

- Transparency and accuracy in disclosure and market information is a key ingredient of consumer confidence;
- IFSA members should be free to decide on their particular business model, be it a shareholder structure or mutual model;
- IFSA members should be free to decide on how their systems of distribution should operate whether by fee for service, via brokerage or commission; and
- There are important linkages between the manufacturing, distribution and advice and IFSA will engage in activities which enhance and promote the value of these linkages.

The Board of Directors of IFSA is accountable to members for the performance of the company. In carrying out its responsibilities, the board undertakes to serve the interests of its members, its members' customers and the broader community honestly, fairly, diligently and in accordance with applicable laws.

IFSA has previously made comments in submissions to the Government, and to various Parliamentary Committees, on a number of the matters referred to in the Terms of Reference. For the purpose of assisting the Inquiry in its review and consideration of the Terms of Reference, our approach in this submission is to:

- identify the policy principle that IFSA considers should guide the Inquiry's response for each of the Terms of Reference;
- discuss the issues involved;
- make a recommendation.

IFSA is pleased to assist the Inquiry in its review of the structure and operation of superannuation industry.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Gilbert', is written over a thin red vertical line.

Richard Gilbert
Chief Executive Officer

EXECUTIVE SUMMARY - IFSA RECOMMENDATIONS

1. **Whether uniform capital requirements should apply to trustees**

1. The law **not** be amended to impose uniform capital requirements on trustees
2. The status quo for public offer superannuation funds be maintained
3. Operational and investment risks be disclosed and explained to fund members.
4. Where operational risk is outsourced it should be to an entity of sufficient substance to carry those risks and support those operational functions.
5. The law should expressly provide that a trustee should not be able to be indemnified from fund assets in respect of a loss incurred by fraud or negligence of the trustee.

2. **Whether all trustees should be required to be public companies**

The disclosure requirements applicable to a public company should apply to the trustees of all superannuation entities. The law need **not** require the trustee of a superannuation entity to be a public company.

3. **The relevance of Australian Prudential Regulation Authority standards.**

IFSA recommends that a formal consultative arrangement reporting to the Parliament be established and that legislation be introduced to provide a primary set of responsibilities for each regulator requiring a regulator to rely on regulation by other regulators where they do not have that primary responsibility.

4. **The role of advice in superannuation.**

That Government should:

- endorse the value of advice particularly in relation to choice of fund and member investment choice;
- reinforce the disclosure basis of our existing laws by facilitating effective disclosure; and
- provide clear guidance to the regulator of the regulatory intent of the law.

5. **The meaning of member investment choice; and**

6. **The responsibility of the trustee in a member investment choice situation.**

Sections 52(4), 58 and regulation 4.02 of the *Superannuation Industry (Supervision) Act 1992* should be amended to ensure that the duties of trustees of a superannuation fund offering member investment choice are to:

- **Formulate and document** one or more investment strategy(s) which may be quite broad or very narrow, depending upon the type of fund and number and range of strategies on offer;

- **Manage** those investment strategies in a prudent manner (eg. obtaining appropriate and timely valuations and updating unit price/asset earnings attribution, equitable expense, including tax liability, allocation etc);
- **Acquire, redeem and report** on investments offered and selected by members in accordance with what has been disclosed; and

that responsibility for investment selection within the strategies offered by the trustee is that of the member.

7. The reasons for the growth in self managed superannuation funds

That Government:

1. Notes the primary reasons for the growth of Self Managed Superannuation Funds are control, the perception of poor performance in the retail sector, and the role of financial advisers seeking to address the various savings investment requirements of their clients.
2. Moves to ensure greater investor protection by requiring uniform licensing of providers of financial services to and in respect of Self Managed Superannuation Funds.

8. The demise of defined benefit funds and the use of accumulation funds as the industry standard

That the Committee acknowledge that the demise of defined benefit superannuation funds is the product of an increasingly market driven superannuation environment.

9. Cost of Compliance

All superannuation related legislation, APRA and ASIC regulatory instruments, policy statements, guidance notes and circulars should be subject to industry consultation and cost benefit analysis before implementation.

10. The appropriateness of the funding arrangements for prudential supervision

IFSA recommends that:

1. The industry levy should be based on the risk rating of the entity;
2. The levy should be reflective of the actual costs incurred in supervising entities regardless of asset size; and
3. Measures put in place to monitor and report on the allocation of resources by the regulator to achieve efficient resource management.

11. Whether promotional advertising should be a cost to a fund and, therefore, to its members

1. The law should be amended to list the types of advertising that can be paid for from superannuation fund assets by fund operators.
2. Regulatory responsibility for the regulation of financial services industry advertising

should be transferred from ASIC to the Australian Competition and Consumer Commission (ACCC).

12. The meaning of the concepts “not for profit” and “all profits go to members”

That the terms “not for profit” and “all profits go to members” and like expressions should only be used where they are completely accurate or properly qualified.

13. Benchmarking Australia against international practice and experience

1. Government should continue to build an effective and efficient superannuation system in Australia in close consultation with industry.
2. The regulatory costs of the Australian system should be benchmarked against international best practice.

14. Level of compensation in the event of theft, fraud and employer insolvency

IFSA recommends that there should be no expansion of the existing compensation arrangements under the law. If the existing scheme is expanded any failure should be funded by Government.

15 Other matters

15.1 Dispute Resolution Schemes

IFSA recommends that Government reduce, through consolidation, the number of existing external dispute resolution schemes available to consumers.

15.2 Policy Committees

IFSA recommends the removal of the requirement on a public offer fund trustee to take all reasonable steps to establish a policy committee. Regulations could still specify how a policy committee is to operate, if established.

15.3 Unit Pricing

IFSA recommends that:

1. Extant products in the superannuation choice environment be required to implement a uniform unit pricing methodology for the valuation and allocation of investment returns.
2. Closed funds and legacy products using crediting rates should be excluded from this requirement as the requirement would present unreasonable costs.

15.4 Product Rationalisation

That the Government adopt the IFSA legislative proposal for product rationalisation.

15.5 Calculators

IFSA recommends that the relevant provisions of the *Corporations Act 2001 (Act)* 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.

15.6 Section 1012IA – Custodial arrangements

The Government should amend the operation of section 1012IA of the *Corporations Act 2001* to provide that where as part of a custodial arrangement a client has access to Product Disclosure Statements (**PDS**), arranged by the provider of the custodial arrangement and brought to the attention of the client, the obligation on the provider to give the client a PDS for investments available through a custodial arrangement is satisfied.

IFSA RESPONSE TO THE TERMS OF REFERENCE

1. Whether uniform capital requirements should apply to trustees

Principle 1

Capital requirements primarily address operational risks. All superannuation fund members are entitled to the same basic level of protection, including the security offered by capital. However, in a choice of fund environment the level of risk that a member is willing to take with regard to their chosen fund is a matter for the member. Members, therefore, need clear disclosure on operational risks and capital adequacy.

When considering the role of prudential supervision in a superannuation context the Australian Law Reform Commission and Companies and Securities Advisory Committee (**ALRC**), described prudential supervision as:

“a series of measures directed at redressing market imperfections in a particular industry. A major way that it does this is by prescribing standards that participants in the industry must observe. It is not a substitute for the assessment of risk by individual investors. Rather, it aims to make it easier for investors to make accurate assessments of the risks involved. For example, by establishing minimum disclosure requirements, a system of prudential supervision can avoid the need for excessive duplication of basic information search costs and provide investors with a proper and reasonable opportunity to measure and assess risk.”¹

In a superannuation context, the primary risks for fund members are institutional risk, investment risk and operational risks. Capital requirements primarily address institutional and operational risks. Where superannuation funds are not providing a defined benefit, capital is not required to underwrite either investment risk or life risk as benefits are linked to the actual market performance of the fund.

While the *Superannuation Industry (Supervision) Act 1993 (SIS)* was developed in a different regulatory environment than operates today, the ALRC statement is equally applicable today as it was in 1992. In particular, fund choice legislation and licensing requirements for regulated superannuation entities (**RSE**) have fundamentally changed the dynamics for the operation of the superannuation system and have created an openly competitive environment across the range of superannuation providers. These factors together with increased fund disclosure and member responsibility for both fund and investment selection provide a regulatory picture that is very different from that established in 1992.

Capital Requirements – section 29DA

SIS introduced universal superannuation in Australia. Up to that time superannuation had been largely restricted to a limited number of employer-sponsored defined benefit schemes and, post the 1986 National Wage Case, industry schemes for employees covered by awards including the entitlement to a 3% wage increase paid in the form of a contribution to a superannuation scheme.

Capital requirements under SIS apply only to public offer superannuation funds. There is, in our view, no justification for universal or uniform capital requirements to be imposed under the law. This does not, and should not, diminish the role of the prudential regulator taking steps to ensure that operational risks are properly managed and that the entities managing them have the

¹ ALRC and Companies and Securities Advisory Committee Report No 59: Collective Investments – Superannuation (31 March 1992)

financial capacity to ensure performance including against adverse events. This can be done in one or a combination of the following ways.

- The trustee of a superannuation fund operated by a public company will have recourse to shareholders' funds.
- The trustee of a superannuation fund operated under a mutual like structure, such as an industry fund, will have recourse to the members' funds to meet all expenses.
- Some operational risks may be underwritten by external insurers.
- Some risks and operations may be outsourced.

In a competitive choice environment, the prudential regulators interest should not be in imposing 'a one size fits all' capital requirement on superannuation funds, it should be in ensuring that each fund and each entity which insures risk or has risk outsourced to it operational functions, is an entity of sufficient substance to manage those risks and support those operational functions.

In the context of the *Superannuation Safety Amendment Act 2004*, APRA has stated that the capital requirements for the trustees of public offer superannuation entities have a threefold purpose:

- they provide some financial resources to act as a buffer against risk;
- they evidence a commitment on the part of the trustee to its superannuation business;
- they act as an incentive to the trustee to manage the entity well.

In relation to non public offer funds, the lack of capital is a structural differentiating factor. While we consider that a compelling case for uniform capital requirements on trustees has not been made out where operational risk is otherwise addressed, we do recommend that the law should expressly provide that a trustee should not be able to be indemnified from fund assets in respect of a loss incurred by fraud or negligence of the trustee.

