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Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Structure and operation of the superannuation industry

TUESDAY, 24 OCTOBER 2006

SYDNEY

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Tuesday, 24 October 2006

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

Members in attendance: Senators Brandis, Chapman, Forshaw and Murray and Mr Baker and Mr Bartlett

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 9.03 am

CHAIRMAN (Senator Chapman)—I declare open this public hearing of the inquiry into superannuation by the Joint Statutory Committee on Corporations and Financial Services. Today is the first time the committee will hear evidence in relation to this inquiry. Further hearings will be held in Melbourne tomorrow and Canberra in a few weeks, and there are additional hearings to be scheduled for the first part of 2007.

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 prejudice to 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.

[9.04 am]

COLLEY, Mr Graeme, Director, Self-Managed Super Fund Professionals Association of Australia Ltd

RUDDIMAN, Mr David, Director, and Chair of Regulatory Committee, Self-Managed Super Fund Professionals Association of Australia Ltd

SLATTERY, Mrs Andrea, Chief Executive Officer, Self-Managed Super Fund Professionals Association of Australia Ltd

CHAIRMAN—Welcome. As I mentioned earlier, this is a public hearing so the committee does prefer that evidence is taken in public. However, the committee would consider at any time a request for all or part of your evidence to be heard in camera if that were your wish. I have before me your submission which we have numbered 70. Are there any changes or alterations you want to make to the written submission?

Mrs Slattery—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.

Mrs Slattery—Thank you. I appreciate the opportunity of presenting before the committee. This is the first time that the Self-Managed Superannuation Fund Professionals Association of Australia has presented to a parliamentary committee. To begin, I thought I would indicate why SPAA exists. It would appear that three or four years ago there were no education standards for advice. There was a need for a support network for practitioners and regulators due to the growing and maturing industry called the self-managed super fund industry. SPAA itself has ownership of the self-managed super fund industry for designation and professionalisation purposes and we are also the peak body for advisers in this industry. The advisers in this industry are a diverse group, comprising auditors and actuaries, financial planners, accountants, lawyers, barristers, educationalists, administrators et cetera.

The purpose of our association was to build educational opportunities and to create professionalism. Our main objectives were to raise standards and to set standards for advice capacity and also for the market. We have a professional designation which is the symbol of authority for SMSF advice and our main objectives are around promoting excellence, building integrity and having best practice. In relation to the background for education, SPAA was actually complementary in the development of PS146, which is the minimum standard requirement for education in superannuation which encapsulates self-managed super fund advice. We were also complementary in developing the industry-endorsed SMSF standards which are housed under quasi-regulator FSEAA, which is the Financial Services Education Agency of Australia. We have actually set a level of professional standards which are the self-managed super fund professional standards for advising SMSFs. As part of those education standards we have an independent certification of a designation for advisers and also of

education within the market. We actually work to assist in developing that for integrity and we work with a number of educators.

In relation to our membership, most of our members are actually leaders in their field from those various professions. They are normally the executive or the senior advisor within a business. We currently have approximately 850 members—that has occurred over the last three years—with about 450 of those members currently being specialists in SMSF advice that range through that large group of professional backgrounds. As part of our process of qualification, we look at the individual's background, their educational knowledge and capacity, their experience, their knowledge particularly of the SMSF industry, and their industry recognition currently.

We would like to put a recommendation to the committee today in relation to the terms of reference, the first one being on the role of advice in superannuation. SPAA believes it is actually critical to have informed, educated professional advice in the marketplace. There are significant complexities in advising in SMSFs and it is really the underpinning basis of why SPAA exists: the provision and encouragement of standards in educational levels that are professional and significant. We believe that if we raise education in the marketplace this will underpin integrity in the market and that if advisers can reach a professional level and impart that to trustees then those trustees can impart this on to the members and that, therefore, will build integrity across time.

The second term of reference which we would like to recommend is the lifting of standards of advice which we believe is imperative in relation to the growth of SMSFs. So we believe that there is, once again, a further need for professionalism and an increase in the level of knowledge and education for that professional advice delivery. Once again, SPAA believes in this implicitly, and the development of our SPAA professional designation as 'SMSF specialist adviser' underpins the capacity. We believe that the growth in SMSFs encourages professional advice.

The third term of reference which we would like to refer to is the relevance of APRA standards. APRA standards continue to be relevant and appropriate in the operation of all superannuation entities, but SPAA's concern is that when a fund transfers between the regulators the responsibility for that transfer between ATO and APRA is often at a time when a small fund is at its most vulnerable. We would like to address the fact that the ATO maintains the investment regulation and that APRA retains the prudential trustee administration and responsibility.

The last term of reference which we want to comment on is in relation to the cost of compliance. Both the ATO and ASIC have actually set a $200,000 minimum cost threshold for a self-managed super fund. SPAA actually believes that cost is only one issue in relation to SMSFs. We believe firmly that appropriate profiling of a potential member or member and trustee and of the circumstances is probably the primary issue, and that cost and balances should be actually addressed during that process. And so we would like to state that we realise that it is important but that there are more significant issues involved.

CHAIRMAN—Thank you. With regard to the reasons for the growth in self-managed funds, you indicate that that has stabilised recently but that over the last five years the number has been growing by about 2,000 per month. Can you give us figures in terms of the rate of growth of the assets under self-managed fund management?

Mrs Slattery—Currently, or over that period of time?

CHAIRMAN—No, over that period. I think you said in your submission that the current value under self-management was nearly $310 billion?

Mrs Slattery—Yes. The current asset value according to the APRA statistics of 30 June is around about—

Mr Ruddiman—I think the average account balance is now $328,000 per fund, and that has increased significantly over that period. I think the concern in relation to minimum account balances has well and truly been negated over the five-year period that you are talking about. So the average account balance has improved significantly.

CHAIRMAN—Do you know what the mean balance is?

Mr Ruddiman—The average is $328,000. Statistically we do not have the figures at hand in relation to the amount of funds that fall under that average account balance and those that are significantly larger, but we can get those figures for you.

CHAIRMAN—I think you said in your submission that the total amount in self-managed funds is about $310 billion. Has that been a steady growth in the total funds, or was there a period where it sort of accelerated and it has now decelerated?

Mrs Slattery—The total funds under management at the moment are $210 billion.

CHAIRMAN—$210 billion?

Mrs Slattery—Yes, $210 billion.

CHAIRMAN—I misread that. I am sorry.

Mrs Slattery—When SPAA came into existence three years ago, the self-managed super fund industry comprised about $103 billion, and the balance in 1999-2000 was approximately what the SMSF industry is now, and that was for the total of the superannuation industry. It has grown significantly. There was a spike in 2003-04 in the number of funds set up per month to being about 3,000 per month, but currently it is residing at about 1,800. If you look at the five-year average, though, you actually see that the number of funds opening per month has actually decreased over that time, whereas the average balance of the funds has actually grown. I cannot tell you off the top of my head what the average balance of the fund was three years ago, but it was in the low $200,000 area and currently it sits at about $328,000. So there has been significant reduction in balances less than $100,000 during that particular four- or five-year period and SMSFs are considered to be the second largest growing sector of the superannuation industry currently.

CHAIRMAN—Do you attribute the reasons for the growth of self-managed funds as being that they incorporate a wide range of features that are not readily available in other types of superannuation funds? You give a couple of examples there of the fact that they more easily provide transition to retirement pensions and superannuation contribution splitting. Are there any

other particular features of self-managed funds that you think have been attractive and therefore have caused their rate of growth?

Mr Colley—I do not know about the rate of growth, but there are investments in small businesses that self-managed superannuation funds can go into, such as commercial property. That sort of thing is not usually available in the larger superannuation funds, principally because they have other interests in their investments; they look at different sorts of portfolios. It is really the readiness or the ability of those superannuation funds to be flexible in changing towards new initiatives from the government—for example, transition to retirement pensions and superannuation contribution splitting. Some superannuation funds at the time decided not to go into that, whereas with a self-managed superannuation fund the members of those funds could, in many cases, certainly start a transition to retirement pension by simple amendments to the rules of that fund.

CHAIRMAN—Is the significant attractiveness of self-managed funds the fact that perhaps the beneficiaries feel they have more direct control over their investments?

Mr Colley—Yes. We find that basically, by having the control over those superannuation fund assets, people are able to make decisions about their future and they are able to invest, and time those investments, to their advantage so that, if they think that a particular investment in the market is suitable to purchase or to sell, then they can do that based on their judgement and advice they may give. The flexibility certainly comes out of that timing aspect of the particular investment. When you think about the many people who have self-managed superannuation funds, those being self-employed people or some executives, they like to control their own destiny a lot more than employees, for example.

CHAIRMAN—In the past, apart from what was seen as relatively low balances in some funds, which you have indicated is now not such a problem, one of the other issues raised in relation to self-managed funds was that a lot of the assets were sitting simply in cash in bank accounts rather than being invested in medium to longer term growth assets. Has there been any change in that in recent times, or is that still an issue?

Mrs Slattery—I think some of those statistics were actually drawn from 30 June figures, which often show a higher propensity towards cash and fixed interest sitting within a fund. We are currently unaware of any statistics that are actually done at times other than that particular time frame, but that does skew the figures towards high cash. The investments of a self-managed super fund are consistently referred to as being more conservative in their nature. They are also referred to as being held for a much longer time period generally.

Mr Colley—You may find that some of that definition of cash could also include fixed interest investments within them, which is a fairly typical investment of all sorts of superannuation funds as part of a reasonable portfolio. Cash and fixed interest is one of the categories of asset allocation.

CHAIRMAN—You make some comments in relation to cost of compliance. What is your view of the recent announcement to increase the annual fee for self-managed funds as part of the government's superannuation reforms?

Mrs Slattery—We would think that if that is going to mean better compliance and more rigorous compliance from the regulators in relation to the payment of that fee, then we would support it because we think that the standard of self-managed superannuation funds should be done on a professional basis. That, coupled with the education of trustees and advisers in relation to those superannuation funds, is something which we support.

CHAIRMAN—In relation to the terms of reference relating to promotional advertising and the meaning of 'not for profit' and 'all profits go to members,' you say that they are not really relevant, I guess, to self-managed funds as an issue? Do you have comments on them in relation to the industry generally?

Mr Colley—Advertising is interesting, because whether it is done internally by the superannuation fund or externally by a service provider to those particular funds, it would seem that promotion is part and parcel of superannuation. To get people educated and to have them understand particular products within the industry is probably worthwhile. We think that while people do advertise self-managed superannuation funds, that is usually achieved by the fees that they obtain from providing that advice and then making recommendations on whether you should or should not use a self-managed superannuation fund. So it seems that the advertising aspect can be done within the fund or externally. It is one or the other, I would think, in relation to the promotion of those sorts of things.

CHAIRMAN—You refer to the need to clarify the regulatory position during a transition from an ATO to an APRA fund. Do you have a preferred option as far as that is concerned?

Mr Colley—Our preferred option for smaller superannuation funds would be for the Australian Taxation Office to regulate those funds. The reason for that is that the—

CHAIRMAN—These are as well as self-managed funds, the so-called APRA funds?

Mr Colley—That is correct, yes. The reason for that is that if it is the investment of those superannuation funds which is the important aspect of that, then the ATO would be more appropriate because they have a role in relation to self-managed superannuation funds and, because small APRA funds are small funds, then maybe APRA is more appropriate in that circumstance. If it was considered that the trustees of those superannuation funds required regulation, that could be seen to be more appropriate to the Australian Prudential Regulatory Authority rather than the Australia Tax Office because of the difference in the regulatory role of both those organisations. But our preference would be for the ATO to look after those.

CHAIRMAN—Do you have a view on the issue that has arisen in some of the submissions regarding the liability of trustees with regard to APRA funds in the context of superannuation choice and the role of the member, as against the trustee, in choosing investments—this is in the context of choice—and the relevant responsibilities and liabilities?

Mr Colley—The investment choice, I would think, should be done independently—that is, that the member should make decisions about that superannuation fund and the investments available and obtain advice externally to the operation of the fund. While the superannuation fund does make information available, it certainly does not provide advice in relation to the members of those funds. So a choice of investments would seem to be a reasonable thing to be

available to those funds, because some people nearing retirement may like a more conservative portfolio in relation to that fund, whereas those who are much younger may choose a more growth-oriented portfolio in relation to that fund because they have many years until they retire.

CHAIRMAN—In the context of your view that the administration of small funds should all move across to the ATO, do you have a definition of a small fund? Is there a quantum amount of funds invested that would determine that? If so, what is it, or is there some other definition that you would use to determine that?

Mr Colley—The legislation gives us a definition of fewer than five members. That may be suitable, but we understand that in some circumstances, if we are going to limit the smaller superannuation funds to related parties—that is, those that are relatives of members of that superannuation fund or business associates—then it may be that a higher number than a maximum of four members could be appropriate. We do get inquiries from members who say that they have a family group with five or six members within it who would like to become members of a small fund and, in those circumstances, the definition of fewer than four members is certainly not suitable. They have to then set up either a number of small funds or go to a larger superannuation fund with an approved trustee, which can prove to be a slightly more expensive exercise. So we think a lifting of the numbers of members of a small fund from four to maybe 10 could be more suitable.

CHAIRMAN—And does that limit of four currently apply to the small APRA funds as well, or are they under it? Does the same definition apply to a small APRA fund as to a self-managed fund?

Mrs Slattery—Yes, it does.

CHAIRMAN—So you would seek to have that lifted to 10 as well?

Mrs Slattery—We would seek to have it discussed, with the possibility of raising it to 10 if that was considered to be appropriate. We did allude within our submission to some of the reasons for the choice of less than five members. There would need to be matters such as control and other aspects looked at, as we have pointed out.

CHAIRMAN—Yes, you spelt that out in the submission, so we do not need to go into that. Do you see any downside? Is there potentially an increased risk in increasing the number of members in a small fund?

Mr Colley—If you require that the members of that superannuation fund also be trustees or directors of the trustee company, it would mean that the decision making process is spread across all members there. You might have 10 ideas if you decide to have 10 members of the superannuation fund. Whereas now, with the majority of self-managed superannuation funds having one or two members in them, the decision making process is not spread amongst so many people, and maybe you come to a better decision in the end.

Senator FORSHAW—Could I ask you to provide that further information you were commenting on at the start relating to the average amount sitting in the funds. You said you did not have with you the number of funds that would actually fall below that figure of $328,000. If

you could give us that as a spread from bottom to top, with the number of funds that fall above and below the average, that would be helpful. You state in your submission that you are not supportive of the idea of capital adequacy for self-managed funds. Could you expand on your reasons why? You say:

> … little would be achieved by requiring a trustee of a self-managed superannuation fund to satisfy minimum capital requirements.

Can you expand on that a little?

Mr Ruddiman—I think because all members are trustees, you have an issue where the larger funds have, perhaps, a $5 million tangible asset, capital adequacy requirement et cetera. It is very different in a self-managed superannuation environment where, as we say, the average account balance is $328,000 and the central control and management of that fund is by the members, for the members, in their capacity as trustee. So a slightly different scenario arises there. But there is also ample provision within the legislation to ensure that those trustees are discharging their duties appropriately in the operation and ongoing management of that fund for the sole purpose of providing those members with a retirement income stream in their retirement.

Senator FORSHAW—I understand the thrust of your position is that the arrangements and requirements are adequate at the moment and it would not necessarily, in your view, improve things. I was wondering if there was some negative aspect to that requirement that you were opposed to as well, that it might actually be substantially deleterious to self-managed funds, as distinct from saying, 'Why change simply for the sake of a little more regulation?'

Mr Ruddiman—I think the impost of some sort of financial guarantee, if we can put it that way, for self-managed super funds would be a significant impost on the trustees and members of those funds if it were put in place.

Senator FORSHAW—Can I look at the other side of the coin, if I can use that phrase, and that is the $200,000 critical minimum mass? In your earlier comments—I am not sure if it was Mrs Slattery, Mr Ruddiman or Mr Colley—I think you were suggesting that that is not as important as other issues. What is your position? Do you believe that someone should be permitted to start a self-managed fund under that amount?

Mr Ruddiman—We certainly have a view that we support the regulator's position on minimum account balances as a starting point for the discussions in relation to the establishment or otherwise of a self-managed superannuation fund. But we think the critical issue is to look at the positioning of a self-managed superannuation fund in the overall context of what the members are seeking to achieve in relation to their retirement planning objectives. There are a number of issues in relation to funds with account balances of, say, less than $200,000 that are deemed appropriate insofar as the funding mechanisms built into the fund—such as insurances, the ability to set up child allocated pensions et cetera. In the circumstances of the individual members, it may be deemed appropriate for them to have their own fund. The decision is affected by a vast array of circumstances other than just the minimum account balance being a dollar imperative.

Senator FORSHAW—I will just comment on a few issues that you have raised in your submission. You have said that you do not believe trustees should be required to be public companies. Can you expand on your reasons for that?

Mr Colley—As to trustees of self-managed superannuation funds being public companies, to us public companies are really set up and maintained for trading purposes, whereas the relationship between a trustee of a self-managed superannuation fund and the members of that fund is a fiduciary relationship. So we would see that there is a difference in relationships between having a public company and having that public company as the trustee of a superannuation fund. Currently self-managed superannuation funds can have a private company as the trustee of their self-managed superannuation fund. The implications of the Corporations Law are that if the directors of that company breach the law then there are penalties upon them for those breaches. For individuals the SIS legislation imposes penalties upon the individuals where they are trustees of their own superannuation fund.

Senator FORSHAW—You indicated also in answer to a question from Senator Chapman that you supported the government's proposal to increase the fee. Were you consulted about that announcement?

Mr Ruddiman—In discussions we had with the National Audit Office the question was asked of us whether or not we thought it was appropriate at the current level, to which we answered that there had not been an increase in the levy since the ATO took over the regulatory powers for these self-managed superannuation funds and that we deemed it appropriate that that occur. Obviously, the figure is something that needs to be determined, and it has been. But we believe that money spent in the right areas is appropriate and that there should be supervision of self-managed superannuation funds by the regulator. One of the things we did suggest, however, was that the trustees of self-managed superannuation funds we believe would be more inclined to accept an increase in the levy if there were sufficient enough information coming back as to how that levy has actually been spent in relation to the ongoing compliance activities put in place by the Australian Taxation Office. What we are suggesting is that trustees are quite happy to have a levy if they know exactly what the levy has been spent on in terms of the ongoing compliance and surveillance activities of the ATO.

Senator FORSHAW—In the event of theft and fraud, as I understand it self-managed funds have no access to compensation. As I understand from your submission, you are not supportive of any changes in that regard. Can you explain why?

Mrs Slattery—If we look at the current compensation requirements under the SIS legislation, section 55 says that if there is poor advice the fund be recompensed by the amount of any detriment to that fund. There are significant penalties within the legislation already to compensate for issues such as theft and fraud.

Senator FORSHAW—The super guarantee is not provided for in the event of employer insolvency in any super fund. Do you have a view about whether or not superannuation guarantee entitlements should be protected in the same way as other statutory entitlements are?

Mr Colley—Yes. Because they are a compulsory requirement, we would think that there should be a guarantee of the payment of that superannuation money to the individuals. The

preservation standards in the SIS legislation ensure that at least a minimum amount be provided which would include the super guarantee amount. But, if it were solely superannuation guarantee contributions going into the fund, there would be expenses of the fund that would reduce. So while you might think that the super guarantee amount should be protected, there may be costs associated with the administration of that amount that may reduce the amount that would be guaranteed. But we certainly support that.

Senator FORSHAW—We are finding more and more that, where there are insolvencies resulting in particularly large amounts owing to employees—and other creditors, obviously, but I am talking here about the employees—who are entitled to the super guarantee, in many cases the payments have not been made into the fund for quite some time and it amounts to quite a deal of money. The final question I have is in relation to the Westpoint scandal; I will call it that. As I understand it, a third of the investors became involved via self-managed funds. Do you acknowledge that that highlights a regulatory failure? I would also ask whether you have any comment on the miss-selling that occurred in that case where commissions of up to 10 per cent were being paid. Do you have any comments on how we can avoid that sort of situation recurring in the future?

Mr Colley—The Westpoint saga is a difficult thing, because it seems to relate to the advice given to those who invested in those arrangements more so than whether a self-managed superannuation fund was used. There were other people who used their own private money, as we understand it, to go into those arrangements. Self-managed superannuation funds were merely seen as a vehicle from advisers in relation to that. It is unfortunate that those funds were used for that purpose. We would see that the advice process is the thing that needs to be looked at there. The financial literacy of people needs to be improved in relation to all investments, not only those investments where there are high amounts of commission paid to the promoters of those arrangements.

Senator FORSHAW—You mean the financial literacy of the members as distinct from the advisers, or both?

Mr Colley—The literacy of both, but I think that the members of those superannuation funds need to appreciate what they should be aware of when they go into these investments. ASIC has made some very nice publications available that talk about the choice of a financial planner, for example, and why you should choose one over another.

Mrs Slattery—I would like to add to that that I think it underpins our whole interest in raising educational standards. Whether or not, as Mr Colley pointed out, it is at the member level, consumer level or at the advice level, to raise knowledge and skills of advisers to a professional level and to raise knowledge, education and understanding at a consumer or member level is imperative. I think the Westpoint incident actually highlights that it was more a case of a lack of financial literacy on the part of the people involved from all areas rather than a particular structure within the superannuation environment being the vehicle that was the cause of the concern. I reiterate that developing educational standards to a professional level for advice is an option to move forward from those sorts of circumstances.

Senator FORSHAW—I note in your submission that you say that educational standards need to be lifted—

Mrs Slattery—Very much.

Senator FORSHAW—and I assume that was where you were going to lead to, which is why I raised the other question. Could you conceive of a compulsory arrangement in that regard, particularly for financial advisers, that standards should be established for educational requirements and training programs? Do you believe that the standards for these should be made compulsory?

Mr Ruddiman—One of the things that we as an association have been concerned about, and hence the reason we have this focus on standards in order to provide some sort of integrity within the system, is that, under PS146 requirements, self-managed superannuation fund advice is not in itself a subcategory that requires an extra level of knowledge, skill and competency in order to provide that advice. I think the issue there is that while it rests in PS146 as a requirement under superannuation, it creates in itself a problem. But that has improved in the introduction of a training register which now deals, specifically through ASIC under PS146, with competency based components in relation to advice for self-managed superannuation. But it is evolving, and it is improving. As an association we are very focused on raising the currency of knowledge, competency and skill in relation to the advice being provided to the trustees who, after all, are making the decisions in relation to their fund.

Mr BARTLETT—You have talked about the amount under management in self-managed funds. What is the experience in terms of the rate of return experienced by self-managed funds compared to larger funds, industry funds and so on, both shorter term and over a longer period of time?

Mr Colley—I really can only comment on a client base that we run through an organisation that I work for which has about 2,700 self-managed superannuation funds. The long-term research we have done with those funds is that, on average, they produce returns about the same as the bigger managed superannuation funds. Because there are so many of them, and each superannuation fund has its own desires as to what that portfolio should look like, some of those superannuation funds outperform the market quite regularly and some underperform the market as well. We are concerned about those but we do not control the actual investments of those funds; it is the trustees who do that. We just look after the administration.

Mrs Slattery—I do not believe that there is actually any statistical data that has been researched to answer your question, Mr Bartlett. But once again, if we work back to profiling, you actually have educated advisers advising the trustees, who are aware of their responsibilities. The profiling of the members of those funds and the investments within those funds actually allow a rate of return that is appropriate for their risk profile moving forward.

Mr BARTLETT—Do you think there would be value in, or there is a need for, such research?

Mrs Slattery—Absolutely.

Mr BARTLETT—Is there any difference in the profile of risk for self-managed funds compared to the larger managed funds? Is there any evidence regarding insolvency or failure of self-managed funds?

Mr Colley—No, not that we know of.

Mrs Slattery—No. There is a net growth of self-managed superannuation funds on a monthly basis from start-up. There are a number that close down. More and more, as people are aware of either their roles or responsibilities, the appropriateness of that fund for themselves or other circumstances, some funds close. I am not sure of the actual statistics through APRA of the number of closures per month, but there are a number of closures per month that probably address those issues.

Mr BARTLETT—But those closures are not due to inadequate returns?

Mrs Slattery—No.

Mr Colley—We find that it is not necessarily performance driven. It is normally the suitability of that structure, or vehicle, for superannuation to the members and the trustees. In a survey of our members we found that just as many of our members are inclined to recommend that a fund be wound up with the member account balances transferred back into industry, retail or corporate superannuation funds, as they are inclined to recommend the establishment of a self-managed superannuation fund. It is all about the members and the trustees and whether or not at the end of the day they are prepared to accept the roles and responsibilities that come with managing a self-managed superannuation fund.

Mr BAKER—I would like to touch on the $200,000 supposed minimum amount. You mentioned child allocated pensions as a reason for a fund being under that amount. I would also like to hear your views on a couple of other issues, for example, company structures as in key-man insurance and trauma insurance. There is a wide range of reasons why a self-managed superannuation fund would have less than $200,000, and I think too much emphasis is being placed purely on an investment of a critical mass of money. Just as important an issue is that how it is structured depends on how partnerships and companies et cetera are structured. I would like you to give other examples, if you could, and expand on them for the benefit of the committee. I think that is important because there has been so much said about this magical level of $200,000.

Mr Ruddiman—As an association whose constituents are mainly practitioners, we find that there is a knowledge attribution to self-managed superannuation funds which is found in younger professionals in the business community who are restricted by the amount that they can contribute to a self-managed superannuation fund through salary sacrifice arrangements, super guarantee et cetera. They have a better grasp of the array of investment product available to them that they can control through a self-managed superannuation fund which makes that central control and management of the fund more suitable to them for achieving their retirement objectives in relation to the accumulation of wealth through superannuation, but particularly through a self-managed superannuation fund. So the level of contributions will increase quite dramatically, but also the performance that they are targeting is a higher performance for a longer preservation period. They are inclined to want to set up these funds, albeit that there may be a higher cost as a percentage of operating the fund in the earlier years than in the latter years, in order to get the traction that they need to get these funds up and running. As you said, in addition there is a whole array of other peripheral issues that for their particular circumstances make it either less or more compelling to establish these funds.

Mr BAKER—I will turn quickly to lifting education standards. As you said before, PS146 really is a generic qualification. There is no one specialisation in any particular area. How can that education standard be lifted in a non-intrusive manner to a tertiary level?

Mrs Slattery—At the moment self-managed superannuation fund industry endorsed competencies are the only competencies in the market that have actually been acknowledged by industry and endorsed that are actually above the PS146 skill requirement as a licensing requirement. So the self-managed superannuation fund requirement in education is the only one that has actually come out above that. That is sitting at a level slightly higher than PS146. Our association has actually set our standards at a postgraduate level. We are at an undergraduate level currently. As we grow, we have a three-year objective to grow that to a postgraduate level of designation and requirement within the next 12 to 18 months. We do agree with you about the advice and educational requirements for SMSFs to be at an undergraduate minimum standard and that underpins our association objectives at the moment. But, to answer you, at the moment SMSF competencies are the only ones that are above that. If there were to be any dealer group or any action in the marketplace then there would have to be an awareness of the fact that those requirements are currently higher than the PS146 minimum standards, which are only a licensing and skill requirement, as you referred to.

Mr BAKER—Because the penalties of non-compliance are so destructive to a fund that there needs to be a balance in the level of professional advice that is actually required when one considers the cost of non-compliance.

Mrs Slattery—Yes. As I said, raising the educational standards, working with the regulators and very closely complementing the industry are the reasons why SPAA exists, and we are very much in favour of raising those standards. Our specialist designation is an undergraduate equivalent in the market and will be raised over time. We do intend to have a specialist audit designation in the future. In addition to those sorts of issues, we support increases in standards and education.

Mr BAKER—It sounds encouraging.

Mrs Slattery—Thank you.

Senator MURRAY—I want to turn to the number of members in a self-managed superannuation fund. It seems to me that having fewer than five members is an unwise policy. The reason I think that is that I think it has limited intergenerational utility. With increasing longevity, I think the likelihood of four direct generations in a self-managed superannuation fund is quite possible now—great grandparents, grandparents, parents and children. It seems to me that what the fewer-than-five-members rule does is produce an unnecessary multiplicity of funds through family groups. Do you have statistics as to the number of funds you may find in some family groups where larger numbers could result in fewer funds?

Mrs Slattery—No, I am sorry. Currently we do not. Currently we are not aware of any of those statistics. Perhaps one of the regulators or the ATO might have those. It is, perhaps, something that we could investigate. As an association we intend to develop statistical information about the self-managed superannuation fund industry, and there are research groups

out there at the moment that are developing statistical information. Perhaps those can be referred to.

