costs and higher returns.

Mr Burns—Yes.

CHAIRMAN—In your previous response you indicated that if the government was of the mind to vary this, you would go out in the marketplace and offer the particular product. Are there any areas in the sole purpose test that you would like the government to amend so people could come within it?

Mr Burns—We take a fairly broad view of supporting members in their retirement income needs. We would certainly welcome the opportunity to expand into other areas that support members in achieving their financial goals over their life. Examples are health insurance, the ability to fund lifetime education and some mobility to use superannuation savings as security for other assets that would help cement long-term financial stability. Those are the sorts of things we would think about at a very conceptual level under that sort of regime. Certainly, we think in an overall environment where individuals are encouraged to provide for themselves for as much of life as possible, then expanding the range of services or features that superannuation funds can offer will provide a more competitive environment.

CHAIRMAN—I think some reference was made in your submission to the issue of member choice and the role and responsibilities of the trustee, the member and/or the financial adviser in the context of that choice being made. Can you just expand on your views. Where do you think the responsibility lies, particularly in the light of APRA's advisory guide?

Mr Anderson—Certainly we had a problem when APRA alerted us at a consultative committee meeting that they were proposing to change the circular along the lines that finally came out. I personally argued strongly against it, because it seemed to me to be inconsistent with other government initiatives such as choice of fund, people taking responsibility for their own retirement needs and so on. It is going to be fairly onerous for a trustee to be able to determine whether it is appropriate for a particular member to have all of their investments in Australian shares or not in Australian shares.

I quoted an example to APRA: when my mother went to see a financial adviser, his investment advice was, 'You need a diversified portfolio, so for Australian shares we'll put you in fund manager A, for fixed interest we'll put you in fund manager B and for property we'll put you in fund manager C' and so on. I really cannot see why that same approach cannot be taken with superannuation. Repeating Senator Murray's point of view, if all of the information is there, why can't a member pick the fund which is best in those particular areas and construct a portfolio to do it? They probably would require the assistance of a financial planner to do that. I must admit we have a difficulty with APRA's circular. We think the responsibility on the trustee is to provide a range of appropriate products from which to choose. Certainly if you have a default product, it should be a diversified product which gives a balance of risk and return. You should be able to offer other products.

Senator SHERRY—You would be fairly unusual in having self-insurance?

Mr Burns—Yes, we would be.

Senator SHERRY—Are there many funds that have that as a feature?

Mr Burns—I think any fund that has had a defined benefit history may well have some residual element of self-insurance. Clearly self-insurance does not fit well with the current regulatory regime.

Senator SHERRY—Yes.

Mr Burns—In our process to become a public offer fund, we had to go through considerable effort to convince the regulator that our self-insurance exposure was residual and would not grow in the future. There were options available to us if we wanted to continue to self-insure, but they were quite costly and administratively complex, which we did not think worthwhile.

Senator SHERRY—Regarding your comments about the cost of advice and paying for it, you argue on page 9:

A financial adviser preparing a full financial plan must consider all the assets and liabilities of his or her client. We submit that the whole cost of such a plan (pre-agreed with the member) should be able to be deducted from a superannuation account provided it is being prepared to support the retirement income needs of the member.

Is there a risk? I am not going to traverse the previous ground that you would have heard from me in terms of the sole purpose test, but is there not a risk in this approach? Given the costs involved, could it be a significant reduction in a member's account balance?

Mr Burns—It could be, Senator. There is no doubt that for many members the cost of a full service financial plan would be a significant proportion of the average superannuation fund account. Our statistics indicate that our members have a much higher average balance than the industry at large. Even with our members, we would find that only a relatively small number actually want to get a full financial plan. There is a much greater level of demand for a simpler financial advisory service, a base service or a call centre base service. To our knowledge, relatively few members want and go ahead with a very detailed financial plan. For members with smaller fund balances who wanted to get a full plan, there would certainly be some risk that it would be a significant slice of that asset, yes.

Senator SHERRY—Referring to your earlier comment about 'more limited advice', in your case, is that the area of greatest or most significant demand within the fund?

Mr Burns—Yes, it would be.

Senator SHERRY—How do you deliver that?

Mr Burns—It is one of the great challenges for us at the moment because we do not have a financial planning arm ourselves. We tend to have to send people somewhere else. We do have a relationship with a financial planning network that we think has the same ethos and motivation, and we can refer members there. We do have an ASIC licence that would enable us to offer personal advice, but we have never actually turned that licence on. We restrict ourselves very

tightly to general advice. Finding a way of providing general advice to members is one of the challenges that we currently face. Do you want to add to that, Barry?

Mr Anderson—I do not think I can say anything more.

Senator SHERRY—If you 'turned that on', would it be your intention to deduct the cost of that advice directly from the member's account?

Mr Burns—Preferably, we would be able to provide that option to members. We think that it would certainly be in the member's best interest to pay for the cost of the advice up-front, once and for all, rather than paying for it forever through trailing commissions. We think that would clearly be a better outcome for members.

Senator SHERRY—In terms of the inquiries you get from members of the fund, what are the areas in which they actually ask advice? Is it the level of death and disability insurance; is it investment options, what they should select?

Mr Burns—In terms of advice, it will generally be about what is the best asset allocation option and what they should be investing in. Most of our inquiries would be very much on the investment side. Even with our employers, the greatest level of interest and engagement with the fund is on the investment side of the fund. We would regard that as the most important thing that we do as a superannuation fund—investing members' money and returning it to them as and when they want it, successfully augmented.

Senator SHERRY—At the moment, how would you provide that advice? Do they go to your planning group with whom you have the relationship?

Mr Burns—Essentially, yes.

Senator SHERRY—What would be a typical charge for that?

Mr Anderson—I am sorry; I do not have the answer for that, Senator.

Mr Burns—The planning group with whom we have a planning relationship offer an initial free consultation, as many do. Then, if a member wants they can go on and get a full detailed plan on an up-front fee-for-service basis. Generally speaking, if a member only wants simple investment advice—we do not have firm statistics on it—the cost would be in the hundreds of dollars.

Senator SHERRY—It would be interesting if you could provide us with some examples. Can you also consider the ease, or lack of ease perhaps, with which this form of limited advice can be provided under FSR? Do you have any observations to make about that?

Ms Lui—There is an ability to provide limited personal advice under our licence, but we have not actually started providing that.

Mr Burns—Senator, the FSR has brought in a much tighter risk and compliance regime around what we or people in the call centre can say to members. Initially we rather light-

heartedly referred to it as the banning of all adjectives in communications with members. The FSR regime has certainly caused us all to put in place much tighter guidelines on scripts and on what anyone in the fund can say to any member at any time.

Senator SHERRY—In terms of page numbers, what sort of size are your disclosure documents?