An approach to address this issue was made in Report 59: Collective Investments - Superannuation and should be reconsidered. That recommendation was:

Recommendation 3.1: Indemnification of members of boards

1. The law should provide that the responsible entity, and the members of the board of management of the responsible entity, for a superannuation fund, an ADF or a PST may not be indemnified out of the fund, ADF or PST for any liability incurred by it or them while acting as responsible entity or member. Failure to comply should be an offence as well as a breach of fiduciary obligations.

2. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must ensure that the annual report for the scheme include a statement whether the responsible entity or the members of the board of management of the responsible entity are insured in respect of their liability to members of the scheme for loss caused by fraud or negligence and, if they are, the prescribed particulars of that insurance.

3. Nothing should prevent the payment out of the fund of the costs associated with obtaining insurance for the responsible entity for the fund, ADF or PST or for a member of the board of management of the responsible entity against fraud or negligence.

Conclusion

The issue of capital requirements for superannuation entities has been considered by Government on a number of occasions since the enactment of SIS. In our view the Government's response to recommendation 16 of Superannuation Working Group, chaired by Mr Don Mercer, continues to be an appropriate response. Essentially, the response to maintain the status for capital requirements was based on a view at that time that the need for capital in the future may be substantially reduced as other factors come into play to address operational risk. That response was formed part of the package of reforms addressing the safety of superannuation that included licence requirements for superannuation trustees together with enhanced risk management and disclosure requirements.

Recommendation 1

1. The law **not** be amended to impose uniform capital requirements on trustees
2. The status quo for public offer superannuation funds be maintained
3. Operational and investment risks be disclosed and explained to fund members.
4. Where operational risk is outsourced, it should be to an entity of sufficient substance to carry those risks and support those operational functions.
5. The law should expressly provide that a trustee should not be able to be indemnified from fund assets in respect of a loss incurred by fraud or negligence of the trustee.

2. Whether all trustees should be required to be public companies

Principle 2

In a choice of fund environment superannuation fund members are entitled to better disclosure in relation to the operations, performance and governance of the trustee and the fund to help them make an informed decision about which fund to choose.

Apart from the family home, superannuation is the most important asset the Australians have. Also. Superannuation contributions are legislatively mandated for employees. Therefore, people should be entitled to a high level of disclosure in relation to the operations, performance and governance of the trustee and the fund that are making decisions about their money. The disclosure rules relating to superannuation entities should provide sufficient transparency so that contributors can make meaningful assessments and comparisons between funds on organisational structure and performance, operational efficiency and governance.

Public companies have a separate set of disclosure requirements under the *Corporations Act 2001*. Given that the majority of employees can now choose which superannuation fund they want to manage their money, as far as is practicable, all trustees should be subject to the same disclosure requirements as public companies. In particular, 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

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022

Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

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. We would recommend a Trustee Board not currently subject to such disclosure be subject to similar disclosure requirements.

Recommendation 2

The disclosure requirements applicable to a public company should apply to the trustees of all superannuation entities. The law need **not** require the trustee of a superannuation entity to be a public company.

3. The relevance of Australian Prudential Regulation Authority standards.

Principle 3

IFSA is concerned to ensure that prudential standards do not unnecessarily duplicate, overlap and conflict with the roles of other regulators; are not excessively prescriptive, impinging on operational flexibility and the capacity to innovate; do not limit competition, add to costs, restrict the range of choices available to consumers or reduce the price value proposition that they receive.

Part 3 of the SIS Act provides for regulations to be made which prescribe operating standards for regulated superannuation funds, their trustees and RSE licensees while Part 15 prescribes statutory standards for trustees, custodians and investment managers of superannuation entities.

APRA issues Guidance Notes and Circulars which are effectively administered as law but without Parliamentary scrutiny.

This issue highlights the need:

- for meaningful consultation;
- to avoid regulatory overlap and duplication
- for regulation to take into account business costs as well as investor protection.

Meaningful consultation

While APRA may consult stakeholders on the content of its Guidance Notes and interpretative Circulars there is no requirement in the law for it to do so and, even where it does consult, there is no effective mechanism for ensuring that concerns are properly considered. IFSA has outlined its proposals for better regulation in its February 2006 publication - *Towards Better Regulation Policy on Future Regulation of Financial Services in Australia (Attachment A)*. Those recommendations apply to all industry regulators and seek to address industry concerns with both ASIC and APRA.

To address the regulatory trend for more rules and black letter law there needs to be a shift in regulatory design and more effective consultative processes. IFSA has recommended a three pronged approach that will involve:

1. greater reliance on the development of industry codes of practice and self enforcement;

2. the introduction of a formal consultative process for proposed regulatory changes and reform proposals; and
3. greater emphasis and reliance on the analysis of the costs and benefits of regulatory proposals.

The IFSA recommendation notes that reform proposals can take the form of draft legislation, regulations, legislative instruments and, in some instances, policy papers and guidance notes. It proposes that formal consultative arrangements apply only to matters and issues having a broad impact on industry operations.

The proposal envisages the establishment of a new body referred to as the Financial Services Committee (**FSC**). It may be appropriate for the role of an existing committee to be expanded or evolve to provide the functions envisaged for the FSC, or to simply establish the FSC as a permanent feature of the process of regulatory reform.

The FSC should be a permanent consultative feature of the legislative and regulatory reform process. However, the FSC should only be an advisory body commenting on reform proposals in much the same way as a Parliamentary Scrutiny of Bills Committee, but with member representatives of Financial Services Industry, Government officials and Regulators.

The FSC would effectively have a role in pre-vetting legislative instruments as part of a formal consultation arrangement. It would, of course, still be open to regulators to make legislative instruments without the endorsement of the FSC. However, where such instruments are made without FSC endorsement they would, it is hoped, attract added Parliamentary scrutiny and be subject to possible disallowance.

Given the experience of industry to date to foster meaningful consultation, IFSA does not consider that the Government response to Recommendation 7.20 of the *Rethinking Regulation: Report of the Taskforce on reducing the Regulatory Burdens on Business* goes far enough. While agreeing with the recommendation, that “a standing consultative body comprising senior stakeholder representatives should be established for each regulator whose decision can have significant impacts on business and other sections of the community”. This outcome falls short of the IFSA recommendation for a more formal process and an FSC like committee to report to the Parliament on reform proposals.

Regulatory Overlap and Duplication

Investment and financial services companies are regulated by more than one agency. Where different regulators seek to control the same business activities there will inevitably be duplication, overlap and conflicts between requirements.

The Wallis Inquiry recommended “an allocation of functions among regulatory bodies which minimises, overlaps, duplications and conflicts.”² Wallis recommended,³ and the Government established the Council of Financial Regulators which consists of representatives of each regulator and the Treasury which was charged ensuring that where more than one regulator has an interest in an issue there is collaboration and exchange of information, processes which are facilitated by MOU’s between each agency. Unfortunately, it is the industry’s experience that these arrangements are ineffective in reducing the regulatory burden on companies and that costly overlaps and conflicts of regulatory requirements remain.

With five regulators (APRA, ASIC, ASX, RBA and ACCC) responsible for various aspects of regulation of the investment and financial services industry the efficiency of both regulation and the industry is dependent on a clear delineation of responsibilities. When each regulator

² ibid, page 198

³ MOU between APRA and ASIC, paragraph 1.2

develops and pursues their individual objectives without cognisance of the others requirements overlaps, duplication and conflicts are inevitable.

Each regulator may claim that their individual requirements are justified given their unique objectives but the industry is entitled to question whether any additional public benefit that might be derived from a duplicated requirement is not outweighed by the complexity and inefficiency it introduces when the core objectives are already achieved by another regulator's more general requirements.

There is a strong argument for the Government to control the proliferation of regulatory duplication, overlaps and conflicts by legislating to provide a primary set of responsibilities for each regulator and requiring them to rely on regulation by other regulators where they do not have that primary responsibility. A specific case in point is APRA's governance standards which are more prescriptive than the ASX Corporate Governance Council guidelines.

The Regulation Taskforce recommended that:

The APRA corporate governance requirements should be consistent with the principles of the Australian Stock Exchange Corporate Governance Council regime which incorporates a similar level of flexibility. There should also be scope to update the requirements to reflect contemporary corporate governance practices."

The Government addressed this recommendation in its initial response to the Regulation Taskforce in the following manner:

The Australian Government notes that APRA is in the process of revising its proposed corporate governance prudential standards following industry consultations in 2005. The Australian Government will refer this recommendation to APRA for consideration prior to finalising its standards.

APRA subsequently released the final version of its prudential standard on governance. The specific requirements do not have the flexibility of the ASX Corporate Governance Council guidelines, but they do allow companies to seek from APRA an individual variation of the standard.

Recommendation 3

IFSA recommends that a formal consultative arrangement reporting to the Parliament be established and that legislation be introduced to provide a primary set of responsibilities for each regulator requiring a regulator to rely on regulation by other regulators where they do not have that primary responsibility.

4. The role of advice in superannuation.

Principle 4

Financial advice helps people make informed decisions about how to make the most of their money, as well as investing and protecting it to secure their long-term financial well-being. Financial advice has a particularly important role to play in addressing Australians' underinsurance and superannuation savings gaps, as well as helping to lift financial literacy standards.

This item raises a number of different issues. They are:

- What is financial advice?
- The need for advice.
- The value of personal financial advice
- How consumers pay for advice - remuneration
- Reasonable basis for advice and potential conflicts of interest

What is financial advice?

Professional financial advice assists people to grow and protect their wealth by helping people making informed decisions. Financial advice covers many topics, including household budgeting and saving, managing debt, estate planning, risk protection, social security entitlements, managing tax, investing and retirement savings:

Financial planners provide general and personal advice. Only a licensed financial planner can provide personal advice. Personal advice is tailored to each individual, usually with the development of a long term financial plan. The personal advice process ensures a planner considers the individual's objectives, financial situation or needs, and then recommends strategies and may recommend one or more suitable financial products to help the client reach their financial goals.