Senator MURRAY—Do you agree with me that it has limited intergenerational utility? Just taking Mr Costello's ideal family into account—you know, mum and dad and one for the country and one for mum and one for dad—you are already over the limit. It seems an unnaturally restrictive number.

Mrs Slattery—It is the reason why we raised it. We are getting an enormous amount of inquiry from our membership that the issue of a less-than-five-member requirement be addressed, that it be debated and an understanding occur as to whether or not the reasons are still relevant or whether there is an appropriateness for actually raising that number.

Senator MURRAY—One of the reasons I want to pursue this with you is I think your selection of 10 is as arbitrary and non-scientific as the selection of five. Surely, you should be coming to us and saying that, with respect to direct family members in an intergenerational context, the statistics are that it is likely to be 11, 13 or whatever number it is. I do not know what number it is. But if you look at grandparents, parents, children and great grandchildren in that way, I would think 10 is as arbitrary as five and may be lacking in precision.

Mr Ruddiman—We support your view insofar as one of the catalysts for this increased inquiry by our members in relation to taking this forward has been the introduction of choice legislation. You have children, whose parents now under choice are able to select the fund they will be members of, who are wanting to join their parents' fund and have their employer contribute to that fund. There is a view currently in practice that the parents are now having to decide which of the children is to be excluded from that process. So we support your view that it is an arbitrary statement to make in terms of numbers—

Senator MURRAY—I am not sure at all what resources your organisation has, so please refuse my request if you do not have the resources, but would it be possible for you to give us a very short supplementary submission which actually indicates from an intergenerational concept, and based on statistics, what an average or typical, meaningful number would be, which encompasses what I would call the direct intergenerational family unit? Is it possible for you to do that?

Mrs Slattery—We will attempt that and get back to you with that summarisation.

Senator MURRAY—Thank you. I am a bit of a fan of consolidation where it is relevant because you get lower fees, economies of scale and so on. It seems to me it is likely, although I am not aware of any empirical studies, that numbers of family groups have been set up because of this limit of five. If the numbers were to be allowed to expand I think you would simultaneously have to allow for consolidation. For example, with a large migrant family from southern Europe that has done well and established itself in this country, you might find its members have four or five self-managed superannuation funds because they are not allowed to create just one. If you are able to answer that issue of the desirability of consolidation now, would you please do so, otherwise you might come back to us with some views on that as well.

Mrs Slattery—We will have to come back to you with some views on that.

Senator MURRAY—Do you recognise the point?

Mrs Slattery—I do recognise the point, yes.

CHAIRMAN—As there are no further questions, I thank you all very much for appearing before the committee. Your responses to our questions have been very helpful in the context of our inquiry.

[10.03 am]

ANDERSON, Dr Michaela, Director, Policy and Research, Association of Superannuation Funds of Australia

CLARE, Mr Ross William , Principal Researcher, Association of Superannuation Funds of Australia

PRAGNELL, Dr Bradley John, Principal Policy Adviser, Association of Superannuation Funds of Australia

SMITH, Ms Philippa Judith, Chief Executive Officer, Association of Superannuation Funds of Australia

CHAIRMAN—I welcome the representatives of the Association of Superannuation Funds of Australia. The committee prefers that all evidence be given in public, but if at any stage you wish to give evidence in private you may request an in camera hearing with the committee, and we will consider such a request. The committee has before it your submission, which we have numbered 68. Are there any changes or alterations you wish to make to the written submission?

Ms Smith—No.

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

Ms Smith—The Association of Superannuation Funds of Australia is the peak industry body across the superannuation industry, so our membership includes corporate funds, public sector funds, industry funds, retail funds, service providers and a range of other professionals who work in the superannuation industry. Collectively our membership represents about 90 per cent of superannuation assets. As the inquiry would be aware, the last few years have been a period of enormous change and review for the superannuation industry. Our submission has attached to it an appendix which lists over 30 government inquiries since 1994. For the purposes of this inquiry, one of the most significant reviews related to the safety of super inquiry, headed by Don Mercer, which focused on a range of prudential matters. As you would be aware, following that, the industry went through the long and costly business of licensing, and is now working on the task of keeping that licence in terms of ensuring that the information and procedures are kept up to date. Pages 13 and 14 of our submission outline the expanded steps and procedures that are now required on the prudential side of a superannuation fund's business. These include documents and information related to fit and proper policy, adequate resources policy, outsourcing arrangements and risk management documents. If you go through those pages, the requirements are extensive, and require some time for bedding down by the industry, we believe, before any sensible evaluation can be made.

On the consumer protection side are the FSR regime requirements and implementation of additional fee disclosure requirements. Our submission points to some possible refinements and improvements. They include, for example, the use of prospective calculators to help educate

individual consumers as to how much is enough and how they are tracking on their savings front, and allowing funds to provide more and better information to current members. My basic message is that Australia has a sound retirement income system. Priority, I think, needs to be on educating people how to understand it, plan and use it, in terms of the FSR and the consumer protection side.

The last point I want to make in this introduction goes to the cost of compliance. ASFA is currently doing its own research as to the cost of compliance for superannuation funds. In doing our research, we asked funds to detail compliance costs that were above and beyond good business practice. Our questions were based on concepts government bodies had developed in recent reviews as to the cost of compliance. Data is still coming in for our research, but the indicators are that we have a very expensive regulatory regime. The additional costs for small funds appear to be in the order of six figures; for medium funds, approximately $500,000; for large funds, millions of dollars. In pointing to this, I should stress that ASFA supports effective regulation that ensures the safety and confidence of consumers in superannuation. The key words are 'effective' and 'regulation', which consider both the costs and benefits of such requirements. Thank you for the opportunity to make those introductory remarks. I welcome any questions.

CHAIRMAN—Thank you. Does anyone wish to add to those remarks? In relation to the issue of uniform capital requirements, which is one of the terms of reference, you say in your submission that international debates concerning the declining role of capital and financial services regulation support your view that uniform capital requirements are unnecessary in Australia's superannuation industry. Can you just elaborate on that part of your submission and on the international debates concerning the declining role of capital?

Dr Anderson—The key word there is 'uniform', and one of the debates has been whether in fact the question of the amount of risk that was there should be what is guiding the capital requirements. I think this is coming out of Basel II, so that is really where we are getting our views on the overseas debate on this issue. As you can see, there are capital requirements within the superannuation industry, but they are not uniform, and there has been a lot of debate to get us where we are now. That has been healthy debate, and I think the outcome has been rather good.

CHAIRMAN—You referred to corporate funds and industry funds as being potentially affected differently by uniform capital requirements.

Dr Anderson—By uniform capital requirements. Industry funds that have become public offer would be currently under a regime that requires capital requirements. Those capital requirements can be satisfied, as we say in the submission, in a number of ways, either by direct holding of net tangible assets, by an approved guarantee or by a combination, or by meeting certain custodian requirements. Within the public offer sector there are capital requirements. They are not strictly uniform; there are a number of options. For the non-public offer funds there are not capital requirements.

CHAIRMAN—Could you clarify the difference as you see it between the non-public offer and the public offer?

Dr Anderson—'Public offer' means that you can offer your wares to the general public.

CHAIRMAN—So that would cover both retail funds and industry funds?

Dr Anderson—Most industry funds now have a public offer status. As soon as they have that status under their licensing, they are required to have a form of capital. But as I said, there are choices within that. I think the retail and the industry sector make use of all of those different ways of satisfying the capital requirements.

CHAIRMAN—When you refer to the corporate fund sector in your submission, are you talking about the retail sector?

Dr Anderson—No, single employer fund.

CHAIRMAN—Okay.

Dr Anderson—A single employer. Sorry, we are not being very clear.

CHAIRMAN—So they are not a public offer fund?

Dr Anderson—No, it would be very unlikely for an employer to allow anybody to join the fund. That is really what being public offer means.

CHAIRMAN—Can you just clarify how the capital requirements differ between that sort of fund and the public offer fund? So within the public offer fund, you have industry funds and the retail funds?

Dr Anderson—Within the public offer funds you have those who have put their hand up and said, 'We want to be able to offer to the public generally,' so that would make them then subject to capital requirements. Those funds that have not said, 'We are open to the general public'—the non-public offer ones—do not have a capital requirement.

CHAIRMAN—Is there any difference between the capital requirement among the public offer funds, the retail funds and the industry funds?

Dr Anderson—There is no difference. If you are offering yourself to the general public, then you can satisfy your requirements either by holding the net tangible assets directly, by an approved guarantee, by a combination of approved guarantee and net tangible assets, or by meeting certain custodian requirements. Those are the options that you have if you are offering your wares to the general public.

CHAIRMAN—Across that range, what variation is there between different funds as to which mechanisms they use?

Dr Anderson—I think there is a combination. There is no standard.

Dr Pragnell—There is no real pattern there; various providers choose whichever arrangement is most suitable for them.

CHAIRMAN—You indicate that operational risk rectification is probably the main need for a capital requirement. You refer to effective and targeted regulatory requirements in that regard. Can you perhaps enlarge on what you mean there?

Dr Anderson—Yes. If you have proper risk management the chances of a risk event occurring are decreased. But if something does arise the question then is compensation and how you make compensation. If you have a capital requirement, it does not necessarily mean that you will be able to satisfy the compensation arrangement out of that. People would have to have an amazing capital requirement if they were going to satisfy any event that occurred. I think there is a question about how much is enough for any event that might happen. So you actually have to bring in a notion of risk management there as well. In other circumstances you can satisfy any compensation requirements by other means. And we suggest other means that funds—even funds that have a capital requirement—would actually have to have as well as the capital requirement. They include perhaps the need for some reserving, certainly the need to look to the outsourcing service providers and their own capital adequacy—this would be done at the time when you are engaging those service providers—and insurance, in some cases. If you are looking at how you prepare yourself for a risk event that occurs, you would have a number of irons in the fire to prepare for that. Capital requirements would not satisfy the payment of all risk events.

Ms Smith—We are saying that the emphasis needs to be on identification of risk, and it goes to the licensing processes that funds now do—the risk management. Really the focus needs to be on prevention of risks and management of those risks in the day-to-day operations. If we were relying on capital adequacy as a way of slopping up the mistakes, it would not work. Really the emphasis has to change to prevention, and we believe that the new licensing regime, as it is now, is requiring much more detailed information from funds. The regulator has much more real-time information about the funds. So the focus needs to be on prevention rather than on having a reserve of money, which at best will be a rather arbitrary amount depending on the circumstances of the fund, to fix the problem later.

Dr Anderson—That is right. It is prevention, and then a number of different ways to compensate for any risk event and residual risk that you might have there.

CHAIRMAN—In relation to corporate governance of funds, it has been put to me that there is a need to review the fit and proper person test, that there is a need to upgrade or make that test more stringent to ensure that trustees or directors of funds are properly qualified and properly experienced to fulfil that role. Do you have a view on that position?

Dr Anderson—At the moment it is quite onerous. I think it is more onerous in terms of what is required than if I were to be a company director. The regulator has requirements that are very onerous. If you look at the licensing requirements, they allow APRA to actually not grant the licence if they are not satisfied, and I think they have actually used that power to make the fit and proper test quite strong. The other thing that is here too is the requirement coming from APRA to have continuous education of trustee directors. I think that is way beyond what a company director usually finds. There is generally no requirement there to actually produce evidence that you have had continuing education, and that is what we are finding from our regulator.

Dr Pragnell—I think our members who went through the licensing process found the development of fit and proper policies and meeting the APRA fit and proper requirements quite onerous and demanding, as Michaela mentioned. That really forced them to look very carefully at governance, at how they ensured proper decision making within the trustee and at how they managed various issues. We have come out of the end of the licensing process building on the already strong governance record of the industry, and definitely applying a fairly demanding standard, which is probably what is expected.

Senator BRANDIS—Surely the difference is that one does not have to be licensed to be the director of a company. As a matter of policy, if parliament decides that a licensing requirement ought to be imposed, one would expect that there will be, of necessity, a threshold requirement that company directors do not need to meet. Going on from that, surely a relevant consideration is whether those who are licensed are in their governance obligations held to a higher or different standard than directors and officers of corporations under the Corporations Act. What do you say about that?

Dr Anderson—I agree wholeheartedly, and I think we are. That was my point.

Senator BRANDIS—But you seem to suggest this was an anomaly, and my point is—

Dr Anderson—No, I am just pointing out that the question from Senator Chapman was: do we need to lift it further? I have just said that it is hard to see how far to go because this is where it should be. These are licensed people who are now having heavy requirements put upon them.

Senator BRANDIS—How does that compare, by the way, with the standards expected of other sectors superintended by APRA—for example, the insurance sector?

Dr Pragnell—In that area, APRA is looking at actually using the superannuation fit and proper requirements as the model that they will apply in those other sectors. Originally APRA was looking at a different approach, and it will actually be using our approach to apply in those other sectors. Obviously, APRA is satisfied that the standard they expect of super trustees is something that they would expect in banking, life insurance and general insurance.

Senator BRANDIS—From APRA's point of view, as you understand it, the superannuation trustee standard is the gold standard?

Dr Pragnell—APRA appears to feel satisfied enough with how it operates to extend it effectively to other sectors.

CHAIRMAN—Another issue that has been raised with me, particularly in relation to industry funds where there is an equal number of employer and employee representatives on the board, is the need for a genuinely independent chairman. Does ASFA have a view on that? Currently it is not necessarily an independent chairman.

Dr Pragnell—Funds are allowed to have an independent chairman. They are permitted to do that under the SI(S) Act.

CHAIRMAN—Should it be a requirement?

Dr Pragnell—A number do.

Dr Anderson—We have had very few dysfunctional boards come to our notice, so I am not sure whether there is a need for it. There is a growing tendency towards this, although we probably need to do some research on that. I think we would have to say that these boards were not working well before we took that next step to make it compulsory.

Ms Smith—There are some very effective boards with that equal representation where it is on a rotational basis, or almost a shared responsibility, and they have proven to be very effective in their operations. Again, I come back to this: it is the regulator who oversees it each year and who considers whether it is an effective board, and whether it is operating in a functional way. I am a little hesitant about saying one size fits and going down this path.

CHAIRMAN—One of the concerns that has been raised with me—and I am not sure how widespread this is—is that in the constitution of some industry funds it is a requirement that the ACTU appoint the chairman.

Dr Pragnell—We are not aware of that at all.

CHAIRMAN—So you are not aware of any funds that have that requirement?

Dr Pragnell—No, none. We are aware of funds, as Philippa said, where there might be a rotation of the chair between an employer representative and a member representative.

CHAIRMAN—This concern was raised with me by a board member of a fund, so I assume that he knows what he is talking about.

Dr Anderson—No, we are not aware.

Dr Pragnell—We are not aware of that.

Senator BRANDIS—You make some observations in section 4 of your submission about financial product advice, and I refer to recommendation No. 5. I think your remarks are fair enough, but what you do not do, unless I have missed something here, is suggest a new definition or even the criteria for a new definition, of where the boundary between advice that is deemed to be financial product advice and mere information is to be drawn. It is a clear enough distinction conceptually, but it might be a bit more challenging to define it in statutory language. Can you take that a bit further and tell us where precisely you think the point of distinction ought to be?

Dr Pragnell—There is probably a key line sentence in the fourth paragraph along the lines that, overall, any communication aimed at explaining internal features of the fund should be permissible without such communications being considered advice. I think that is probably where we would like to see the line drawn in terms of funds being able to communicate with existing members about investment choices or insurance features in particular, without that tripping them into the advice space.

Dr Anderson—There is another sentence after that, which is—

Senator BRANDIS—Alerting a member?

Dr Anderson—That alerting members to things that are part of the scheme that are government initiatives is also part of education.

Senator BRANDIS—It is more information than advice?

Dr Pragnell—Yes, and that line can be very blurry, and funds have struggled—I think everyone has struggled—with this for many years. If you want to communicate with members—

Senator BRANDIS—Here we are: this is the committee that will make some recommendations about it. Would you narrow it even further and limit advice to a statement which contains a recommendation either to do or not to do something? That seems to me the narrowest connotation of what advice is. Do you say that it should be that narrow for it to be advice, or would you acknowledge that it needs to be broader than that?

Dr Anderson—We have generally played with that idea. I suppose because it is so neat we are a little uncomfortable to say that that covers everything. We would probably like to think a bit further—

Senator BRANDIS—If you could take that on notice, because I think it would be very useful to us to have more than merely a discursive commentary on the distinction, which I think is the real distinction—that is a point well made—to have an actual proposal.

Dr Anderson—Yes.

Senator FORSHAW—I hesitated to go to my questions earlier because I was looking for a reference in your submission, but I cannot seem to find it. My recollection is that you made a comment about breach reporting requirements to APRA. The quote I have is that they are not appropriate and should only require reporting of material or significant breaches. Would that not increase risk? Would you like to fill out that comment?

Dr Pragnell—At the moment where our members are struggling—and it would be interesting to hear what the experience of the regulators has been—on the APRA side is that in particular there is no materiality threshold as there is on the Corporations Act side. On the Corporations Act side, in reporting breaches to ASIC there is a materiality threshold that needs to be reached before the breach is then reported to the regulator. That came about due to some rather lengthy and considered discussions between industry, government, Treasury and ASIC about making sure that the regulator received the information it needed to actually be able to undertake appropriate enforcement actions. The lack of a threshold means that the regulator runs the risk of being swamped with a large number of non-material, non-significant breaches being reported. Questions that get discussed range from the ridiculous to the sublime, such as, 'Do I have to report a spelling mistake in a product disclosure statement?' I know that people kind of laugh it off, but people are actually discussing those kinds of things in this area. The problem is that, if the regulator gets swamped with—

Senator FORSHAW—They are all trying to get everybody proficient in the English language these days.

Dr Pragnell—Yes. But there are experiences overseas, for instance in the UK where, when the Pensions Act was introduced there in the late 1990s, there was no materiality threshold for breach reporting to the regulator. The regulator was then swamped with hundreds of thousands of breaches being reported, and the regulator basically went to the government and said, 'We are getting too much. We cannot analyse this information. We actually need a materiality threshold so that we can better organise the data that we are getting.' What happened in the UK is part of the experience that we are drawing on. There is the issue of materiality threshold but there is also the basic issue about alignment between the ASIC and APRA requirements, which is particularly frustrating to our members at the moment and which the government, through FSR refinements, is seeing fit to progress and to hopefully address.

Senator FORSHAW—Just turning to advice, I understand that the recent ASIC shadow shopping survey outcomes indicated one in five planners making recommendations not in the best interests of their clients, either because of commissions or relationships with an institution. Do you have any comments on how we can improve that situation or any comments on the findings?

Dr Anderson—For us, the notion of disclosure has always been essential. At the moment we are refining our policy on the notion of advice, the remuneration for advice and how that might impact on the advice that is given. That piece of work is still being reviewed by our board, but it seems clear to me that the whole question of disclosure, how you disclose and in what way you disclose, is central and perhaps what we have not got at the moment is appropriate disclosure. We have disclosure but it does not seem to be working in the way that it ought to be.

Senator FORSHAW—By appropriate, do you mean that it is easily readable and understandable by the consumer, or is it also a failure to actually disclose material information?

Dr Anderson—It is probably more the way it is presented; we have to be able to do that better. We also need to get back to the consumer education part as well. That is going to be an incredibly important part of any solution to any adverse findings in this area.

Senator FORSHAW—You said that you are doing work on this at the moment. Can you tell us when that might be finished, when a report will be available and what form it is going to take in terms of taking it further? Could you just fill it out a bit more, particularly the timeframe that you have got in mind and what you would expect to happen after you have finalised your proposals.

Dr Anderson—We have in development a set of principles around remuneration and advice. It is a high-level set of principles, starting with the fact that we do value advice. We do think advice is good and that good advice is going to come from a number of areas, not just from financial planners; it gets back to our notion of the funds themselves being able to provide information. At the moment that distinction between information and advice is not clear, so this set of principles is being developed. What we will be doing very shortly is putting it up on our website for consultation, because this whole area of advice is a very difficult area. We are struggling with it as we try to put in the right processes for the industry and for consumers to play their part as well. So we are putting this up on our website for comment and we will come back. I do not see this as something that will be ready before next year.

Senator BRANDIS—Surely there must be some precedence in other fields for the definition of advice. For example, I am thinking of the insurance policies that cover advisory professions like consultant physicians or barristers in relation to the provision of advice. This is not a new issue.

Dr Anderson—Where we started was with the shadow shopping, which found inappropriate advice. There were some issues there around conflicts of interest and how people managed those. There are two things going on. One of them is that within our industry we have this tension between what is information and what is advice, and we have suggested that we need to be firmer on our position there.

Senator BRANDIS—You need to show us where the line is to be drawn.

Dr Anderson—That is right. It is actually quite difficult, as you have said. The other thing here that comes up with the shadow shopping is the conflicts of interest that arise in our industry. Dealing with both of those and getting a coherent policy has been a struggle, and we are hoping for a giant breakthrough shortly.

Senator FORSHAW—My question was directed to the second one of those, as Senator Brandis had talked about advice. Do you have a view on the proposition that there should be a single regulator, rather than it being split between APRA and ASIC?

Dr Anderson—If we had started off with a clean sheet of paper pre-Wallis we may not have ended up where we have ended up, which may have not been the best solution in terms of where we are. At the same time we now have a structure which has been established. There would certainly be a range of quite significant costs and destabilisation for the industry if we looked to reconfigure the arrangements that are there now. There would be significant costs or uncertainty if we were looking to unbundle that and change it again. So our first priority really has been looking at a better collaboration and consistency between the two regulators so that we are not getting duplication of red tape. We spoke earlier about the frustration around the breach reporting and the differences that are there, the frustration around surveys that are going out from the two regulators that are really asking for the same spread of information but in slightly different formats, and the expense for funds having to prepare information for two different sets of surveys. Our priority has been to try to get rid of some of that duplication and additional red tape that has come about by having two regulators in play.

Senator FORSHAW—I appreciate as well that a significant part of your submission—and this has been put by others—is that by this time there has already been so much change and so many inquiries and so on. I am not agreeing necessarily or commenting, but I am just noting that is part of your submission as well. I want to ask you the same question I asked the Self-Managed Super Fund Professionals Association with regard to the Westpoint scandal, tragedy, debacle or whatever you want to call it, and the fact that a substantial number of the investors affected were in self-managed funds. Do you have any comment about that?

Dr Pragnell—The point made by Graeme Colley from SPAA was quite a good one, that the self-managed funds were merely vehicles through which people basically invested, and that the issue really is around advice and disclosure and ensuring that the quality of advice and the level of disclosure is at a level where people can make informed decisions about these types of

investments and enter into them with their eyes wide open. ASIC, as previously mentioned, to its credit does recognise that there needs to be some improvement to the quality of product disclosure statements: that they need to be clear, concise and effective; and that they need to be effective consumer communication tools so that members or potential investors understand what they are investing in. Again, from the media reports and the commentary that we picked up around Westpoint it seemed that people thought they were investing in bricks and mortar when they were investing in CDOs. So it is important to ensure the quality of that disclosure, the quality of the advice and a level of financial literacy so that people can enter into these products and actually know what they do.

Mr Clare—Just coming back to that comment and the literacy question, that is important because the members and trustees of the self-managed superannuation funds are very similar to high net worth investors, or those individuals with substantial sums of money. If they have that, often it will be through a self-managed fund, as well as the possibility of direct investment. But it is the individuals who are investing and it comes back to that question of disclosure and understanding of what is told to them and the financial literacy of individuals when they are making decisions about investments so they understand the risk-return trade-offs and the nature of different investments.

Senator FORSHAW—One of the concerns I had about the earlier answer from the self-managed funds is that you cannot just brush it away. I am not saying this without respect, but if they are marketed or if they are put up as being superannuation funds ultimately for people's retirement benefits, then they are different to people who have substantial funds that they can invest and who perhaps might lose money or might make a huge profit on the stock market or property. To my mind, it is a different set of objectives. The fact is that people with self-managed or personal superannuation funds are going to be at much greater risk than large financial institutions or large super funds, simply because when they go down that person's entire future superannuation goes down. That is not necessarily the case when a bank or a major fund invests and takes a big hit, because the economies of scale are so large that it can survive and bounce back.

Ms Smith—I would certainly agree with you that people going into a superannuation fund that is supervised by APRA have the advantage there of having the rigour of APRA looking at the investment strategy and risk management; they have the advantage of professionals who, by their very definition, for the most part are going to be more astute than at least some of the individuals in the self-managed area. You will have a spectrum of people. So almost by definition self-managed funds are limited to individuals who say they are taking on the responsibility versus a managed arena where they are not. The other thing I add is that perhaps in the regulatory frame there needs to be a greater clarification, as I understand it, as to which of the regulatory bodies is in fact responsible for this area of investment. As ASIC indicate, they are doing their best on education but there is some ambiguity in terms of the scope of their coverage in this area.

Senator FORSHAW—I also asked a follow-up question about Westpoint that went to compensation in the event of employer insolvency. In your submission you argued that it should be provided for. Have you any views about how it should be provided? For instance, should it be provided through GEERS?

Dr Pragnell—We have previously raised this both with government and with this committee that we support the inclusion of unpaid superannuation in the GEERS program. We also believe in granting the ATO the necessary powers to pursue employers over unpaid superannuation guarantee. In our minds there are important changes going forward that we would like to see to ensure that employees do get the superannuation that is due to them.

Senator FORSHAW—With regard to compensation for theft and fraud in self-managed funds, do you agree that the current compensation arrangements should be extended to those funds?

Dr Pragnell—I do not think that we do.

Dr Anderson—We do not think that it is appropriate.

Senator FORSHAW—Why not? They are not fraudulent or they do not—

Dr Anderson—It is the nature of being self-managed that makes them not fit in with the general. They make the decisions. They are the trustees who make the decisions, whereas what we are doing with the other levy is protecting the people who are receiving other people's decisions—the people who are impacted on by fraud, theft or whatever. It is protecting the members of the funds who are not the trustees. We have always seen it as important that self-managed funds are very aware of the fact that they are the members and they are the trustees; they have the responsibility there.

Senator FORSHAW—One concern, even in small funds of fewer than five people, is that it does not mean that everybody is equal in terms of their involvement in the decision making, even if they are notionally equal as trustees.

Dr Anderson—That is one of the reasons why you might look to the numbers being small.

Mr BAKER—There has been a lot of discussion on information and advice and where it crosses over. Turn to page 36 and the illustration there. It is great, but my concern is that for the consumer the estimated superannuation balance when you retire is $311,000. Has there been any calculation included in that to give the figure as at today's dollars? It is page 36 of our book, recommendation 7.

Mr Clare—I have it in front of me. Basically when we do calculations and projections we always do them in today's dollars using an average earnings deflator. We have done that consistently and for some time. It is now getting embedded into other people's calculators, including that on the ASIC website. Going forward there is a process looking at uniform assumptions for calculators in the superannuation investment sector. That has been a slightly protracted process, but one of the agreed things seems to be to use deflators—current dollars—rather than future telephone numbers.

Mr BAKER—Sure. It was just a concern that it was not qualified.

Mr Clare—With this sort of statement you would have the assumptions given so that people could understand, but we would look to uniform practice and reasonable assumptions and a statement of those in all such documents.

Mr BAKER—I move to recommendation 8, which has the table headed 'Incidence of investment choice as reported to APRA'.

Mr Clare—I have that in front of me.

Mr BAKER—The third row has the average number of options: corporate, four; industry, nine; public sector, six; and retail, 61. What is the optimum level of choice? If you turn right back to basic investments, you have cash, fixed interest or capital guaranteed funds, property, Australian shares and international shares. What is the optimum level without confusing the consumer out there with too many choices?

Mr Clare—We have discussed this in a number of different papers. In the retail sector some retail master trusts might have hundreds of investment options, but in almost all instances we also have the involvement of a financial planner or adviser. Basically they are using those options available to construct a more limited portfolio or outcome. It is more a tool for the very many advisers who typically use a retail structure. What we see with members of retail funds is that they end up with investment choices which look similar to one of those other categories. It is just constructed out of a menu by the advisers, because some advisory groups have different approved lists because they have done research on certain investments. Some advisers or advisory groups will prefer one Australian share manager or one property manager compared to a different advisory group. It is more a menu for selection. I do not think that there are too many individual superannuation fund members who are sitting down going through the product disclosure statement ticking off that they like that one or do not like the look of that one; it is more a tool for the adviser in those processes. Funds are discovering that there is quite a bit of behavioural finance literature around and consumer literature. One example given is supermarket experiments. If you give people 15 jams to sample, they might try one or two of them and they will not make a purchase because it is all too confusing, but if they are given four, five or six, it is a much more effective process for them to choose from. Probably when you are getting over single digits you are getting into a situation which can be potentially confusing, but there are ways of dealing with that. Some individuals want the option available but generally it will not be used. Most people go with the defaults in funds, either what the fund sets or what the adviser sets. That makes it workable from a much bigger menu.