Mr Burns—Our financial services guide would be—

Mr Anderson—It is about four pages.

Mr Burns—Our PDS is about 30 pages.

Senator SHERRY—Have you done any work on how many members actually read the PDS and whether they understand it?

Mr Burns—We could only go anecdotally on that, based on the sorts of queries that we receive from members. We know how many members, for example, have asked to see the risk management document that is available to members.

Senator SHERRY—How many is that?

Mr Burns—None we are aware of. It was prepared at great expense, audited and reviewed on a regular basis, and it is a very significant—

Senator SHERRY—Have you let APRA know that?

Mr Anderson—We have told APRA.

Mr Burns—Yes.

Senator SHERRY—I will quote it back to them at estimates next week.

Mr Burns—It is a useful discipline for the organisation to go through of course, but a member's benefit is another thing. Certainly, anecdotally we would be very surprised if many members read all the way through a PDS or even a financial services guide.

Senator SHERRY—When you send out the fund statement, presumably the annual report goes out with it. Have you done any work on the readership of the statement versus the annual report?

Mr Burns—It will be a lot less this year than in any previous year because statements are in the process of multiplying in length. We would get a spike in calls to the call centre after statements go out. Typically they will be factual queries about levels of insurance cover, how benefits are calculated and so on. In terms of the membership as a whole, it would be a small percentage of members. Our experience is that each member will call the call centre maybe 1½ times a year on average. It tends to be a small group of members who make a lot of inquiries. Our view is that a large group of members do not actively get engaged with the fund.

Senator SHERRY—I am asking these questions because you are the first fund that we have actually had today that can deal with some of these practical issues. Quickly going back to the advice relationship you have with that planning group, are they permitted to debit the cost of the fee advice on investment options against the member's account?

Mr Anderson—Not yet, mainly because we have not put the process in place to do it. We have developed the necessary authorisations and so on so it could be done.

Senator SHERRY—With what I can loosely refer to as the growing professionalism of trustees—the training and knowledge base of trustees today is very different compared to 10 or 15 years ago—do you see advantages and/or disadvantages in that as a consequence of the greater degree of regulation and licensing?

Mr Burns—I will ask Barry to comment on that one. He has had a lot of experience with the fund in the past days.

Mr Anderson—Certainly, one can only support the principles behind fit and proper policy. It is appropriate that the directors of a trustee company satisfy minimum standards and are appropriately trained. As you would have noticed from our submission, we have a structure where everybody is elected; in some cases we have directors who are appointed who then have to go through a very steep learning curve. We have an education program to train them up so that they do reach a satisfactory standard. A lot of the decisions that are made at the trustee board level, though, are really commonsense decisions, so if the average person understands what the language is about they can make a positive contribution to decision making.

Mr Burns—I would just like to add to that. We are obviously a competitive business in a very complex and dynamic industry, the financial services industry. We would certainly think that it is a positive advantage for our board to have members with experience and exposure to that industry. In the process of selecting a new chairman, who took on the role on 1 January 2006, one of the major criteria for the subcommittee of the board was to try and find someone who had significant experience and exposure to the financial services industry, which is a very complex animal to deal with. As management, that would also have been one of our goals, because otherwise the board is getting its view on this industry in which it competes—it competes with some of the biggest organisations in the country and some major international competitors; those are our competitors—solely from management, which we do not regard as a healthy situation for the board.

Senator SHERRY—Effectively, the position of chair from 1 January—I do not want to know his name; it is not important—reflects a more professional knowledge base of financial services, compared to, say, 10 years ago?

Mr Burns—Yes, that is the case.

Senator SHERRY—The other trustees are elected in a slightly different set of circumstances from most other funds. What you would do if you had a member elected who did not pass the PS146, for example? How do you deal with a circumstance like that? Democracy is fine, but there are now guidance notes on education training requirements.

Mr Burns—Even though we might require directors to obtain their PS146 accreditation, there are limits on what they can say to members and employers, and we remind them of that regularly. If a director went away to get their PS146 and failed to get it, then we would expect them to re-sit it until they actually passed.

Senator SHERRY—Finally, with regard to the size of the fund, increasing regulatory requirements, knowledge et cetera, have you got sub-committees as part of the trustee structure?

Mr Burns—There are four committees that report to the board. Two of them are fund committees—the investment committee and the appeals and review committee—and, effectively, they include members other than directors of the trustee company. Two other committees—the audit and compliance committee and the remuneration committee—are comprised solely of board members, so they are company board committees, if you like. In total there are four committees.

Senator SHERRY—So you have the ability to co-opt people who are not elected from outside onto the two sub-committees?

Mr Burns—Yes, onto the two fund committees. For example, the investment committee does bring in people from outside the organisation.

CHAIRMAN—Following on from what Senator Sherry was asking in relation to corporate governance, I note that you sought to increase the size of your board by adding some independent directors. Apparently APRA were not favourable to that. Can you perhaps enlighten us as to their reasoning, if they gave any reasoning for it?

Mr Anderson—The board was very aware of its obligations under APRA's fit and proper policy. It has a meeting once a year when it considers these strategic and philosophical issues. In preparation for that meeting, we thought that the board should perhaps consider reducing the number of elected directors and replacing them with independent directors so that particular expertise was brought to the board. You may be aware that APRA had approved a change to the trustee of HOSTPLUS. It had three employer directors, three member directors and three independent directors. We asked APRA if that was a model that we could consider, and their response was: 'You can't take that as a possible reference point—that APRA would approve that structure if you were to come to us.' We felt that, if that was APRA's approach, then perhaps the board should be thinking about doing other things.

Senator SHERRY—I am a bit confused. Were they saying yes or no?

Mr Anderson—They were saying, 'Just because we've approved it before, don't think that we are going to approve it again,' because HOSTPLUS had particular problems.

Senator SHERRY—Yes, that is right. I am aware that, at least in some cases, APRA have suggested as part of the licensing process that some funds should have independent directors. I am just a bit puzzled as to why you met a non-committal response with respect to your proposal.

Mr Anderson—Since then we have actually raised this issue with Treasury and they have said, 'You should go back and ask APRA again; they might change their view.'

CHAIRMAN—Given that your board is currently half elected by all the members and half appointed by the employers, what would have been the means of appointing the independent directors—the board itself?

Mr Burns—The process would have been for the board to form a sub-committee to look for directors with appropriate qualifications and experience.

CHAIRMAN—And then the board itself would appoint them?

Mr Burns—The board itself would appoint them on a contractual basis.

CHAIRMAN—They would not be subject to election in the future?

Mr Burns—No.

CHAIRMAN—They would appointed by the other members of the board?

Mr Burns—Yes.

CHAIRMAN—It has been suggested to me that, more broadly, industry funds should have an independent chairman, which you have.