The need for advice

Mercer Wealth Solution's 2006 *'Financial Literacy and Retirement Readiness Survey'* reported that:

"When working Australians were asked how they would rate (out of ten) their own knowledge about both investments and superannuation, they scored an average of 4 out of 10. This suggests that they readily admit that there is room for improvement. Nearly half rated themselves as having 'none' or only 'minimal' levels of knowledge about investments and superannuation, while less than one in five rated themselves as 'strong' or 'sophisticated'.

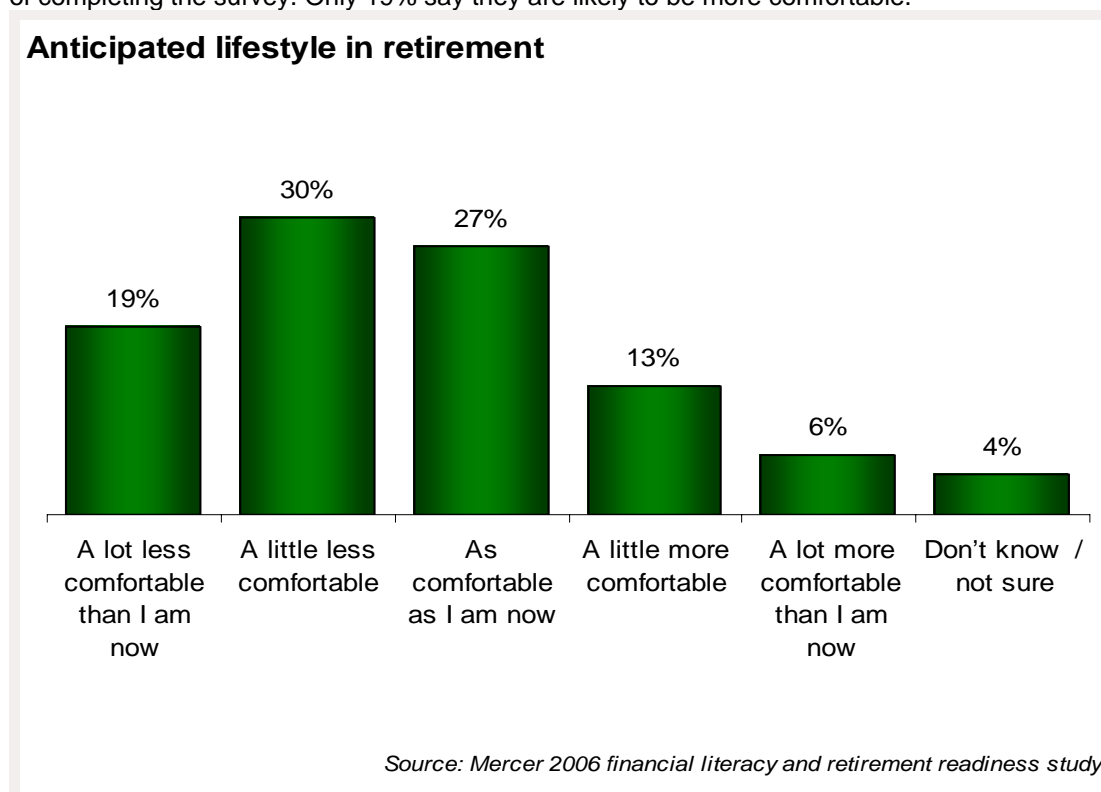
and that the vast majority prefers to consult a financial adviser or account when they need information.⁴

Financial advice and the retirement savings gap

IFSA's analysis of the retirement savings gap in March 2006 estimated that there is savings shortfall of \$452 billion, or \$93,523 per person in today's terms. The Mercer Survey showed that

⁴ Mercer Wealth Solution's 2006 *'Financial Literacy and Retirement Readiness Survey'* (DATE), Chapter 4 - How confident are Australians in their knowledge about investments and superannuation, at page 15

49% of people anticipate being less financially comfortable in retirement than they are at the time of completing the survey. Only 19% say they are likely to be more comfortable.



Over the last decade, the Government has made significant changes to superannuation that will help encourage people to save more and assist in addressing the savings gap. For example, the generous co-contribution scheme provides a significant incentive for lower income earners to top up their superannuation. Likewise, the recent simplifying superannuation plan will provide a tremendous boost to superannuation savings, by removing the benefits tax and simplifying the rules.

IFSA's retirement savings gap research demonstrated the importance of encouraging Australian's to make additional superannuation contributions above the basic Superannuation Guarantee. Results from the research find that for example, a 38 year old female with average income would need to make additional contributions of 9.3% above the basic Super Guarantee to close the savings gap and achieve adequate income in retirement.

However, it is not clear that people are taking advantage of the incentives to voluntarily contribute to superannuation. Research conducted by Newspoll for IFSA in July 2006 showed that only 23% of people are currently making additional contributions to their superannuation (see **Attachment B**). Table 1 shows that the highest proportion of those making additional contribution are those closest to retirement.

Table 1: Additional contributions to superannuation by various groupings.

	Additional contributions into Superannuation
Total	23%
18-34	10%
34-49	30%

50-64	33%
Married	29%
Not Married	14%
Less than \$70,000	21%
\$70,000 plus	27%
Have a financial adviser	39%
Do not have a financial adviser	17%

The Australian superannuation system places a lot of responsibility on the individual to make financial decisions. For example, the individual is responsible for determining 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.

Knowing which decisions to make and how to take advantage of the different incentives in order to maximize superannuation savings can be a complex and difficult decision for many people to make. Undoubtedly education, information and quality advice are critical in helping people understand how take advantage of the many incentives and achieve their retirement goals.

Financial planners and the role of advice is an important factor in helping people understand how to make the most of their financial situation. For example, the results from Table 1 (above) show that those seeing a financial planner are twice as likely to make additional contribution to their superannuation compared to those that do not see a financial planner.

The Government's Financial Literacy Foundation initiative and the launch of its '*Understanding Money*' campaign is an important step in raising financial literacy standards within the community, helping prepare people to make important financial decisions. While these programs serve to highlight the importance of financial matters and will help to ensure that future generations are better prepared to manage their financial affairs, the importance and value of professional financial advice in delivering behavioral outcomes today cannot be understated.

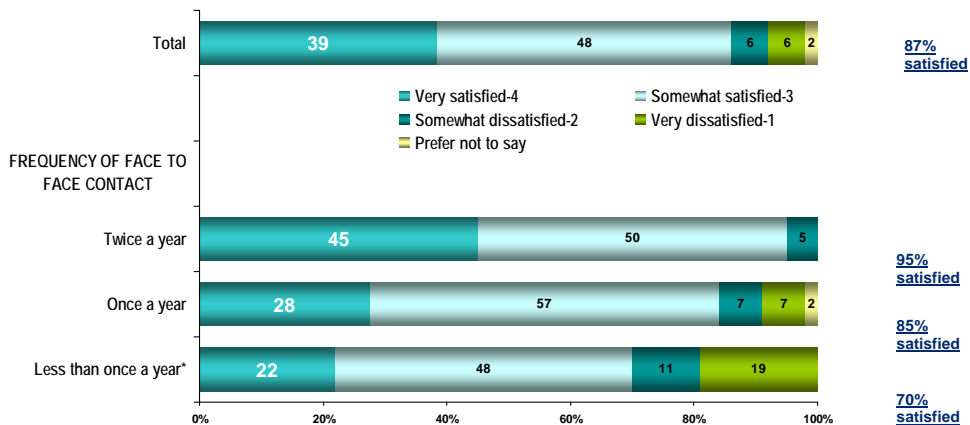
In recent years, there has been much criticism of financial planners and the value of the advice they provide. While there have been some issues in meeting the requirements of the financial services regime (introduced in 2002 and effective from 2004), the criticism directed at the advice industry has a significant impact on peoples' impression of the advice industry and ultimately reduces individuals confidence in seeking advice from professional financial planners. Many individuals would benefit significantly from receiving financial advice as opposed to doing nothing.

The value of personal financial advice

A study undertaken by Taverner Research for IFSA in December 2005 revealed that 87% of individuals that use a financial planner (40% of those with Super) are satisfied with the level of service they receive (Chart 1 below). For those who interact with their financial planner at least twice a year, the proportion increases to 95%.

Satisfaction with Financial Adviser

Taverner Research December 2005
 Base: Currently use a financial adviser - n=147



*Small base, treat percentages with caution

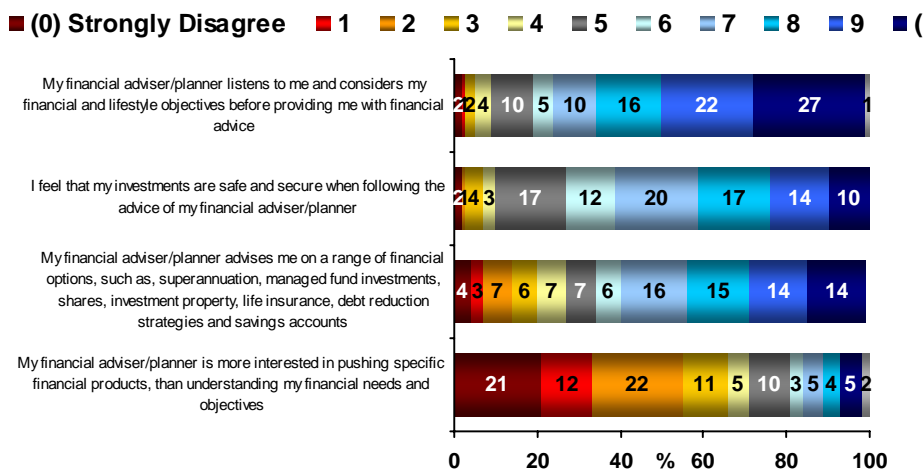
Q21A. How satisfied would you say you've been with your personal experience with financial advisers/planners? Would you say...

Importantly the advice they receive extends beyond just superannuation, with 73% of respondents agreeing with the statement

'My financial adviser/planner advises me on a range of financial options, such as, superannuation, managed fund investments, shares, investment property, life insurance, debt reduction strategies and savings accounts'

The responses to this statement are shown in Chart 2.

Chart 2:



International research also supports the value of advice in boosting retirement saving. A 2002 report from the Association of British Insurers shows that 46% of low to middle income earners

said that they would not have commenced retirement saving without receiving advice from a planner to do so.