Mr BAKER—Hence another issue of what is information and what is advice. How many ways can a capital stable fund or a balanced fund or an aggressive fund be constructed? I am sure every investment house out there wants to be involved, but that is just one of those grey areas. Westpoint has been mentioned. I will go back to Ms Smith again. Surely there has been an overemphasis applied to the messenger or vehicles, if I could use those words. At the end of the day surely the attention should be on the regulator—whether it is ASIC or whoever—and product rulings to allow something like Westpoint to be out there in the marketplace and not so much on the advisers who are going on the advice that is actually being put out in the marketplace. I look forward to your comments.

Dr Pragnell—On that issue, one thing we have had in Australia is that reasonably sophisticated products can be offered to retail clients as long as disclosure is provided. Again, some of those products may suit certain types of investors but some of those products might be too difficult and complex for the average investor to get their head around. There have in the past been debates about whether or not certain types of products should be restricted from certain types of investors. I think that is a type of reform that has to be undertaken very carefully, because you do not want to clamp down on innovation in the marketplace, but at the same time you want to protect consumers. Finding that balance is always going to be very difficult.

Mr BAKER—I would like you to comment on the superannuation changes in the last budget. People in the industry continually put forward the complexities of pre-1983 service, post-1983 service, taxed and untaxed, and throw in undeducted contributions. Has this been a positive step forward in simplifying the whole process?

Dr Anderson—Absolutely. Our research indicated that one of the barriers for people about superannuation, even though they thought it was a good thing, was the complexity, which was off-putting. The very big positive about the changes going forward is that they start to strip away some of that complexity and we can start to get better engagement with people about superannuation and what it means to them. That is not to say that we have stripped away all the complexity.

Mr BAKER—That is an opening for the next question: the role of government for the next set of complexities that need to be addressed.

Dr Pragnell—The budget changes, as Philippa mentioned, generally do simplify the system and do make it better for members, but they do present some new challenges for both industry and for funds. One is the tax file number issue. There is going to be a greater obligation on the quoting of tax file numbers to superannuation funds, otherwise the members will be subject to tax penalties, so we are looking forward to industry working with government to try to get the message out to individual members about the importance of quoting their TFN to their superannuation fund. That is important to make sure that this system works properly in terms of the contribution limits.

Dr Anderson—The group that was left out there is the employers. The employers have a very big role in making sure that the TFN is sent to the fund. If we all work together, TFNs are wonderful. They will make a real difference to the system and the way it operates, but we do not want to have a lot of the most vulnerable people out there without the TFN being penalised. So it will be quite a big campaign for industry, government and employers to protect those people in the new regime.

Mr Clare—Logically our comments about improving the definition of advice and reducing compliance costs in the industry tie in with your comments about the next area of complexity. They are major areas where we have already identified excessive costs at the moment and scope for improvements which benefit both funds and members. We need better disclosure, and simpler and more useful information and advice going to members rather than artificial restrictions and lawyers picking over various documents for no good public policy purpose.

Mr BAKER—Hence the information that you will come back to us with. Everything comes back to information/advice and where the two fit in. It is encouraging to read in the 2005 report into Australia's ageing policies that the OECD said Australia's superannuation guarantee system was one area where the country was well ahead of other nations in trying to provide sufficient incomes to retired people. That must be encouraging from an industry perspective, not that we want to rely on benchmarking against other countries.

Ms Smith—It certainly is. The interesting thing about the compulsory nature of superannuation is that it has provided a very important tier in the Australian system and in fact is appreciated by the population as a whole, who acknowledge that it provides a discipline and structure. They would not have saved to the extent unless that was there. As that report says, Australia is often quoted as being the best example in that area. I would say that it is a case of the glass being half full. We still have a way to go in terms of ensuring adequacy, particularly for middle income people. We welcome the government's changes for removing the complexity of super, but to our minds there needs to be some additional steps to ensure adequacy of savings, particularly for middle income groups. The sorts of areas that we have flagged as being potentially useful going forward are, for example, what we have described as soft compulsion, where the idea of people who change jobs might be required to save a bit more through salary sacrifice than the nine per cent, but with the power to opt out if they have other problems.

Mr BAKER—There are incentives like the co-contributions?

Dr Anderson—Yes, if we could extend that to middle income people and maybe removing the SG threshold so that lower income casual workers also get the benefits of the superannuation savings. There are a number of initiatives that we can take forward to build on the excellent structure that we have in place at this point.

Mr BARTLETT—There is a question here about the respective responsibilities of government, the industry and the individual to make adequate provision for their own retirement savings. I would argue that the incentives that the government has introduced, in terms of the co-contribution and in terms of tax concessions, particularly on exit taxes and benefits, in the last budget are very substantial. To what extent has the industry got a role to play in further encouraging voluntary take-up of superannuation? In that context, I noticed a report on the front page of the *Sydney Morning Herald* this morning that indicated that for male baby boomers the average accumulated retirement savings in superannuation is only $87,000 and for women it is only $8,000. Could it be argued that the industry itself and associations such as yours have a much greater role to play in that regard?

Ms Smith—There is a role for all parties, and the key parties to ensure an adequate retirement income strategy are basically the government, employers, individuals and funds. We all have a role to play in this, and the role of funds has been in terms of education. Certainly ASFA has tried very hard over recent times to get a debate going so that people could understand and fix a goal in terms of answering that question about how much is enough and therefore taking appropriate action. We did research with Westpac in terms of describing to people what lifestyles they would buy at different levels of income, and that is also behind our recommendation about the prospective calculators. It helps people set a target and then be able to work for it, which is very important.

Education is a very important element. The research has been done overseas and, when we look at international examples, education is just one plank. In fact the idea of having a structure and discipline which people work within is also very important. So one of the very important things is changing people's awareness that nine per cent is not enough. At the moment people think nine per cent SG: that is what the government thinks, therefore that must be enough. We need to change the norm more from nine per cent to 12 per cent. The idea of the soft compulsion or having a structure which is not compulsory or obligatory does two things. It says that the norm should really be 12 per cent and it also provides a structure which provides an easy discipline for people to work within.

Mr BAKER—Surely the vehicle would be starting in the education system when they are at high school or primary school, basically.

Ms Smith—That is ideally where we should be.

Mr BAKER—Instead of when they get to 16 or 17 and they encounter this word 'superannuation'—what does it all mean?

Ms Smith—The important thing there is that the government changes do assume that people will start saving earlier than they do now and save more regularly. In the future the gallop towards your retirement will no longer be available. I have to say that we still have a lot to do to get both the understanding and the motivation for the under-40s to kick in, because the reality of retirement seems irrelevant for many people of that age.

Mr BAKER—The process needs to be put through the education system at primary school or high school so that the psychology of the reason for and how superannuation works is already in the cognitive process to move forward.

Ms Smith—That would certainly be one of the pegs, but you are looking at almost a generational change for that to actually come through the system.

Senator MURRAY—I want to return to your recommendation 8, which is really what we have been discussing. You gave some interesting analogies for the United Kingdom and Sweden, requiring that forward projections are provided with certain safeguards. It seems to me that that was automatically the case with defined benefit funds because, by virtue of its definition, you knew what you were getting. But with the accumulated funds becoming the dominant mechanism now, I do not think most people are aware as to the effect of what they are doing in the long term. I tend to support your approach, but I would be interested to know whether you have any empirical research which indicates the behavioural consequences of doing this. It seems to me that nine per cent is almost a safety net; it is a minimum. What the government has done is to provide all of these incentives to top it up, but missing in that mix is an understanding of what happens when you add those two together and what your eventual retirement benefit will be.

Ms Smith—ANOP Research Services referred to it. We do regular research each year where we benchmark consumer attitudes towards superannuation and savings generally.

Senator MURRAY—That is a different question. I asked you whether there was empirical research which indicates the behavioural consequences. For instance, use your example of Mr Person under 40 and you have indicated the estimated superannuation balance when you retire is $311,000. With respect, that is meaningless, because if you are retired for 30 years what does that mean? Most people want to know what they will have on an annual basis.

Ms Smith—We would agree. Our recommendation illustrated that; our preference would be that that gets described as an annual budget.

Senator MURRAY—Exactly. It is one thing to recommend the government pursue reforms that would permit superannuation funds to provide benefit projections, but if you are asking for a legislative mechanism for that you need to be able to justify it with: these are the behavioural consequences. For instance, if a person earns $30,000 now and wants to have $30,000 a year when they are retired and their superannuation balance was a particular amount, how much more would they need to put in over time? That is really what you are driving at.

Ms Smith—That is what the calculator would in fact allow people to do.

Mr Clare—It tends to be difficult to just give a one annual income in retirement figure in the Australian system. In some other jurisdictions it is easier because they have different social security systems. Here the majority of people in retirement rely in whole or in part on the age pension and their draw down of that will depend on their assets and income over time. Retirement income also depends on the age at which you retire. You can have some sort of single instances of retirement income given in an illustration, but often it is better done within an interactive calculator, taking into account individual circumstances.

Senator MURRAY—Having been at the heart of the negotiations which produced the dollar versus percentage for your calculator and all those sorts of outcomes, I am aware of the complexity you outline. I wonder if your recommendation is not in fact wrongly phrased. My instinct would be that the government not pursue any reforms at all but simply lift the restrictions and let the industry work out the best way to do these things, within prudential limits. As you pointed out, currently ASIC policy statement 170 places strong restrictions on the use of prospective financial information, and it is that restriction that prevents you trying to develop custom-made calculators.

Ms Smith—You are right in saying that there needs to be some flexibility going forward. There does need to be agreement so that there are standardised assumptions about what the earning assumptions are and how you go about the price deflation.

Senator MURRAY—Surely that merely requires government not to pursue reforms but to say, 'We are having nothing to do with this; however, it must be resolved between the following bodies and you must come to an agreement.'

Dr Pragnell—That is what is happening right now.

Mr Clare—This process is underway in a somewhat protracted fashion. We do have ASIC involved. We have had some industry working groups and there are still some matters to be resolved, but that is very much the preference and intention of ASFA. We want to work within

the industry to develop agreed standards for these calculations and calculators, and we see that coming from industry being a better process than it being a government decision as such. That is what we are working on.

Senator MURRAY—As you know, committees like this produce recommendations which hopefully the government will react to positively and later on we will discuss what those will be. My own instinct is that our recommendation should simply be that government merely approve the use of prospective financial information, subject to agreement between key bodies as to how that should be structured within a timeframe. Apart from that, government should keep its sticky hands out of it.

Dr Anderson—We may have phrased it a little clumsily, but that is where we agree.

Mr Clare—That is very much in line with—

Dr Anderson—We just want permission to come up with the standards and to do it.

CHAIRMAN—Earlier we discussed whether the so-called twin peaks—APRA and ASIC—were appropriate as against the single structure. You raised the issue of overlapping and inconsistency between their regulatory roles. Accepting that we maintain the separation, are there areas there where rationalisation of responsibility of roles could occur?

Dr Pragnell—We have already discussed breach reporting. That is one key area that we can get some rectification on. There are other areas such as data collection by both of the regulators. Another is notification of certain changes. For instance, if you are changing a responsible officer under both your ASIC and your APRA licence, you have to complete separate documentation that you then have to send off to each regulator. In those kinds of areas definitely we could see some harmonisation which would be of assistance. Some of that requires regulatory change like breach reporting. Some of it only requires some administrative coming together by the regulators. That issue was well discussed during the business regulation taskforce. The government has been pursuing a number of these changes through the FSR refinements process, and the regulators have taken it upon themselves to open up more of a dialogue with each other on a number of these issues. There is definitely progress on this. If we can get rectification around some of those issues that would be good.

CHAIRMAN—In relation to promotional advertising, you submit that promotional advertising is a legitimate expense that may be met from fees, but you also say that under the sole purpose test there must be a connection between the advertising and the benefit to members. What is the benefit of promotional advertising to existing members?

Dr Anderson—Partly it is knowing what their fund does. It is almost education. If I look at some of the promotion that is going around, my view is that it is as much aimed at those who are currently members of the fund, so that they understand what they are members of and why, as to get new members. One of the things that we do know is that a lot of people unfortunately do not know much about their fund. In a sense the visibility of the fund acts as much as an education event as it does to get other new members in.

CHAIRMAN—Would mass TV advertising be a cost-effective way of doing that, compared with information sent direct to members?

Dr Anderson—Probably.

CHAIRMAN—It is wasted on a lot of people who are not members, isn't it?

Dr Anderson—I am more likely to actually key in and say, 'I think I know that fund,' or, 'I think that might be my fund,' and listen to it. A lot of people do not read what you send them so, depending on where you place the advertisement, it may in fact be a very effective piece of information for members.

Mr Clare—Large funds use a variety of communication methods. There are mass mail-outs. They are big customers of Australia Post. Much of that information gets binned. It is just the nature of it. It is a turn-off for some people. Some funds are starting to use targeted emails as a method of communication to those members that they have contact details for. Some will use their call centres when there are incoming calls to then give some additional information. Part of the suite is also advertising where funds are required under the APRA requirements to have a documented legitimate case for doing that within the legislative constraints. There are roles for all of those techniques.

CHAIRMAN—As there are no further questions, I would like to thank each of you for appearing before the committee and for your assistance with our inquiry.

Proceedings suspended from 11.24 am to 11.32 am

ANNING, Mr John, Manager, Policy and Government Relations, Financial Planning Association of Australia Ltd

BLOCH, Ms Jo-Anne, Chief Executive Officer, Financial Planning Association of Australia Ltd

KEAVNEY, Ms Glenese, Member, Superannuation Committee, Financial Planning Association of Australia Ltd

POLLOCK, Mr Brian, Member, Superannuation Committee, Financial Planning Association of Australia Ltd

POWELL, Mr Keith, Member, Superannuation Committee, Financial Planning Association of Australia Ltd

CHAIRMAN—Welcome. 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 an in camera hearing from the committee and we would consider such a request. The committee has before it your submission, which we have numbered 38. Are there any alterations or additions you wish to make to the written submission?

Ms Bloch—No.

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

Ms Bloch—I would like to make an introductory statement focusing on the main points in our submission. I am joined by a number of colleagues from the FPA who are also available to answer questions, and we do represent quite a wide range of membership. The Financial Planning Association of Australia is the peak professional association for financial planners. We have some 12,000 members across a network of 31 chapters that operate on the ground. We represent some five million Australians with a collective investment value of an estimated $630 billion in assets.

The FPA has taken a leading role in the protection of consumer interest by raising the standards of financial planning in Australia through our own professional standards, and the need to adhere to those as a member of the FPA, through educational programs and through membership of a formal complaints scheme. We are also the sole licensee in Australia of the certified financial planner designation, and Glenese and Keith both have that designation.

Conflicts of interest principles became effective from 1 July, and this is a landmark set of principles for the FPA in that we are requesting of our members that advice is delivered in the interests of clients, that remuneration or benefits paid to advisers should not be biased and that remuneration should be split between advice and product so that the client can clearly see the benefit and the cost of that advice.

The key issue that we wish to highlight today and to this committee is the importance for many Australians of receiving professional financial planning advice on superannuation and, indeed, on their particular interests. Superannuation is an integral part of our financial security and it forms the basis for the retirement plans of many Australians. I think we all know that Australians' expectations of their living standards in retirement are higher than the average person's current levels of superannuation will provide, that is, there is a retirement savings gap.

We certainly concur that a number of positive changes have been made more recently to improve the tax position. Initiatives such as co-contribution certainly help, and we know that the Literacy Foundation, for example, is trying to increase the level of education and knowledge about superannuation, amongst other money issues. However, the FPA wants to stress that appropriate and ongoing professional advice will play a very significant part in helping Australians achieve their goals, which are a financially sustainable retirement. Advice is a much broader concept than pure investment advice, and in terms of super it can include advice on issues such as your retirement needs, how much you actually need to live on, income projections, analysis of your risk profile, asset allocation, risk insurance, salary sacrifice strategies, tax planning, whether you are able to benefit from co-contributions, advice on Centrelink benefits and a whole range of issues.

We have seen a number of changes over the years, and whilst we certainly support the general principles behind financial service reform—in fact, we strongly endorse and have worked through a number of those principles—we do also want to represent today the fact that the cost of the regulatory burden that we are now faced with is in some ways a little excessive in terms of delivering the consumer benefit. So there are very substantial statements of advice and fairly convoluted procedures and so forth to deliver that advice. I am hoping that my colleagues, Glenese and Keith, can provide some very good examples as to why we think that the regulatory burden has increased the cost and not necessarily delivered the benefit.

Members tell us in huge numbers that the costs are in fact considerable, that there are significant complexities. When you are looking at consolidation of super, for example, in many cases they are walking away from this because there are substantial barriers to delivering advice—advice to people who really do need it. We are working on several fronts to make advice of super consolidation more affordable, but we find that there are a number of issues that we are talking to both the government and Treasury on, and which we have in fact mentioned in our submission, that indicate that there are still some measures to go before we are delivering affordable and accessible advice to Australians who most need it.

We also stress that the super guarantee component ought not to be excluded from the advice component. It is a critical part of an individual's ongoing asset. It is a critical part of their retirement goal. In fact, if an adviser is to provide comprehensive advice that meets their clients' needs, we find it difficult to imagine how you could in fact take the SG out, and we do strongly urge this committee not to endorse or support any moves that quarantine the super guarantee from the advice framework.

The last issue I want to talk about is member investment choice. We are concerned—and we have mentioned this in our submission—that APRA's interpretation represented in their circular, which was released in March 2006, will in some ways undermine member investment choice arrangements in public offer superannuation funds, and we do believe that this has implications

for a number of our members. We understand the role of the trustee is to determine the suitability of an investment at a fund level, but we strongly urge that where a member gets individual advice that advice is acknowledged, accepted and understood by the trustee, because we feel that it is that individual's right to get that advice. In fact that advice might be more suitable to that particular individual's circumstances. So we do call for regulatory change to confirm that professional financial planning advice takes into account an individual's needs and overrides any general obligation of a trustee.

In closing my opening statement, I want to restate that there is considerable value in receiving advice as demonstrated in a number of surveys. One in particular conducted by IFSA in September 2005 indicated that of the sample survey—the individuals that they surveyed who had a relationship with an adviser—86 per cent of cases agreed that they had more clearly identified their lifestyle and financial goals. In 85 per cent of cases they agreed that they were more confident that they would achieve their financial goals, and in 85 per cent of cases they said that they were more in control of finances. We cannot stress enough how important the value of advice is and how important it will be to help Australians achieve their retirement goals.

CHAIRMAN—Thank you. In relation to the issue of advice, you say in your submission that there has been some criticism of fees and commissions being charged in relation to superannuation guarantee contributions paid into a member's account. You also say:

... if there is advice or some other service provided in relation to that money, it is legitimate for the provider of that service to be paid for that service. Any mandated move toward upfront fee-for-service might disenfranchise lower income earners who simply cannot afford to pay for advice through an upfront lump sum.

Does that indicate that through the commission system of remuneration there is in fact significant elements or some element of cross-subsidy between those people receiving advice who are investing substantial sums and those who are investing relatively modest sums?

Ms Bloch—I think you will find that in fact—Glenese, I do not know if you want to deal with this—commission structures can vary according to the asset size of particular clients, and I think they can be modified to suit the specific services that an adviser has been engaged to provide. I do not think you envisage necessarily always a flat level of commission irrespective of your account balance. That commission structure is often scaled to reduce as assets increase, if that is what you are getting at. Is that your point, that a flat two per cent irrespective of your asset balance is necessarily cross-subsidisation?

CHAIRMAN—No, not necessarily a flat rate of commission. You are saying that an upfront fee may not be affordable by low-income earners, or those with consequently a relatively low amount of funds to invest. But surely also the commissions derived from the investment of those funds, at whatever rate, would also be relatively low and probably would not cover the cost of advice in any case. In that instance it would seem there must be some element of cross-subsidisation.

Ms Bloch—I get what you are saying. That is up to the adviser and the client, firstly, to determine, so that they can work out the appropriate level of remuneration and, therefore, advice that goes with that. I guess an adviser has a portfolio of clients that they can determine how best they are remunerated. I think what we are seeing in terms of consolidation of super demonstrates

that in some cases the cost of advice and the requirements of delivering that advice are certainly not covered by any commission payment, so to that extent advisers are necessarily often providing services and they are not getting fully remunerated for that service. I guess it is swings and roundabouts in some cases.

CHAIRMAN—That was the point I was making, that a low-income earner, or a person with a relatively low level of funds to invest, irrespective of whether they are charged a fee for service or commission it is probably not going to cover the cost or the time that the adviser would be allocating to provide appropriate advice.

Ms Bloch—That is right.

CHAIRMAN—So there must be some element of cross-subsidisation from other clients to cover that.

Ms Keavney—Or there could also be in a sense pro bono work that you might do for the children of your clients, where they have got small account balances and they might not personally be able to afford to pay for the hours you could put in for the advice, but you are doing it as part of the context of family advice.

CHAIRMAN—That leaves the question as to why would a fee-for-service approach deprive such people of advice as against a commission approach, given that you would accept that both of them are at a relatively low level for those people? They are still paying for it, whether they are paying by commission or by fee for service.

Ms Keavney—If they do not have a cash flow surplus to allow them to pay a fee but they do have a superannuation balance, a component of which could be used to pay for the advice, it would still be the same cost but they just do not have the cash flow surplus to be able to pay.

CHAIRMAN—In that context you are talking specifically about superannuation guarantee people.

Ms Keavney—Well, any superannuation.

CHAIRMAN—If people are putting money into superannuation surely they could use a portion of the money that was going into the fund to pay the fee rather than have it paid by commission out of the fund? What is the difference?

Ms Bloch—I think there are different ways of structuring this, and you are starting to see that choice in the delivery of how you can pay for these sorts of services. We have a good example, which we can talk through later, of a particular individual with a number of superannuation funds, and you might structure an upfront fee for the initial advice and then a commission for ongoing advice or a fee for ongoing advice or a commission that covers the whole lot. That is where you need to have the flexibility between adviser and client to structure an arrangement. We do certainly want to make the point in terms of providing affordable and accessible advice that the costs of providing the sorts of advice and the comparisons and so forth that our members are providing are not always covered by an upfront fee or necessarily a commission—this is an issue that we have talked about in our submission. I know you are picking up the issues of cross-

subsidisation, but you have hit on a very good point irrespective of whether it is a fee or commission, and it is a point that we certainly would like to make very clear.

Just going back to the other issue, there are different ways of being able to pay for that advice. The other thing is that that is just on superannuation. There might be other issues that that particular individual needs advice on, so they might have investment requirements, debt issues, Centrelink problems or whatever. It is not only on superannuation, although that is often necessarily used to pay for that advice, I understand. But you raise a very good point that, whether it is fee or commission, it does not always cover the cost of advice.

CHAIRMAN—That leads to the issue of how you can be sure, if you are paying for your advice through commission rather than through an upfront fee, that you are in fact getting independent advice. Not that there is anything necessarily wrong with commission based remuneration; I do not think there is anything wrong with that. But generally commission based remuneration is based on marketing or selling a product rather than giving independent advice on a product. I am just wondering how you sort that out.

Ms Bloch—Commission is another form of remunerating your adviser, and our conflict of interest principles require that the commission be split between advice and product so that you can see which component goes to advice and which bit goes to product, and our conflict of interest principles also require that the remuneration does not bias the advice that is given, and that in fact the advice and necessarily the implementation of advice is in the interests of the client. I think that is a legislative requirement, anyway. It is not that we have come up with some revolution here. We are just demanding of our members that these things are put on the table and the clients absolutely understand what it is they are paying for.

Can I also say from a commission point of view that there is a huge amount of ongoing advice required in some cases. You can often put a set and forget strategy in place, but in some cases—and we can talk through this in quite an amount of detail—you do need to review your strategies, you need to look at your contribution levels, you might like to look at your asset allocation, there might be market movements, or in fact you might simply want advice to say, 'Don't do anything.' So that commission is not only about the initial piece of advice and a product. It is also about providing ongoing advice, being able to ring your adviser whenever you like, being able to ask them questions across a whole range of different issues without necessarily having to sign a cheque. But it is only one form of remuneration and, clearly, the consumer or the client needs to understand what it is there for, what it is in dollar terms as well and what the benefit is.

CHAIRMAN—Does the FPA have a view on ASIC's recent shadow shopping exercises?

Ms Bloch—Do we have a view?

CHAIRMAN—On their outcome and the validity of their conclusions?

Ms Bloch—Did you want to comment on that, John?

Mr Anning—Yes. While not wishing to argue about the particular percentages that ASIC came up with in terms of the shadow shopping survey, we agreed with ASIC that the shadow shopping report was a very important snapshot of the advice that was being given on

superannuation, and there were a number of issues that were and are being addressed. We would like to highlight that they found that a very high percentage of advice did have a reasonable basis, with a very high percentage of clients who were satisfied with that advice. So certainly it was not a 100 per cent positive report card for financial planning but it had some very good findings as well.

Ms Bloch—Some of the issues in addition to that that we have raised in our submission, and continue to raise with Treasury, include the need for scalability of advice, materiality thresholds and for things that were evident in the shadow shopping outcome. So there were some policy implications there that we continue to press for and argue for as well.

CHAIRMAN—You recommend regulatory changes to confirm that professional financial planning advice should override any general obligation a trustee may have in respect of member investment choice. Could you comment further on the relative responsibilities of the trustee and the financial planner and indeed, I suppose, the individual investor in the context of investment choice, and in the context of your recommendation did it imply that financial planners should take responsibility for any failings or deficiencies in the advice given?

Mr Anning—We certainly did not intend in the wording of our recommendation to put the planner in the position of the trustee. I think the point was rather that the trustee has a duty to manage the financial wellbeing of the superannuation fund, which could still be managed while recognising the ability to act on individual member investment choices when backed by professional financial advice. The scale of the superannuation funds these days, together with modern finance management techniques, mean that it is not necessary to maintain a rigid rule that the investment choices of individual members have to be consistent in all cases with a single investment strategy.

CHAIRMAN—Can you comment further in relation to your recommendation:

There should be no mandated default investment strategy for superannuation guarantee contributions.

Ms Bloch—This goes back to that member investment choice situation. There is a lot of evidence to indicate that a number of members are simply not exercising choice or not necessarily thinking about their choice and are opting into default funds which, for all intents and purposes, may work in some circumstances but certainly do not necessarily, in our view, maximise opportunities for members. For example, is there enough choice between a 20-year-old and a 50-year-old in their potential default strategy? Our proposition is that we think too many people are going into default funds and not necessarily understanding or making active choice. Again, this goes back to the member investment choice situation. If someone is not confident enough or does not have enough information to make a decision, then advice might be able to help them determine an appropriate investment strategy that is right for their needs. This is not something that should necessarily occur in all circumstances, but certainly the high incidence of members defaulting is of some concern, which is why we advocate no mandated default fund. Individuals should certainly have the right for their SG, for their total superannuation component, to exercise choice. The default is there for those people who are not able to, and we recognise that. But you have to be able to give people an option.

CHAIRMAN—You also raise the issue in relation to promotional advertising of the sole purpose test, and you expressed the view:

General advertising by a fund does not arguably meet the sole purpose test. Nor is it justified by general trust law in terms of remuneration of trustees.

I do not know whether you were here when our previous witnesses indicated they thought that general advertising did meet the sole purpose test. Can you expand your views on that particular issue?

Ms Bloch—We are not actually anti-advertising at all, we are simply saying that the costs need to be disclosed. We do question whether advertising is necessarily education focused. I think you would argue that some of the adverts that you see on TV are about competition in the market and are about promoting one fund versus another. We do not necessarily have a problem with advertising per se. We are simply saying that we do not necessarily think it is actually part of a super fund's obligations, but if you want to advertise and if you have a cost allocated to it and if you are able to pay for it then at least members ought to know what that cost is and they need to accept that that is a cost. You can argue the toss as to whether it is education, promotion or otherwise as long as members first and foremost are aware of that cost and accept it. I would question whether a lot of the advertising is about education, because it is a very competitive market out there.

CHAIRMAN—You quote a letter to trustees from APRA Deputy Chairman Ross Jones, which says inter alia:

In our view, imposing marketing expenses on current members primarily to attract new members where the benefit of such expenses falls primarily to the trustee (by way of enhanced remuneration) or other parties would be inconsistent with the sole purpose test and may give rise to inequities among generations of members.

Have you raised with APRA these issues that you are raising here in relation to advertising and, if so, what response have you received?

Mr Anning—No, we have not raised those issues specifically with APRA. They came up in the context of this inquiry and we put the views in the submission that we made.

CHAIRMAN—You recommended full disclosure of the costs of advertising, and also the disclosure of any ancillary benefits received by trustees from sponsorships. What do you have in mind there?