Mr Burns—Yes.

CHAIRMAN—What is your view of that—that rather than a chairman being appointed according to the particular constitution of the fund, which can vary, there should be a requirement for an independent chairman of industry funds?

Mr Burns—I am not sure that we would have a view on that, other than what we might think personally as individuals. Certainly we have an independent chairman and we think it has worked very well for us.

CHAIRMAN—You indicated your view of the importance of the fit and proper person test a few moments ago when discussing it with Senator Sherry. Do you see a need to raise the bar, as it were, for that test or do you think it is high enough at the moment?

Mr Burns—It is early days in the application of it to superannuation—certainly in our experience. Fitness and propriety are assessed separately. The propriety test is obviously an individual one under our established procedures for determining that a person is proper to serve on the board. I think that is fairly routine and straightforward. The fitness test applies to the board's overall skills. We would imagine that there will be an increasing trend to look at the abilities and qualifications of individuals to meet that fitness test. We would generally expect that that bar will probably be raised higher over time.

Mr Anderson—I would like to add one extra comment. Currently two of the directors on the board are directors of listed public companies. The four member directors all have superannuation qualifications, so it is not as if these people are just off the street. The interesting thing about the election that we are currently running is that about one third of our members are

semi-retired or retired. There are a number of retired company directors. Some of them are standing in this particular election. There is quite a range of candidates from which the members will be able to choose, some of whom are very well qualified.

CHAIRMAN—Does the board make recommendations as to who should be supported?

Mr Burns—No, it does not—not at all.

CHAIRMAN—You do not operate like a public company in that regard?

Mr Burns—It is slightly different.

CHAIRMAN—With regard to your suggestion that the twin peak structure should be changed to a single regulatory body, could you perhaps enlarge on that? Obviously there are some problems of overlap and so on with regard to the current administration between those two bodies, but equally, if you look at the UK model, there have been some problems with the unitary structure. Do you think that moving to a unitary structure would overcome those problems?

Mr Burns—Yes. We are not sure that a unitary structure would overcome all problems. We were looking at it from the angle of the two different approaches and the inconsistencies between the two bodies with which we have to deal. There is also the expense and management effort that is required to deal with two completely different regulatory bodies. Our view is simply that, philosophically, if you were designing the system from scratch, we would suspect that one body would have to be more efficient than two.

CHAIRMAN—This was designed from scratch, though.

Mr Burns—I will take that back in that case.

Mr Anderson—I would like to add an additional comment. The approach taken by the two regulators is quite different. At APRA, for example, there is one particular staff member who oversees Equipsuper and is very familiar with our design, and so on. At ASIC, if an issue arises, it could finish up with any analyst. We have about 90 different product designs. If you are talking to the ASIC analyst and it is a different one from the one you spoke to last time, you have to remind them, 'Hang on, we're just talking about this one particular product design that is an issue.'

CHAIRMAN—That is all the questions that I have. Any further questions Senator Sherry?

Senator SHERRY—No.

CHAIRMAN—Thanks to each of you for your appearance before the committee and for your assistance with our inquiry. It is much appreciated.

Mr Burns—Thank you for the opportunity.

[4.58 pm]

SILK, Mr Ian Scott, Convenor, Industry Funds Forum; and Chief Executive Officer, AustralianSuper

HEWETT, Ms Helen, Executive Officer, Industry Funds Forum

WATSON, Mr Paul, Deputy Executive Director, Superannuation, MTAA; and Executive Committee Member, Industry Funds Forum

CHAIRMAN—I now welcome the representatives of Industry Funds Forum. The committee prefers that all evidence be given in public, but if at any stage of your evidence you wish to give evidence in private you may request an in-camera hearing of the committee and we would consider such a request. We have before us your submission, which is numbered 73. Are there any additions or alterations you wish to make to the written submission?

Mr Silk—Not to the written submission, no.

CHAIRMAN—Mr Silk, you wanted to make a comment before you go to your opening statement?

Mr Silk—Indeed. The comment was simply that given that some of your numbers have had to move away, and given the hour, if this is going to be a truncated session, we are very happy to adjourn and appear before you in Canberra on the 20th. Alternatively, if you want to proceed now, then we are equipped to do so and expecting to do so. We are in your hands there, but we are happy to offer you that option.

CHAIRMAN—Thank you Mr Silk. Senator Sherry what do you think?

Senator SHERRY—I do not want to show any disrespect for the witnesses. I am happy to go until midnight.

Mr Watson—Unfortunately, Senator, you will sympathise that I have to be on a flight to Canberra tonight for a commitment there first thing in the morning.

CHAIRMAN—What time is that?

Mr Watson—That would require me to leave in about 40 minutes. That does not mean that my colleagues would be unable to continue.

CHAIRMAN—I think we can proceed, and if other members of the committee have any issues that they want to address with you in the light of what subsequently appears in the *Hansard*, we could then perhaps recall you in Canberra.

Mr Silk—Thank you. I might make a brief opening statement. I will begin by thanking the committee for receiving our written submission and giving us the opportunity to appear today

and answer any questions in relation to our submission or any other matters that you might raise. We have provided a 50-page submission and we would just like to highlight a couple of brief matters that were contained in that submission, before responding to any questions.

Firstly, we see no need for a change in the capital adequacy rules as they currently apply. We are also interested to observe that that seemed to be the overwhelming view of most of the other parties that made a submission on that particular term of reference. We see no overall benefit in requiring all trustees to be public companies. Again, we note that that seemed to be the overwhelming view of those parties that made submissions on that term of reference.

In relation to financial advice, we note the obvious point that quality financial advice directed to the best interests of clients is a positive thing. We also submit that commission remuneration imposes a conflict of interest on planners that is incapable of being managed and can only be effectively addressed by removing it. We believe that commissions should be banned from compulsory superannuation guarantee contributions. We also believe that financial planners should have a legislative obligation to act in the best interests of their clients. Many planners do that now, but we cannot think of a good reason why there should not be a mandatory obligation on all planners to do so.

My final preliminary comment is in relation to advertising. The cost of advertising is a legitimate operational expense of a superannuation fund. All operational expenses are ultimately borne by the member or the consumer. A choice of fund environment requires funds to be able to advertise their wares, particularly to their members.

CHAIRMAN—Thank you, Mr Silk. With regard to the issue of whether trustees should be required to be a corporation, while that seems to be the general view, other views have been expressed in evidence that there should be greater disclosure requirements on the part of certain trustees than is currently the case. We have heard from some witnesses that the disclosure requirements that apply to corporations should apply to the trustees of superannuation funds. Some witnesses believe that that is already the case. There seems to be some difference of view on this. What are your views on that particular issue?