IFSA believes that the industry and its stakeholders, including government and regulators, should actively promote the importance of financial advice, particularly for superannuation. Certainly, the role of financial advice needs to be acknowledged as an important and desirable component in both the choice of fund and member investment choice scenarios.

How consumers pay for advice - remuneration

There are a number of ways that consumers can pay for their financial advice – as a commission, an agreed percentage of their assets, or a fee for service, or a combination of these ways. It is important to ensure that consumers are able to choose how to pay for financial advice and a range of available payment options.

Commissions have received negative coverage in the media, by consumer groups and the regulator. The suggestion is that commissions create conflicts of interest and that financial planners only recommend products that pay the highest commission. This has translated into the approach of ASIC to conflicts of interest, strongly suggesting that industry should reduce its reliance on commissions and move to a fee for service remuneration model.

However, the facts are that financial advice, like any professional service can be expensive with an initial financial plan costing on average between \$2,500 and \$3,000. Paying the full cost of financial advice upfront as a fee for service payment is out of the reach of many Australians seeking financial advice. It also creates a barrier to those not financially well off in seeking advice. Commissions allow people to access advice and pay for it over time via their savings. Commissions also tie the interest of the consumer and the financial planner, and give an incentive for the planner to maximise a consumer's savings.

Removing commissions from the remuneration mix will be to the detriment of middle to lower income consumers who cannot afford to pay the fee for service. IFSA believes that commissions are an important means of paying for advice, and any perceived conflicts of interest can be managed by disclosure.

ASIC should ensure that it does not limit the remuneration methods available to both consumers and advisers. It is not for ASIC to determine whether commission or fee-for-service arrangements are the most appropriate form of remuneration. Indeed the current disclosure requirements in the law and the significant investment by both Government and industry in raising the standards and enhancing the regulation of financial advisers should not be undermined by the regulator. Instead, in a highly competitive and transparent market (driven by FSRA disclosure provisions on fees), competition should be the effective regulator on remuneration structures and payment levels.

The Government response to Recommendation 12 of the Report of the Senate Select Committee on Superannuation Report: Planning for Retirement was, in our view, appropriate. That recommendation and response were:

Recommendation 12

The Committee recommends that the Productivity Commission investigate the remuneration arrangements for financial planners, especially whether there should be a more direct relationship between the amount of work performed and the fee charged.

Response

The Government considers that it should not directly intervene in remuneration arrangements for financial service providers and superannuation investment fund

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022

Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

managers. The Government believes that it is for the market to determine the level of fees, costs and remuneration applying to financial services provided by advisers.

*The Government is committed to ensuring a robust, competitive market for financial services and products, including those for superannuation, through the mechanism of disclosure. Financial services regulation under Chapter 7 of the **Corporations Act 2001** requires full disclosure of fees charged by advisers and remuneration they receive from product providers, including commissions in various forms. This is achieved through upfront disclosure before advice is provided in a Financial Services Guide and as part of the Statement of Advice when personal financial advice is given. Disclosure requirements include revealing a non-monetary benefit or interest, for example, 'soft dollar' commissions.*

The Government believes that it is important to avoid regulating the market in such a way that distortions are created whereby only fee for service financial advice is provided. Such an outcome might have the undesirable outcome that access to financial advisers is denied to those unable to afford fees for service.

Consumers should have the choice in how they want to pay for financial advice, be that by a commission or on a fee for service basis.

Industry structures and conflicts of interest

The financial services market is characterised by a significant degree of horizontal and vertical business integration in addition to boutique operations. The diversity within our industry is a significant strength and offers investors a wide range of investment choices.

Reasonable basis for advice, the approved product and services lists

In giving advice, planners are required to ensure there is a reasonable basis for the financial strategy(s) they suggest and any product recommendation they make. Based on the current views of the regulator, there is concern within the industry about how planners are able to meet this obligation when recommending products from a restricted approved products and services list (**APSL**). The use of an APSL also raises issues about how the licensee can effectively manage conflicts of interest, particularly where in-house and related party products are on the list.

The regulator has raised concerns about the use of an APSL and meeting the reasonable basis for advice requirement. Under section 945A of the Corporations Act, a financial planner must give consideration to, and conduct an investigation into any product when making a product recommendation to a client and, must ensure the product is appropriate to their client's circumstances and needs.

The regulator has raised the question as to whether the APSL may prevent a planner meeting the reasonable basis of advice obligations, particularly when switching advice is given. IFSA believes that the law requires a planner to ensure that any product recommendation that is made must be *appropriate* for the client. The planner is not required to recommend the *best* product in the market. Therefore, as long as the products on the planner's APSL contains products that are appropriate to meet their client's needs (regardless whether they are in-house products), then a restricted APSL should not prevent a planner meeting their reasonable basis obligations. The law requires planners to recommend appropriate, not best products.

Conflicts of interest

The financial services market is characterised by a significant degree of horizontal and vertical business integration in addition to boutique operations. The diversity within our industry is a significant strength and offers investors a wide range of investment choices.

The Discussion Paper released by ASIC in April 2006 entitled **MANAGING CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES SECTOR** gave rise to a significant level of concern amongst industry participants. Taken to its extreme, the ASIC approach to conflicts management would have had the effect of undermining existing industry structures and operations and limiting the range of choice and services to consumers.

The *Corporations Act 2001* addresses potential conflicts of interest in a systematic way, principally through disclosure and the requirement for conflicts management. Section 912A(1)(aa) of the Act requires a financial services licensee to 'manage' any conflict arising for its financial services business. The section does not require a licensee to avoid conflicts unless, of course, the conflict would breach another provision of the law. That obligation reflects the commercial reality that business arrangements and behaviour must comply with the law.

*"A critical lesson from the common law is that conflicts of duty and interest as such are not objectionable per se. What is objectionable first and foremost, are undisclosed conflicts"*⁵.

The ASIC Discussion Paper appeared to express a bias particularly against conglomerate arrangements and institutional ownership of advisor groups. The fact is that many customers prefer to obtain advice from an adviser who is backed by the financial strength and security of a large financial institution and to invest through a product from the parent institution as long as it is clearly disclosed and they receive choice and appropriate advice regarding their underlying investment and insurance options.

IFSA responded to ASIC in a positive way acknowledging the role of ASIC in providing guidance but recommending that the case study approach adopted in the Discussion Paper be replaced by a principles based approach (IFSA Submission dated 23 June 2006). Industry concern with the use of limited fact case studies is that they can ultimately be used by field officers as a substitute for the law and this can cause considerable dislocation to a fair and efficient regulatory system. Rather than offering guidance, the use of case studies can potentially create uncertainty. IFSA offered to work more closely with ASIC on developing Principles which appeared in draft form in Section D of the Discussion Paper.

Of particular concern in the advice context was the ASIC commentary on its CASE STUDY B11 - Super funds that don't pay commissions. It states that:

*"the remuneration model forces AdviceNetwork to prefer commission paying products over products that do not pay commissions. Ideally, this conflict **should be avoided** and is only partly addressed by disclosure and control mechanisms"*.

Generalised, the comment is not consistent with both legal requirements and Government policy, nor does it reflect client payment or selection preferences. It should be recognised that, in the process of making a purchase decision, customers are influenced by a range of factors such as brand, reputation, utility, efficiency, reliability, risk as well as current and past relationships. The fact that a providing entity's fees are based on commission means that while there is a potential conflict of interest that must be appropriately disclosed, it doesn't necessarily mean that the client is disadvantaged. In fact, the very opposite may be true once the full range of client choice factors are taken into account.

The example provided suggested that the licensee does not permit its advisers to charge fees for service. IFSA is not aware of any licensees within its membership that do not provide advisers the choice to operate on a fee for service basis where the client pays directly for the advice. In all likelihood, the example is not relevant because it does not reflect current industry practice.

⁵ Finn, 1993, page 97taken from St James Ethics Centre website www.ethics.org.au
 Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
 Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

However, if this were to be the case, the adviser could elect to change licensee and/or, the client could choose an adviser that could provide such a facility. To our knowledge, under the current law these two options operate in a highly contestable market (ie. no fetters on member choice and competitive adviser market). Advisers and clients have the right to determine what is in their own interest and to make the choice accordingly. Many clients prefer to pay their adviser through a commission or through a fee for service negotiated with their adviser. For adviser and client convenience the payment is often collected through the product platform.

If some superannuation funds choose not to provide this choice to their clients, or to restrict the arrangement to a limited number of advisers, then that is a matter for a highly contested market to determine. In many cases, funds that do not provide this choice also do not provide the opportunity for members to benefit from financial advice and accordingly do not offer a mechanism to allow clients to pay for advice. Some funds do provide access to advice through salaried advisers paid by a related entity. In some instances, not all of the costs of advice are borne by the client through the fee for service. The fee for service payment, or part thereof, is indirectly drawn from the client account in the relevant fund thereby lowering the overall returns to the client through that fund. Other funds might provide the advice via a subsidy from the whole of the fund. All of these various arrangements involve possible conflicts of interest and should be clearly disclosed.

Recommendation 4

The Government should:

- endorse the value of advice particularly in relation to choice of fund and member investment choice;
- reinforce the disclosure basis of our existing laws by facilitating effective disclosure; and
- provide clear guidance to the regulator of the regulatory intent of the law.

5. The meaning of member investment choice; and

6. The responsibility of the trustee in a member investment choice situation.

Items 5 and 6 are interdependent.

Principles 5 and 6

1. Advice is fundamentally important in a member investment choice environment.
2. A trustee is generally not in a position to second guess the investment choice of a member.
3. The role of a trustee in a member investment choice regime is to ensure that the investments available for selection by the member are suitable for incorporation into a member's investment savings strategy.
4. Superannuation is now personal investment and investment choice is the member's responsibility.

Following the enactment of SIS, the financial services industry developed structures to deliver investment choice to fund members in accordance with sections 52(4), 58 and regulation 4.02 of the SIS regime. Member investment choice is, therefore, not a new concept. When combined with rapid technological advances and greater administrative efficiencies in the 1990s, member investment choice became part of the framework for the development and rapid growth of superannuation administration platforms that are offered mainly through licensed investment advisers.