Ms Bloch—I think you come across a range of different issues that trustees might engage in. I think the previous people did talk about all sorts of different forms of communication, various activities, whether it is education, trips or whatever it is. We are simply saying that we do not necessarily disagree with the activities but we do think that members need to understand how they are paid for.

CHAIRMAN—You also recommend that the committee, in relation to the concept of not for profit, or all profits going to members:

The committee addressed the issue of transparency of super funds, particularly in the area of service providers and the issue of inconsistency of reporting fund returns.

Can you perhaps enlarge on what you had in mind there and what you mean by 'service providers'?

Ms Bloch—There are two issues there. The first one on service providers is that we accept the not-for-profit fund status, but a number of services delivered to those not-for-profit funds are necessarily delivered by service providers who do make a profit. We think that there is some confusion out there between what really is not for profit within a super fund and some of the service providers providing services to those particular super funds. We do not argue with the status. We simply say that the related parties should be disclosed and that the relationship should be understood, because we think that there is some confusion. I think that covers it. You wanted a comment on the service provider issue in particular?

CHAIRMAN—Yes. Who do you have in mind in relation to service providers?

Ms Bloch—Administrators, fund managers, insurers—there is a whole range of different service providers who provide services to super funds, irrespective of who they are. We appreciate the super fund has a not-for-profit status, but are you disclosing the full cost structure and all the related party interests and financial arrangements to members? We think there is some confusion there around what not for profit is or where all profits go back to members. Sure, there is no problem with that particularly, but there are service providers sitting under there that do make a profit.

CHAIRMAN—Do you think there is a need to drill down in terms of transparency beyond the super fund itself?

Ms Bloch—Yes, just some full disclosure.

Senator FORSHAW—In terms of a couple of the recommendations you make, firstly, the one in regard to reviewing the existing exemption under the corporations regulations to ensure that only holders of an AFSL are able to provide advice, this effectively removes the exemptions for accountants. Could you expand on your reasons why that should happen?

Ms Bloch—Why we resist further exemptions? We feel that there needs to be a level playing field in the provision of advice and we believe that the licensing arrangements should apply to all professionals advising advice in that space. I really think that is where it begins and ends. There is an exemption that has been provided and we did argue strongly against that exemption. We feel that there is again some confusion for clients between who can provide what advice in a particular self-managed super fund arrangement, and we feel that it would be much easier if everyone was licensed to provide that advice as is required in other areas.

Senator FORSHAW—Can you be more specific about what you mean by there is 'confusion' amongst consumers?

Ms Bloch—When you are setting up a self-managed super fund, your accountant can provide you with certain information in a certain area and then you may need advice in another. They tell us that that fine line—

Senator FORSHAW—Such as?

Ms Bloch—You might ask whether a self-managed super fund is appropriate for you versus, let us say, a managed investment or some other structure, and an accountant can certainly help you look at structures, but then you might say, 'What investment strategy should I actually undertake? Should I put my money in a growth strategy or cash or whatever?' That is where we are saying that, if you are going to provide advice that extends down the full spectrum of helping you with your end goals, then you should be licensed. It does require clarification, and we believe that providing advice is something that you should be licensed to do and that you should not stop and start the process.

Senator FORSHAW—The issue relates to investment advice; that is essentially the argument.

Ms Bloch—I think that is one of the issues.

Senator FORSHAW—I gathered that is what you meant.

Ms Bloch—Yes.

Senator FORSHAW—I just needed to have that on the record.

Mr Anning—If I could just pick up on that, the accountants' exemption is actually very difficult to adhere to in practice, and for anyone merely to advise on the structure of a self-managed superannuation fund without getting into the advice space is difficult, as shown by the outcomes in the ASIC shadow shopping report; the majority of accountants who were surveyed actually were acting without appropriate licence authorisation. So we believe the exemption really needs to be rethought.

Senator FORSHAW—In terms of the recommendation about advertising, which Senator Chapman has asked you about, you recommended that it should be disclosed. In what form? Should it be just aggregate disclosure for the fund or per account?

Ms Bloch—I think the cost of that particular marketing expense, if you want to call it that, and what comprises those marketing expenses should be provided to members, maybe in an annual statement or in that sort of form. I do not know that you necessarily need to provide it on an individual basis but you can certainly include it in the annual report.

Senator FORSHAW—I have asked other witnesses questions about the Westpoint saga. I am not sure if you were here to hear the question but apparently about a third of the investors in that operation, where around $300 million was lost by up to 400 investors, were via self-managed funds. There was also concern raised about mis-selling, where commissions of 10 per cent were being charged. I am interested to hear comments from the association about their reaction to that.

Ms Bloch—Certainly, Westpoint raises all issues across the full spectrum. Whether it was a self-managed super fund or whether it was a direct investment is neither here nor there.

Senator FORSHAW—This is an inquiry into super and we are just focused upon self-managed funds for the moment. I am not suggesting that there are not other issues.

Ms Bloch—I think it does go back to the advice, the nature of that advice and whether that advice was appropriate. In some cases, that advice was for the self-managed super fund to invest in that particular investment.

Mr Powell—Or maybe they did not receive advice. In a lot of instances that was the case. There were various seminars by unlicensed people selling DIY funds. Along with that, I understand they were also offered the investment into Westpoint, and that was completely outside of the advice arena. I think we should distinguish there, of the people who lost money in Westpoint, as to who lost it under advice, what type of advice it was—was it appropriate in that it was part of a diversified fund, or was it outside of those arrangements? Also, I understand that a fair proportion of the moneys there were sold directly as part of selling a DIY fund, which was nothing to do with members of the FPA.

Senator FORSHAW—The basis of the question I am asking is really in relation to regulatory failure as distinct from apportioning blame or anything like that. Other people in other inquiries have been set up to do that in other proceedings. I want to get a reaction from the Financial Planning Association, as I have asked the other groups, about what flows from it in terms of improving regulation both as to advice and particularly in relation to the work done by your members?

Ms Bloch—I think you get the full gamut, where some of it was entirely appropriate and some of it was not, although we are still investigating a number of complaints and a number of members in that frame. If I was to say what needs to come out of this, I think there are a couple of issues. We do need to make it clear where there are high-risk investments or where there are higher commissions paid that the client absolutely understands that, and I have talked a lot in the last couple of weeks about warning bells. Clearly, we would like all of our advisers to be entirely professional and provide appropriate advice in the interests of the client. But if that is not going to be the case and we cannot completely control that, what are the warning signals from a client's point of view as well, and how do we provide information that sets warning bells going in the client's mind? We are talking, for example, about a five-point summary on top of a statement of advice, 'These are the things you must know.' Statements of advice can be 50 or 60 pages long. Does the client always understand that the commission is high? Do they always understand their particular risk profile and so forth? We are looking at putting some key risk, remuneration and service parameters on top of the statement of advice so that we can set the alarm bells going. Clearly that is one area. What can trigger alarm bells? What can trigger the sorts of things that you want your client to walk away from, or you want them to say, 'Look, this is questionable. Why are you doing this?' But I would have to say also there were plenty of cases where there was zero commission provided on Westpoint as well. It is very difficult and we are still going through the process of nabbing all the outcomes because, as I said, you have the full gamut.

The early indications are in terms of: how do you get the alarm bells going? How do you provide that sort of framework where questions can be asked? If it is a complex product and you do not understand it, walk away from it. If your adviser cannot explain it and you are really still uncomfortable, walk away from it. If you think that 10 per cent is too high, walk away from it. I know the alternative position is that not everyone is going to know that 10 per cent is too high, and in fact it could even be argued that in some cases, if it is a high-risk investment with high returns, 10 per cent might even be seen as appropriate. We have to work through all these sorts of angles and try to provide better information and better warning signals to be able to look at these sorts of things.

I think there are a range of other areas in terms of where you think something is not going right, and ASIC's role in stepping in and looking at these sorts of issues. But just from our advisers' and their clients' perspectives, certainly there are things that we can be working on. But I would hate for you to say, if you implemented them all at the end of the day, could you avoid a Westpoint? I do not know that that is the case either.

Senator FORSHAW—I have two other brief issues. Firstly, in terms of the insurance requirements for financial planners, the FSR Act in 2001 was intended to ensure adequate insurance coverage for financial planners. It was deferred to July this year and has again been deferred until early 2007. Have you been consulted by the government on what is happening in regard to these legislative requirements, and do you have any concerns or any comments to make about the delays?

Mr Anning—We have been in discussion with the Treasury about these requirements. We pressed our concerns that the guidance needed to be provided, that the provisions within the act could not simply be allowed to operate without development of guidance between Treasury and ASIC, and we asked Treasury to be part of those consultations. I do not believe we have been contacted recently in that regard.

Senator FORSHAW—Do you have any firm indication as to when this is going to be completed?

Mr Anning—We have no firm indication, sorry.

Senator FORSHAW—That is a bit like us. The other question was: do you have a view or a policy about whether or not financial members of your association should advise people to establish a self-managed superannuation fund under the critical mass figure of $200,000 that is generally put forward as a benchmark figure?

Ms Keavney—I would think that under the general know-your-client rule, where you are comprehensively looking at the person's situation, you would only be making that recommendation if there was the likelihood of very strong contribution growth or perhaps a business was going to be sold or an inheritance was going to be received. But it is in that context of to what extent would superannuation be appropriate. Then I think it is really very important that you look at the financial sophistication of that client, because if they are very naive I think it is dangerous to be having a self-managed super fund. Just on Westpoint, if people had a self-managed super fund and they were not able to even see risk or to have a single investment,

which it is necessary under the legislation to be able to justify a single investment rather than diversification, which would be the norm.

Senator FORSHAW—Yes.

Ms Keavney—So that would be all very important in whether one would make a recommendation. I tend very often to discourage people, because I do not think they have the sophistication or want to take on that liability, particularly in their retirement years.

Senator BRANDIS—Ms Bloch, can I go back to some observations you made in the context of Westpoint to Senator Forshaw? I want to explore them with you more generally. You said that perhaps some funds might consider that they need a 50- or 60-page statement. It seems to me that one of the difficulties both in your industry and in other sectors as well—for example, company prospectuses—is the sheer volume of information a regulated entity considers that it is obliged to provide, even if only to protect itself from the suggestion of lack of disclosure. Can in fact it operate in the opposite way, that the volume of information, particularly to an unsophisticated client, makes the information inaccessible and opaque? I see you nodding furiously. Would you or others at the table like to comment on whether that is a real problem in this industry and what we ought to do about it?

Ms Bloch—Yes, you are absolutely right. When I mentioned the 50- or 60-page statement of advice I was not necessarily pointing to that as the font of all knowledge and information for the poor consumer.

Senator BRANDIS—No.

Ms Bloch—We were talking about a cover page that sat on top of that which said, 'These are five things you must understand and you must be aware of—service, remuneration, risk, related parties, those sorts of issues. You really must understand these things, and if you do not you must be asking questions about it.' I absolutely agree. We also do not have the statement of advice. We have got the financial services guide, the product disclosure statement—we have a raft of things. I think also this is where an adviser can come in and make sense of some of these sorts of issues, providing the education around what is going on as well as providing the advice.

Senator BRANDIS—Assuming the person or client concerned has an adviser.

Ms Bloch—Assuming the person has an adviser. That is absolutely right.

Senator BRANDIS—Would I be right in thinking that the less sophisticated the client is the less likely they are to have an adviser?

Ms Bloch—This is our proposition. We do believe that advice is well needed by a large number of people, and that there are necessarily some obstacles to providing that advice, and that we want to work toward removing some of those obstacles because it is a valuable component of helping someone achieve their goals. Adding disclosure, adding pages of information, providing more voluminous documents is not necessarily the main aim. That should be simply a statement of a discussion or a transaction that occurred. This is the documented evidence of what it is we have discussed, and I could ask Glenese and Keith to comment. The

extent to which their clients potentially understand or read the statements of advice and their particular role is probably something that you want to explore.

Ms Keavney—One of the key issues I wanted to bring today was the importance of ongoing advice. If you develop a relationship with a client, over time they become more and more able to trust you and you develop a way of being able to explain things that matches their knowledge level.

Senator BRANDIS—You get to know your client.

Ms Keavney—Yes. But for many clients also they make a decision to have an ongoing relationship with an adviser because people approaching retirement have a concern that when they die their spouse, who may be financially lacking, is then going to be suddenly very vulnerable. So it is actually like an insurance policy to know there is a trusted colleague. For many of my clients that is part of the decision to have the ongoing relationship.

Senator BRANDIS—Coming back, though, to the point at which the relationship commences, it seems to me that in Australia at the moment this is a rapidly growing problem because you have hundreds of thousands of people from family backgrounds where there were not substantial asset holdings as a result of the growth of prosperity in this country in the last 10½ years. Now people with no financial sophistication, whether through formal education or through what they might have learned in the household when they were young themselves, are in fact in control of very substantial assets and they have no idea how to manage them, no idea what to do with them, and when they go to a superannuation fund it is almost an act of faith. They are not in a position to be judgemental in a comparative sense between funds, and they are absolutely in your hands. You really have a fiduciary duty to them in a very full sense of the term, do you not?

Ms Keavney—I believe that the role of the financial planner is very much to provide an ongoing education process. You cannot teach somebody everything all at once, but as part of an ongoing relationship they develop more and more understanding of risk and return.

Senator BRANDIS—I do not know if you were in the room before when we were having a discussion with earlier witnesses about this distinction between advice and information, but when you say 'education' you remind us that in fact it is not as simple as that. It is not merely providing information and not merely perhaps giving advice but actually educating the client—

Ms Keavney—Yes.

Senator BRANDIS—who perhaps is completely ignorant of financial management about the way in which to deal with their assets. That is, in a sense, beyond advice, is it not?

Mr Powell—Our challenge is to write a statement of advice that the ordinary person can understand. Whereas there is a lot of information that we have to put in a statement of advice, we also have to break it out with executive summaries so we can actually get the message across, and then run through the statement of advice with these people so they can have some grasp of it. I do not ever subscribe to the fact that a person should just sign on the dotted line after receiving a statement of advice.

Senator BRANDIS—No.

Mr Powell—I always sit down with the person and go through that statement of advice. I say, 'Take it away and read it and come back,' and I state quite openly that no question is a silly question and, 'Ask any questions if you don't understand it.'

Senator BRANDIS—Indeed.

Mr Powell—So the whole idea is that we go through an educative process.

Senator BRANDIS—Do you think that the legislation as it is currently written gives you sufficient protection and, indeed, gives the client sufficient protection as well to deal with that quite high level of engagement?

Mr Powell—It is probably not the legislation but some of the interpretations that are coming through the regulator that are complicating the whole issue to come down with issues of materiality in terms of, say, consolidation of a number of superannuation funds that your teenager might accumulate through all of their afternoon and weekend and holiday jobs. Just to do that could cost you $2000 on a time basis or on a fee-for-service basis, which you would never do.

Senator BRANDIS—Without improving the client's understanding, I suppose.

Mr Powell—Without improving their understanding. We have to go through and pull out the salient information, and they might only have $100 in the fund and it costs us $500 in time to do that. It is ridiculous.

Senator BRANDIS—Indeed. It seems to me that all of these conversations we have in this sector and in other sectors as well about disclosure place a premium, almost an uncritical premium, on the greater provision of information. But I think what you are telling us is that in this particular field, and particularly dealing with unsophisticated or non-judgemental clients, in fact too much information can be as great a vice as too little?

Mr Powell—It can and then they switch off. They see a document this thick in front of them, and they do not want to see that. This is a problem in our industry. When we are going through our qualifications we are charged with the duty of writing a statement of advice that your most unsophisticated relation can actually read and understand. We are coming from that premise and we are trying our hardest, but that is what we are faced with.

Mr BARTLETT—Just following further on with the issue of the difference between advice, information and education, how do you respond to the recommendation put by ASFA, by the earlier witnesses, that there ought to be a distinction and that funds ought to be able to provide information as distinct from advice, without the licensing requirements and the SOA requirements?

Mr Powell—I operate as an adviser for a number of corporate superannuation funds and with those corporate superannuation funds we give seminar advice. Most people on the factory floor and so on think superannuation is a no-no and they do not understand anything about it. You

mentioned default funds. About 88 per cent to 89 per cent of people are in default funds. What I do is I design, as an adviser, some mini portfolios by age group to overcome this problem with default funds not really satisfying the progression of ages of clients. It all comes down to advice, and continuing advice and education that we look at the whole time.

Mr BARTLETT—I will ask you for a specific answer to that question. Do you agree or disagree with ASFA's recommendation that funds ought to be able to provide general information and education without the requirements of a statement of advice?

Mr Powell—Funds have to provide information about their fund but then there is a disconnect between information about that fund, how it relates to you personally and how it should be taken up by you personally.

Mr BARTLETT—You do not see a problem there?

Mr Powell—The funds should provide information. You can get information in that form, but whether the person reads it or consigns it to the circular file is another thing. That is why it should be presented both there and in physical seminars to explain this situation.

Ms Bloch—In support of that, we certainly have some sympathy for the need for information and education before saying absolutely we agree or, no, we disagree. We would again like to understand the definition between education and advice and be able to provide people with an easy transition from the one to the other so that you are not stopping and starting in your relationship. I guess that is Keith's point. It is easier if you are providing advice because you can provide education and advice. If you are providing education and you move into advice, that is where the boundaries become a little blurred. We would simply just want to understand that, but we are certainly sympathetic to that need, and you should be providing information. The more education the better. There is absolutely no dispute, but when it is moving up the line let us avoid more confusion, more changes and more areas to have to debate and understand.

Mr Powell—One illustration is a 28-year-old who has $10,000 in superannuation in his corporate super fund. He has a wife and two children and a mortgage of $200,000. He says: 'Why should I worry about it? It is 30 or 40 years before I look at that money?' Again, more importantly, attached to that should be $200,000 to $300,000 of life cover. Should he drive out of the premises and have a road accident or whatever, then that becomes the whole family's security. This is where advice is very necessary. A person can switch off and have a disconnect without the education coming across to his personal circumstances as to what he really should be doing. This is where we try to assist in that, to impose and show them the necessity of looking forward and of the power of superannuation. Not only of their accumulation but the risk cover, et cetera, coming through as a package. That is where we educate the whole time and we advise, so that they do have appropriate cover. If they are not receiving advice, they are not getting that.

Senator BRANDIS—When you speak of education, that suggests to me a higher standard of duty on you than even giving advice, because I would have thought education requires at least a level of satisfaction on the part of the conveyor that the recipient understands what they are being told, whereas advice perhaps does not mean that. Advice might be a one-way street but, if you have got an obligation to educate, do you not have an obligation to be satisfied that you have achieved a certain level of understanding? If you do not achieve that level of understanding,

might it not be said that you are in breach of some sort of a duty? How do you protect yourselves against that suggestion and should there be statutory protections for you if that is the breadth of your task?

Ms Keavney—When you write a statement of advice, you need to give the reasonable basis for your recommendation, which is part of the education process. If the client cannot understand the basis on which you have made the recommendation, and that needs to be there and you need to go through it with them, so then they will be able to endorse the recommendation, otherwise it really is a very vulnerable recommendation.

Senator BRANDIS—That is my point. That makes you very vulnerable. What protection do you need if your obligation is beyond merely identifying the reasons for your advice but also having a level of satisfaction that what you are saying is understood?

Ms Keavney—I do joke with clients that I am going to test them on it later, but I do not think that we really want to go to that level.

Senator BRANDIS—I would have thought that it is a serious problem for you, and perhaps that is something that we could address in the report that we write, that is, appropriate protections for the industry.

Ms Bloch—We need to think about how this is necessarily played out, but there is a high obligation, whichever way you look at it, between an adviser and a client to deliver advice that is in their interest, and certainly you would hope that they would understand it. It is hard to see how you could regulate or prove that point, but we are certainly happy to discuss it.

Senator BRANDIS—When we are dealing with large institutions and their relationships with individuals and where there is an asymmetry in knowledge and information, the story of the development of the law since whenever you can remember is a story of an expanding frontier of obligations on the party in possession of the monopoly of information and understanding. It is something that you do need to think about and something that parliament needs to think about.

Mr BAKER—Under *Superannuation choices are not simple* you did touch on IFSA's survey, which showed:

…those with a financial planner were more likely to have less debt, invest any windfall in superannuation, understand what factors contribute to their super fund earnings and make extra contributions to their super fund. Additionally, the survey also found that 67% of respondents agreed a qualified financial planner was the best person to help them with their financial affairs.

Further:

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.

Using the basis of that comparison, there have been concerns put out there in advertising that we have got industry funds, no commission; other funds, commissions; these are better returns et

cetera . This is a complex mixture. There are lots of questions within this. I am very interested in your point of view of how an industry fund can say that they earn a higher return than a non-industry fund when we know the complexity of investment structures with its shares, cash, fixed interest, international and Australian property, and it says that 99 per cent are in default funds. I am just interested in your concerns and your perspective when you throw that all into the mix?

Ms Bloch—In terms of putting performance figures and research on the table, industry funds will tell you that this particular research will put the top 10 funds. They will take a balance or a growth fund and they will show you those figures, and another piece of research will show you another set of figures. I am sure those figures are all substantiated. It is a question about which funds you are comparing with, which research you are using and all those sorts of issues. I do not want to comment any further, because I am sure those issues are all well substantiated documented research that has been through legal review and so on. The critical issue is the difference between the cost of advice and the issue that I think you are alluding to, where an industry fund is compared with a retail fund. One is shown as being a lower cost fund than the other and that it is, therefore, by definition a better fund. Our proposition is simply that there is no disclosure, that the retail fund cost actually includes advice in most cases and that there are benefits to that advice. This is a debate that rages in the industry and that is probably the issue. When it comes down to performance, we all know that past performance is no indication of future returns. You can debate research and so on; it is difficult to argue that toss. There are some very high performing industry funds. I certainly do not want to take that away from the issue. The issue that we have goes down to the cost of advice, the payment of advice and the value attached to that advice. That is probably the key debate that we have.

Mr BAKER—You are just getting to the point that I was trying to make. The message that is sending out to the community is: so long as it goes into a default fund, that is okay; do not worry about the advice and all the other issues that those individuals could be assisted with, whether it is income protection insurance, trauma insurance, life insurance, accumulated savings, how much money they need to retire on or short-term savings, which they are missing out on because of the message being sent out that a default fund is for everybody. The statistics show 99 per cent. That is the proposition that I was putting to you.

Ms Bloch—Yes.

Ms Keavney—The inference could be that therefore you do not need advice.

Mr BAKER—Exactly.

Ms Keavney—I have put together a summary, which I would like to table, of the huge number of areas where we can add value in ongoing advice where there are changes in personal circumstances, economic conditions, and legislative changes, which continue to happen all the time, such as some of the ones that will arise out of the latest round of changes. Just another point is that our firm, for example, uses industry funds and we charge on a fee basis. The client might get that return, but there is no acknowledgement of the fee paid and what that fee might have covered and as to why they would be in that particular industry fund or not. It is not comparing apples with apples.

Mr BAKER—That was the concern that I had.

Senator FORSHAW—Are the words 'due to the apparent absence of individual advice' your words or are they taken from the websites of REST and HOSTPLUS?

Mr Anning—For the record, they are our words.

Senator FORSHAW—What you are saying is that they disclosed that 99 per cent of members have invested in the default or balanced option, and you are asserting that that is due to the apparent lack of individual advice?

Mr Anning—Yes.

Senator FORSHAW—That is what I wanted to clarify.

Senator MURRAY—I want to put this question to you in the context of a mythical Mr and Mrs Jones. They have two parts to their financial lives. They have their own individual financial affairs and they have a self-managed superannuation fund. With respect to their own individual financial affairs, they are entitled to deal with those as they see fit. All they have to do is put in an annual tax return. That is pretty well it. But with respect to a self-managed superannuation fund, the same two people have a fiduciary duty. At present, for a self-managed superannuation fund you must keep a set of books, you must produce an annual set of accounts, you must have a strategic plan available, it must be audited. There is a fiduciary environment there. What is missing in the fiduciary environment is the requirement that you take advice. The question to you is: do you think that if people are to operate with self-managed superannuation funds, part of the fiduciary obligation on them should be that they must take advice and, if they must take advice, should it be open-ended or confined and should it be periodic or regular? By 'periodic' I mean, say, once every five years or something of that sort, because obviously there is a cost attached to these things. It does seem to me odd that industry funds, corporate funds, retail funds and so on are all professionally advised and have a very strong fiduciary element to their environment, but there is nothing of that with respect to self-managed superannuation funds.

Ms Keavney—In principle that would be an excellent safeguard for those people who are not financially sophisticated, if they went in that direction, but there would also be—

Senator MURRAY—You are qualifying it already with respect to whether they are financial sophisticated. You either have a fiduciary duty or you do not. It has nothing to do with whether you are sophisticated. A fiduciary duty surely requires you to have conducted certain safeguards in the interest of others.

Ms Keavney—It may be that the members who are also trustees do have the appropriate knowledge and skills to be able to run it without requiring advice. For example, would partners of law firms who may specialise in superannuation, or accounting firms or financial planners who are qualified in the area of self-managed super funds need to seek advice?

Senator MURRAY—In other fields—and other members of the panel with me here would know it probably better than I—sometimes when a lawyer or an accountant enters into a transaction they are still required to take independent advice to ensure that there is a proper distance between what they are doing in their personal capacity and their professional capacity, so I do not think that always applies.

Senator BRANDIS—If I may say so, fiduciary duties are elastic. They can be greater or lesser, depending on the particular circumstance. One highly relevant circumstance will be the degree of reliance of the recipient on the advice.

Senator MURRAY—I take that point and I think that is accurate. My question to you is: could you come back to us—because I do not have enough time and it is not in your submission—with a general view in this area? My view is that there is no fiduciary duty at all at present applying in this respect. As part of your fiduciary duty as a trustee of a self-managed superannuation fund you are not required to take advice. I accept it can be elastic. What I would like you to come back to us with is this: do you think it is appropriate to provide it and should it be qualified with respect to elasticity, to use Senator Brandis's term? If you do think it should be provided, should it be annual or should it be periodic and over what terms? Could you also give some of the pros and cons of it. I will ask you that on notice.

Mr Powell—There is one thought that you could take away with you, and that is that a self-managed super fund must have a documented investment strategy. As part of that and as part of the audit program they have to do every year, the auditor should check to see whether the performance of the fund has been in accordance with the investment strategy, and give it a tick. Without introducing another raft of legislation, that could be a way of controlling that risk that you are referring to.

Senator MURRAY—Your answer indicates the shortcomings, if I may say so. An auditor, typically attached to an accountant, is not allowed to provide advice in the way that I am referring to, which is fiduciary advice. I would like you to give this a bit more thought.

Ms Bloch—Yes.

Senator MURRAY—My second area of questioning relates to nomenclature. There is an argument that financial planners are not independent of their commission takers, and that the only way they would be independent is if they operated on a fee-for-service basis, and people argue about whether you should or should not have that happen or whether there should be a mix and so on. Perhaps one solution is to move away from that and require the nomenclature to describe to the customer exactly what they are getting. This is what I mean by this. For instance, do you consider that the descriptor that attaches to a financial planner, either in the primary descriptor or the subdescriptor, should indicate what the client is dealing with? For instance, if you only sell AMP products as a financial planner, should you be required to write down that you are a franchisee, which is effectively what you are; or if you provide products from AMP, MLC and Colonial, that you are an agent, because you are operating for a number, and that is effectively what you are; or that, if you are completely independent, you might have in your descriptor a fee-for-service or you might have the word 'independent' attached to it. Essentially I am saying to you that, by choice of the nomenclature, you would tell the client what sort of operator you were and then you could choose the fee structure that fitted that nomenclature. What happens at present is that there is no way a customer knows that 'financial planner' in one circumstance could mean fee-for-service and in another circumstance could mean somebody who is effectively tied to a house that is providing advice. If you are able to answer straight off the cuff that is fine, but again I would be more than happy for you to amplify that in a subsequent submission.

Ms Bloch—This is a matter that the UK Financial Services Authority has, in my opinion, dealt with very well. They have three levels of description. You are either a tied adviser, a limited panel adviser, so you can offer a few products or sorts of advice, or you are a whole of market, where you can provide comprehensive advice.

Senator MURRAY—Is that descriptor underneath the name? Would it be 'financial planner', 'whole of market', that sort of thing?

Ms Bloch—No. When you enter into a relationship with your client you need to state upfront whether you are providing advice on the tied or a whole of market basis, and your client can say, if you are on a tied basis and you work for, let us say, AMP, you say to your client, 'I am on a tied basis and I will only be putting AMP services or products on the table. Are you okay with that?' Then they will agree or disagree. If they agree, then they fully understand it and the remuneration structure and service structure is clearly outlined and they will sign off on it.