Mr Watson—We are of the view that there is no obvious advantage to members of superannuation funds that are governed by trustee structures to be public companies as opposed to their current structure. That view is largely borne from an examination and therefore a conclusion of the consequences of Corporations Law, the SI(S) Act and trust law. We would argue that superannuation trustees, particularly in relation to industry funds, are more highly governed on their range of those duties than public companies who do not have the obligations of trust law, the SI(S) Act and related legislation.

The bar has been set quite high for trustee boards, particular after the introduction of the registrable superannuation entity—RSE— licensing requirements. For instance, a public company is not subject to the fit and proper requirements that a trustee board is under RSE licensing. We would argue that that is a higher bar and a higher test. When an institution is charged with the responsibility of investing other people's moneys for their retirement incomes, the higher tests are welcome and quite proper. Unfortunately, I have not heard the previous evidence given to you today or yesterday. I am not sure what other matters have been put to you

in relation to a higher prerogative or test under a public company structure, but I am more than happy to respond to elements of that suggestion as you might put to us.

CHAIRMAN—Do you think the current fit and proper person test is set at an appropriate level or is there room for improvement? Should the bar be set higher?

Mr Watson—To take that in a reverse order, there is always an ability to improve regulatory structures and prudential regulations. Having said that, we have just come through a two-year transition period of RSE licensing in superannuation in Australia. They have gone through a very thorough and very investigative process with APRA to ensure that they have been able to warrant to the regulator to get a licence. They have brought into existence a very formal policy for their board in terms of fit and proper. Many boards going through that exercise have actually undertaken skills gap analysis, external review and other mechanisms to ensure that they have been able to warrant to the regulator that they are collectively fit and proper and, individually, that they are people who take their responsibilities and prudential onus of being a trustee most seriously. Emerging from the RSE process, I would say that it is presently at an appropriate level.

As with many things, I suspect there will be a period where there will be a bit of a post-implementation review done by the regulator to see if the standard in the test is sufficient—is it too prescriptive or not prescriptive enough? Quite clearly, industry welcomes working with all the stakeholders in ensuring that the prudential level of safety and comfort for members is the right level.

CHAIRMAN—One of the issues raised in this context—it was probably also in the context of the terms of reference regarding the concept of not-for-profit and all profits going to members—was service providers in superannuation funds and whether there was sufficient transparency in the decision-making process that lead to a particular service provider providing those services. I think the Financial Planning Association was one of the bodies that raised this issue yesterday. Industry Fund Services Pty Ltd provides services to a lot of industry funds and is in fact owned by a number of those funds. What is the process by which service providers are appointed? Is it put out to tender? Is it done on a cost efficiency basis? Given the fund is owned by Industry Fund Services, does that give the particular service provider a leg-up in terms of its ability to get that work?

Mr Silk—The short answer is that Industry Fund Services do not have a leg-up by virtue of the ownership arrangements that might apply to them. There are a number of reasons, but foremost is that trustee directors of industry funds have a legal and a moral obligation to act in the interest of members. If they were to appoint a higher cost or lower quality provider to provide a certain service when a lower cost and/or better quality provider was available, they would be failing in those two duties. In almost all areas in which IFS is involved by way of service provision to funds, there is a formal tender process or some other form of transparent process aimed at eliciting the best outcome for members. For the FPA or anybody else to raise it is quite ridiculous. Frankly, if they have evidence of that we would be delighted to see it tabled and we would be able to successfully challenge it. We can say that with some confidence. Raising falsehoods, rumours and innuendo does not serve anybody's purpose. If they have got the evidence, fantastic; table it and we will address it.

Senator SHERRY—On this issue, isn't it true that as a result of the RSE licensing process, APRA have issued guidelines and checked off against the guidelines in this area as part of the just completed licensing process?

Mr Silk—That is right. The licensing guidelines have a number of key elements, one of which is outsourcing provisions. These provisions are complied with by industry funds. There are a number of elements in the terms of reference and from what we heard second-hand that have been raised by various parties in the last day and a half. We are happy to respond to any that are put to us by the committee today. In a sense, the proof of the pudding is in the eating. A number of these issues are inputs or process matters. We invite the committee to take account of those because they are important, but frankly less important than the outcome. As far as the industry funds are concerned, the runs are on the board.

SuperRatings, the independent ratings organisation, has just released data identifying the top ten performing balanced funds for the five years to the end of August 2006. Each and every one of them was an industry fund. I can point to any number of ratings organisations where the overwhelming majority of the highest awarded funds are industry funds and I could go on and on. In relation to the matter that you have just raised, those results could not be achieved if the funds were making inappropriate choices in relation to service providers or, in some other way, they were delivering suboptimal outcomes for members.

CHAIRMAN—I take what you are saying, Mr Silk, in terms of balanced funds. I am just looking for the quote in the submission that addressed one of those issues. I accept comparing balanced fund with balanced fund, obviously the analyst would be correct in that. I will read to you one of the assertions or claims made in Financial Planning Association submission. They are talking about the importance of advice being given to members and say:

By way of comparison it is interesting to look at several of the large industry funds, REST and HOSTPLUS 5 where they disclose that 99% of members are invested in their default or balanced option, due to the apparent absence of individual advice. Whilst in the current market returns on these funds have been quite good it must be suggested that at least a percentage of those members would have been better off having received advice and placed in less conservative strategies such as Australian share funds or emerging market funds where returns have been up to 50% higher in the current economic environment.

The issue they are raising is that if you compare default funds or balanced funds with balanced funds, industry funds shape up very well. But if members were getting advice they may have invested in funds that were perhaps a bit more aggressive in their investment strategy and have done significantly better. What is your response to that?

Mr Silk—I think it is a pathetic intellectually bankrupt argument. In the last 12 months Australian share options typically went up about 24 per cent. That is the percentage the market went up; some managers did better, some worse. If you had invested in the Australian stock market exclusively in the last 12 months you would have done better than a balanced fund. To point to one or two instances and say, 'If they'd invested in the best performing options they would have been better off'—of course, with the benefit of hindsight. I would be much more impressed if they said, 'We think they should invest in an identified option for the next 12 months and we're sure they'll be better off.' That is the first point.

The second point is that REST and HOSTPLUS are unusual funds in this important respect—that is, the vast majority of their members are very young people. For many it is their very first job and they are part-time and casual workers. They earn modest incomes. Nine per cent of a modest income is a modest superannuation amount accumulating in your early 20s or so to a modest superannuation balance. Under those circumstances, most people do not have a great engagement with their superannuation. I think we all know that is true of the general population, but it is certainly true of young people who are decades away from retirement and who have a very small amount of money in superannuation. To expect that most of those people would seek out a financial advisor is simply unrealistic.