APRA regulation of Investment Choice

APRA Superannuation Circular II.D.1 “Managing Investments and Investment Choice” (**Circular**) was originally issued by APRA in 1998 and was updated and reissued in March 2006. The 2006 Circular was issued following extensive and constructive consultation between APRA and IFSA. We believe that while the changes made in the Circular following IFSA’s representations improved the document, there remains a fundamental uncertainty in the law which gives rise to a difference in interpretation by IFSA members and APRA as to the operation of sections 52(4) and 52(2)(f) of SIS.

It is the view of IFSA that the position now adopted by APRA on member investment choice is inconsistent with the original intent of the law. APRA’s views, as set out in the Circular, are a departure from the superannuation industry’s interpretation of the relevant SIS provisions and the way in which APRA has allowed the master fund/WRAP industry to develop over the last decade. The APRA approach would place significantly more responsibility on a fund trustee in a member investment choice situation over and above responsibility for offering and managing suitable investment strategies for members.

This issue is of increasing significance as the platform industry continues to grow rapidly. If the current situation is not corrected, and limitations are placed on investment choices made by members within certain investment categories, regulated superannuation funds will be at a competitive disadvantage to self managed superannuation funds (**SMSFs**) where there are no investment choice restrictions. As a result, superannuation investment choice, some clients will transfer to a SMSF to create the flexibility they need to avoid what they and their advisers will perceive to be limited investment choice within a fund and vanilla investment outcomes. Given the uncertainty in the interpretation of the relevant provisions, IFSA considers that this matter should be determined by the Government and the law amended to clarify the operation of sections 52(4) and 52(2)(f) of the SIS Act.

Investment Choice, investment caps and the role of advice

APRA has advised that under SIS, the availability of advice to fund members is not a relevant consideration that trustees can take into account in satisfying their responsibilities to fund members. Yet in the investment choice context, administration platforms provide the 'infrastructure' (reporting, trade execution, custody etc) for advisers/dealer groups to implement and run investment strategies of their clients. Likewise, trustees offering member investment choice are under a legal obligation to formulate and document one or more investment strategies on offer to members. In so doing, and based on differing legal advice, some trustees have placed investment limits on certain asset types.

Some IFSA members offering superannuation administration platforms have experienced significant negative comment from advisers and dealer groups regarding investment limits in Superannuation (for managed funds and equities) where the trustee requires them. There is a strong consensus across the adviser community that platform providers are not in a position to know what is / is not a good investment for their individual clients and it is unreasonable and unrealistic to expect trustees to do so.

Advisers/dealer groups have statutory responsibilities to know their clients financial position and goals and are able to utilize the investment platform as an efficient 'execution / maintenance tool'. To address their statutory obligations for the provision of advice to retail clients, advisers/dealer groups generally establish investment committees for the purpose of conducting due diligence on funds and stocks (this also involves looking a rating agencies) as part of an investment strategy.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022

Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

Model portfolios developed by dealer groups are designed to provide investors with a structured portfolio and exposure to certain asset types.

The facts are that a client may hold a significant part of their overall portfolio outside of a platform. Under the investment choice model permitted by the law, portfolio construction is the responsibility of the member and investment selection will generally be holistically based on the allocation of investments across the asset classes of cash, fixed interest, shares and property according to the client's risk tolerance and investment time frame. These are matters that the platform provider will not know.

IFSA considers that the regulatory arrangements introduced by Government for investment choice, in both superannuation and non-superannuation products, are primarily disclosure based. Based on our understanding of the law, the **prudential obligations** of a trustee in a superannuation investment choice and fund choice scenario, are to have in place appropriate systems to:

- **Formulate and document** one or more investment strategy(s) which may be quite broad or very narrow, depending upon the type of fund and number and range of strategies on offer;
- **Manage** those investment strategies in a prudent manner (eg. obtaining appropriate and timely valuations and updating unit price/asset earnings attribution, equitable expense, including tax liability, allocation etc);
- **Acquire, redeem and report** on investments offered and selected by members in accordance with what has been disclosed.

The availability of investment choice recognises that no single strategy is best or appropriate for each and every member, particularly for members of large and widely offered funds. This implies that the strategies that may lawfully be offered by trustees will involve varying levels of risk, including risks associated with reduced levels of diversification (as compared to other strategies).

While there is much in the APRA Circular with which industry would agree, the critical differences revolve around an interpretation of the law that would effectively extend trustee responsibility to individual member investment choice and ignore the availability of financial advice in member investment choice. SIS should be amended to expressly recognise the role of advice in superannuation and to limit the role of a trustee where member investment choice is offered to the formulation and documentation of investment strategies, managing investments selected by members, and to acquiring redeeming and reporting to members on those investments.

Recommendations 5 and 6

Sections 52(4), 58 and regulation 4.02 of the *Superannuation Industry (Supervision) Act 1992* should be amended to ensure that the duties of trustees of a superannuation fund offering member investment choice are to:

- **Formulate and document** one or more investment strategy(s) which may be quite broad or very narrow, depending upon the type of fund and number and range of strategies on offer;
 - **Manage** those investment strategies in a prudent manner (eg. obtaining appropriate and timely valuations and updating unit price/asset earnings attribution, equitable expense, including tax liability, allocation etc);
 - **Acquire, redeem and report** on investments offered and selected by members in accordance with what has been disclosed; and
- that responsibility for investment selection within the strategies offered by the trustee is that of the member.

7. The reasons for the growth in self managed superannuation funds.

Principle 7

Individual consumers have the right to determine what is in their best interests and how their retirement savings should be invested.

Self managed superannuation funds (**SMSFs**) have become an increasingly significant part of the Australian superannuation landscape over the last five years. The Reserve Bank of Australia in its Financial Stability Review report stated:

By fund type, industry and self-managed funds have recorded the strongest growth in assets under management over recent years. These funds, together, account for nearly 40 per cent of industry assets, compared to around 23 per cent five years ago (Graph 59). At the same time, there has been a decline in the share of total superannuation assets held in public sector and corporate funds⁶.

IFSA commissioned Investment Trends Pty Limited (ABN: 141 074 856 56), a specialist research and consulting organisation, to produce a report examining the SMSF market, drivers of growth to date, asset allocation, the role of advisers and the role of managed funds within SMSFs. The report is based on two detailed quantitative surveys totalling 1,189 SMSF members conducted by Investment Trends in December 2004 and October 2005. A copy of the February 2006 report, *SMSF Trends*, is attached (**Attachment C**).

As advised in the Report, SMSFs are now the second largest segment of the superannuation market behind retail super. As of June 2005, around 300,000 SMSFs held \$166 billion in super assets, up 24% in the preceding 12 months (Source: APRA). Assets held in SMSFs are now growing faster in percentage terms than any other superannuation category besides industry funds.

The research found that SMSF investors cite an average of 3.3 main reasons each for setting up their SMSF. While there has been a belief that SMSF growth was cost driven, only 24% of the SMSF investors surveyed cited saving money on fees as an important driver. Four distinct, though overlapping, reasons for establishing an SMSF were identified. They are:

- **Control** - By far the most popular reason given for setting up a self managed super fund is investors' desire to exercise more control over their super (55%).
- **Poor performance** (36%) from existing super funds often drawing attention to fund charges (20%)
- **Accountant's suggestion** (33%)
- **Financial planner suggestion** (29%)

The researchers noted the proportion of investors reporting that both financial planners and accountants as the instigators for the establishment of SMSFs had fallen over recent years, as more investors themselves initiate the establishment of an SMSF. However, it must be recognised that recommendations from accountants was a catalyst in the significant growth of SMSFs over the past decade and continues to be a significant driver.

It should be noted that the element of control is available and used by many SMSFs through administrative platforms (retail WRAP arrangements) offered by the funds management industry. While a certain level of control is also available to investors through retail superannuation master funds, the regulatory approach of APRA has been to limit member control and investment choice.

⁶ Reserve Bank of Australia, Financial Stability Review , September 2006 at page 37.

The Butler Walker 'Analysis' (July 2006) publication makes the following comment on the small fund market:

The small fund market is an enigma. Operating costs are high and there is little evidence of better performance. Yet, many Australians take this option. People want greater control; distrust institutions; think they can do better etc.

Certainly, moves by APRA to restrict member investment choice are a relevant factor in the expansion of this market segment.

The Provision of Appropriate Licensed Advice

As can be seen above, accountants play a major role in the establishment of SMSFs with 33% of investors who participated in the research saying that they established a SMSF at the suggestion of an accountant. An area of ongoing concern is that of the role of the accountant, particularly where they are acting outside the Corporations Act licensing regime.

Examples of potential consumer detriment in the SMSF area are evidenced in both the recent ASIC Shadow Shopping Survey on Superannuation Advice and the following from ASIC's Chairman at a recent conference when commenting on ASIC's "work on illegal early access to superannuation", Mr Lucy said;

"ASIC is working closely at a cross-agency level with APRA and the ATO to minimise transfers from legitimate superannuation funds to sham self-managed superannuation funds⁷"

The Shadow Shopping report, released by ASIC, covered twenty two cases of advisers who were not licensed to provide advice. Eighteen of these were accountants⁸. The report stated;

"In some limited circumstances, accountants can give advice on superannuation issues without needing to come within the AFS licensing regime." It went on to say "In four cases the unlicensed accountant stayed within the accountant's exemption". Further "in 16 other cases, 14 unlicensed accountants and two tax agents illegally gave advice on issues that required a licence. These cases included:

- advising the client about particular superannuation funds (not SMSFs), including staying with an existing fund, consolidation and asset allocation decisions within funds; and
- recommending making extra contributions to a specific super fund to access tax benefits, without warning that other factors may be relevant and the client should seek advice from a licensed adviser."

The examples expose a significant risk to some superannuation investors and, although the sample was small, it showed that almost 78% of the accountants covered in this survey gave consumers illegal advice regarding superannuation.

⁷ ASIC's Super Strategies: 2006–07 An Address by Jeffrey Lucy AM, Chairman - Australian Securities and Investments Commission at The Association of Superannuation Funds of Australia 6 September 2006 Sydney, Australia

⁸ Shadow shopping survey on superannuation advice - An ASIC report April 2006

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022

Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

The industry has long argued for a level playing field in relation to the regulated provision of financial services and, in particular, the removal of the special treatment of accountants when providing services in relation to SMSFs.