Senator MURRAY—That is the second stage, where you have got the client before you. I am really talking about the prospecting stage, where somebody might be responding to an advertisement or checking through a directory of some sort and may want an immediate indicator of the sort of person to whom they should go. That is why I am referring to nomenclature. Agents and franchisees are very clearly understood in people's heads. Do you think there is some prospect of getting away from worrying about how people are rewarded and how people are charged by communicating with them right up front in the way in which financial planners describe the kind of fee service or the kind of fee structure that you are likely to encounter? That does not take away, incidentally, the requirement when the person is before you to go through the process that you have outlined.

Ms Bloch—There are some opportunities and we are already debating some of the issues around being able to demonstrate the sorts of different models. Do not forget that we also have salary planners. I do not know that remuneration is the issue. What we need to put on the table is the manner in which you operate, the sorts of advice that you may or may not provide and the limitations that you may or may not have, ranging through to people like Glenese and Keith, who provide services across the full spectrum, and there might be different parts of that spectrum. One of the issues that you might want to put on the table is remuneration. I do not know that we would start with, 'I'm a fee planner' and 'I'm a commission planner' and 'I'm a salary planner', because that sort of also implies that, therefore, you should expect a certain level of advice or a certain this or that, which I do not think is the case. I do not think your remuneration is necessarily going to deliver better or worse advice depending on which one you take.

Senator MURRAY—I accept that.

Ms Bloch—I certainly accept that there are definitely ways that we can make it a lot more clear what type of business model you might have or what sort of advice that you are going to provide. I do not know if there is anything that you want to comment on?

Senator MURRAY—Before you do comment, I accept your point but I disagree with you, because many people are increasingly aware—partly as a result of all of the 'choice' advertisements—that the way in which remuneration is taken in superannuation significantly

affects the end benefit that you are going to get, because of the way in which commission fees might be taken. Remuneration, whilst not the whole story, is a big part of the story, and it very much relates to whether or not you are tied.

Ms Bloch—That is actually not the case. There are a number of advisers who are not tied and who do get paid commission for services.

Senator MURRAY—Yes.

Ms Bloch—This is what I am trying to put on the table. There are all sorts of different models. I do not think that advice and the way that you pay for advice is the key driving factor. I accept that it is an important aspect and I accept that you should be able to choose the different way you want to pay for advice and the types of advice, and then ultimately the product that you might want to get, but to put everyone into one camp or the other and have to categorise yourself is something that I would see we might have some issues with.

Senator MURRAY—Can I suggest this, because I do not think we can resolve this in a short spell of time. If I was to summarise the core intent of this inquiry, it is to try to find mechanisms, means and proposals that improve the end outcome for all of those who have superannuation, basically so that they end up with more in their pockets. That is what you are on about in this. I think the discussion that we are having attaches to that. It is not covered in your submission, and I think the nomenclature does matter. We can argue about the kind of nomenclature. I do not have your experience or background with respect to what is being done elsewhere. If you do have the opportunity to put in a supplementary submission to us—I will not call it 'advice'—

Ms Keavney—Are you saying that the nomenclature is regardless of how you are paid?

Senator MURRAY—Maybe it should or should not include how you are paid. That is why I use the terminology that is commonly understood in the marketplace, franchises, agents, tied houses, free houses—that sort of thing. Do not be confined by that. What I am searching for is this: there are hundreds of thousands, literally, of self-managed superannuation funds and hundreds of thousands of people who operate their financial affairs and manage their future without self-managed superannuation funds. Many of those want a pre-signal when they go looking for a financial planner or adviser, either through directories or advertisements or whatever, and the nomenclature helps them with that. My question to you is: is that a form of pre-signal we can give that just helps people to go to the right person at the right time, recognising that you have still got to go through the process that you outlined earlier?

Ms Bloch—Yes.

Senator MURRAY—Are you happy with that?

Ms Bloch—Yes, that is fine.

Ms Keavney—Yes.

CHAIRMAN—As there are no further questions, I thank all of you for appearing before the committee and for your contribution to our inquiry.

Proceedings suspended from 12.53 pm to 1.30 pm

HILL, Mr Damian Michael, Chief Executive Officer, REST Superannuation

MILLS, Ms Brenda Lorna, Manager, Legal Risk and Compliance, REST Superannuation

CHAIRMAN—Welcome, Mr Hill and Ms Mills. The committee prefers that all evidence be given in public, but if at any stage you wish to give evidence in private you may request an in camera hearing with the committee and we will consider such a request. We have before us your submission, which we have numbered 54. Are there any changes or alterations you wish to make to the written submission?

Mr Hill—No.

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

Mr Hill—Thank you for the opportunity of presenting to the committee. I will give you a bit of REST's background and then highlight some of the issues from our submission that we thought were important to bring to the committee's attention. REST is one of Australia's largest and strongest superannuation funds, with around 1.6 million members and $11 billion in funds under management. Most of its members come from the retail industry. However, there is a large personal division as well. Apart from offering the typical industry fund division, there is, as I said, the personal division, which makes the fund public offer, and also a corporate and pension product. We have over 800 pensioners and over 10,000 in our corporate master trust as well.

REST was the first superannuation fund to be granted an APRA licence, which was granted on 30 September 2004. APRA and REST worked collaboratively in that licence process based on our good governance in that we would be an appropriate guinea pig for the new APRA licensing process. REST's overriding objective is to provide members and participating employers with effective communications, superior administration and competitive long-term investment returns.

As part of a large profit-to-members superannuation fund with significant economies of scale, REST is able to provide the participating employers and members with services at fee levels that we believe represent excellent value for money. We also have an education program for our members, which is flexible and interactive and is delivered through various channels. A large part of this education material is developed in conjunction with Education Key, which is a joint venture between three of Australia's largest superannuation funds to provide accessible and effective education material for our members.

It is important to understand that our members generally come from a low socioeconomic status, a lot of part-timers and casuals, and do not in the normal course of business necessarily get access to services that some others in the general community might. REST members also have access to personal money coaching and financial advice through an arrangement with Money Solutions, which is a jointly owned operation between REST's administrator and also a private services company. They have contracted with REST to provide general financial product advice and, if requested by the member, personal financial advice.

REST's major concerns are, firstly, the large number of regulatory changes affecting the superannuation industry. There are more obviously on the way with the budget announcements. The second concern is the financial literacy of our members. On that point I would note that, in our view, the financial services legislation has unfortunately limited us and other superannuation funds in communicating to our current members the benefits that the fund offers. The result of this is that we restrict opportunities to offer information as sometimes it could be construed as advice, and the use of advice triggers requirements for disclaimers, training and provision of financial services guides. I am not saying that it is an easy nut to crack. I do not necessarily have the final solution for that, but I do see it as an impediment to our effective communications.

From our research, and Money Solutions research, we found that even though 75 per cent of our members are under 35 years of age with an account balance of around $3,500, they are still quite often seeking personal financial advice, usually on specific single issues. I would also raise the issue of member protection. Having said that, we have a large number of part-time and casual workers in the retail industry. They tend to have low account balances, on average around $6,000. The levy is based on our asset size and not on average account balances. We would like to discuss this further, because we believe this is an inequitable distribution of this cost amongst the industry and that there are far more equitable ways that share the burden of protection amongst the broader superannuation community.

In regard to the payment of advertising from the fund, we genuinely believe that this can be justified as a legitimate expense in the correct circumstances. Section 62 of SIS, that is, the sole purpose test, sets out that each trustee of a regulated super fund must ensure that the fund is maintained solely for the provision of retirement benefits for each member of the fund. Whether spending the fund's money on promotional advertising is in conflict with this test, that is a test that needs to be addressed by each trustee. We hold the view that existing members of a fund benefit from promotional advertising as it helps to assist existing members to stay with the fund and educate them about the benefits of the fund or enables new members to join the fund, potentially giving greater economies of scale.

In relation to profit for members, we state that we are a profit-to-members fund, and we interpret 'profit' to mean a non-distributable surplus that arises after all expenses of the fund are paid. It should be distinguished from return-all-profits-to-members, which implies that there is some kind of income distribution, similar to what shareholders get. Instead, the profits after the expenses are paid are retained in the fund for the benefit of members. REST does not currently pay its trustees, only reimbursing them for their expenses, such as travel, for example. We do not currently pay commissions. Our financial advice service gets paid fees on a contractual basis on a fee-for-service basis.

'Not-for-profit' should mean that the trustee does not charge fees and that it is only reimbursed for expenses of operating the fund, including, where appropriate, reimbursement for arm's length directors' fees. Further, there should be no benefits to associates, as somebody could set up a fund and not charge trustee fees but charge excessive management fees for granting management rights to associated entities.

In regard to financial planning, I have already touched on this but we agree that there is a role for financial planning and financial advice providers for superannuation funds. As I have said, we have entered into contractual arrangements to give financial advice, both general advice and,

where the member requests it, personal financial advice. We also believe that it is appropriate to allow, in some circumstances, for the cost of each advice to be deducted from a member's superannuation account, this being subject to the sole purpose test. What we have found with this service—and I am happy to take questions a little later on this—is that it is a service that is not traditionally available to our typical members. The financial planning industry has not traditionally covered the members that we have in our fund.

In regard to prudential supervision, we paid APRA for prudential regulation in excess of $300,000 last year, and we note that this is calculated by using a determined percentage set by the minister under the supervisory levy act to assets. We believe that there is potentially a better way that is partly asset tested because assets are some surrogate for risk. But there should also be a specific levy on assessment of risk so that there is incentive for trustees to be governed appropriately. So instead of larger funds subsidising the cost of supervision of smaller funds, there is a failure to differentiate between high-risk and low-risk funds. With the introduction of RSE licensing, the number of trustees available to fund the levy has vastly reduced. This means that a small number of existing funds are bearing a larger proportion of the costs.

REST has good governance and risk management processes and, as a result, has never needed unusual regulator intervention, whereas this has generally been focused on the smaller funds. I would say this is where the greater risk generally lies. Funds that do comply and can demonstrate an ongoing commitment to compliance should be rewarded and not penalised for their efforts. For example, there could be a reduction of the levy for funds that meet appropriate compliance obligations and can demonstrate a compliance culture and effective controls. This could be achieved through the APRA PAIRS rating of the fund.

In regard to compensation for theft and fraud, we would also suggest that an appropriate way forward in regard to funding this might also be through a partial asset test, as is the case at the moment, and also a levy based on risk management and not size, because that is where we see that some of the risk has occurred in the past. I will now close my opening submission and seek questions from the committee.

CHAIRMAN—Thank you very much, Mr Hill. In both your written submission and your remarks you referred to the advice service that you are offering to members and indicated you were prepared to elaborate on that.

Mr Hill—Yes.

CHAIRMAN—This is the advice that is offered through Money Solutions, I understand, from that submission?

Mr Hill—That is correct.

CHAIRMAN—Could you perhaps just elaborate on that and in particular indicate how it is funded?

Mr Hill—The Money Solutions service is a service that we believe is a unique offering in the Australian environment. This was a journey we undertook over many years and, in effect, we found that the traditional financial planning network did not provide services to our members.

We were getting feedback from our members and via our field staff that there was a need for financial guidance from our members, but the traditional financial planning network generally was not attuned to providing those services.

In terms of how we have structured that service, we have a phone guidance service whereby over the phone members can seek guidance on single issues that are related to superannuation. We are very mindful, obviously, of the sole purpose test in this regard. If they need to take it further, it can be ramped up to a full financial service that people are traditionally familiar with.

Our experience to date is that over 10,000 of our members have sought this service. Generally it has been on single issue advices—things such as consolidating their super, voluntary contributions—rather than the broader context. We provide advice on those matters over the phone, provide a full statement of advice and the requisite documentation as is required by FSR. Only about seven per cent of the members who receive advice via that mechanism then decide to take it forward and get a full financial plan. The people who are taking it up are skewed towards the younger ages. We are hitting a demographic that has not traditionally been serviced by the financial planning network, and I can understand why they did not service it.

Our reason for offering the service was not to compete against the traditional financial planning network. It was to give our members access to a service that there was a need for and that they could not otherwise access. This is consistent with what we have done throughout our history. A previous example of this would have been the provision of group insurance to part-timers and casuals; they would not previously have had access to that service through the traditional retail environment.

The other part of your question related to the funding of that. It is on a fee-for-service basis. The trustee has considered what part of the service it should fund, and we fund the first and the initial call, but subsequent pieces of advice and indeed full financial advice must be funded by the member themselves. That is how we have structured the funding basis.

CHAIRMAN—Money Solutions is a completely independent financial—

Ms Mills—Yes. It is under its own financial advice licence. It has a licence for personal financial advice. We do not have that kind of licence. They are a separate entity from us.

Mr Hill—We have no ownership.

CHAIRMAN—No ownership?

Mr Hill—No equity stake in it whatsoever.

CHAIRMAN—Do you know who owns—

Mr Hill—Yes, it is 50 per cent owned by our administrator, Australian Administration Services, and the other 50 per cent is owned by a trust called Duenna Services Pty Ltd.

CHAIRMAN—When you say ‘your administrator’—

Mr Hill—That is the administrator we outsource to. Again, we have no equity staking our administrator. We operate on an outsourcing model. Again, we have no stake. They are the overall owners.

CHAIRMAN—In terms of the fees that you pay to Money Solutions for this initial, for want of a better term, consultation that members can have, is that a fixed annual consulting fee or is it based on the number of members that obtain access to the advice and the time that takes?

Mr Hill—It is based on the number of people who access that advice.

CHAIRMAN—All right.

Mr BARTLETT—How much do they charge for the subsequent financial planning consultation and statement of advice regarding investment options?

Mr Hill—I do not know that I can answer the question specifically in regard to investment options, but the—

Mr BARTLETT—Financial advice.

Mr Hill—The fee for service is variable depending on the quantity of the advice provided and can range, say, for a very simple question from a few hundred dollars up to, as I said, a couple of thousand dollars for a full financial plan on a fee-for-service basis.

CHAIRMAN—It is fee-for-service, not commission based?

Mr Hill—That is right; it is fee for service.

CHAIRMAN—In regard to advice and choice, you refer to the APRA circular *Managing investments and investment choice*. You say that that has put trustees in a very difficult position in trying to comply with the regulatory requirements, which may be in direct conflict with the member's own choices and, if I might interpose, could also be in conflict with financial advice they are given from a planner or other source. This is an issue that has been raised earlier today. Can you perhaps enlarge on how that is restricting REST in servicing your members and what you perhaps see as the solution?

Mr Hill—I am not going to profess that REST is fully knowledgeable of the circumstances of each and every one of our members. Any obligation that is tried to be put on the trustee to become aware, I think, is problematic. That is one of the interpretations that can be made of the APRA paper. In our view, in terms of the offering of investment choice in accordance with the covenants under section 52 of SIS, it is up to the member whether they seek advice or not. We certainly would encourage them to seek advice on an issue such as investment choice so as to work out the appropriate investment choice for their superannuation assets when considered as part of their total financial wealth package.

We do not see that we should be making a call in the absence of knowledge about a member's full financial circumstances as to what would be the appropriate investment choice for them other than to provide the default fund for members should they not make a choice.

CHAIRMAN—Another issue that we had some discussion on this morning is where the cost of promotional advertising should be borne. I note from your submission that you, in essence—and I think I am probably fairly summarising what you are saying—argue that promotional advertising is a cost that can legitimately be borne by the superannuation fund even if it is directed at attracting new members, because that has the beneficial effect to existing members of reducing their pro rata costs of administration and the like?

Ms Mills—You get benefits arising from a greater volume of members. Therefore, you are able to offer discounts for having that greater number of members there.

Mr Hill—I believe it is up to each trustee to be able to justify in the context of the sole purpose test that that is a legitimate outcome of the advertising. If the outcome is consistent with the sole purpose test, I see no reason why we would try to set up a market where some players in the market can advertise on one basis and others are restricted from advertising. I think we should have a level playing field as to the advertising throughout the industry.

CHAIRMAN—Correct me if I am wrong, but I recollect seeing advertisements that advertise the benefits of industry funds generically rather than advertising REST as a particular fund, for instance. Where do you think the line falls in regard to that sort of advertising?

Mr Hill—I can only say that we are not participants in the campaign that I think you are referring to. Again, I think it is up to the trustees of the funds who are participating in that to justify—

CHAIRMAN—So you are not part of that program?

Ms Mills—No.

Mr Hill—No, we are not part of that advertising campaign.

CHAIRMAN—You indicated that you outsource your administrative services to—

Mr Hill—We outsource almost all of our services. That is the business model that we follow.

CHAIRMAN—Does the organisation Industry Fund Services provide any of your services?

Ms Mills—They use Superpartners, I think, for their administration services, and we do not use it. We use AAS, which is a different entity.

Mr Hill—In the overall conglomerate that I think you are referring to, Mr Chairman, the service that we do partake of theirs is the credit control follow-up in order that we follow up employers so our members get the contributions that they are due. But that would be the only one. I should add that we have recently offered home loans to our members.

CHAIRMAN—That is through—

Mr Hill—Through Members Equity—

CHAIRMAN—Through Members Equity Bank. Again, is REST one of the owners of IFS—

Mr Hill—We have no equity in that. We are not an owner.

CHAIRMAN—What about Members Equity?

Mr Hill—Similarly.

CHAIRMAN—I think those are all the questions I have for the moment.

Senator FORSHAW—In relation to a couple of the earlier terms of reference, you indicate that you are not supportive of proposals regarding capital requirements. I am just trying to find again the review on trustees being required to be public companies, which I think you do not support.

Mr Hill—Yes.

Senator FORSHAW—What would be the impact on REST, a large industry fund, if those changes did eventuate?

Ms Mills—Is that the requirement to be a public company?

Senator FORSHAW—Both. Beyond saying you are opposed to them, I am just trying to ascertain the arguments why the impact—

Ms Mills—Interestingly, in our submission at point 2, under the Corporations Act you have voting restrictions for public companies, section 195. Then under the SIS regulations, 4.08(3) requires two-thirds of all directors to have to vote in favour of a resolution. If you have those two requirements running together, you may have a situation where the board decisions are actually paralysed. For instance, you have a board of eight directors. You have four employer directors and four employee directors. Under regulation 4.08 a resolution is not valid unless at least six directors vote in favour.

Assume that three of those directors have a material personal interest under section 195 of the Corporations Act for public companies so those directors cannot vote if they have a material personal interest. That means the board cannot vote on that resolution as it has insufficient directors who can vote on it to pass it. There is a real paralysis there where you try and run the two legislative requirements together.

Mr Hill—We are currently subject to the capital requirements that exist as a public offer fund by the mechanisms that are outlined in SIS. We note other submissions and in particular the ASFA submission in this regard and are supportive of their position.

Senator FORSHAW—That would not have any material impact upon the fund, would it? I am not trying reduce, minimise or negate your argument. Directly on REST it is not an issue—

Mr Hill—It depends on where that capital comes from, as to whether it is coming from the members funds directly or whether its coming from the sponsors. I would not be prepared to concede that it would have no impact whatsoever.

Senator FORSHAW—Thank you. I just wanted to clarify that. You also referred to duplication between APRA and ASIC. I asked this question this morning of ASFA. Its response was that, if you started from a clean sheet, you might have only one regulatory body but things have moved on. Do you have a view about a merger of APRA and ASIC under a single financial services regulator?

Mr Hill—It is easy to say that the current situation is suboptimal. An example is that ASIC is the regulator in regard to disclosure but, depending on the materiality of an incident, you do not need to report to ASIC. But with APRA, which is not the regulator of disclosure, regardless of materiality you have to report. There are a number of anomalies in the current structure. To the extent that the outcomes from that can both benefit the industry and continue to protect the consumer in that environment, generally we would be supportive of it. But I do not want to underestimate the effort that would be involved in moving from our current position to a single regulator.

Senator FORSHAW—Have you seen the submission of the Financial Planners Association?

Mr Hill—I personally have not read that submission at this point.

Senator FORSHAW—Let me quote from its submission. Under the heading 'The value of advice demonstrated' there are four lengthy paragraphs. It states:

> 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.

They footnote the reference to REST and HOSTPLUS to the websites of both funds. The comment 'due to the apparent absence of individual advice' is their assertion as to why you have 99 per cent of members invested in default or balanced options. I thought one of you would like to comment upon that, because in my view it is put as a critical comment against the idea that individuals should have access to individual advice and that in these large industry funds—the two mentioned—that is not happening.

Mr Hill—I can confirm the figures that about 99 per cent of our members are on the default option. However, I think it is not correct to draw the assertion that that is because of a lack of advice availability.

Senator FORSHAW—Is the balanced option the default option?

Mr Hill—It is a balanced type—70 per cent to 30 per cent approximately. It is asserted that it is because of a lack of advice availability. As my earlier comments suggested, we do offer advice. We find that only seven per cent of our members who seek advice actually go on to a full financial plan. I would say that it is the financial planning bodies themselves that have not been

providing access to advice to our members on a cost-effective basis, that our typical member would not get access to such services.

We agree that there is value to advice. I think our initiative with Money Solutions supports our going down that path, and that we are supportive of advice. By and large, with a young demographic I think the issue is more engagement, about small account balances, and whether people are engaged at any point in time. We have tried to make advice accessible to them where they would not have obtained it elsewhere. But I do not for a moment suggest that that would mean that all of our members will suddenly seek advice on investment choice now that it is available.

Senator FORSHAW—The provision or access to advice is an important consideration, certainly now with choice. Protection is also important, is it not, particularly in the areas of the membership of REST, that demographic?

Mr Hill—Yes. In our submission we talk about the importance of advice and that we think that the financial services legislation has limited the way that we and superannuation funds can communicate with our members because of the potential for it to be construed as advice. We and many other superannuation funds that I am aware of have taken a very conservative view in the communications to our members because of the risks involved.

I take your point that the protection of the consumer is a very important aspect to this. But if the protection of the consumer leads to the inaccessibility to the service, then I am not sure that we have the balance right. You can protect the consumer as much as you like, but if they cannot get access to the service as a result then I think that is a suboptimal position for the consumer.

Senator FORSHAW—I had in mind the protection of the actual members' funds. In other words, if you have got a small amount available then you have not got much to play the market with and therefore not as much flexibility.

Mr Hill—It is a very relevant issue for the fund. You will note that obviously under one of the terms of reference we raised the issue of member protection. We live and breathe this every day as to what is the appropriate mix of services to provide our members, given their frugal means or meagre account balances at this point in time, but we believe that advice is one of those. We do not expect all of our members to take it up on day one. It is when they need that advice that they can have access to it, and we take that very importantly. We think it is a worthwhile service in that regard. We view the benefits of it to our members as they go through their life as if we can give them a little bit of advice at an earlier stage than they would traditionally have got it and they change their behaviour. Let us say that make a voluntary contribution and get the co-contribution as a result. The impact of that over time through compound interest is, we believe, a huge benefit to the member but can we justify them having to undertake a full financial plan in order to do that? We find that more difficult to justify. This is why we have tried to offer this unique model that allows them to nibble away at a reasonable cost, in our view, in order to get incremental changes over time that suit them.

Senator FORSHAW—It mirrors, too, the growth of industry super where, certainly from my recollection, and I declare that I had an interest years ago as a union official when they were being established, you started with a very conservative investment strategy with very often a

capital guarantee and expanded that as the funds grew to more options, bringing in a broader range of investment advisers rather than just having the one and also now a broader range of products available. You are nodding. You are agreeing.

Mr Hill—It is things like insurance.

Senator FORSHAW—It is consistent with the idea of progressively ensuring security. That is the objective but at the same time, with critical mass development, expanding that out to broader choice.

Mr Hill—I agree. There are other examples of it as in your initial insurance where the premiums were a dollar per week. That was appropriate given that people were getting three or four per cent at the time. As things have gone on, what is the appropriate level of insurance or the default level of insurance that should be provided? There are a number of examples consistent with what you have put forward.

Senator MURRAY—You have said that our experience shows that over 92 per cent of our members who receive single issue superannuation advice do not wish to go to a full financial plan. I presume the eight per cent who do are likely to be over 35?

Mr Hill—They are largely over 35. They are certainly very heavily skewed in that area and skewed even closer to retirement.

Senator MURRAY—I draw attention to that over and under 35. It really comes to the issue of targeting. You have said later on your submission that approximately 45 per cent of REST members have an account balance of less than $1,000, who I would expect to be almost all under 35, and the average account balance of a REST member is only $6,000. You then say approximately 75 per cent of REST members are under 35 years of age with an average account balance of around $3,500.

Mr Hill—Yes.

Senator MURRAY—So three-quarters of your members are below 35 with an average of $3,500. The rest have obviously got quite significant funds because it almost doubles your average to $6,000 and because most people receiving single issue advice are under 35. The question arising from all that, because I think you are almost unique in the whole superannuation fund in knowing most about younger superannuants because they are the majority of your members—

Mr Hill—We would have the youngest median members.

Senator MURRAY—Yes. Do you think that it is practical, feasible or even likely that we will ever be able to—in a public interest sense—agitate interest in that demographic in their future? I worry about the idea that everybody should be taking financial advice and preparing for the future. The reality is that people below 35 are worried probably about the present and not the future.

Mr Hill—Undoubtedly they are. They have more pressing needs and their focus is much more short term. We struggle with the engagement of young members all the time. Despite having meagre funds, I cannot see an argument where you should not make the most of them anyway, however meagre they are. There are initiatives such as the financial literacy taskforce and the bringing of that forward into the school curriculums. That is a positive but it is not a short-term solution to engaging people of this age.

Senator MURRAY—Let me explain where I am going to with this because you are probably a bit in the dark. We talk about the provision of advice in macro terms. What I mean by 'we' is we legislators. All the statements of advice and product disclosure statements are generic. Do you think regulators should be starting to think about whether the provision of advice to different demographics, particularly younger demographics, should be designed with that demographic in mind? In other words, based on your experience should it be a shorter version, more relevant and more particular?

Mr Hill—What you are suggesting is consistent with what we are saying about the restrictions that FSR have about us communicating with our members and my point about if, as a result, a service is inaccessible to a group of members because of that protection, then I am not sure that it is an optimal situation.

Senator MURRAY—Have you any thoughts in your mind as to how statements of advice or product disclosure statements could be differentiated to be more relevant to that demographic?

Mr Hill—Certainly the quantity of information that is given to members is excessive in the circumstances to what they are interested in and what they would engage with. Also we have to potentially look at the mechanisms by which we deliver the communications materials.

Ms Mills—The other issue is where you have got a tailoring of advice. That means that you are going down the personal advice track, which means that we do not have a licence to do that. We would like to do that but FSR restricts us from doing that, so therefore our communications to these target areas are not as meaningful as they could be. The issue there is, because FSR says as soon as you start tailoring your advice to suit a certain person, that means that is personal advice and that is outside of our licence restrictions.

Mr Hill—For example, if we know that they are a young person, are we taking their personal circumstances into account in changing the communications that we give to them? If there is some mechanism by which we are allowed—and any fund can do this for whatever demographics are appropriate—to target a group and treat them on a group basis and change the communications mechanism, whether it is the content or the delivery style, without falling foul of the personal advice regime, for the vast majority of people who would not ordinarily get advice that is a path to a better solution.

Senator MURRAY—Let me switch this around in a different direction, which is again in my mind. The best guarantor of a secure and sustainable retirement regime for Australia is if young people are engaged early and commence the saving process early. Therefore, if the present system of disclosure, advice and information is a switch-off, does it need to be re-examined with a view to how you motivate greater savings habits?

Mr Hill—I would agree that for the greater outcome for Australia, that people making the most of their means—be it superannuation or otherwise—through appropriate communications—

Senator MURRAY—In your experience have you ever found, in discussions with regulators or the industry forums that you are in where these matters are discussed, that approach discussed or taken?

Mr Hill—Personally in any environment that I have been in I have not been party to those types of discussions. The discussions have revolved more around the protection of the consumer against behaviour that would see other people enriched, as opposed to the end member. So the protection mechanisms are the strongest element of the debate. One of the areas that I would like to see progress made in is that it is quite difficult in the current environment to provide projections to members. Projections can be a dangerous mechanism, particularly if they are used to game between one provider and another. If they are using that mechanism in that way then they are counterproductive. But, in order to engage people as to what this nine per cent is and what voluntary contribution and co-contribution actually mean down the track, I think they are one of the more valuable tools that could be available in the tool kit to communicate to, for example, young members, yet they are very difficult to be able to justify under the current regulatory environment.

Senator MURRAY—The last area that I want to discuss with you is the multiplicity of low account balance members that you have, which incidentally must increase your administration costs enormously relative to the dollars at stake. Do you know whether you have an unusually high number relative to other superannuation funds of member accounts without TFNs, or do you know if you are typical?

Mr Hill—From the analysis that REST has done, about 62 per cent of members have tax file numbers.

Senator MURRAY—So it is 38 per cent without?