The final point is that the trustees of both those funds are very mindful of the composition of their membership and have put a lot of effort into determining the default option, knowing that many of their members will go into that option. The investment performance of the default options of both those funds has been very good. If you see all of that in totality, those funds have served their members interests particularly well.

Senator SHERRY—Are you aware of the FPA's claim, 'apparent absence of individual advice'? Do either REST or HOSTPLUS have a contracted relationship with a planning provision provider?

Mr Silk—HOSTPLUS have an arrangement with Industry Funds Financial Planning network. All of their members have access to a bank of salaried financial planners. I am not sure of the full scope of REST's financial advice, except I know they have one very innovative element—that is, limited personal advice can be provided to people who call a call centre and they are patched through to an organisation called Money Solutions. They may well have an arrangement with a full service provider, but both organisations expressly provide and advertise to their members the availability of those respective services.

Ms Hewett—I will add that a lot of balanced funds are very different. If you have a look at the asset allocation, you will very often find that a significantly higher proportion of assets are growth assets in one rather than in the other. If you look at both of the balanced funds REST and HOSTPLUS you may well find that that is the case, because of the profile of their members.

CHAIRMAN—Where do you think the line should be drawn between the relative responsibility of the trustees and the member, as promulgated by APRA, in the member choice situation? Do you accept what APRA has promulgated or do you think there are difficulties with that that need addressing?

Mr Watson—This is a particularly difficult one for superannuation funds and trustees in particular—and I have heard the evidence given by the previous witness. In a similar way, the APRA circular that goes to this point runs against the grain of the tenet of superannuation law that says that a trustee is responsible for formulating and giving effect to an investment strategy that has regard to the whole circumstances of the fund. This includes risk and liquidity and a range of other things. The APRA circular suggests that in a regime of choice and, to use a coined phrase, consumer sovereignty, a trustee might veto or trump a member's request to have an investment strategy that is different to what might otherwise be universally set by the trustee for the fund. This puts trustees in a very difficult position in terms of knowing or understanding where the regulator stands on this in prosecuting or promulgating the law.

On the one hand they have a SI(S) Act duty to formulate and put into practice an investment strategy. If a member comes and says, 'I would like to transfer from that to an alternative strategy,' then, if we are truly in a member choice environment in terms of an individual strategy, they need to get appropriate advice in formulating what is good for them as an individual. It puts the trustees in a very difficult position if a circular suggests that a trustee's obligation in terms of the universal structure of the investment strategy should override a member's choice as it exists within the framework of what is being offered by that particular fund. If there is an investment strategy that does not suit the member at all, that is where the choice of fund regime really comes into play. That is a home pretty much for everyone, depending on their risk and return profile and what they are seeking in terms of their retirement investments—whether that is industry funds, retail funds or self-managed superannuation funds. This is a tenet of our submission and an area that needs quite close examination, because it is a very difficult crossroad for trustees in what they are being asked to do.

CHAIRMAN—Have you taken this issue up with APRA and, if so, what has been their response?

Mr Watson—Yes, I understand that quite a number of funds have taken in up with APRA and that they are alive to the issue. As to what is being considered internally in terms of that circular being reviewed or looked at, I could not answer that.

CHAIRMAN—Can you give your view as to why you regard full disclosure of commissions as an inadequate solution to what you see as the potential for conflict of interest for commission based advisers?

Mr Silk—Fundamentally, that is because the evidence that we have seen most recently in the ASIC shadow shopping report reveals that consumers—who at the end of the day should be the prism through which we look at these issues—are unable to understand, in some instances, that commissions apply and, in many instances, the impact of those commissions. That is the fundamental test that we apply: what is in the best financial interests of members and what is in the best comprehension interests of members? We struggle to see a basis upon which you could support commissions, rather than run around with some difficulty trying to find arguments to support them.

Senator SHERRY—I will raise two possible changes that may improve the position, and I would be interested in your response. In my view you are correct in your observation that members are generally unable to understand the impact of commissions and to identify their impact, et cetera. Given the current FSR disclosure regime, do you believe that in a very much simpler FSR disclosure regime circumstances would significantly improve?

Mr Silk—There is of course a tension between the two competing considerations, disclosure on the one hand and protection of the individual on the other. We would prefer a more consumer-friendly FSR regime. That does not necessarily indicate, as some of the submissions to the inquiry would have it, that the disclosures currently provided should be stripped away and, to put it baldly, that people have a much reduced amount of paper to read. We would argue that the objective should be that important information should be prominently and comprehensively displayed to members rather than start from a proposition that we should get this down onto half a page of paper.

Senator SHERRY—So, for example, in the case of disclosure of fees, having it in red or highlighted on the first or second page would be an improvement on it being X number of pages through the document?

Mr Silk—Indeed. This comes back to the point about consumers being at the forefront in consideration of an issue such as this. I know that ASFA has done a lot of comprehension testing in this field. It really should be an obligation on the regulators that are introducing any new mandatory documentation, in particular that which is directed at consumers, across the industry to do some consumer comprehension testing to validate the assumptions that might be made about whether or not people can understand it and make the right judgements.

Senator SHERRY—The other possible change that I was going to raise with you is that most commission based selling is dial down. I am not sure how many consumers actually know or utilise that. You may be aware of some data on this. I have certainly been pursuing it with some other organisations. If it was in fact dial up rather than a dial down, so the product price was the basis and then the planner had to argue or bargain for their add-on fee, whatever that might be, do you think that would lead to a significant improvement?

Mr Silk—It is certainly a better model to dial up than to dial down. There would need to be a lot of consideration given to the actual operation of that model. Whilst it is theoretically a better model, if it operates de facto as a dial-down situation in the privacy of an adviser-client discussion, then of course that does not progress it very far at all. The notion of the product having a cost or a fee attached to it and then, quite separately, a cost or fee attached to the provision of advice is a good model.

Senator SHERRY—That brings me to my next question, which I raised with some witnesses earlier. It seems to me that the cost of the current commission based model mixes up two essential costs: the actual cost of what I would term legitimate advice and the cost of selling the product. I am not sure where you could practically separate those. Do you have a response to that?

Mr Silk—I think you can separate them. Industry funds separate them quite effectively. The Industry Funds Forum members standard fee model for industry superannuation funds operates on the basis that there is typically an administration fee which covers a range of issues including sales—for want of a better term, as you posed it, Senator—then separately access to financial advice, which is usually paid for entirely independently of the sales and other costs associated with being a member of the fund.

Can I make a general point by way of clarification; hopefully it will be well understood by this committee. Some of the comments that have been made in recent times about the industry funds, in particular the Compare the Pair campaign, have sought to position industry funds as being critical of financial advice and/or financial advisers. It goes without saying that good quality financial advice is a positive benefit for members. Our beef is not with individual financial advisers and it is certainly not with the provision of quality financial advice. Our beef is with a remuneration structure which can serve no other purpose than to create a conflict between the interests of the provider of that advice and the recipient of that advice. It is not about advice and it is not about advisers; it is about the remuneration model.