The initial regulation which became effective in May 2003⁹ provided, in our view, sufficient scope for the accounting profession to deal with appropriate matters required for the efficient administration of a fund. The extension of that scope by a further regulation which became effective in February 2004¹⁰ has led to confusion within the accounting profession as to where the line is drawn and in some cases, as shown in the ASIC report, an inappropriate outcome for investors. It is our recommendation that at the very least this latter Regulation should be removed for the avoidance of doubt and to ensure consumers are protected by the appropriate licensing regime.

Recommendation 7

That Government:

1. notes the primary reasons for the growth of Self Managed Superannuation Funds are control, the perception of poor performance in the retail sector, and the role of financial advisers seeking to address the various savings investment requirements of their clients.
2. moves to ensure greater investor protection by requiring uniform licensing of providers of financial services to and in respect of Self Managed Superannuation Funds.

8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund.

Principle 8

The introduction of compulsory retirement savings, and an increasing propensity on the part of employers to shed responsibility for superannuation as not being core to their business, together with greater labour market flexibility, have caused a shift from defined benefit schemes which typically gave a narrow cross-section of employees significant benefits to a more general and equitable distribution of employer provided benefits through market linked products.

Prior to the introduction of compulsory superannuation saving through the Superannuation Guarantee most superannuation was provided to a limited range of government and corporate employees through employer sponsored defined benefit funds. These schemes, while in many cases quite generous, tended only to provide significant benefits to very long term employees.

One of the outcomes of a more open economy, structural reform and increased labour market flexibility during the mid to late 1980's and early 1990's was changes to occupational superannuation with the introduction of award superannuation and then the superannuation guarantee levy. This was followed by the closing to new members of defined benefit schemes not only by employer sponsors but also by government, including the military and more recently parliamentary schemes. New members are offered participation in an accumulation scheme (defined contribution schemes). The remaining defined benefit scheme arrangements tend to be for services, fire and police etc, where the physical nature of employment requires early retirement.

⁹ Regulation 7.1.29(5)

¹⁰ Regulation 7.1.29A

Reasons for this both in Australia and globally have been:

- Increased costs in providing defined benefit retirement pension plans;
- Avoiding the risk of under funding and shifting of risk for investment performance from the employer to the employee;
- Increased individual involvement, more investment choice, immediate vesting, and portability at job change

Increased costs

Population ageing has seen not only an increase in the number of people who survive to retirement, but also larger numbers of people living for much longer periods in retirement. This trend has increased costs of providing defined benefit retirement pension plans and raised significant doubts about the affordability of defined benefit pensions into the future. As a result, many defined benefit plans in the developed world are either closed to new members or have been terminated altogether.

Increased risk

Employers find defined contribution plans attractive because they are easy to communicate to employees and there is no under funding risk. The shift from defined-benefit to defined-contribution pension plans effectively transfers risks from employers/governments to individuals. Such risks include market risk, inflation, investment planning, and longevity risk.

One of the principal objectives of the federal government when it closed the various defined benefit schemes was to provide arrangements which would give all members, no matter how long or short their tenure as a government employee, a fairer allocation of benefits provided by the employer. The shift to accumulation schemes also constrained the emerging funding gap for governments and has limited the prudential risk associated with corporate schemes.

The trend away from defined benefit scheme arrangements is consistent with greater labour market flexibility with employees now more likely to have a larger number of different employments during their working lives, addressing the potential for unfunded liabilities by having market linked accumulation schemes, and placing greater responsibility on individuals for the growth of their retirement savings.

Greater member involvement and choice

Defined contribution plans have become attractive to employees because of increased individual involvement, more investment choice, immediate vesting, and portability at job change.

In Australia, the shift to a defined contribution model is relatively advanced. The Australian Government has implemented a number of measures aimed at reducing growth in unfunded public sector superannuation liabilities, including the establishment of a Future Fund. The Future Fund will begin to fund the superannuation liabilities already incurred but for which no provision has been made. The Fund aims to accumulate financial assets to offset the Government's liabilities by 2020.

Recommendation 8

That the Committee acknowledge that the demise of defined benefit superannuation funds is the product of an increasingly market driven superannuation environment.

9. Cost of compliance.

Principle 9

APRA should be required to consider, and take into account, industry efficiency and the cost of compliance in its administration of the law.

The costs of regulation include not only regulatory levies and cost incurred for internal and external compliance and administration resources, but also costs associated with limiting the choice of products and processes and inhibiting innovation. Superannuation regulatory costs are incurred both as a consequence of complying with the law and requirements imposed by ASIC and APRA.

Legal compliance is a significant operational undertaking for financial institutions generally. The volume and scope of regulation has the potential to create a compliance driven culture that may lead to a risk adverse business environment. Additionally, the apparent perception of government officials and regulators that industry has the resources and can implement changes “overnight” at minimal cost is a serious concern.

The cost of regulation indirectly affects customers. While product and service providers have and will continue to absorb some costs, the reality is that a significant portion of regulatory costs incurred are passed onto customers. Unnecessary costs erode future savings.

The Financial System Inquiry¹¹ considered that Australia’s regulatory costs in 1997 were high, with only the US having higher compliance costs. The report estimated total compliance costs in Australia as exceeding \$720 million, equivalent to 7.6 basis points of assets. Since 1997 there have been a series of major legislative reforms commencing with the *Managed Investments Act 1998* through to the *Financial Services Reform Act 2001*¹² and finishing with the Superannuation Safety¹³, Superannuation Choice¹⁴ and CLERP 9 Acts¹⁵. Each had a major impact on industry structures and involved a significant additional compliance element. The Anti-Money Laundering and Counter Terrorism reforms are about to impact the industry.

The IFSA Key Industry Statistics Survey for the last 5 years has shown that there have been significant increases in the costs to industry in the areas of information technology, regulatory compliance and customer service. The current costs for IFSA member companies to comply with the financial services industry regulation is about 10 to 15% of total operational costs.

Given that even minor regulatory changes will now generally involve some changes to the technology and operational systems underpinning the delivery of products and services, the compliance costs of relatively small regulatory changes may be quite high. The Government response to the *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* is moving in the right direction to address the implementation of reforms that have not been subject to adequate consultation and cost benefit analyses. However, in this context we repeat our recommendation at item 3 above for the introduction of a formal consultative arrangement to report to Parliament.

¹¹ The Treasurer announced on 30 May 1996 the establishment of an Inquiry into the Australian financial system, to report to him by 31 March 1997

¹² The Financial Services Education Agency Australia (FSEAA) reported by Media Release dated 13 December 2005 that just to get compliant under FSR has cost Australia’s licensed Financial Services providers more than \$224 million. The survey was undertaken by Victoria University, funded by the Taxpayers Research Foundation Ltd and supported by FSEAA

¹³ Superannuation Legislation Amendment (Superannuation Safety and Other Measures) Act 2005

¹⁴ Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004

¹⁵ Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004

Costs of providing superannuation

The following provides a short statement of the drivers for the cost elements in operating a superannuation business in compliance with all legal requirements.

1. *Staffing and Recruitment*

Staff with appropriate expertise is becoming increasingly difficult and expensive for regulated entities to source as the regulatory regime has become more complex. Employment costs are a significant proportion of total compliance costs for regulated entities.

Increasing regulatory complexity leads to the need to have access to legal, compliance and risk expertise. Market forces have meant that those with the appropriate expertise have been able to command higher salaries, which has led to increased compliance costs for regulated entities. A review of the large number of financial services legal, compliance, and risk roles advertised by recruitment firms at any point in time and the salaries which they can command, provides an indication of the high demand for and cost of individuals with relevant expertise.

2. *RSE Licensing Specific Issues*

The framework for RSE licensing is sound, however, unless there is good reason for differentiation, the responsible entity and managed investment regimes should be the same. A single set of licence requirements should apply to entities that are both responsible entities of managed investment schemes and trustees of regulated superannuation entities. We note that following inconsistencies between these regimes will lead to increased compliance costs for RSE:

Breach Reporting

Industry has raised this issue in a number of submissions to Government. Whilst we note that Government has made a commitment to review this matter as part of the FSR Refinements process, this is a good example of where regulatory inconsistency has increased costs to RSE's at the expense of other risk mitigation measures.

The requirement to report all breaches, whether or not material has led to an excessive cost burden through the development and ongoing management of incident management systems. As a result there is a concern that limited resources are committed to "incident management" rather than focussing on underlying root causes.

Responsible Officers

The requirements applying to the appointment and continuing performance of responsible officers should be the same under Corporations Act and SIS.

Compliance Plans/Risk Management Plans

Content, audit, review and lodgement requirements applying to compliance plans under the Corporations Act and to Risk Management Plans under SIS should be aligned.

3. *Regulatory Costs*

Regulation adds to costs. The superannuation industry carries significant compliance costs and the regulator has significant costs which are passed on to regulated entities through levies.

These costs are ultimately borne by shareholders and consumers both as expenses against investment returns and reductions in the value proposition of regulated products.

Recommendation 9

All superannuation related legislation, APRA & ASIC regulatory instruments, policy statements, guidance notes and circulars should be subject to industry consultation and cost benefit analysis before implementation.

10. The appropriateness of the funding arrangements for prudential regulation

Principle 10

An appropriately funded regulator is an important element of a well regulated industry. However, such regulation also requires regulators to efficiently allocate resources.

We note, with some concern, the significant increase in the levies for larger entities, particularly superannuation entities. It is questionable whether the justifications put forward for the increase in the levy to be collected from industry are sound. We particularly note that the superannuation trustee population, post the conclusion of the superannuation licensing transition period on 30 June 2006, will be less than one third of that prior to the commencement of the transition period. We understand that as at 11 May 2006, only 248 licences had been issued of the 325 trustees that had sought an RSE licence and, that the trustees of 876 superannuation entities had not applied for a licence.

IFSA acknowledges two key concerns in relation to the regulation by ASIC and APRA. They are:

- both our regulators have a need to recruit and retain quality human resources, and to this end industry has a responsibility to assist wherever possible; and
- our regulators have had a clear and discernible need for increased funding to address the implementation and ongoing regulation resulting from the significant changes under Financial Services Reform Act (**FSRA**), the introduction of Super fund choice and Super Safety post HIH (although HIH had somewhat limited implications for the regulation of superannuation funds).