Mr Hill—Yes, 38 per cent without.

Senator MURRAY—Is that typical?

Mr Hill—Of the industry funds that I have talked to recently, because obviously tax file numbers under the budget changes are of a particular interest, we are not as atypical as we might have thought we were, so it seems that that is in the ballpark of figures. That causes us significant concern about which of our members who do engage with us and make voluntary contributions actually will not be eligible for the co-contribution. With the mechanisms we have got to get tax file numbers, it is one of the biggest threats of the budget changes that were announced earlier in the year.

Senator MURRAY—What programs have you got in place to lift your TFN number pick-up?

Mr Hill—We have a number of programs that we have been employing, including allowing members to quote that via their product disclosure statements when they first join. Not all

members initially fill out a product disclosure statement. Their employer may join them but the employer may not provide the tax file number. We have recently undertaken an exercise where we approached 6,000 of our members who paid a voluntary contribution last year and had not provided us with a tax file number. We provided opportunities via the phone system, via the web and via paper to respond and give us their tax file number. These members, as a result, if they do not give us a tax file number would not be eligible for any co-contributions going forward, despite making voluntary contributions and being otherwise eligible. Just over 2,000 of them provided their tax file number out of 6,000.

Senator MURRAY—Only one-third?

Mr Hill—Just over one-third.

Senator MURRAY—It is very hard to get them out of members, because they are disorganised or whatever human reason they have. Are employers a better target?

Mr Hill—The most logical targets for these are the employers and the tax office. The problem we face from a government point of view and from an industry point of view is that we have this—and I will use the round number—38 per cent of existing members who do not have tax file numbers. Unless some effort is made to resolve that then we are headed down a path that could have grave consequences for complexity. In some instances it could lead to another surcharge, potentially.

CHAIRMAN—You are saying they do not have tax file numbers?

Mr Hill—Yes, 38 per cent have not provided tax file numbers.

CHAIRMAN—They have not advised you of their tax file numbers?

Mr Hill—Yes. We need a mechanism for employers to provide the numbers for that group who have not provided in the past. If we rely on the individuals, then we are going to have quite a high degree of—

Senator MURRAY—Do you think that the law should require all new members—I accept it might be difficult with old members—to provide TFNs automatically?

Mr Hill—In my understanding of the law, it is that it has always required employers to pass on tax file numbers when they receive them for superannuation purposes. I am not aware that it has ever been enforced by a regulator at all. Without being the person to advocate for compulsory tax file number provision, it is highly desirable for matching.

CHAIRMAN—There is a box that you tick on the form where you authorise the employer to release it to the fund, isn't there?

Mr Hill—Yes.

Senator MURRAY—I just wonder why it should not be compulsory. I cannot see any reason why anyone should resist that view from your perspective, because to recover TFNs later on is a highly costly exercise.

Mr Hill—An example of a situation that we could find ourselves in is that a member does not provide their tax file number but the tax office is able to match them through their matching processes that they have got a tax file number—

Senator MURRAY—They do not tell you that, though.

Mr Hill—They do not tell us that. They will require us to withhold tax from the member's account. The member will not necessarily read our statement to see that tax has been deducted and then, if they take more than four years to provide their tax file number, they will not get the tax back. But during the entire time the tax office has known who they are and known what their tax file number is.

Senator MURRAY—That is another question I wanted to ask you. Do you think if the tax office does do a matching that they should be obliged to advise you that they have matched and what the match is?

Mr Hill—That would be the optimal situation to ensure less work for all in the industry, including the tax office, and less downside for members in the withholding of tax. So, in effect, their account balance is growing forward.

Senator MURRAY—The last question in this area is the lost members accounts. My supposition, based on your numbers and low account balances, is that you would be a huge component of the lost members accounts. Now, of the percentage of your superannuation funds that get cycled into the lost members funds register, is the percentage higher or lower than the industry average? Do you know, and what is it?

Mr Hill—I am afraid that I do not have the figures on that. I would certainly be able to say that the retail industry is one with quite a transient employment base, so from the point of view of those moving house and not notifying of their new addresses, we would be one of the higher ones, but I do not have the figures to support that at this stage.

Senator MURRAY—I do not want to ask you a commercial-in-confidence question, so please do not answer it if you do not want to. Are you able to say how many members that you have?

Mr Hill—Almost 1.6 million.

Senator MURRAY—Could you tell me, of that 1.6 million, how many a year are likely to get moved to the lost members account?

Mr Hill—I do not have those figures. I could tell you how much we transfer to an eligible rollover fund and they would be between 20,000 and 30,000 typically a year. There would be a higher proportion than that which would be lost. For example, we are going through the mailing

of our annual statements, as most superannuation funds at this stage are, and we will get tens of thousands of statements and annual reports returned unclaimed.

Senator MURRAY—I wonder if you can give us those stats, because this is a signal of how the system is not meshing together. This government is within the orbit of government data in trying to get far more fluidity, flexibility and connection between different government databases. It seems to me that you experience the same thing. I am interested in the percentages and numbers who do not have TFNs—you have said about 38 per cent; that sounds about 600,000 to me—numbers of accounts, numbers that get lost, numbers that you get returned when you send out advices, people not advising you, numbers that end up in the lost members funds and those sorts of things. I am not asking for anything that involves doing too much work but I would like that detail just so that we can get an understanding of the kind of clogging, if you like, of things in the system where it is not working well.

Mr Hill—I can take that on notice.

Senator MURRAY—Of course.

Mr Hill—The only other comment that I would make there is that I think that the two-barrel definition of a lost member is clogging up the system in that the inactive members is a particular concern. I worked on a working party with the tax office many years ago on this, and our experience is that many inactive members know where their super is and are actively not making the choice to move it. They do not consider themselves lost, so they are surprised when they are categorised as lost in many circumstances. That is responsible for potentially overstating what is a lost member.

Senator MURRAY—It is like a rainy day bucket for them?

Mr Hill—Yes.

CHAIRMAN—I would like to just ask some questions in relation to governance. You reject the notion that all funds should be governed by a public company. What is your current corporate governance structure? Are you a trust structure?

Mr Hill—We are a trust company.

CHAIRMAN—A trust company?

Mr Hill—Yes. We have eight directors. Four of them are appointed by employer representatives; four of them are appointed by employee representatives. From the point of view of a chairman we have, if you like, co-chairs. They alternate at each meeting of both the board and the relevant committees.

CHAIRMAN—You say the employers are appointed by the employer representatives and employees by their representatives. What is the actual process for that to occur?

Mr Hill—They are nominated by the employer association or the employee association, as is relevant.

CHAIRMAN—So the individual employers or the individual employees do not get a direct vote in the appointments, it is the peak body on both sides?

Mr Hill—The peak body representative of the largest proportion of them does do that. As I said, we have chairs that alternate at each meeting.

CHAIRMAN—Do you think there is an argument that the individual components of those bodies, rather than the bodies themselves, should appoint the trustees or the directors?

Mr Hill—In our circumstances I cannot see the benefit of that outweighing the cost of having elections amongst 1.6 million members. I think it is just a cost burden that would not have a requisite pay-off.

CHAIRMAN—Then the chairman alternates from—

Mr Hill—From meeting to meeting.

CHAIRMAN—Any of those eight can be the chairman?

Mr Hill—No, there is one. There are two co-chairs, one nominated from either group, and they alternate the chair of the board and the various committees meeting to meeting.

Senator FORSHAW—You talked earlier about a level playing field. I am just picking up on Senator Chapman's last line of questioning. If you did that for these large industry funds, then you would have to do it presumably for master trusts?

Mr Hill—Similarly you would be asking AMP—seeing as the sponsoring organisation appoints all the directors for its trustee company—to go to its 300,000, 400,000 or 500,000 members and do the same thing. As an overall exercise for the industry, with 22 million accounts at least, whether the trade off is appropriate, I fail to see the benefit.

CHAIRMAN—You draw a distinction between that and between the shareholders in a major corporation?

Mr Hill—I do. The trustees and the directors have a fiduciary obligation to act in the best interests and this is outlined in various aspects of legislation. They have obligations in that regard. They are in some sense representative anyway through where they come from—the sponsoring organisations—so I certainly do not hold a view that the current structure is unrepresentative of the members or the employees underneath it. From a governance point of view the equal representation, particularly amongst industry funds, does add to the governance structure in that we do have that representative structure. In my experience some of these directors are those most closely attuned to the underlying members of the fund, as opposed to some other structure that might be proposed.

Senator FORSHAW—It is a bit like with the Commonwealth Bank. I am not a shareholder, I am just a customer.

CHAIRMAN—You are a shareholder, did you say?

Senator FORSHAW—I am not. I am a customer. You understand why I make this point?

Mr Hill—I do.

CHAIRMAN—It has been suggested to me that there is a need to lift the standard of the fit and proper test for trustees. In your experience do you accept that view?

Mr Hill—It is a relatively new test and it is still proving itself. When compared to other governance structures, it seems to me that it is a higher test than is generally out there in other avenues. I think it supports the premise of getting the right people with the right skills onto trustee boards. We are supportive of the fit and proper test as it currently stands.

CHAIRMAN—I thank you both very much for appearing before the committee and for your contribution to our inquiry.

Mr Hill—I thank the committee for the opportunity.

[2.30 pm]

DUNNIN, Mr Alex, Executive Director, Editorial and Research, Rainmaker Information Pty Ltd

CHAIRMAN—Welcome, Mr Dunnin. The committee prefers that all evidence be taken in public because this is a public inquiry. If at any stage of your evidence you wish to give evidence in private, you may request an in camera hearing with the committee and we will consider such a request.

Mr Dunnin—That will not happen, that is fine.

CHAIRMAN—We have before us your submission, which we have numbered 52. Are there any alternations or additions that you want to make to the written submission?

Mr Dunnin—No.

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

Mr Dunnin—Thank you very much for the opportunity to appear at the inquiry. I will just give you some background on who Rainmaker is. We are a specialist research and publications group. Reflecting that, we try as far as we can to be as pragmatic as possible when it comes to looking at the marketplace, because most of our time is spent trying to explain to people how we think the system works so that hopefully they make wise decisions. We sometimes like to say we believe we are in the explaining business.

With this in mind, I will just cut to the chase on our headline views about some of the terms of reference we have addressed. We have grouped the first several—capital requirements of trustees and requiring them to be trustees. The real issue for us is the consumer's need to very easily see who or what entities are behind the super fund that controls that entity. Because trustees are the ultimate arbiters of their funds, consumers need to easily see who the trustees actually are. On both counts the industry is improving, but we believe it needs to improve a lot more. Imposing uniform capital requirements or making them public companies, we would argue, will be helpful only if it addresses these transparency goals. Because of this, Rainmaker is concerned that we do not end up solving the wrong problem.

Following on from this, Rainmaker advocates that disclosure rules be expanded to require greater explanations about what organisations are behind each fund and who are the trustees—not just company names but the names of the actual people. This means the entity holding the shares in the trustee company and the names of major shareholders. We argue as strongly as we can that to say simply that the super fund X is operated by trustee company Y does not tell anyone anything. I can dig out that information as a researcher but I suggest that most consumers would have no idea.

Advice, member investment choice, trustee responsibility and self-managed funds have been bunched together. When consumers join a super fund they are fundamentally signing on for a promise that by the time they retire they will have saved enough money to grow old gracefully. Funds, of course, deliver this through investment returns. Not all consumers are the same and they have this uncanny knack of not always wanting the same investment choices, and this is partly why so many funds now offer choice. In fact, some funds offer up to 1,100 investment choices. I was explaining this to some industry fund trustees yesterday and they nearly had a heart attack. Making sense of these choices is why advice is so important, and even industry funds recognise this. Advice and member investment choice therefore go hand in hand and complement each other. In fact, that is why we started our own selectadviser.com.au website.

Because trustees run their funds and they are responsible for them, it therefore follows that trustees are responsible for the choices that are available to members through their investment menus. Therefore, it is incumbent upon them to provide adequate resources—be that advice—to help members navigate those choices. If you accept this paradigm of choice—we would argue that the fundamental product for the superannuation industry is choice itself—the growth of self-managed super funds is simply a manifestation of how some consumers, particularly high end and more affluent consumers, want maximum choice and flexibility. Indeed, this is why we suggest industry funds, master trusts, self-managed funds and, soon, managed accounts are just different stations along the choice railway line.

Advertising—the whole point of super choice is to open the market to competition and to let consumers choose who should look after their money. Therefore, it is a force for good, in our view, because it simply democratises the industry. It puts the focus on members and not just employer sponsors or their union sponsors. In this environment advertising can be necessary because it is simply a very cost-effective way to communicate with large numbers of members and large numbers of prospective members. We believe imposing advertising restrictions just because it is superannuation is anti choice, anti consumer, anticompetitive and even, dare I say, unAustralian. It is true that some believe that advertising should not be paid for out of deductions from member accounts, but we would counter that no fund actually specifically deducts the payment from a member's accounts just to pay advertising. Instead they deduct fees from members' accounts to pay their operating costs and derive any profits.

Our plea is simply that people concerned about advertising costs should really be fighting to minimise total operating costs and passing these savings on to members as the lowest possible fees. Again, we are concerned that we could be trying to solve the wrong problem. Even worse, advertising controls could be tantamount to trying to tell trustees how to actually run their operating budgets, which we think—while it might be ideal in some cases—could actually end up being quite naive and unworkable.

What is 'not for profit'? That is a very curly question, as you know. Rainmaker agrees that the term is convoluted and open to exploitation, but we also believe that formally defining it in a way that applies specifically to superannuation and that does not undermine the charity sector is going to be unworkable. We wish the advocates of such a definition the very best of luck.

CHAIRMAN—With regard to your submission, you say under the section headed 'The role of advice' that the fundamental fee differentiator among super funds is investment menu, whereby low cost funds are associated with simple direct-sell super funds and high cost funds

are associated with more flexible investment menus. Of course, other factors impact pricing as well, but these are among the most pivotal drivers. In a sense what you are saying is that you get what you pay for?

Mr Dunnin—Yes. The reason we came to that perspective is that, for a lot of our work we have been researching superannuation since 1992, and it was about seven years ago that we first proposed a way to look at super fund fees. By coincidence, it turned out to be the way that IOSCO looks at fees and therefore the way Treasury, ASIC and everyone else looks at fees. We do not believe fees are difficult to understand. It is just a bit controversial from time to time.

The big question that came to our mind was: why were some funds so low cost and some funds so high cost? We figure that it cannot be because some funds are necessarily better. It really came to a head when we started to realise that there is a very strong correlation between the number of investment choices that super funds offer and its costs. The reason industry funds are so low cost is not because they are inherently better, it is because they are fundamentally different. They are different because they have very low sales distribution structures. They basically sell their wares through SG arrangements through awards, so straightaway they have a controlled market. Therefore, they do not have to pay for shoe leather to go out to every country town and every suburb in Australia. They are also very simple products.

Products that are simple tend to be easier to operate, have lower overheads and therefore lower costs; it all starts to make sense. We will often say to consumers, 'If you want a low cost fund, look for a simple fund you can join.' Conversely, talk to a financial planner—a planner is in the business of really helping you navigate choice and to get that choice working for you. But when you start to engage a financial planner, of course, you have to pay for that service somehow.

CHAIRMAN—Would you regard advertising that focuses purely on fees as, in a sense, somewhat misleading?

Mr Dunnin—I do not think that it is misleading. It is only part of the story. When people advertise, they always look for their main advantage. Toyota will advertise some of its cars based on fuel. For some people that is really important. For the driving I do that is not an issue. I do not think it is misleading, but I think it is only part of the story; they think that is their strength.

CHAIRMAN—Who do you provide your services to?

Mr Dunnin—Hopefully anyone in Australia. We provide our service to the industry itself and increasingly people who use the industry. We started providing industry research to pension funds and fund managers. As time went on, we found more and more of them were referring to our information in their annual reports and in their prospectus. They were trying to quote us in their newsletters, et cetera. That invariably brought us into contact with interest groups, lobbyists and even, dare I say, some politicians and media, because people started to figure out that we were getting quoted by, say, AMP's annual report. Then the media would talk to us and we would give them our views on particular things to do with the marketplace and how to make sense of super funds. Then consumers starting ringing us up and asking us for help in choosing super funds. Employers also starting ringing us up.

We realised that there was not any generic information about how to make sense of super. There is lots of generic information about how to buy a car, but there is not much generic information about how to buy a super fund. That is why we created our *Selecting Super* handbook, which is now in its fifth year and we have been going on ever since. Increasingly, we are trying to publish information that we used to just reserve exclusively for the industry, but through the internet and other means we believe that all consumers should have access to that information. That is why we published a few wide-release books through some mainstream publishers as well.

CHAIRMAN—Essentially you provide information and analysis of that information?

Mr Dunnin—Yes.

CHAIRMAN—It is provided directly to funds, fund managers and the like but through publications to a broader audience?

Mr Dunnin—Yes.

CHAIRMAN—You do not provide individual personal advice?

Mr Dunnin—That is correct.

CHAIRMAN—You make a suggestion for the introduction of transparency requirements for disclosure information regarding trustees and how they operate. Can you elaborate on the benefits of that proposal? Is that likely to be a contentious proposal for trustees?

Mr Dunnin—The superannuation industry has a wonderful habit of arguing for years over some things that are sometimes inconsequential, so I imagine a proposal like this would be very contentious. As to the reason we say that, I am not a lawyer so I cannot debate whether there should be improved capital adequacy or whether there should be capital requirements—I will leave others to decide those things.

But if we are going to try to impose those sorts of regulations, I suggest that it is not the regulation itself, it is what we are trying to achieve. I suggest to the committee that what we are probably trying to achieve is not just yet another rule; we want to try to improve the transparency of who is actually running the fund. I go to a range of super funds and their websites and if I want to figure out who is really running the funds it is quite hard. I am a researcher. I can dig, weave, ring up the CEO, I can chat to people and then I am fine. A good example is the product disclosure statement, or PDS, for MLC MasterKey Super. If you want to find out who is running the fund, they will then refer you to the Universal Super Scheme, and there they just have one line that says, 'MLC Nominees Pty Ltd is the trustee of the scheme.' They do not say much more.

If you have a look at AMP Flexible Lifetime Super. They just say that Flexible Lifetime Super is part of the AMP Superannuation Savings Trust and, 'We are the trustees of SST and responsible for all aspects of it.' That is good to know, they are doing the right thing, and this is absolutely no criticism of them whatsoever. These are reputable companies. But if I am working with another organisation, perhaps with the Alex Dunnin Super Fund working out of Belconnen

in Canberra, who am I? How does the consumer know that I am any good? Not just by saying that there is a trustee company called Alex Dunnin Trustees. We need to start to say to people, 'Who is behind these companies?'

Australian Super has taken a huge step in the right direction. They have some pages on their website that describe who they are. It is called 'Who we are'. They talk about their affiliate industries. They talk about the industry groups, unions and employer groups that are represented by the board. They talk about what they do. They talk about their standards and so on. But I think they should go the next step and say, if a trustee company owns the fund, who the shareholders are of that fund. Not everyone would want that information—perhaps only 0.1 per cent of people need that information—but it should be there if people need it.

If we just impose capital adequacy on a trustee company when we still cannot figure out who it is or who is behind it, we are not solving the problem. We often say to people that one of the big tests with a super fund is who runs it. Can you trust that those people are going to be there in 60 years when you retire? If you cannot answer yes to that question, perhaps you had better go to the next super fund. That is a pivotal question for superannuation. Superannuation has fundamentally promised that, when I retire, there is going to be a big fat cheque waiting for me with lots of zeros on the end, so I have to be able to trust that the guys are going to be there to mail me that cheque.

CHAIRMAN—You were here when I was asking the previous witnesses about the way in which their trustees were appointed or their board was appointed. For industry funds do you think that the current method of appointing trustees is the most appropriate or is there a better way to go about it?

Mr Dunnin—It was a fantastic set of questions. A couple of years ago, I recall Westscheme—a major industry fund in WA—that was trying to introduce a system where members could vote. In terms of one of the things that is going to occur in Australia, I do not need to tell the committee that unionisation in Australia is falling at quite a heavy rate of knots and, that being the case, it might be possible to say that a particular union is heavily involved with an industry fund but that does not mean that lots of individuals are involved with that union. So if the fund is representing members, should members have some say? I have some money with an industry fund. I am not in a union. That does not upset me about the fund, because it is a really good fund. I have been there for a couple of years and I am leaving my money there. But I do not get a say, because I am not in the union. The whole point of Super Choice and consumerism generally is providing choice to consumers so that they can make their own decisions.

I refer to Damian Hill's comments about running an election for 1.6 million people. That is so big that you are going to need the Electoral Commission involved. It is one of those classic conundrums. I absolutely support the theory of democratisation of the industry, because it is the consumers' money, it does not belong to the trustees. Legally it does, but you know what I mean.

Senator FORSHAW—Would you then extend that and apply it to every single super fund?

Mr Dunnin—You would have to.

Senator FORSHAW—That was Mr Hill's other point in response to my question.

Mr Dunnin—You are exactly right. One of the things that I have found—forgive me for saying this—entertaining about the terms of reference or the inquiry was the issue of people saying that super funds should not advertise. What they are really saying is that industry funds should not advertise. If you are going to impose bans or restrictions on advertising it applies to everybody and not to a particular group. You cannot democratise the industry, provide open choice and then come along and put on certain restrictions against certain types of funds. That was just be totally inequitable. I absolutely agree with your point.

Senator FORSHAW—This is not put as an argument against your proposition of democratisation but in the knowledge, of course, that industry funds have a history to them as to how they were established.

Mr Dunnin—Yes.

Senator FORSHAW—They grew out of award super and employees in a union.

Mr Dunnin—They have been so successful that other parts of the market are trying to mimic them.

Senator FORSHAW—Including the master trusts. This point is obvious but I will put it to you so that it is on the record: for instance with REST, a lot of the services are delivered, at the end of the day, by companies that are in the business of insurance and superannuation, anyway.

Mr Dunnin—Yes.

Senator FORSHAW—I will just make that point. You have agreed with it, but the fact that they may have a board of trustees that has union and industry representatives on it is not the full picture.

Mr Dunnin—That is correct. This is a conversation I have with a lot of the super funds. The super fund is evolving so that most funds are becoming public offer. Even Richard Gilbert from ISFA made the same point. Just about every fund is in the public offer business and so they are learning how to deal with consumers generally. They might have started in the building industry, the clerical industry or whatever the case is, but as they become public offer and as their members move around the industries and move from job to job they are increasingly dealing with the public.

Senator FORSHAW—I have some history, going back many years, of being involved in the establishment of some industry funds. I can well recall the head of the Business Council in Australia at the time launching a huge attack on union involvement in industry super funds. The funny thing was that all of the companies that were involved in management, the provision of the insurance and a lot of the investment advice for those industry funds were in fact members of the Business Council of Australia, for example, AMP, Westpac and so on.

Mr Dunnin—I am sure his members would not have knocked back investments from industry funds, either.

Senator FORSHAW—Of course not; exactly.

CHAIRMAN—In relation to the terms of reference regarding not-for-profit and all-profit-to-members concepts, you say that even though funds may be not for profit and all profits go to members, these funds also use many service providers who are themselves very profit focused, and that could include advertising services as well as administrative services.

Mr Dunnin—Yes.

CHAIRMAN—Do you think there needs to be greater transparency regarding who provides services to superannuation funds?

Mr Dunnin—I absolutely agree. Our firm started life as a research group. It is our backbone. I love transparency. To the point of ad nausea; I just love transparency.

As to the complexity of the term 'not for profit', it comes back similarly to the initial terms of reference. It comes back to who is actually running the fund. I have been to meetings where chief executives of super funds have been trying to explain to members that they are not for profit and the members shoot their hands up saying, 'What do you mean? I thought you were trying to make profits for me.' 'Oh, no, it is the trustee company that is not for profit, but the fund itself is very profit focused.' Then they spend the next 15 minutes trying to explain what the term means. Then they will start to say, 'We are the new mutuals', and then they will spend 20 minutes explaining that. 'Oh, no, we are profit for members.' You have seen the ads and you have seen all the explanations yourself. When you are trying to explain a three-word phrase with a 1,000-word explanation something tells me that it is obviously not working. That is my point.

CHAIRMAN—Do you think there is a need to drill down in terms of what services are being provided and who is providing those to the funds?

Mr Dunnin—Yes. One of the things that we have really tried to promote as much as we possibly could through the Rainmaker group, our *Selecting Super* and other media work we do is that there is almost this notion that a fund is not for profit and that that somehow makes it better. It does not makes it better at all, it just makes it different. Just because a fund is not for profit does not mean that it is going to make good investment returns, give me good insurance, give me access to good services such as advice. It just tells me where that fund has come from.

A good example, if you want to have a fund that is low fees—it is not just about not-for-profit funds that are low fees—I can point you to AMP funds that are actually cheaper than most industry funds. Virgin Super and Max Super have entered the market. They are lower cost than a lot of the not-for-profit funds for particular groups of members. They are profit focussed. There is nothing wrong with making a profit; I want to feed my kids when I get home. We all want to make profits. There is nothing evil about profits. I agree with you.

There should be more transparency. My suggestion is: let us encourage more transparency, but let us not make it so complicated that you need to have a PhD in law from Sydney University to understand it. That is all I am saying.

CHAIRMAN—What is your view of ASIC's recent shadow shopping survey regarding superannuation advice?

Mr Dunnin—I personally think it is time for that issue to move on. One of the things that I find interesting about the shadow shopping is that it is almost like it does not matter what the planners do, they just seem to cop it. For example, an AMP financial planner is licensed primarily to give me advice about AMP products. If they are then accused of not giving me advice about products that are not in the AMP stable and then we give them a hard time for that, I find it a bit bizarre, because all the regulations are about how they can only talk about products on the authorised list. The regulation was a good idea at the time but it has got a bit out of control.

An industry fund representative spoke to me at a seminar in Canberra several years ago. There was a shadow shopping exercise that they had been doing for about three years. He was one of the shadow shoppers three years ago and he said, 'It was fantastic being a shadow shopper, getting stuck into planners and then reporting back to *Choice Magazine*.' I said to him that he should not be saying that. That does not dismiss the issue about complex—

CHAIRMAN—He had a predetermined agenda?

Mr Dunnin—I would say yes. I have blown his cover now, but to me it indicated that the survey was pretty small and probably not as pure as it could have been. Financial planning provides a really valuable service and, like any service, it has to be delivered properly. We have to get rid of the conflicts of interest. But if planners are only allowed to talk about particular products because that is what they are licensed to talk about, then we cannot crucify them for not talking about other products. What we should be doing is thinking about the regulation that is overrestricting them. Shadow shopping is fantastic, but I think to bag planners for doing what the law tells them to do is just silly.

Senator FORSHAW—Do we have any data or is it too early to determine the impact of choice on fees and charges?

Mr Dunnin—There are a couple of issues there. It is probably a little bit too early to give you a heads up straight black and white issue. With respect to choice of funds—and you might have been following the industry—from various surveys 18 months ago I came to the conclusion that somewhere between zero per cent and 100 per cent of people would be changing super funds; there was this frenzy about what consumers would do when they are able to choose.

Senator FORSHAW—Did you tell *Choice* magazine that?

Mr Dunnin—We talk to *Choice* a lot. The main trigger point for when people change super funds is when they change jobs. According to the Bureau of Statistics, around 15 per cent of people change jobs each year. After choice of funds has been in for just over a year, according to Investment Link, the proportion of people who have changed super funds is around 12 per cent. Investment Link are a super fund clearing house group. Job mobility is the big trigger for changing super funds.

Is it impacting on fees and charges? I would say generally that it is too early to tell. I would expect it, personally, not to lower fees but to promote much better clarity about segmentation of the market place. It is going to really bring a lot of those issues onto the table.

Senator FORSHAW—You are in the business of tracking and assessing super, so will you be able to ascertain what impact choice will have or will have had on returns? There was an assumption, at least in some of the arguments in favour of choice—and there were a number of them, such as the classic that you should have freedom of choice because you should have freedom of choice—that it would provide better opportunity or greater opportunity for people to earn more, lower fees and so on. In terms of returns and better performance, will we be able to ascertain that?

Mr Dunnin—Not directly. The big issue with choice is that there are too many things that impact returns. There could be a run on the resources market. That is going to have such a massive impact on the stock markets and therefore upon returns, as we have seen over the last few years. You do not need me to tell you that. If choice is going to have any impact on returns, it is going to be because we are lowering costs and that that is being passed through. The fees are going to have an impact because consumers are going to swap from high fee funds to low fee funds. That therefore means portability has to be the key, which means that it has to be really easy to change super funds.

The Treasurer was giving a speech somewhere recently and we received a press release. He was making indirect comments about making it as easy as possible for people to change super funds. I suggest that changing super funds is almost as hard as changing banks. It is great in theory to say let us go to another bank, but it takes 18 months to fill in the forms.