CHAIRMAN—On that point, can I take up the current advertising campaign that claims that industry funds pay no commissions. It has been presented in at least one submission to us, and it is now acknowledged, that perhaps some funds do pay commissions. How do you see that in the light of the advertising? On the surface it would appear that that advertising campaign is in fact misleading.

Mr Silk—There are 17 funds that participate in the industry funds' marketing campaign, as it is called. There is the Lifetime of Difference campaign and the current iteration—the Compare the Pair campaign. It is true to say that none of those participating funds pay commissions at all on any product or in any guise. So I can expressly address the issue, can you tell me whether these funds have been identified to you by name?

CHAIRMAN—One has: Health Super.

Mr Silk—I know this for certain, they are not a member of the Industry Funds Forum, the broader group that the three of us are representing today. So the comment I make is not in a representative capacity. I have read that commission is paid on a post-retirement product of some sort, but they are not one of our members.

CHAIRMAN—If that is the case, why did Mr Garry Weaven, the chief executive of IFS, who I understand are running the campaign—

Mr Silk—They are facilitating the campaign.

CHAIRMAN—In response to this issue he is quoted as saying, 'We're quite happy for it to be taken as a broad brush understanding of these funds, because if there are one or two exceptions it doesn't change the main message.'

Mr Silk—I do not know whether he said that or not; he has not expressed that precisely to me. All I can say is that Health Super is not—

CHAIRMAN—He was quoted as saying this in an IFA article.

Mr Silk—Again, he has not expressed that to me. All I can say is that Health Super is not a member of the Industry Funds Forum. I understand that in relation to its main retirement accumulation part of the fund, it does not pay commissions. As reported, it may pay commissions on some of its post-retirement products as opposed to its superannuation products per se, that being money that is accumulated in a person's working life.

CHAIRMAN—Do you think that Mr Weaven is brushing aside the issue without taking it seriously in that response? Why not give the response that you gave—that none of the funds involved in the advertising campaign do in fact pay commissions?

Senator SHERRY—We should ask Garry that one.

Mr Silk—Senator, you have been in public life a long time and I daresay he did not give a one-sentence response to the journalist. He may well have put it in the appropriate context, but I

think somebody might have been trying to make a bit of mischief there. When seen in the full context, as I have hopefully portrayed it today, the facts are readily apparent.

Mr Watson—This is also a campaign that has undergone the scrutiny of ASIC and others at various times, in terms of its factual content, and it is well on the record as having been passed as fit.

Senator SHERRY—Have you observed the recent ads being placed by the FPA? It appears to have been so successful in its thematic approach that the FPA has decided to copy it.

Mr Watson—I am not quite sure.

Senator SHERRY—There was an ad in the paper I read on the weekend.

Mr Watson—There should have been a little 'c' under Compare the Pair. It is a very powerful tagline indeed. Yes, I have seen the ads.

CHAIRMAN—Yesterday one of the witnesses acknowledged that there were probably elements of cross-subsidisation in commission based advice. The commission paid by lower net worth individuals was being cross-subsidised by commissions paid by higher net worth individuals. In a sense, if you remove commission based advice and replace it with fee-for-service, those lower net worth individuals will not be able to afford significant advice. What is your response to that?

Mr Silk—We are critical of commissions being paid on compulsory superannuation guarantee contributions and have called for the abolition of those payments. We are conscious that that is one side of the story, but does it leave a void and, if so, how is that best filled? Our submission proposes a limited form of access to a member's superannuation account for the provision of financial advice related to their superannuation benefits. Importantly, it has some conditions attached to it so that it is not open slather. The model for people who do not have access to cash to pay a financial planner up-front removes the argument that the removal of a commission based arrangement would leave a range of low-income people without access to financial advice. Frankly, it has very little validity.

Let us not forget the fundamental point we make—that is, financial advice provided by a commission based planner is likely to be tainted by the conflict of interest inherent in the commission structure. If we are saying that a commission based structure is fundamentally flawed and that the advice emanating from it is likely to be tainted then it is not a bad thing that a person actually misses out on that advice.

CHAIRMAN—What if commissions were allowed, but they were legislated to say that they had to be a flat rate across all funds. In other words, one fund could not pay a higher commission than another fund. The remuneration would be by commission, but there would be no personal benefit to be gained by the adviser for advising one fund against another.

Mr Watson—I am not sure that this is really going to assist or get to the nub of the problem. I thought ASIC wrote something powerful in its 2006 report:

It is clear from the survey that there was a higher risk of inappropriate advice where either the advisor received commission-based remuneration or the advisor recommended a product from an associated company. While disclosure is a critical part of consumer protection, this survey suggests that it can only play a limited role in protecting consumers from inappropriate or conflicting advice.

I say that in the context that I do not think better confessing the sins, so to speak, is going to give us a better model. I think we have actually got to look at the underlying root of the problem.

CHAIRMAN—I was not suggesting—

Mr Watson—If commissions were all a flat base, the model that Ian has just described that we are advocating is that members can pay for the advice that they need. Quite often this is advice that is not about very complex estate planning or testamentary trusts, it is about simple things. For example: 'My employer offers salary sacrifice—what is it, should I avail myself of it?'; 'Member investment choice—should I look at something different from the balanced option?' These are the fundamental financial issues that play on our particular members' minds. They can get very comprehensive advice from a salaried adviser on these issues for a very modest fee—several hundred dollars—and with no continual trail involved or a commission, a clipping of the ticket.

Whether it is a basis point fee on commission on money going into a fund or someone is able to avail themselves a modest amount from their superannuation account for the specific purpose of getting advice on how to best structure their super, we say that paying for it in fee-for-service dollars is a far more appropriate and transparent model than the commission based model.

CHAIRMAN—Going back to the shadow shopping, you referred to one of ASIC's criticisms being advisers tended to put clients into funds that they represented.

Mr Watson—There was a tendency towards that.

CHAIRMAN—I find it strange that ASIC raised that as an objection. I would have thought if you go to an AMP adviser, you would be expecting that they would be advising you on AMP funds. The same as if you went to a Holden dealer you would expect they would advise you to buy a Holden, not a Ford—as distinct from going to an adviser who is not tied to one.

Mr Watson—That is certainly quite okay. Quite naturally the adviser will be very au fait with their own in-house products. But my understanding is, particularly with regard to the recent issue AMP had with ASIC and the enforced undertaking that came from that, in getting to that result it had to be determined if there was a more appropriate product. It had to be determined, to use that analogy, whether the grass greener where they were standing already as opposed to what was being advised to them. ASIC tended to find that, with regard to the advice, all of the independent elements of what was in the best interests of that particular member may or may not have been carried out. As the product list happens to be slightly weighted towards in-house products because of the knowledge and in-house research done, I am not sure whether that means that that is necessarily the best product for the person in front of them.