Following the implementation of these major legislative changes, it is now appropriate that our regulators examine their resourcing in light of a more settled regulatory environment and market conditions. It is IFSA's view that, as with any business entity, there are always opportunities to make efficiency gains to lower overall cost structures. Part of any such review involves the need to prioritise the use of limited resources to areas identified as presenting the greatest risk and warranting the most regulatory attention. Pricing of regulatory services should then reflect the risk and regulatory allocations of resources - the higher the risk the higher the regulatory levies for that segment of business.

IFSA looks forward to working with both APRA and ASIC in formulating their regulatory risk strategies and IFSA also looks forward to regulator decisions to implement changes in resource allocations that result in efficiency dividends. The Government's statement of expectations will no doubt assist in this process, as will meaningful consultation between the regulator and the regulated on future risk and resourcing needs.

Recommendation 10

IFSA recommends that:

1. the industry levy should be based on the risk rating of the entity;
2. the levy should be reflective of the actual costs incurred in supervising entities regardless of asset size; and
3. measures put in place to monitor and report on the allocation of resources by the regulator to achieve efficient resource management.

11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.

Principle 11

1. Advertising is essentially a commercial matter and the determination of member benefit is a difficult question that without further clarification will be subject to debate and inconsistent practice.
2. ASIC is not a competition regulator. Regulatory responsibility for the regulation of financial services industry advertising should be transferred from ASIC to the Australian Competition and Consumer Commission (**ACCC**).

Superannuation funds and their trustees are required to comply with the 'sole purpose test' requirement of section 62 of the SIS. The object of the sole purpose test is to ensure that regulated superannuation funds are maintained for the purpose of providing benefits to persons upon their retirement, or their dependants in the case of a person's death before retirement. The trustee of a regulated superannuation fund must comply with the sole purpose test to attract the taxation concessions available to a complying superannuation fund.

An APRA letter to trustees dated 14 March 2005 has provided some guidance on the relationship between the sole purpose test and advertising expenditure by superannuation funds:

[Marketing to retain existing members and/or recruit new members] *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;*

This statement gives rise to uncertainty in the post choice marketplace as funds compete for new members. Accordingly, we recommend that if Government considers that certain types of advertising for fund purposes can be paid for from fund assets then, it should expressly identify in the law permitted advertising.

ASIC and Misleading advertising

ASIC has taken an aggressive stance in relation to advertising by the retail funds sector. On the one hand it has held that the use of past performance information in advertising and promotional material is misleading (ASIC Media Release, Wednesday 9 August 2006) while permitting financial projections to be used dominantly in advertising with minor qualifications and continuing to accept generalised comparative statements on fees as the primary differentiating factor in financial returns.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022

Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

IFSA considers that the consumers and the market place for financial products, including superannuation, would be better served by the Australian Competition and Consumer Commission (**ACCC**) regulating financial services industry advertising. The ACCC is familiar with structures and arrangements in the industry and has the necessary expertise to regulate advertising. ACCC procedures are driven by a long corporate history of regulation in this area, by a strong body of case law, and ACCC has specialist and expert staff who, on a day to day basis, deal with these matters. It is noteworthy that ASIC, on its FIDO consumer website, states that “To resolve your problem quickly it is important to find the right organisation to help you. A simple check now can prevent delays later. The questions below will help you to decide who can deal with your complaint”, and then at question 3 directs the user to with a complaint about advertising to the ACCC¹⁶.

Recommendation 11

1. The law should be amended to list the types of advertising that can be paid for from superannuation fund assets by fund operators.
2. Regulatory responsibility for the regulation of financial services industry advertising should be transferred from ASIC to the Australian Competition and Consumer Commission (**ACCC**).

¹⁶ See www.fido.asic.gov.au

Is your complaint about:

- **prices**
- **competition**
- **unfair market practices**
- **product safety**
- **franchises**
- **advertising**
- **online shopping?**

If so, you should contact the Australian Competition and Consumer Commission (ACCC) or State Government consumer bodies. For more information visit the ACCC website or your State consumer agency listed above.

ACCC website: <http://www.accc.gov.au>

See ACCC's website www.consumersonline.gov.au for information regarding online shopping. Complaints in relation to overseas based businesses are dealt with by econsumer.gov.

12. The meaning of the concepts “not for profit” and “all profits go to members”

Principle 12

The terms “not for profit” and “all profits go to member” and like expressions should only be used where they are completely accurate or properly qualified.

Retirement savings are managed by a variety of entity types, some are public or private companies others are mutual entities.

In the context of superannuation the terms “not for profit” and “all profits go to members” have been used in connection with mutual funds. Mutual entities differ from companies that are driven by creating value for shareholders by distributing profits in that they are associations of persons who have joined together to achieve a benefit in which all members participate or are entitled to do so. As they do not have shareholders they do not have a requirement to distribute profits. The investment returns of mutual entities are attributed to members investment accounts after covering the expenses of operation, either by the mutual itself or as payments to outsourced service providers which themselves may be public or private companies.

As noted in the June 2006 Analysis publication of Rice Walker Actuaries, “While the trustees of not for profit funds do not seek to profit from the activities of the fund, they are still influential in allocating the income of the fund to various activities”. Those activities may generate income and profit for the providers of services to a superannuation fund.

Fees paid in a superannuation context eventually end up in the hands of individuals, whether shareholders, employees, or service providers further down the chain. The fundamental issue and responsibility of trustees is not whether the remuneration paid is “for profit” or “non-profit”, but rather whether it is “reasonable” or “excessive” reward for the activities performed for the fund. The principle that the trustee act in the best interests of members is enshrined in law. “Not for profit” entities can pay excessive rewards for services just as much as “for profit” entities.

Recommendation 12

That the terms “not for profit” and “all profits go to members” and like expressions should only be used where they are completely accurate or properly qualified.

13. Benchmarking Australia against international practice and experience

Principle 13

Australia should seek to have the most efficient and equitable superannuation savings and pensions regime possible.

Dealing with the pressures of ageing populations

Due to the fiscal pressures of an ageing population and the need to improve adequacy of retirement income arrangements, most developed countries have now moved to a multi-pillared approach to the provision of retirement income, shifting the burden of provision from the state to employers and individuals. Fourteen out of thirty OECD countries now have mandatory or quasi-mandatory funded pension schemes in addition to traditional and many countries are also offering incentives to encourage voluntary retirement savings.

Australia's three-pillar approach to retirement incomes, comprising compulsory and voluntary private savings, and a means-tested, publicly funded age pension, has been endorsed by the World Bank¹⁷ and other international bodies as a model which offers the best prospect of being fiscally sustainable and providing higher incomes in retirement. In this regard Australia is ahead of the pack.

The three pillar system ensures Australia is well placed in terms of its ability to cope with the ageing of the population compared to other developed countries which have traditionally required employees to participate in unfunded employment or earnings-related retirement income schemes. There are a number of features of Australia's retirement income system that ensure it compares favourably to those of other countries.

Superannuation coverage in Australia rates highly compared to the private retirement savings plans of other countries. In Australia, 90% of the workforce is covered by superannuation, while the proportion of workers covered by private plans is 45% in the US, 60% in the UK, and 40% in Canada.¹⁸

The Australian Government provides significant incentives for individuals to save voluntarily through superannuation. These incentives are provided by way of concessional rates of income tax and co-contributions for low and middle income earners.

As part of the May Federal Budget, the Treasurer announced reforms that will boost these incentives by way of removing tax on end benefits for individuals over 60, extending concessional tax treatment of superannuation and co-contributions for the self-employed and reducing the age pension assets test taper rate. The Australian age pension means test (comprising of an income test and an assets test) ensures that the pension is appropriately targeted to those most in need while remaining affordable for the Government. These reforms are also aimed at removing significant complexity in the superannuation tax arrangements, improving the adequacy of retirement income and providing greater incentives for older workers to remain in the workforce.

In terms of dealing with the fiscal pressures of an ageing population while promoting higher incomes in retirement, Australia's system is fairly advanced. Many of the challenges faced by other countries are not significant concerns for Australia. We should, therefore, proceed with caution when considering adopting features in other systems in isolation as there is a potential to undermine the integrity of our own system.

Costs of regulation

Australia's superannuation regulatory framework is well-regarded by overseas jurisdictions for providing a relatively safe and secure investment environment for superannuation fund members. We also have a strong competitive market offering employees a choice of superannuation fund and portability of benefits. Recent financial services reforms have also brought about greater levels of transparency and disclosure to fund members.

A big challenge facing the Australian superannuation system is ensuring that the regulatory environment keeps pace with industry change and that the benefits of any regulatory change outweigh the costs. We consider that Australia's the costs of regulation in the Australian superannuation industry should be benchmarked against the costs of regulation in the retirement income systems of other jurisdictions to ensure our industry is internationally competitive.

¹⁷ World Bank, *Averting the Old Age Crisis – Policies to Protect the Old and Promote Growth*, Oxford University Press, 1994.

¹⁸ H.Bateman and G. Kingston, *Comparative Performance of Retirement Income Systems in the Anglosphere*, School of Economics, University of New South Wales, April 2005.

As the table below demonstrates, Australia is relatively well placed compared to other countries in terms of the ability of the retirement system to cope with this ageing of the population, especially in contrast with nations such as Japan and Switzerland whose old age dependency rates are projected to increase to markedly higher levels.

Funding levels compared

Country	Total pension assets (\$US billion)	GDP 2003 (US\$ billion)	Total pension assets as % of GDP	Population (millions)	Total pension assets per capita (US\$)	Old age dependency rate 2000 (%)	Old age dependency rate 2030 (projected) (%)
Australia	426	514	83%	20	21,657	18	32
Japan	2,463	4,301	57%	127	19,328	25	52
Netherlands	545	513	106%	16	33,820	20	40
Sweden	226	302	75%	9	25,322	27	46
Switzerland	319	316	101%	7	43,753	24	53
UK	1,266	1,795	71%	59	21,454	24	40
US	7,438	10,857	69%	289	25,773	19	33

Source: UBS Global Asset Management publication. Data is based on GDP and population data from OECD. Old age dependency rate is population aged over 65/population in working age (15-64), expressed as a percentage. Total pension asset data at 31 December 2003 unless stated otherwise: Australia: APRA. Japan: Japanese Ministry of Health, Labour & Welfare, UBS Global AM estimates (31 March 2003). Netherlands: CBS (30 September 2003). Sweden: Government of Sweden. Switzerland: Bundesamt für Statistik (31 December 2002). UK: UBS Global AM estimate based on National Statistics data. US: Federal Reserve.