Senator FORSHAW—It is pretty well understood that people will often change banks because of fees and charges, particularly today given the relative interest rates that you earn on normal deposits. But, equally, people will shop around for a better return on interest where they have a substantial amount of money to invest and go to other products other than banks. But I would have thought that it would be possible at some point to survey people who have shifted from a fund to another fund on the basis of expected performance and measure satisfaction. You have to ascertain who those people are.

Mr Dunnin—I agree with your point. The whole point of choice is that people can actually make a move if they wish. As to where that counter-argues against the cost issue—now that funds are in the open market, for example, REST, they have to spend money advertising in a way that they did not have to do before. I personally believe it is really healthy that funds have to market themselves, because in doing that they have to articulate their value proposition, which means they have to be getting on the front foot and saying, 'This is what we are good at and this is why you should join us.' That is why Super Choice is so powerful. Even if no members move, it is still a fantastic thing to happen, because it is forcing funds to come out of the bunker and explain to their members what on earth it is that they do all day. I think that is terrific.

Senator FORSHAW—Finally, do you have any comment or evidence on what impact those tables of performance have on the ordinary employee or small investor out there who picks up the *Financial Review* or some other paper and sees a table 'The best performing funds' or 'The top 10' and there they are. There is a mixture of industry funds and other funds. Does that really impact upon people's decisions now?

Mr Dunnin—I would say so, based on the emails and phone calls that we get. If we are late with a table—

Senator FORSHAW—That is basic information, is it not?

Mr Dunnin—Yes.

Senator FORSHAW—It is like 'star' earned 13 per cent and someone else got 11 per cent.

Mr Dunnin—That is a fundamental product of what those funds are delivering. I would also say that, because that is what funds are actually delivering, why should members not have a place to go to get that information? I have gone through these exercises trying to buy a car. I love the fact that I can go to *Wheels* magazine and get information.

Senator FORSHAW—I am not knocking it. That is not always paid advertising. They may be paying to another organisations like yours or—

Mr Dunnin—That is spot on. We keep saying that past performance does not predict future performance, but every time people, even high-end consultants look for a fund manager, they always look at their past returns. We would say that the issue is, therefore, to teach people how to read those tables intelligently. That is why we believe those tables of performance are so important, because it forces funds, again, to get out and start telling their members how they have been going.

I will tell you as a researcher that when funds, fund managers, super funds, master trusts or anybody else starts refusing to provide that type of information, more often than not either they close up six months later, they announce some massive restructure or something goes belly up. Every time people stop providing information or refuse to provide it, usually I think there is a reason.

Senator FORSHAW—What I am leaning here to is that that information comes from the fund—

Mr Dunnin—Yes.

Senator FORSHAW—but it is put into the paper or the publication by the paper itself or by some other agency. It might be Rainmaker, it might be a similar body. So I am thinking that in some ways it might be a bit like the stock exchange the way it actually provides financial data. It is not seen to be advertising but rather is seen to be just the facts of the day in terms of rates of return. That could be a good thing.

Mr Dunnin—I agree. If people have got tens of thousands of dollars invested, I think for them to say, 'I want to know how that is going,' is a fair question, and I think it is great that now they can get the answers to that on most occasions, and they can get it for free from our website.

Senator FORSHAW—That is the best advertising you have had. Thank you.

Mr BARTLETT—I am interested in your statement on page 10 of your submission. You say:

… Rainmaker believes the superannuation industry debate of industry funds versus master trusts is really a distraction to the real battle emerging between master trusts and SMSFs.

I am interested in what you see as the implications of that future battle, the growth of SMSFs and the implications in terms of regulatory requirements, prudential issues, rates of return and the effectiveness with which people can accumulate retirement savings.

Mr Dunnin—That is a very big question.

Mr BARTLETT—It is, indeed, but requiring only quite a short answer.

Mr Dunnin—The reason this particular angle has fascinated us is that we have been to countless forums and seminars and I have even presented at conferences and have written articles on the same topic. There is almost this 'us and them' battle between master trusts and industry funds. Any industry I think suffers this disease, but industries have a habit of arguing amongst themselves, and that is fantastic. It is a lot of fun. But we then say to our consumers, 'Oh, you don't seem to be engaged with us. You don't seem to understand us.'

Last year I was involved with the money expos in Sydney and Melbourne and I started talking about industry funds versus master trusts, and there were blank looks on people's faces. I used to be a schoolteacher; I know a blank look usually when I see one. They would just go blank and they did not know what I was talking about.

Then I started talking about super funds generally and about choice and getting advice and making sense of the menus, and all of a sudden they started engaging. I would start talking in what I think are more pragmatic terms, and then we would have a great conversation about superannuation.

But this thing about master trusts, it is the dumbest word. People even talk about baby master trusts. Do you know what a baby master trust is? They also talk about baby wraps. They are the terms we use in this industry. Then we say to consumers, 'Oh, my goodness. You don't seem to understand superannuation. Don't you know what a baby wrap is?' It is insane.

When you actually look at where the money is shifting, the master trusts are growing at about the same rate as the self-managed super funds and the industry funds are growing in percentage terms tremendously. But the money battle has been won by the master trusts for the time being. If the strategists of the various wealth management groups have got a client with $200,000, they are not worried about that client bailing out of ASGARD to join CBUS, they are worried about that fund bailing out of ASGARD to go run their own money.

When you talk to a lot of what I would consider the serious strategists, they are the discussions they want to have. They know the issue with industry funds versus master trusts is interesting, but it is really not the main money game at this point. Again it reinforces to me that our industry is based upon legal issues, compliance, tax accounting, all that sort of stuff. To understand our industry, and I say this with the greatest respect to accountants and lawyers, you have got to have a bit of that accounting and lawyer thing in you to understand it. So most human beings do not get it. If we keep speaking to them as if they are an accountant or a lawyer, no wonder they are going to be disengaged. It comes back to some earlier questions.

What impact does it have upon regulation or whatever? I would say it should have no impact because I do not think there should be differential regulation. With self-managed super funds, I

have had conversations with people, and even some associations—industry funds—who hate the concept of a master trust or hate the concept of paying a financial planner. I have discussions with people running master trusts who hate the concept of industry funds, and they argue, 'Why would anyone want 50 choices? Why would anyone want 500 choices?' Then other people say, 'Well, how can you survive with only five choices?' So they have all these funny arguments that are like: is AFL better than rugby union? I think the answer to that is easy. Rugby union is much better. We know that. But the way we debate these things in our industry is so esoteric and bizarre.

Senator FORSHAW—You got some blank looks there.

Mr Dunnin—Exactly.

Senator MURRAY—I am with you, mate.

Mr Dunnin— I have been in meetings with people running master trusts and the way they criticise self-managed super funds for offering too much choice, too much flexibility, it is almost like I am talking to an industry fund person criticising a master trust person, except they have moved along one slot. We often say to people, 'Look, I don't care if you join an industry fund, a self-managed super fund or a master trust. The point is, understand what you are joining. You join a self-managed super fund because you want maximum choice and maximum flexibility, so make sure it works for you.' It is not a good or a bad solution, it comes down to whether it is appropriate for you, so therefore people joining those arrangements need to understand them. Sometimes we have ideas from people saying, 'It's a bad thing people want to run their own money.' Why? I do not see why it is bad. It is only bad if they blow their money, but they are not bad structures in themselves. I was not here this morning when the SPAA group was talking, but I imagine they would have been giving a similar message. If you look at the numbers, I think there is a different reality unfolding when you look at these statistics compared to some of the debates that occupy our industry's time.

Mr BARTLETT—Has your research shown any significant difference in average rates of return between self-managed funds and either of the other two?

Mr Dunnin—It is very hard to monitor the returns of self-managed funds because, by definition, they are incredibly diverse. There were 330,000 at last count, something in that order. We can make some guesstimates about their returns based upon average asset allocations, but when we do that the self-managed associations get very upset because the ATO figures tell us that lots of that money is in cash, but they reckon that is not a real number.

I live in Canberra so sometimes we head down to Thredbo to go skiing when there is snow, and you run into people at some of the bed and breakfasts and they will talk about their self-managed fund and how it made 1,000 per cent. So it is one of those things where some people have made a lot of money out of running their own funds, so I think they can be tremendous structures if you know how to use them. I have not got one. I would love to be in a position to have one. That is my goal.

CHAIRMAN—For the record, would you explain what a master trust and a baby master trust are? What is the difference.

Senator MURRAY—And a baby wrap.

Mr Dunnin—A master trust is effectively a super fund run by a retail group that has lots of investment choices. That is really all it is. A baby master trust is one that does not have so many choices. Why? Because they are finding consumers are getting confused when you present them with a super fund master trust which has 100 choices when the planner says, 'Why don't we present them with a fund that has 10 choices or 20 choices?' Because it is smaller, we call it a baby.

CHAIRMAN—But the choices are still all managed funds, are they not?

Mr Dunnin—Yes.

CHAIRMAN—There are no direct investments.

Mr Dunnin—Correct. That is a very good point to make, because some funds are starting to offer direct share access. Even some of the industry funds operate ASX200 access. On the advice point this is a fascinating one. When some of the industry funds started offering ASX200 access choices on their menus, some of the retail wealth management groups rang us up. They could not understand how funds could offer that with no automatic advice support, because they knew if they tried to offer that almost without automatic adviser involvement, they believed ASIC would shoot them down. But again, some of the industry funds are doing that and other super funds are doing that because they believe their members will take up those services, which is just the evolution of the industry. The car industry is evolving now where I can buy a standard Commodore and it has got more features than probably a top of the range BMW had 10 years ago.

Senator MURRAY—I was thinking when you were talking, Mr Dunnin, that reputation is always built on the past, and in fact people rely on your reputation for the future. That probably applies to your company as well. You are starting to become a Standard & Poor's type rating agency.

Mr Dunnin—We are not quite that big, but I would like to be.

Senator MURRAY—You know what I mean. I am speaking in reputational terms in superannuation. It moves you to a position of market power. Have you or your company ever experienced improper influence, such as people trying to spin you a line? Is this an experience of yours?

Mr Dunnin—It is becoming an experience from time to time. As a part of having all this research material, we launched our own trade publication called *Financial Standard* several years ago. I am now the managing editor of that, so I have a media hat on when I am running that news service. We do a daily email newsletter and so on. I get more spinners dealing with me there, but I think I have been around long enough where I can deal with that quite easily. From our research side we have people who come along and say, 'We are not going to advertise or deal with you because you're anti-retail,' or, 'You're anti industry fund,' or, 'You talk too much to the financial planners.' So we sometimes get involved in these tribal disputes, but it does not really

trouble me. It has not been any great angst to date. I used to be a teacher in the western suburbs of Sydney so you would have to do a bit more to scare me.

Senator MURRAY—I have taken a particular interest in this area for many years. I have found a number of not-for-profit and for-profit organisations that provide information or represent particular segments are a bit murky in themselves. I am not suggesting you are. I will give you an example. Years ago I questioned ACCI about their antecedents and so on, and they have always been very good, saying, 'These are our number of members. This is how we are elected. This is how people are appointed,' and so on and so forth, which is back to your point of transparency. With respect to consumers, there are organisations that deliver a service for consumers which might be less than transparent in their own dealings. With the Australian Consumers Association, for instance, the way in which people are appointed, elected and governed is not quite as straightforward as you might hope. So the question arising from these observations to you is: do you think when we are looking at regulation in the broad, people like ASIC and APRA ought to keep an eye on the analysers and the information providers, such as yourself and others, to ensure that their governance mechanisms, and I suppose IFSA and AFSA and everybody else who is in the game, are up to the mark.

Mr Dunnin—I think that is a fair point to make. I know ASIC from time to time has talked about licensing research. I think that is probably part of your question. There are similar moves like that in the US. Where it sometimes gets a little bit curly for us is that I have had people at seminars say that all the research groups and all the ratings groups should have a standard methodology.

Senator MURRAY—That is ridiculous.

Mr Dunnin—I have said that we will have a standard methodology when there is only one super fund in Australia.

Senator MURRAY—Yes. That is stupid.

Mr Dunnin—If the future fund takes over everything, that will solve that problem.

Senator MURRAY—Sounds a bit like Mr Ford. You can have any colour you want as long as it is black.

Mr Dunnin—His cars actually had more than one colour, but I will not go into that right here. That is actually a bit of a myth to an extent. ASIC and the regulators—it is probably more an ASIC issue because it is probably more on the disclosure line—should definitely have an interest. They have actually come along and said, 'If you are going to be running what we call corporate super fund tenders, you need to be licensed and so on.' I think that is a very fair point to make.

Senator MURRAY—I want to ask you about an area of analysis which interests me. I heard you earlier put great emphasis on mobility, on portability, and of course the ability to consolidate and all those things that go with it. I think it is a great feature of choice. Have you, as an agency, done any research into funds which are being a bit sticky fingered with respect to people's money? Let me explain what I mean.

Mr Dunnin—I think I know what you mean.

Senator MURRAY—I am sure you know what I mean, but this is for the record. In business it is a not uncommon strategy to delay payment, and over time, of course, that improves cash flow and return to those who delay payments. If you time your delaying of payments on a consistent basis to be a few days over your terms and conditions, (a) the supplier gets used to it and you get to use their money. I have observed that there are a number of industry super funds which have a decidedly sticky approach to making portability and consolidation happen easily. I will give you an example of what I think is a good industry standard. I will not give you the bad industry standard, but I will give you a good one. I think MLC is a good player. They are extremely helpful in any matters to do with consolidation or portability. They are efficient, timely, courteous and so on. This is based on my observations. But the others are very large companies which have adopted a sticky approach to these matters. Of course, these things reach me both anecdotally and through observation, but they are not empirically based or analytically based. So I wonder if you have done any work in this area?

Mr Dunnin—We have not, because that is an issue that the clearing houses would actually be picking up. We have had conversations with a major clearing house group, Investment Link. I am not sure if you have heard of them, but what they do is provide an information hub. They have an electronic payment system where employers can send a cheque to a central repository and then that money is farmed out to all the super funds that the individual employees want to use. So from having super choice and having that clearing house being in action for a couple of years, and obviously last year it has been a big year for them, they have got a lot of experience now with which super funds are great to deal with and which ones are the stickier ones. I have had some conversations with them which they have sworn me to secrecy about, because they have done some research on that very issue. They would be good people for you to talk to.

Senator MURRAY—The question is how can this be dealt with. The government—

Mr Dunnin—A baseball bat.

Senator MURRAY—Yes. There are some people at this table who are probably quite good at that. The question is this. The government has very properly and rightly, supported by the parliament, decided that portability will occur and consolidation will occur. But I see no mechanism to enforce that. The government has put immense money and resources into lost members' funds, advertising and trying to encourage people to do these things—setting up the networks. But when you try to consolidate or make something portable, for the ordinary person so many administrative impediments arise that unless you are persistent people will say, 'Oh, it's too hard.'

Mr Dunnin—Yes.

Senator MURRAY—Then that money gets left in the fund which, of course, in my view is the purpose of making it administratively difficult.

Mr Dunnin—Yes.

Senator MURRAY—So it is a serious question. Do we need penalties? Do we need a government instruction to regulators? Do we need somebody like you to analyse and expose it?

Mr Dunnin—I think the answer to all those questions is yes. What we also need is regulation that facilitates it, because one of the things the trustees will say is that, 'Well, the rules say that as the trustee we have got to make sure we do the right thing,' and some trustees genuinely believe that if someone rings up and says, 'I'm with low-cost fund X and I want to move my money to master trust Y,' they go, 'Hang on. That doesn't sound right. I've got to make sure that Alex is trying to do the right thing here.' So they go into this process of, 'How do we know Alex is making the right decision?'

Then you can have issues where it used to have to be all done in 90 days and it is moving to 30 days. Why it cannot be done like a bank account, I do not know. So they will say, 'I fill in my form, I send off my form and that is when the 90-day period starts, but I might have left off my post code. So they send me back my form, I re-send my properly completed form and then the 90 days starts again.' So there are lots of those sorts of shenanigans that go on. In terms of structured research to see what the real story is rather than the anecdotal evidence, that will be a hard one. I think the clearing houses would be ideally positioned to really see how good funds are at switching money around.

Senator MURRAY—I am not familiar with the clearing houses. Tell us who they are.

Mr Dunnin—Imagine you are an employer—

Senator MURRAY—No. Tell us their names. That is all I want.

Mr Dunnin—The major group is Investment Link. There is another group called Essentials, which is owned by the Bravura Group. BT have their own clearing house facility. I will describe what they actually do. Imagine I am a small business employer in Goulburn. I might have 20 forestry workers working for me and I want to do the right thing by my workers and let them choose which super fund they want to use, but the biggest lament—the biggest hassle—employers have is not so much superannuation itself but sending off 20 cheques to 20 different super funds. Because it is amazing how many super funds still rely upon cheque payments.

Senator MURRAY—So you are telling me that if the regulator that is responsible goes along to see those clearing houses they will get the inside market information as to who is adopting, if you like, a policy—

Mr Dunnin—A lot of that information would be available to the clearing houses. I am not sure if, say, ASIC or APRA would have authority to get it from them though. I will leave that to other people to argue that one.

Senator MURRAY—Okay.

Mr Dunnin—What a clearing house does is that I can say is, 'Hang on. Instead of my payroll person sitting in the garage in Goulburn trying to send out 20 cheques every month, what we can do is just send one cheque to this, if you like, administrative hub clearing house group, and we tell them, 'Okay. Fred wants his money to go to AMP. Alex wants his money to go to BT. Larry

wants his money to go to CBUS,' et cetera, and then they will actually farm the money out. So as the employer I am sending one cheque and there is a database at the clearing house which just tells them how to break that cheque up.

That is what a clearing house does. It just farms that money out. So administratively it is a fantastic solution.

CHAIRMAN—Mr Dunnin, thank you very much for appearing before the committee and for your assistance with our inquiry.

Mr Dunnin—Thank you very much. I really appreciate your time.

[3.32 pm]

GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association Ltd

O'REILLY, Mr David John, Policy Director, Investment and Financial Services Association Ltd

CHAIRMAN—I welcome the representatives from the Investment and Financial Services Association. The committee prefers that all evidence be given in public, given that this is a public inquiry, but if at any stage you wish to give evidence in private you may request an in camera hearing and the committee would consider such a request. We have before us your submission, which we have numbered 60. Are there any changes or alterations you wish to make to the written submissions?

Mr Gilbert—No, Mr Chairman.

CHAIRMAN—If not, I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Gilbert—I thank you for inviting us to give oral evidence. I would like to make a brief opening statement. IFSA is a national not-for-profit organisation which represents retail and wholesale funds management of superannuation and life insurance industries. IFSA has over 135 members who are responsible for investing over $950 billion on behalf of more than 10 million Australians.

Senator MURRAY—Did you say $950 billion?

Mr Gilbert—Yes. Member compliance with IFSA standards and guidance notes assists in the promotion of industry best practice. IFSA has been a strong supporter and an active participant in the development of sound, adequate retirement incomes policy for Australians. In fact, we see our role as very much partners in the public policy-setting process. In 2003 we released a major policy statement: Retirement incomes and long-term savings; living well in an ageing society. That policy statement identified a retirement savings gap of $600 billion and called for policy makers and the super industry to make changes aimed at simplifying the system and improving incentives to save within superannuation.

Interestingly, that comprehensive body of work has not been substantially challenged, even by the most vociferous industry critics. Early this year we released a second edition of that particular research, and it shows that the gap has narrowed and it has narrowed because we have had some very good outcomes in the superannuation taxation and also with the co-contributions, but still it found that more can be done.

IFSA is a strong supporter of the government's Simpler Super package announced by the Treasurer as part of the 2006 budget. We have been working closely with Treasury and the government to the lead-up and the implementation thereof. While these measures represent some

of the biggest changes in superannuation since the enactment of SIS and the SGC, they are a huge step forward in addressing Australia's retirement savings gap. Nevertheless, it is still incumbent on the parliament to ensure that the legislative structure underpinning the operation of Australia's superannuation industry is up to the task. The structure for the regulation of super in Australia should promote a viable industry that encourages well-regulated and fair competition and enables fund investors to maximum their retirement savings in a safe and secure environment.

As a general comment, we consider that a review of the law underpinning the structure and operation of the superannuation industry is appropriate at this time for a number of reasons. The SI(S) Act has not been the subject of any significant review since its enactment, and the parliament should ensure that the law and its administration is not out of step with current day requirements and developments, including technological and market developments over the last 12 years. While we consider that the current structural requirements for the regulation of superannuation are solid, the laws have not kept pace with industry changes and consumer demands. Maintaining the current laws may challenge the efficiency and effectiveness of the superannuation market.

The superannuation industry in Australia today is very different to the industry operating in 1993. Our system now places a lot of responsibility on the individual to make financial decisions on how much income they want in retirement and how much they need to save in order to achieve it. Likewise, the individual is responsible for determining the way in which their superannuation is invested based on their attitude to investment volatility. The industry has the responsibility to inform and advise consumers as well as managing their savings.

The IFSA submission to the inquiry addresses each of the terms of reference and lists eight issues under 'Any other relevant matters' that we consider are important for the future operation of the industry and that will benefit consumers. Each of the first 14 terms of reference touches on a matter that is relevant to our industry, so therefore the focal points for our industry are: first, operational risk and importance of disclosure. It is worth highlighting some of the facets of operational risk. Let me go through them quickly. The first is pricing errors that include unit pricing and incorrect crediting rates. I can reveal to the committee that shortly we will be unveiling three new standards with regard to unit pricing. The second risk area is accounting errors; third, legal and compliance errors; fourth, transactional errors; fifth, false and misleading statements in correspondence, advertising and product disclosure statements; sixth, due diligence errors, including incorrect information in product disclosure statements; seventh, privacy breaches; and lastly, performance calculation and dissemination errors.

The second focal point is the fundamental need for a strong and effective advice industry, without which ordinary consumers will be significantly disadvantaged. IFSA believes that the industry and its stakeholders, including government and regulators, should actively promote the importance of financial advice, particularly for superannuation. There needs to be a recognition that the industry in advice in Australia is fundamentally sound and that sustained criticism of the advice industry runs counter to recent government attempts to improve financial literacy and financial understanding.

The next point I would make in relation to advice is that we have had research which shows, and this is consistent over three research series, that 87 per cent of individuals who use a

financial planner—40 per cent of those have super—are satisfied with the level of service they receive. For those who interact with their financial planner at least twice a year, the proportion increases to 95 per cent satisfaction. So I think there are mixed messages out there in the media and within the regulator about advice in Australia; it is in a much better condition than most of us would read about.

The third and final point I will make is that we need a more effective mechanism to ensure that superannuation laws and regulation promote efficiency and effective industry operations and appropriate investor protections. In particular, the need for legislative reform to enable the industry to rationalise financial products that present high levels of institutional and consumer risk. Some estimates have recently put the number of managed funds in Australia as high as 9,500, and that exceeds the whole of the number of managed funds in the USA. That is why we have been asking Chris Pearce, the parliamentary secretary, to move on that front.

The final point I would make is that there needs to be even more effective consultation mechanisms between the industry and the regulators. That concludes my opening remarks. I am very happy to take questions.

CHAIRMAN—Thank you very much, Mr Gilbert.

Senator BRANDIS—Mr Gilbert, I want to explore with you a bit further the question of advice. We had earlier in the day a discussion with other witnesses about the boundary between the provision of information and the giving of advice, which seems to me to be not an entirely artificial distinction but nevertheless a distinction that is very difficult to draw. Do you think there ought to be a recognised statutory boundary between the provision of information and the giving of advice in relation to superannuation products? Should that be a statutory boundary and how should it be defined?

Mr Gilbert—I will pass over the technical aspect to David O'Reilly, who is assisting me today, but in a general sense the point of distinction is about knowing your client. Once you become involved in getting to know a client's risk potential, what their long-term aspirations are for investment returns and their overall needs, then you are in the business of giving advice. If you are giving information only on a single product, that is a lot different to knowing your client fully and getting the right product for that client. Over to you.

Senator BRANDIS—Before you start, Mr O'Reilly, so you would say that we look in the relationship between the particular product and the particular needs of a given client to determine the point at which one goes beyond merely giving information about the product and giving advice, because it is tailored to the needs of the given client.

Mr Gilbert—I think that is a very good conceptual beginning.

Senator BRANDIS—Thank you. Yes, Mr O'Reilly?

Mr O'Reilly—This is an issue that has been bedevilling the industry for some time. The regulator has taken quite an aggressive approach to the definition in particular of personal advice. The way the legislation operates, if an adviser was to take into account any personal factor of a client, either directly or indirectly, the regulator would consider it to be personal

advice and therefore a whole range of documents would have to be provided. We have put in a submission to the parliament—

Senator BRANDIS—Sorry. Before you go on, excuse me for my ignorance of this, but where is that standard to be found? Is it merely the practice or guidelines of the regulator or does it have a statutory or regulatory basis?

Mr O'Reilly—It is the regulator's interpretation of the provisions of the Corporations Act.

Senator BRANDIS—Which provisions?

Mr O'Reilly—In terms of the definitions of personal advice and general advice.

Senator BRANDIS—Is that interpretation set out in some sort of policy statement or other transparent guideline?

Mr O'Reilly—It is a matter of practice, and the regulator certainly has made a range of statements in relation to what it considers to be personal advice.

Senator BRANDIS—These are published by the regulator.

Mr O'Reilly—These are published by the regulator, but certainly the line between what is general advice and what is personal advice is very difficult in practice to identify.

Senator BRANDIS—Is it IFSA's view that that line requires clearer statutory definition?

Mr O'Reilly—It certainly is.

Senator BRANDIS—I appreciate what Mr Gilbert helpfully said before, but do you have a specific form of words to propose to us?

Mr O'Reilly—We do.

Senator BRANDIS—Was that in your submission, by the way?

Mr O'Reilly—It is not, but we did lodge a submission with the parliamentary secretary in terms of the next round of refinements of the Corporations Law. The distinction between general advice and personal advice was identified as a possible proposal and we have responded to that both in the original submission and a supplementary submission. We will be happy to provide it.

Senator BRANDIS—If you are prepared to send that to the committee, that would be good, because this is something we will have to come to terms with. Were you finished on that point, Mr O'Reilly, because I want to go on to something else.

Mr O'Reilly—Yes, that is fine.

Senator BRANDIS—When I say 'something else', it is still within the broad topic of advice. It seems to me as well—and it really fits in very neatly with what you said, Mr Gilbert, about the needs of a particular client—that there is yet another element here beyond information which might be regarded as the most neutral and disengaged form of communication and beyond the giving of advice which implies a level of engagement with a client. It seems to me that, particularly these days when there are so many people who find themselves holding quite valuable assets and taking a greater deal of interest in superannuation, and specially self-managed funds, than was the case perhaps 10 years ago, beyond giving advice you almost reach the point at which a client, particularly an unsophisticated client, needs to be educated about what superannuation is and about what their choices are. So it is not merely even giving them advice, but teaching them. Do you think that is a fair observation and, if that is the case, it seems to me that the industry needs some protections or at least a definition of the limits of their fiduciary duty to clients in those circumstances in which there is a fairly high level of reliance.

Mr Gilbert—Your statement is generally a correct one. We do need to do more as an industry. We fully support the government's work in the financial literacy task force which they now have running, and I think it is very good to see that. It seems to have attracted non-partisan support across the parliament. It is a very important program. That is the first point I would make. The second point I make is that when we publish something on the IFSA website we do so knowing that ASIC will trawl the website and find an error and ring us up if it is wrong and say, 'Correct it.' So even we at IFSA, and we are not licensed under the Financial Services Reform Act, are becoming fairly gun-shy about putting material on the website which—

Senator BRANDIS—Of course, I am talking about superannuation funds, that where you have a superannuation fund with a relationship with a particular client and the client has just no idea but is looking for guidance beyond common or garden advice, it seems to me that one of these days a court is going to say, 'Well, once you undertook to explain this in detail to this client you assumed a heightened level of fiduciary responsibility to the client.' Where that happens I think the industry is entitled for the level of its exposure and the level of its obligation to that unsophisticated client to be limited. What do you say about that?

Mr Gilbert—I think there may be emerging a need for some ring-fencing there. The trust law which we operate under is trust law of the 1800s or even earlier, and the fiduciary obligations that are on super fund trustees and other providers' licensed is very onerous.

Senator BRANDIS—Indeed it is, but Senator Murray and I had an exchange about this earlier in the day. The thing about the fiduciary obligations, more than most areas of the law, is that their content is variable, but the one thing you can be sure of is the more asymmetric the relationship the more expansive the width of the obligation, and that is my point.