The other reason we would prefer the model we are advocating is that it allows people to engage a salaried adviser of their choosing who they believe provides a level of independence

they want and with whom they are comfortable. If that person is owned and tied to an institution, so be it. If it is a person who has no ties and is strictly independent of any service provider or manufacturer, again, we would advocate that that is probably the better model.

Mr Silk—The Holden-Ford arrangement is often raised in this context. If you go to a Holden dealer, you are expecting to be sold or have entreaties made to you to purchase a Holden vehicle; if you go to a financial adviser, in most cases, you are expecting some broader view of the world than one line of products. If that is not the case and the building is emblazoned with the sign of a particular provider, there are posters in the room and the person says, 'I'm delighted you're here, you realise of course that I work for X and I'll be seeking to sell you X products', well that is pretty close to the Holden arrangement.

CHAIRMAN—That was the situation to which I was alluding, where you go to an AMP branded—

Mr Silk—It is not just that you go to AMP; it is unmistakably a case of an AMP salesperson seeking to sell you AMP products. If you go there with that clearly in your mind as the consumer, then fair enough. But most people go to financial advisers expecting a breadth of options to be provided for them, because it is their interests that they are expecting to govern the transaction, rather than the interests of the adviser or of AMP, to use that example.

Senator SHERRY—We had a bit of discussion about this issue in the context of the recommended product list. Do you believe that that is now relevant, given effectively it is a restraint of trade? A planner cannot recommend anything that is not on the product list and the product list, by very definition, is selected by the providers who provide the product. It does not include a range of types of funds. Do you think it is relevant, given that you can now access via the internet information that is required for planning purposes for any of the 300 registered funds?

Mr Silk—I think that argument might have had some credence 10 years ago, but it has next to no validity now. There might be reasons why certain types of funds are not on a recommended list, but you cannot credibly say it is because we do not have access to information or we do not know where to obtain the information. That is just a nonsense.

Senator SHERRY—That is the argument that is seriously advanced by some people who argue that industry funds should not be on a product list, because they cannot get the information.

Mr Silk—I think it is well known that AMP put a dozen or so industry funds on a list a couple of years ago and removed them with some fanfare earlier this year. In a sense, the removal of the funds was probably the most transparent part of that whole process because of course the funds were not promoted much, if at all, by the advisers. When AMP removed them, they said it was because they did not have sufficient information about the funds. Of course that is a complete nonsense. We know why they did it and that is fair enough in the current environment. To state it was because there was insufficient data available is palpably incorrect.

Senator SHERRY—Presumably their compliance people should have been sacked for putting them on the product list in the first place.

Mr Watson—I think those funds were on the list to the extent that they were on watch or on hold—I am not sure of the correct term. They gave the planner a capacity to know enough about the fund to suggest there might have been an alternative that was better, but not to actually recommend the fund as a product in which to invest.

Ian mentioned earlier that there are now a number of independent research companies in Australia that quite thoroughly research industry superannuation funds. Their research is available both commercially and publicly in various forms. Published research by these companies shows that going back one, three, five, seven, even 10 years, industry funds are predominant in the top 10 consistent returning funds over those periods. For product lists to contain none of those funds—none—is rather questionable in terms of wondering whether the research being done by those particular entities is thorough enough.

Senator SHERRY—Can I just raise a practical issue about your proposed prohibition ban on commissions on the nine per cent superannuation guarantee? We do know that there are a substantial number of people, not primarily higher income, who make additional contributions to superannuation.

Mr Watson—Yes.

Senator SHERRY—It is about one in eight who make co-contribution payments and—again, it is hard to get data on this—there would be a significant number of middle-income earners who salary sacrifice. If you had a ban on commissions on the nine per cent superannuation guarantee, would the response of a planner simply be to jack up or apply a commission to the voluntary additional contributions to collect the same level of commission?

Mr Watson—One would hope and expect that if that was to occur, the market would very quickly sort them out in terms of the fees being charged for that advice. It certainly is a live risk and an issue in terms of loading up the spectrum of the person's voluntary or discretionally contributed superannuation, be it superannuation guarantee, award or whatever. If the element of the mandated superannuation under advice was prohibited from having commissions applied against that, one would think that it would be a very complex model to charge in discretionary pieces for that advice. That would hopefully accelerate a move towards a more transparent fee-for-service across the whole gambit of money under advice.

Senator SHERRY—You may not be aware, but I think one of the last Senate select committee reports on the co-contribution unanimously recommended a prohibition of commissions on the co-contribution. And that included the Liberal members of the committee.

Mr Watson—Yes, I agree with all that.

Senator SHERRY—I have a couple of other issues quickly because I am aware of the time. Going back to the issue of capital adequacy, in the Australian system there is a compensation provision up to 90 per cent in the event of theft and fraud. Effectively that is safeguarded if the worst happens and fortunately it rarely happens. Secondly, we have the DC system, where the member bears the risk in terms of the variable rate of return, whether it is in the default or the investment options. Why would we need capital adequacy in those circumstances?

Mr Watson—One of my colleagues will answer as I will have to leave at this point. I do apologise. I will be spending a very lonely night somewhere on the Tullamarine garden beds otherwise.

CHAIRMAN—You are excused, Mr Watson.

Mr Watson—Thank you, Chairman. Thank you very much.

Mr Silk—We agree with the preamble to the question and it buttresses our argument that the current arrangements for capital adequacy are sufficient. There are a whole range of new elements in the regulatory regime that have been introduced through the APRA licensing process, all of which were specifically directed to enhancing the security of members' savings. Whilst it was a major task for all of those funds that acquired a licence to acquire the licence, I think it is unarguable that the safety of the system has been enhanced by that process and the security of members' savings within that system has been improved. We think the current arrangements in relation to capital adequacy are appropriate and there should not be a need for changes to the system that are implied by the term of reference.

Senator SHERRY—Mr David Knox, who appeared earlier this afternoon and I think wrote the submission for Mercer, held the same view and drew our attention to the fact that where there was an event that required some special expenditure—for example some unforeseen collapse in the computer system, it could happen—that required a significant and quick injection of funding, the best approach would be for a level of reserve to be established within the existing fund rather than a capital adequacy approach. Do you have any comment on that?

Mr Silk—A number of industry funds operate what is variously described as an operational reserve or an administration reserve. It is a very small percentage of members' funds which still remain the ownership of members, to use that term. They are held for just that eventuality.

Senator SHERRY—Is there any data available? I assume it would be in their annual reports?