However, accumulated superannuation contributions alone are unlikely to provide an adequate retirement income for most Australian workers, with many set to retire on less than half their average salary, well short of the 65 percent to 75 percent of their current income retirement planners generally estimate that retirees need.

Awareness among pension providers of developments beyond their own national borders has heightened considerably. In Europe in particular, the moves towards a pensions directive engaged the interest of national governments and scheme sponsors alike. Early drafts included quite prescriptive investment restrictions which were unacceptable to several member states.

The cross-border pension fund rules finally approved by EU ministers in 2003 leave funds broadly free to decide their investment strategy. The Directive became EU law in September 2003. It is clear that investment strategies, and pension provision in general, are on the road to becoming more homogeneous in Europe and, indeed, around the world.

Recommendation 13

1. Government should continue to build an effective and efficient superannuation system in Australia in close consultation with industry.
2. The regulatory costs of the Australian system should be benchmarked against international best practice.

14. Level of compensation in the event of theft, fraud and employer insolvency

Principle 14

In a competitive market where investor choice operates guarantee and insurance arrangements are inappropriate where they effectively penalise good corporate citizens and increase the risk of failure by marginal operators.

Existing compensation arrangements under Part 25 of SIS in the event of theft and fraud are an appropriate regulatory response to criminal activity of this nature. Member protection is, however, reliant on diligent trustees and effective prudential regulation.

IFSA is aware that various recommendations have been made to Government to introduce limited compensation schemes within the financial services industry¹⁹. Our responses to those recommendations are equally applicable to the issue posed under this item. Essentially, the IFSA response has been:

1. to support for basic legislative mechanisms to underpin Australia's failure management arrangements, but not to support the setting up of a limited but explicit industry funded guarantee scheme;
2. in the event that an industry solution to institutional failure is not developed on a case by case basis, we consider that it is appropriate for Government to step in and provide short term liquidity such as that envisaged under the proposal with those costs being recovered to the extent of available assets;
3. even a partial guarantee will not reduce the potential for systemic risk if a significant player fails.

What a guarantee is likely to do is:

- to increase competition from product providers who are not risk averse;
- provide comfort to investors/policyholders/clients who may be encouraged because of the guarantee to invest with riskier entities; and
- provide support for riskier business activities at the expense of efficient and well run organisations.

Generally, IFSA considers that the case has not been made for the introduction of a guarantee scheme over and above the existing:

- depositor preference arrangements for ADIs;
- life insurance statutory funds;
- priority arrangements for insurance policyholders; and
- compensation arrangements under Part 23 of the SIS Act.

Proposals for further guarantee arrangements may be a politically expedient solution for Government to calls for support in the event of institutional failure, they do not address the broader economic impacts on market behaviour in terms of competition, efficiency, cost and moral hazard inherent in the proposal.

In circumstances where regulatory failure is identified as a significant contributor to institutional failure, Government intervention and support is not an unreasonable community expectation. Guarantee proposals potentially shift a significant cost burden onto otherwise 'innocent' parties - competitors in the same industry sector and, to their shareholders and members. The imposition

¹⁹ Government Discussion Paper on Financial System Guarantees
 Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
 Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

of a financial system guarantee on industry, even where levy arrangements are triggered only after the event, will result in additional costs to industry that will be passed to policyholders. Hence, the net effect of any limited explicit guarantee would be to shift the financial burden to a smaller taxpayer base, rather than a fairer distribution to taxpayers at large.

It should be noted that well run organisations expend a significant amount of time, money and attention on internal systems to comply with industry regulation and meet the needs of their customers. Any intervention by a regulator will generally have a commercial impact on business. Likewise, any action by Government to introduce a financial system guarantee will undermine that investment by industry and will, in our view, have the effect of diminishing consumer trust in industry thereby increasing moral hazard.

In summary, the introduction of any explicit financial system guarantee will:

- result in increased cost to customers;
- reduce standards by underwriting inefficiency/complacency;
- increase the risk of failure;
- be anti-competitive;
- result in more claims on a fund because customers have less incentive to be risk averse; and
- diminish trust in the industry.

Conclusion

If the Committee was to recommend the introduction of any broader compensation arrangements for institutional failure, we would recommend that a legislative scheme be limited to provision of short term funding by the Reserve Bank, administered by APRA, with costs being recovered by the sale of assets of the failed institution. Such legislation would remove the need for special purpose legislation to be introduced on a case by case basis, provide for the orderly wind-up of the institution, and alleviate the immediate consumer impact. The solution is readily transferable to an employer insolvency situation and to the extent that funds cannot be recovered they should be borne generally by the public from Government revenue.

Recommendation 14

IFSA recommends that there should be no expansion of the existing compensation arrangements under the law. If the existing scheme is expanded any failure should be funded by Government.

15. Any other relevant matters

15.1 A Single Disputes Resolution Scheme

The Financial Services industry is characterised by a number of different dispute resolution schemes. The ASIC website lists 8 different schemes and, of course, there is provision for ASIC to approve further schemes.

Given the size of the Australian market it would be in the interests of both industry and consumers to rationalise the number of schemes where they effectively cover the same ground.

- 1. Financial Industry Complaints Service (FICS) - FICS deals with complaints about financial services providers including life insurers, funds managers, investment advisers and planners, stockbrokers and some superannuation providers.**

2. **Insurance Ombudsman Service Limited (IOS)** - IOS deals with complaints about general insurance companies.
3. **Banking and Financial Services Ombudsman (BFSO)** - BFSO deals with complaints about financial services providers including banks, foreign exchange dealers, deposit takers, credit providers, mortgage brokers and some insurance and investment providers.
4. **Credit Union Dispute Resolution Centre (CUDRC)** - CUDRC deals with complaints about most Australian credit unions.
5. **Insurance Brokers Disputes Limited (IBD)** - IBD deals with complaints about general or life insurance brokers.
6. **Financial Co-operative Dispute Resolution Scheme (FCDRS)** - The FCDRS deals with complaints from consumers about those Australian credit unions and building societies who are members of the scheme.
7. **Credit Ombudsman Service Ltd (COSL)** - COSL deals with complaints about individuals and companies that operate in the credit industry and are members of the scheme. (Formerly called the Mortgage Industry Ombudsman Service)
8. **Superannuation Complaints Tribunal** - The Superannuation Complaints Tribunal (SCT) is an independent tribunal set up by the Commonwealth Government to deal with complaints about superannuation funds, annuities and deferred annuities, and retirement savings accounts. If all of the financial services you provide are covered by the SCT, you do not have to join an approved external dispute resolution scheme.

Recommendation 15.1

IFSA recommends that Government reduce, through consolidation, the number of existing external dispute resolution schemes available to consumers.

15.2 Removal of the requirement for Policy Committees for public offer superannuation funds offering investment choice

Policy Committees were a recommendation of the Senate Select Committee on Superannuation in its report *Safeguarding Super – The Regulation of Superannuation* (June 1992). Recommendation 5.6 of the report was “that each individual plan or sub-plan with arm’s length members in master trust arrangements be required to have a policy committee comprising equal representatives of employers and employees to advise the trustee”.

While the requirement served a useful purpose as a transitional matter IFSA does not believe that the SIS requirement for a policy committee should apply to a trustee where:

- it is an independent trustee of public offer funds;
- the investment strategy of the fund provides for individual beneficiaries to give directions to the trustee (ie the fund is a master trust);
- the directions relate to the strategy to be followed by the trustee in relation to the investment of a particular assets or assets of the fund; and
- the directions are given in circumstances covered by regulations made for the purposes of paragraph 52(4)(b) of SIS.

The functions of a policy committee are set out in regulation 3.06. The following comments are made in relation to the requirements in terms of their relevance to a public offer fund with individual member investment choice.

1. **Provision 3.05(a)(i)** - provides an avenue for members of the fund to inquire about the investment strategy and performance of the fund;

Comment - not applicable/irrelevant, as members of policy committees do not by virtue of that position have access to information about the performance of the investments in an individual member's Account. This is a fundamental tenet of the Federal Government's Privacy legislation. So, it is clear that a policy committee simply cannot fulfil this function where there is individual member investment choice.

2. **Provision 3.05(a)(ii)** - provides an avenue for the trustee of the fund to obtain the views of members of the fund concerning that strategy and performance.

Comment - This provision is not applicable or relevant, as members have individual investment choice.

3. **Provision 3.05(b)** – provides an avenue for members of the fund to inquire about the fund's operation or performance.

Comment - This provision is not applicable or relevant for the reasons given above. In any event, members will have direct access to a trustee's investor services function, whose day to day responsibility it is to deal with member enquiries of this nature.

4. **Provision 3.05(c)** - provides an avenue for the trustee of the fund to obtain the views of members of the fund concerning the fund's operation or performance;

Comment - This provision is not applicable or relevant to a master fund trustee as it can only deal with individual members in relation to their Account and the performance of their Account.

5. **Provision 3.05(d)** - provides an avenue for the trustee of the fund to obtain the views of members of the fund on their information needs;

Comment - Again, a master fund trustee only usually ever deals with individual members in relation to these matters and all periodic reports and the fund's Annual Report go direct to individual members, so it has little or no relevance in the master trust context.

6. **Provision 3.05(e)** - assists the trustee of the fund in dealing with complaints.

Comment - again, for privacy law reasons, the trustee would never normally share information about an individual member's complaint with a policy committee and would only ever deal with an individual member, or their financial adviser in relation to a member complaint. So, access to a policy committee for this purpose has no practical application.

In the master trust context, current privacy law (which post-dates the policy committee provisions of SIS) severely affects the utility of the policy committee provisions as a whole.