Mr O'Reilly—Certainly. We have moved into an era where, as Mr Gilbert said, more emphasis is being placed on the investor, the superannuant, to make investment choices and to understand. There is a lot of documentation and publication that does go out. Much of that would fall into the realm of general advice. When it comes down to personal advice I know that there are many superannuation funds that, one, are not licensed to give personal advice and they are fairly hesitant in terms of the documentation that they will put out for fear of giving personal advice. Yes, more needs to be done in terms of the law. In terms of the education of people out

there, of course, superannuation is compulsory and it is a shared responsibility between government, industry and trustees to do so.

Mr Gilbert—A further point, and it is actually in our submission, is that SIS does not refer to the role of the financial advice. I do not think there is one reference to advice in SIS. When SIS was written the money was going into funds where advice was not needed because they were simple, uncomplicated and fairly predictable. That has changed.

Senator BRANDIS—So this is a clear area of law reform which you would urge us to make some recommendations about.

Mr Gilbert—Absolutely.

Mr O'Reilly—It certainly is. The issue in point which I think is covered in our submission involves member investment choice. This is an area where, in our discussions with APRA before the release of their circular, one of their statements to us was simply that they cannot take into account the fact that an individual may have got independent advice in terms of where to put their money. That is not a matter which the law allows them to take into account. We may debate that, but certainly that is their interpretation of it.

Senator BRANDIS—That seems anomalous to me. If the client has taken independent advice, as a matter of common sense it seems to me that the burden upon the superannuation fund should be lighter than if the client has not taken independent advice.

Mr Gilbert—We would agree. Taken to its logical absurdity, the fund would have to check every investment selection.

Senator BRANDIS—Yes. The last point, again on the question of information, is really the opposite of the point we have just been exploring. It seems to me that again when it comes to the issue of the client making an educated choice there is also the problem of too much information, that there is the risk that in order to, as it were, protect themselves against suggestions of insufficiency of disclosure some funds might provide so much information—we heard a witness today talk about 50 or 60 pages of information—which in particular to an unsophisticated client will be so overwhelming that it in fact will be more opaque than if they provided less but more material and focused information. What do you say about that, and is that something that we also ought to regulate?

Mr Gilbert—Under the refinements process we have made about three submissions on this right now. We believe that the long-term solution here is a very simplified up-front document, and the rest of it is incorporated by reference with hot links to a website. That website can be looked at by the regulator, which is what a regulator does well, and made sure that the information there is absolutely above board, but the individual can focus on those key elements of the decision-making process which can be brought down to three or four major points.

Senator BRANDIS—I fully and enthusiastically support the philosophy of choice and it animates the government's approach to superannuation, but it has to be a real choice. The presentation to in particular an inexperienced client of an enormous variety of facts is a bogus

choice if it in fact makes it practically more difficult for the act of choice to be exercised, would you agree?

Mr Gilbert—I totally agree with you.

Senator BRANDIS—I take it we might find this form that you are talking about in one of these three submissions you have referred to as your specific proposal?

Mr O'Reilly—Yes, I think it is referred to there.

Senator BRANDIS—You might send it along to us as well?

Mr Gilbert—We will.

Senator FORSHAW—I will not pursue any further questions from the discussion you have just been having with Senator Brandis, but it just occurs to me that what we cannot lose sight of in this debate about advice and information is that, at the end of the day, it is being charged for in some way or another. In that respect, I am not sure how you can either eliminate or reduce the concept of fiduciary duty to an extent where it becomes almost meaningless. I do not suggest Senator Brandis was suggesting that, but I think we have to be a bit careful about how far we follow that down. Senator Murray mentioned MLC earlier, and maybe we have to go back and re-examine those cases of MLC and Evatt many years ago.

Mr O'Reilly—Could I just make a brief statement?

Senator FORSHAW—I thought that might provoke a comment.

Mr O'Reilly—In terms of advice, the law requires an advisor to give appropriate advice. The fiduciary obligation on the trustee is a different obligation. The obligation on the trustee is always to act in the best interests of clients. It is important always to bear in mind that there is a distinction between the fiduciary obligation on a trustee in terms of acting in the best interests of clients and the obligation under the law on an advisor to give appropriate advice.

Senator MURRAY—Which is where Senator Brandis and I were focused earlier, on the fiduciary obligations on trustees.

Mr Gilbert—Yes.

Senator FORSHAW—I think we were getting into a discussion about what is advice and what is not advice, and at the end of the day that question may only ever be resolved in each individual case where there is litigation or some action that causes you to go back and determine whether or not in fact financial advice was being given and whether the person was entitled to do so and so on. I had a few straightforward questions about some other issues. First, you argue for uniform licensing of self-managed funds. One of the issues that has been mentioned in other submissions is this question of the exemption for accountants. Can I take it that you think that exemption should be removed?

Mr Gilbert—Yes, we have always said that. I would add one further comment, that the fundamental difference as it stands, in terms of the effect on the consumer, is they do not have a dispute resolution mechanism of the type that is required by financial planners. The Financial Industry Complaints Service is hearing all of the complaints out of Westpoint, and they will, although there is some doubt about that—they will ultimately. If an accountant were involved in that, there is no external jurisdiction.

Senator MURRAY—I assume your proposal that the disclosure be fined down, if I can describe it that way, would assist your case for removing the exemption from accountants, because they would have to provide far less than under the present regime; is that right?

Mr Gilbert—That is one, but the other point is the absence of an EDR, external dispute resolution, scheme.

Senator MURRAY—Yes, but when this committee considered the issue of accountants before, one of the issues was that advice of this kind was often ancillary, and the obligation on what were frequently very small businesses would be so great for an ancillary purpose that it was not justified. If you are advocating in fact a very much thinner form of disclosure, then the onus on accountants is lowered; is that right?

Mr Gilbert—I think that is right. If we ended up with a simpler statement of advice and simpler regulation around that, yes.

Senator FORSHAW—You mentioned Westpoint a moment ago. Following up on that, about a third of the investors were through self-managed funds. Would you agree that this highlights a significant regulatory failure and, if so, what can we do about it in the future?

Mr Gilbert—We have not had a $400 million-plus failure in this industry since the Estate Mortgage and Aust-Wide Property Trust crashes in the late eighties—touch wood, yes. That is why the parliament in its infinite wisdom decided that it would pass the Managed Investments Act—an act that I think has proven to be a very robust mechanism. It has protected people. In Westpoint's case, they fell outside the Managed Investments Act, and it is IFSA's strong belief that, if Westpoint had been within the Managed Investments Act, we would have had additional protections for investors. Our view is that the parliament should legislate so that those sorts of schemes are brought under the Commonwealth jurisdiction, and that property investment type schemes like that come under the Managed Investments Act. You have a compliance committee, independent directors, greater disclosure obligations and all of those things that protect investors. I think some people too easily fall into the trap of blaming financial planners for that. There had to be a scheme in the first place, and apparently the scheme was making false promises, in the second place. Some of the financial advisors no doubt put people into that scheme in good faith on the basis of the guarantees that were offered.

Senator MURRAY—They also used promissory notes, which allowed them to evade the requirements in the Managed Investments Act.

Senator FORSHAW—The critical minimum mass is a figure of $200,000. Do you have a view about whether or not the self-managed funds should be permitted to be established under that amount? I have asked these questions of other witnesses today.

Mr Gilbert—We have always thought between $200,000 and $250,000 is a mass. I am happy to send the committee a copy of one our surveys that indicates that the average total amount spent in fees in running a self-managed super fund is $3,500, and that is a lot of money. Once you put that as a percentage of $100,000 or $200,000, that is a very high management expense ratio. So we think it has to be around $200,000 to $250,000.

Senator FORSHAW—Another issue with regard to self-managed funds is compensation for theft and fraud, and from your submission I understand that you do not really see any need for change in this area. There is no provision for compensation at the moment; why not?

Mr Gilbert—It is about two words: moral hazard. We say that, if trustees of funds can operate on the basis that investors will always be recompensed if something is wrong with the funds that operate on that basis, and investors similarly work on that basis, then the protective behaviour that goes on before a decision is made may well be lessened. There is some experience in the United States of their pension protection schemes, where they have higher levels, and we say that the 75 per cent or the 80 per cent or whatever it is has been very effective in Australia in setting about the right types of behaviour to protect people, keeping in mind that the losses we have had have been in self-managed super. Only a very small amount, a couple of basis points, of the money in our industry since SIS came in have been the subject of theft and fraud. We say that a partial recovery is probably the best. My members, who do come from the medium to the bigger fund size, have considered this, and I think you would probably find, if you asked the industry funds the same, you may well get some of them saying the same thing. A lot of the bad behaviour and the bad compliance is happening in the low end of town, in the small end of the business, and the bigger and the medium-sized part of the business do not want to be in a situation where they have to cross-subsidise.

Senator FORSHAW—On a related issue, not so much with respect to theft or fraud, but that could be involved, as to employer insolvency, currently the superannuation guarantee contributions are not protected in the same way as other entitlements. Other witnesses have agreed that it should be brought under GEARS. Do you have a view on that?

Mr Gilbert—Without answering that question directly, we supported the move from yearly to quarterly mandatory collection or contribution of SG amounts, and the parliament in its wisdom again passed that law. Perhaps a better move might be to move to monthly, although the small business lobby would not like that. If you went to monthly, it means that there would be less likelihood of a large amount being lost.

Senator FORSHAW—One other issue—and I know that other senators have raised this as well earlier today—is in regard to the levy, which it is proposed to be increased from I think $46 currently to $150. What is your view about this, and were you consulted about it? It was not in the budget initially.

Mr Gilbert—Yes, it was in the budget but, no, we were not consulted. But $47 for a Tax Office regulation is very low. I think it is probably in the interests of those funds that they have better regulation. That way you probably can prevent market failure. In other words, keeping proper records, keeping track of your investments, and if the Tax Office or whichever regulator has the job is funded and resourced through self-funding, then it is in the interests of the investors. My members pay much more than that—actually hundreds of thousands of dollars—to

be regulated by APRA, and we have had very stiff increases to pay for the increased APRA regulation under the Safety of Super proposals. That figure has not been increased for quite some time. We think that it is in the public interest that the figure be increased, and that that part of the industry self-fund this regulation.

Senator FORSHAW—I think you are consistent with other witnesses today on that. My recollection is that it was not in the original budget announced, but it has been formulated in the post-budget plan, if you like, of the super funds.

Mr Gilbert—Mind you, we did not advocate that. We did not make a submission.

Senator FORSHAW—Finally, without trying to re-write history or, as someone said, go back to a clean sheet, which we cannot necessarily do, what is your view about a single financial services regulator combining or replacing APRA and ASIC?

Mr Gilbert—Our support is still for the twin peaks. The industry invested very heavily in the twin peaks, and in terms of our industry they have actually worked quite well. We have had some problems, but there has not been amongst our members any major failings, and investors in our industry have not lost money as a consequence of poor regulation. Yes, we did have HIH, but that has gone on and we have now changed certain arrangements to better protect the general insurance industry. Our position remains that we have two regulators. Until my members direct me otherwise, that will be our position.

Mr O'Reilly—Having said that, one of the issues that certainly needs to be address is regulatory overlap, which increases a whole range of costs to our members. So there are concerns there.

Mr Gilbert—As you have asked that question, I could add that, in our submission, we have suggested quite a major change in position for us, and that is that the regulation of advertising for superannuation or our industry be referred to the ACCC, because we believe that the ACCC overall has the expertise to do that work. We are not talking about product disclosure arrangements or the licensing but advertising, which is currently done by ASIC, and we think that would be better placed in the hands of the ACCC.

Mr O'Reilly—We have made a recommendation in terms of addressing this regulatory overlap problem such that for a lead regulator, where two regulators are involved in a particular area of the law, the law clearly indicate that one is a lead regulator and that the other regulator needs to rely on them for that information and decision. We have sought to put up a practical recommendation to address regulatory overlap.

Senator MURRAY—I cannot remember your saying so. What particular areas of regulatory overlap are you referring to?

Mr O'Reilly—I think we are just talking generally about regulatory overlap.

Senator MURRAY—But I hear it always said, generally—

Mr O'Reilly—We experience that in terms of licensing. Certainly there are issues in terms of—

Senator MURRAY—What in respect of licensing?

Mr O'Reilly—This is in terms of the trustee licensing—

Mr Gilbert—And governance arrangements.

Mr O'Reilly—And the AFSL licensing. A trustee needs to be licensed by APRA. A trustee also needs to be licensed by ASIC in terms of its financial services licence. There is naturally some overlap between those things. Our members had to run the gauntlet twice in terms of licensing for substantially the same or similar types of information. One of the other areas where there is overlap is certainly with respect to governance. One would have thought that the Corporations Act covered the field in terms of duties on directors of companies.

Mr Gilbert—Another one is breach reporting, where under ASIC law it is all material breaches; under APRA law, it is all breaches. The other day I saw a letter from one of my members to APRA reporting that they had made a $4 error in unit pricing for the whole fund. So the red tape issues stand out when you have to report on those for one but not the other.

Senator MURRAY—The breaches matter is easy to resolve, I would have thought. You just apply materiality to both. I would have thought governance is easy to resolve, because governance is primarily an ASIC responsibility. I would have thought that licensing would be primarily an APRA responsibility. Is that right? I am concerned that the issue of regulatory overlap is used as an argument to have one regulator, which is why I want to know what the overlap is and how you would solve it. I have just done a quick kind of back of the envelope sort of response, and I am sure it is more complex than that, but that is my commonsense reaction.

Mr Gilbert—I think that argument can be put. The other point about moving to a single regulator from two is the risks you have during the transition. Regulators have a whole culture of having an eye on the ball, people not worried about their jobs tomorrow or whether they are moving from Canberra to Sydney, and some say that the HIH failure was a failing of the fact that we moved the ISC into APRA. So we have to be very careful in making massive movements in terms of regulator change.

Senator FORSHAW—I think there were enough warnings out there; they should have picked it up, irrespective of where they were on the Hume Highway at the time.

Mr Gilbert—I take your point, Senator.

Senator FORSHAW—Thank you, CHAIRMAN; I think it is about 15 years since I was in a super inquiry with you, Mr Gilbert, but I was sitting where you are. Nice to see you again.

Mr Gilbert—Thanks.

Mr BAKER—With respect to benchmarking Australia against international practice and experience, you have stated in your submission:

Government should continue to build an effective and efficient superannuation system in Australia in close consultation with industry.

The regulatory costs of the Australian system should be benchmarked against international best practice.

Have you had any experience in that actually occurring?

Mr Gilbert—It is possible with some costs. We now have cost data that compares various regimes, but regulatory cost data is much harder to find. I am on the board of a company called FICA, the Finance Industry Council of Australia, which is starting to look at benchmarking. At this stage what we are doing is fairly embryonic.

Mr BAKER—To make a substantive correlation?

Mr Gilbert—At this stage I do not think we could.

Mr BAKER—Could you expand on 15.5, the section under 'calculators':

IFSA recommends that the relevant provisions of the Corporations Act 2001 be modified by introducing new regulations under section 926B and section 951C of the Act to exempt providers of calculators, including investment risk and insurance risk profilers which provide personal advice, from the obligations under Parts 7.6 and 7.7 of the Act to the extent that they apply to a person providing personal advice. The exemption could be subject to conditions set out in the regulations. One such condition could be that the provider complies with industry standards developed in consultation with ASIC.

Mr Gilbert—It is a pretty sad situation. The industry got to a point about 12 months ago where we had to take calculators off our websites. These calculators allow the individual to put in their own circumstances—they might put in the rate of return, a cost structure, how long they will be contributing, and their age—and the calculator then works out their result. But we had the spectre of the regulator telling us that we cannot trust an individual to pick some figures to put into the calculator. So they could do it on their spreadsheet at home, but if Colonial First State put up a calculator, to use an example, all of the input variables had to be governed by what the regulator said. We are trying to give you advice to the effect that we need some clarification on that front so the calculators can be done personally.

Mr BAKER—As per investment return, as per inflation rate—

Mr Gilbert—Yes, and whatever the individual wanted to put in. Based on what they might have in a product disclosure statement or some advertising, but certainly the fund manager or the super fund provider cannot be in control of every individual's circumstances to put in all of the assumptions.

Mr O'Reilly—Also, the interpretation by ASIC was that, because these calculators take into account personal characteristics of a client, they fall within the definition of personal advice. So it goes back to the issue that we were talking about initially in terms of the distinction between general advice and personal advice.

Mr BAKER—I would also include information.

Mr Gilbert—Yes.

Mr O'Reilly—Information.

Mr BAKER—What are your views on the most recent budget and the change in superannuation as far as the industry is concerned?

Mr Gilbert—We say that any system of super tax that moves from a TTT system to a TT system in one fell swoop is a good result. I think there has been sufficient time for us to work through the detail, which we are doing now with the Treasury, and hopefully on 1 July next year these changes will come into swing, and that is a good result for Australian savers.

Mr BAKER—Are you comfortable with the transitional processes that have been put in place?

Mr Gilbert—Yes, absolutely. We have had good consultation, and we are still working through some issues, but nothing that will stop the industry from working.

Senator MURRAY—I want to cover one additional area, and that is nomenclature. I covered it a little earlier today. When the chairman first showed me the draft terms of reference of this inquiry, I reacted positively straightaway. I did so because this is a committee that examines market based activities. Most of all we have a market kind of orientation. It seems to me that the whole superannuation industry has shifted from a relatively structured, not consumer-friendly trust kind of relationship into a dynamic market transactional based activity, and it is still shifting like that.

You can see those aspects with regard to things like advertising, the way in which products are being rationalised and so on. Mr Dunnin of Rainmaker earlier illustrated the nomenclature problem with respect to the way in which the broad industry describes itself—highly unfriendly from a consumer point of view. I want to talk about a different area, which is financial planners, and it relates directly to the fee-for-service versus commission kind of argument, or a combination of the two. I think we are talking about hundreds of thousands of affected people. The discussion about disclosure tends to be of what happens once a person is in front of a planner. I am interested in the stage before they get there; in other words, the decision that they make to go to a planner. Generally that will not be an informed decision. It is achieved through looking in a directory or whatever.

Mr Gilbert—Or word of mouth.

Senator MURRAY—Or word of mouth, in which case nomenclature matters. Frankly, the way in which providers make their money needs to be as varied and flexible as anything else. Some can be on fee-for-service, some commission, some mixed. It needs to be like that. My question to you is whether the way in which financial planners are described should be used as a mechanism to inform customers? For instance, if someone is in a tied house arrangement in the normal market, they are referred to as franchisees, if it is a direct relationship with one provider. If they have a relationship with a number of providers, they are agents. So it could be AMP, Colonial, MLC and a number of others. If they are a free house, they can be described as independent. I think this is one of the ways of fixing the concerns about how people earn their

money. If someone is a franchisee or an agent, they are likely to be commission based. If they are independent, they are likely not to be, although they could be. I want to ask you to go away, because I am sure you have not thought about it before, and write back to us with a submission—if you want to—

Mr Gilbert—We would.

Senator MURRAY—Would you indicate whether a better description, clearer nomenclature, would assist in this area?

Mr Gilbert—I would be very happy to respond now.

Senator MURRAY—Do you understand the point I am making?

Mr Gilbert—I do exactly. If I responded now, it would be too brief to meet the needs of what you need here. I think we should go away and come back with a detailed definitive response. I am very happy to do that. I understand where you are coming from. My only comment is that it would be very hard to have black and white distinctions in the market. You have to be careful that people's ability to be able to sell various products across the spectrum was not curtailed because of a definition that stopped them.

Senator MURRAY—I am looking for language that consumers can easily understand, and 'financial planners' to me is too generic. Once the person arrives at the door, even the whole disclosure stuff might not convey to them that they are actually talking to a franchisee, effectively, or an agent.

Mr Gilbert—We understand. We will look at it and come back to you.

Senator MURRAY—Thank you. One other area I wanted to quickly pick up with you is with respect to an area I asked Mr Dunnin earlier. I think it is possible that research or analytical agencies may become as important in the superannuation area as they have become in the stockbroking area, where people like ASIC have paid particular attention to ensure that the sort of advice that is available to these people is accurate and informed, and the same as that as provided to the public. Do you think the regulators should start to pay any attention or particular attention, or have some guidance rules, for the governance and framework in which analysts operate in this area? They develop immense market power.

Mr Gilbert—I agree totally. They are the gatekeepers and the traffic directors. Some of them are licensed under FSRA, so therefore they have to comply, and they obviously do get regulation. But I think it would be fair to say that the regulator, ASIC, has not done a lot of work in that area, and has tended to look at product disclosure statements and financial planners at the expense of possibly looking at some of the research houses who are licensed. As to whether they should all be licensed and there should be a code, I think that is something on which we need to come back to you, unless Mr O'Reilly has something to say.

Mr O'Reilly—No.

Senator MURRAY—I must stress that I am not looking for a highly regulated outcome, but I believe that consumers, particularly informed consumers, will rely more and more on the reputation of analytical benchmarking research houses. Therefore, we need to be sure that they are not subject to improper influence or anything of that sort.

Mr Gilbert—We agree. It is very important.

CHAIRMAN—In your submission you recommend that trustees should not be required to be public companies, but you recommend that the disclosure requirements applicable to public companies should apply to the trustees of all superannuation entities. Can you elaborate on that? Also in your submission, you say:

> ... there is scope for improvement in the related party transaction and disclosure requirements in relation to a superannuation fund. This is increasingly important given that people have more scope to choose their superannuation fund. However, the trustee of a superannuation fund need not be a public company. Unlike the public company directors who are required to disclose the nature and value of benefits received for services provided, and persons named in a managed investment scheme prospectus who are required to disclose the nature and value of benefits received for services provided to the responsible entity (related party requirements of Chapter 2 E and the disclosure requirements of section 711(3) of the Corporations Act), no such requirements apply in a superannuation context.

First, could you elaborate on the benefits of that, and also, are you aware of some specific examples of related party transactions in the context of the superannuation industry?

Mr Gilbert—Basically no, because they are not disclosed, so I think it would be improper for us to say what we might have heard on the grapevine.

CHAIRMAN—But you have heard something on the grapevine?

Mr Gilbert—You hear lots of things on the grapevine. But, seriously speaking, the size of the super money pot is so big now, and the complications are so great, that the bar needs to be raised on the operation of all funds by way of related party disclosure and director emoluments.

Mr O'Reilly—We are talking largely about public money, public savings, and the requirements that apply to public companies in relation to disclosure, and those requirements should apply in a superannuation context regardless of whether the entity that is the trustee is a public company or not. It is a deliberate accident of the law that, in terms of related party transactions, et cetera, they are restricted to public companies and public company disclosure. In a superannuation context, we are saying that, regardless of the status of the trustee in terms of public or private, the same disclosure requirements which would otherwise have applied to a public company should apply to that trustee entity.

Senator MURRAY—Because of the quantum?

Mr O'Reilly—Because of the fact that you are dealing with the savings of many individuals.

Senator MURRAY—Because of the quantum of the funds involved?

Mr Gilbert—Yes. I guess there are level playing field issues here, too. The banks hold public savings, and so do credit unions, and they are subject to the full panoply of the sorts of disclosures we are talking about here.

CHAIRMAN—Is this also relevant to the issue of the term of reference related to the concept of not-for-profit and all-profits-to-members in terms of service providers?

Mr Gilbert—Where they are related parties, but not only for that reason, perhaps those things should be disclosed. In terms of for-profit and not-for-profit, our point is that ultimately someone makes profits in providing services. Perhaps those things need to be better disclosed somewhere. Perhaps there needs to be some sort of regulation around the proper usage of those terms. If I could add just one more point—strictly speaking, all the retail funds are not-for-profit; they charge a management fee, but the fund does not make a profit. All the profits made by a retail fund are distributed to the individuals, and the head company charges a management fee. What is the difference between that and a superannuation fund in the not-for-profit sector that has directors that might be receiving a salary?

CHAIRMAN—Point made. In relation to advertising, and whether promotional advertising should be a cost to the fund and therefore its members, you quote a letter from APRA of 14 March 2005 which says, inter alia:

> In our view, imposing marketing expenses on current members primarily to attract new members is difficult to justify; imposing marketing expenses on current members where the benefit of such an expense falls primarily to the trustee (by way of enhanced remuneration) or other parties would be inconsistent with the sole purpose test and may give rise to inequities among generations of members.

In ASFA's submission, I think they refer to the same issue, and they say that guidance for funds on the use of promotional advertising has been provided by letter from APRA dated 14 March 2005, and they say that further clarification has been given by Mr Stephen Glenfield, General Manager of APRA's Specialised Institutions Division, at the March 2005 CMSF conference, where Mr Glenfield said—and they have paraphrased what he said—that while advertising that was solely directed towards recruiting members in the new choice environment might be deemed to breach the sole purpose test, this would not necessarily be the case when the advertising fulfilled other associated purposes. He said those other associated purposes could include informing existing members of the benefits they are receiving or any new services that would be made available. He is reported as saying that existing members of superannuation funds must get something for it to be justifiable under the sole purpose test, and what we would ask trustees to do is to demonstrate what benefits existing members receive from such advertising. There does seem to be a bit of an inconsistency there between the original letter and the clarifying statements.

Mr Gilbert—Hence we asserted that there seems to be a confusion and perhaps it needs clarifying. At the end of the day, if the parliament said that you can advertise, and everybody advertised, the consumers are the ones who will see the net return go down as a consequence of a massive advertising campaign. So let fund trustees and fund providers go into the competitive market without the doubt of advertising. That is why we have said that we should clarify it and allow people to advertise.

CHAIRMAN—A couple of the groups of witnesses today have argued that advertising benefits existing members because, if it results in an increase in membership of that fund, the cost of administering the fund is spread across a larger number of members, so the cost to each individual member is lowered. What is your response to that?

Mr Gilbert—If that happens, fine, and if it does not, will the members who have left the fund be refunded for the fact that the advertising was misspent? The next question is: who refunds the money, and where does the money come from?

Mr BAKER—There has been a lot of advertising regarding industry funds, so where is that funding coming from?

Mr Gilbert—It is coming from the funds, and in good faith they are expending that money to get a bigger slice of the market, a bigger membership base, and they say they are getting economies of scale. If that does not happen, someone has to be brought to account.

Mr BAKER—But in their submission, the FPA has stated that around 99 per cent of members of REST and HOST were basically in default funds. Is it healthy to be sitting in default funds? What sort of advice are they receiving?

Mr Gilbert—Probably none. By default fund, you mean they have not exercised choice?

Mr BAKER—Yes.

Senator MURRAY—Either you have a market or you do not. Either you have proper marketing with a market or you do not.

Mr Gilbert—And have regulatory noise around it I think is problematic.

CHAIRMAN—Are you suggesting that the measure of the claim regarding advertising would be a visible decline in members' fees?

Mr Gilbert—Yes, economies of scale.

CHAIRMAN—If that does not happen, then the sole purpose test would not have been met?

Mr Gilbert—Absolutely. And economies of scale, with the economic textbook definition, is by volume; having volume, you reduce the per unit cost.

Senator MURRAY—Or you remain competitive? If some can advertise and some cannot, you have a problem.

Mr Gilbert—I guess the point is that most of the retail fund providers advertise out of the entity which is receiving the management expense ratio. If this were opened up, then it would be a level playing field. There would be no doubt about the level playing field.

Senator MURRAY—That is right; you need the market.

Mr Gilbert—Yes.

CHAIRMAN—So the distinction is drawn between industry funds that are advertising out of member funds and retail funds that are advertising out of their management fee?

Mr Gilbert—Yes, paid by the head entity that offers the services to the fund.

CHAIRMAN—Could it not be argued that that management fee would be lower if they were not advertising, so therefore more would go to the members of that fund?

Mr Gilbert—Of course. There is a cost. There is no magic money pot here.

Mr O'Reilly—Our concern has simply been that this is an area where there has been some uncertainty; it is an important area. In relation to all of our recommendations, we are pushing for a level playing field, and this is one area that would benefit by that type of intervention or clarification.

CHAIRMAN—So you are saying there should be some specific black letter law defining exactly what are the limits on advertising?

Mr Gilbert—I think the trustees should exercise that discretion.

Senator MURRAY—That is right, free up the market. That is why none of us manage the economy.

Mr Gilbert—Just as the trustee that decides to use the you-beaut platform to do the IT for the fund is running the risk of spending potentially more or potentially less than the competitor.

CHAIRMAN—But are not the trustees exercising that discretion now?

Mr Gilbert—In relation to that, yes, but without a problem. Here it is the regulators who have intervened and said, 'These are the guidelines', and there is some uncertainty.

CHAIRMAN—Okay.

Mr Gilbert—The regulator says that you have to arm's-length type transactions in relation to all of those other things. Perhaps the arm's-length approach might be the best way of approaching the advertising dilemma.

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

Mr Gilbert—Thank you very much.

Committee adjourned at 4.34 pm