Mr Silk—It would be disclosed in their accounts.

Senator SHERRY—There was some discussion earlier about the licensing process, the transition period of the last two years and the review that is to take place into that process, which I think is actually starting now. Given that all superannuation funds have been through a very, very significant rigorous overview of the last two years at significant cost and that funds will again face some major changes as a consequence of the government's recent announcements on superannuation, do you think it is reasonable to suggest that there be a pause for at least some period while funds have the ability to consolidate their position? That they do not have to face continuing ongoing cost pressure year after year?

Mr Silk—If that question had been posed in the terms of reference, it would probably be the only one where there would be a unanimous response from everybody who made a submission. I think there is a sense of reform fatigue in the industry. There are of course two key stakeholders in this industry; the funds and the operators of the funds on the one hand, and the members on the other. It would certainly be in the self-interest of the fund and the operators if there was a pause and a chance for consolidation. I think the member perspective is very important here.

There is an increasing appreciation amongst members of the value of superannuation. There still remains the issue of members thinking it (a) rather complex and (b) being prone to change too frequently. Both the industry and in a bipartisan sense, political parties, are seeking to enhance members' confidence in superannuation and their willingness to contribute to their own retirement savings. The financial literacy taskforces is just one element of that. I think members would really welcome a moratorium on significant change at least, so that they can get an enhanced appreciation of what the system is about and not have to accommodate a series of ongoing changes, which is the sense that a number of our members have about how the system operates.

CHAIRMAN—But you would not suggest if there are improvements that can be made that we should not make them. For instance, in the interests of stability, you would not have forsworn the budget reforms, would you?

Mr Silk—Not only those but the extension of the co-contribution, the abolition of the surcharge, all those things are enhancements to the system unquestionably and have been welcomed more or less universally. I am not talking about that so much as issues that impinge adversely on members.

CHAIRMAN—I understand. Regulatory issues.

Senator SHERRY—Regulatory administration issues.

Mr Silk—That is right.

Senator SHERRY—As a matter of interest, do you know what the range of cost was per fund—obviously it varies—to meet the recent licensing?

Mr Silk—Not amongst our members but we can obtain that and provide it to the committee.

Senator SHERRY—I would appreciate that. There was a discussion earlier about the allegation from the FPA about alleged conflict of interest in contractual arrangements. If there is in fact a conflict of interest that is not managed particularly well, would not retail providers have exactly the same set of issues to deal with? The AMPs, the AXAs, they all have various separate but related investment management planning groups. It is exactly the same issue that would have to apply there too; APRA would have to ensure proper independent contractual arms-length negotiations, would it not?

Mr Silk—It is the same issue at a conceptual level but the magnitude of the issue is entirely different. As far as the industry fund investors in that body are concerned, IFS represents a miniscule part of our assets whereas—I do not want to particularise—but a large financial services entity that had a trustee operating a superannuation entity will typically outsource to a related party a whole range of services—administration, legal services, a lot of the investments where most of the money is made in this industry. Typically it is another element of the parent body. As I said, the magnitude of those conflicts dwarf the issues that apply in the industry fund arena.

Senator SHERRY—There might be an issue if not next week at estimates, later when APRA appear for us to explore how they are dealing with those sorts of potential conflicts. Interestingly some industry funds at least contract the services from those providers.

Mr Silk—Those commercial providers?

Senator SHERRY—Yes, to varying degrees.

Mr Silk—Most industry funds have commercial relationships with some of the big name commercial providers in the industry who have multifaceted elements to the business such as funds management and custodial services. There is this slightly unusual relationship where they are competitors in terms of retail superannuation to members, but are often a client service provider relationship at a wholesale level.

Senator SHERRY—Following on from the earlier discussion, if you accept the argument that fee-for-service advice is preferable and taking into account your view that we do not want further change in the regulatory structure given the amount of change there has been, is there a real need to ban commission-based advice given that it seems that it is moving in that direction in any case? Some of the financial planning arms now have indicated they are moving purely to a fee-for-service arrangement. Apart from industry super funds, some of the commercial funds managers have now moved away from a commission paying basis of attracting funds. Dimensional is one that does not pay commissions and there might be others that are moving in that direction. Is it not happening in any case that we are moving towards the fee-for-service basis?

Mr Silk—We are moving in that direction but at a glacial pace, and in many instances there is an inverse relationship between the hoopla surrounding the announcement of a move away from commissions to the impact of the reality of that change. A number of the announcements of a transition from a commission-based arrangement to a fee-for-service arrangement reveal in the fine print that it is a long-term project and that it will be at the option of individual planners. I was talking earlier about the need to engender consumer confidence in the industry and one way of doing that would be a moratorium on change, change that adversely impacted members. A banning of commissions would certainly not adversely impact members. It may—

CHAIRMAN—I hope you would not make any changes that would adversely impact members.

Mr Silk—The imposition of the surcharge was not welcomed by a lot of members, I can assure you.

CHAIRMAN—That was a taxation issue.

Senator SHERRY—A pretty important one!

CHAIRMAN—We have got rid of it! If there was an overnight ban on commissions would that cause serious disruption in the planning and advice industry?

Mr Silk—If there was a ban on commissions?

CHAIRMAN—Yes. If there was an overnight ban on commissions would it be too big a bite to swallow in one lump?

Mr Silk—Again, it comes back to who is the key stakeholder. If it is the planners then it would impose a major problem and an unacceptable problem. If the key stakeholder is the consumer or the member, it is an unambiguously positive development.

CHAIRMAN—What about an education approach to the consumer saying, 'It's in your best interest to go for a fee-for-service planner; ignore these commission-based planners'?

Mr Silk—That is good obviously to the extent it has a material impact, but the reality is there are far more commission-based planners than there are fee-for-service planners. Those numbers have not changed a lot over the last 12 months. Despite announcements from MLC and a handful of others, there is no indication there is going to be a substantial change in the foreseeable future. Self-regulation will not work here; self-interest of the relevant providers dictates that. This is a call that government has to make.

CHAIRMAN—A different subject. The CPA submitted to us today that there should be removal of the 10 per cent rule for tax deductibility of personal contributions so that everyone has equal flexibility in determining the tax treatment of their contributions. They believe it is in the interest of consumers What is the Industry Funds Forum's view on that?

Mr Silk—That is not an issue that the forum has considered. I am not in a position to put a view to you on that matter.

CHAIRMAN—Can you come back to us on that?

Mr Silk—Yes, I would be happy to do that.

CHAIRMAN—Any further questions? If not, thank you very much for your appearance before the committee and for your assistance with our inquiry.

Mr Silk—Thank you.

CHAIRMAN—The committee stands adjourned until our next public hearing on 20 November, although we will have a private meeting prior to that.

Committee adjourned at 6.03 pm