IFSA Submission

Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System

Issues Paper – 14 December 2009

Phase Three: Structure

INDEX

1. **EXECUTIVE SUMMARY**……………………………………………………………3

2. **SUMMARY OF RECOMMENDATIONS**……………………………………..9

3. **ISSUES:**………………………………………………………………………..11
   PART A………………………………………………………………………...11
   PART B………………………………………………………………………...38

1. Executive Summary

The Review into the *Governance, Efficiency, Structure and Operation of Australia's Superannuation System* has provided industry with the opportunity to constructively evaluate the environment and parameters in which it operates.

Australia's retirement savings system is recognised as world leading, with Australians able to enjoy an established system that combines voluntary and compulsory savings for retirement with an Age Pension safety net. Our system rates well in any international comparison and its robustness during the financial crisis is testament to its fundamental soundness.

The Melbourne Mercer Global Pension Index 2009 ranked Australia second in a comparison of 11 retirement income systems around the world, based on factors such as system design, regulation and governance. The comparisons included the Netherlands, Sweden, Canada, UK, US, Chile, Singapore, Germany, China and Japan.

Superannuation savings also play an increasingly important role in the Australian economy as a whole, with superannuation funds representing an important source of capital for Australian companies and infrastructure developments. Superannuation funds have played an important role in facilitating the large scale de-leveraging of Australian corporations and are also the source of approximately half of the venture capital funding and later-stage private equity funding in Australia.

Given this context, achieving the right outcomes from this Review is crucial not only to the superannuation industry, but for the retirement incomes and lifestyles of all Australians – as well as the Australian economy.

IFSA believes that the regulatory structure of superannuation in Australia should therefore enable a competitive, member focussed industry to provide members with the opportunity to maximise their retirement savings within a predictable and secure environment.

While IFSA continues to encourage Government and the Review panel to endorse the current structure, operation and governance of the Australian superannuation system, we have also considered existing requirements that could be finetuned to take account of innovation and evolution in the industry and to better meet consumer demands for greater efficiency and effectiveness.

These considerations have been guided by the following core principles:

- increasing consumer confidence, engagement and understanding;
- stability and certainty;
- promotion of competition through an open and level playing field in all parts of the superannuation system;
- greater transparency in key areas such as performance, pricing, governance and service levels; and
- enhanced adoption of technology and electronic transactions.

IFSA believes strongly in the fundamental strength and integrity of the Australian superannuation system. There are, however, areas for improvement. Opportunities exist to make legislative, regulatory and operational adjustments with the potential to deliver significant benefits to members. Taken together, these improvements have

the potential to significantly reduce costs, improve efficiency, and increase retirement incomes.

Consumer confidence

The confidence of members and the safety of our superannuation system are fundamental to member engagement and ensuring they save enough for their retirement. The primary risks that superannuation fund members face are institutional risk, operational risk and investment risk.

IFSA believes that capital requirements must underpin institutional and operational risk in the superannuation system and that the existing $5 million capital requirement for Registrable Superannuation Entities is inadequate. For this reason, IFSA has called on the Government to review existing capital requirements.

Similarly, the recent financial crisis has highlighted issues in the governance of fund liquidity. Fund liquidity is primarily dependent on asset allocation, pricing methodology and the frequency of pricing. Lack of appropriate levels of fund liquidity will result in a trustee being unable to meet its obligations to members to pay benefits on time, to enable switches without distorting strategic asset allocations, or to facilitate portability under Superannuation Fund Choice.

To ensure equity within the superannuation system, IFSA has long advocated the introduction of uniform unit-pricing standards for all public-offer APRA regulated superannuation funds.

IFSA believes that a disciplined and transparent approach to asset valuation and unit pricing (in most circumstances calculated on a daily basis) is the most equitable allocation method, as investors are credited with the actual returns earned on their investments from the day they invest.

Where daily unit pricing is not used, there can be significant misallocation of investment earnings in any particular period.

Engagement and understanding

It is acknowledged that there are currently a significant number of superannuation members that are not actively engaged in their superannuation and who are also wholly reliant on Superannuation Guarantee contributions. How to better engage these members to ensure they maximise their retirement savings represents one of the central challenges for both Government and the industry.

Effective information, education and advice are all central to increasing member engagement. Targeted campaigns, designed at encouraging people to find their lost superannuation and to increase their financial literacy, are areas where Government can play an important role.

Australia’s retirement system often requires people to navigate their way through complex decisions. The often-present deficit in member education to make such decisions has, to a large extent, been ameliorated through the availability of professional financial adviser networks and trustees ability to provide limited intra-fund advice.

Financial advisers play a critical role in the planning and provision of long-term savings. Advisers bridge the knowledge gap that exists between the trustee and the superannuation fund member. While the Government has taken steps to allow limited personal advice to members by the trustee through a superannuation fund, the lack of any formal recognition in SIS of the provision of, or the need for, financial advice is a serious failing in the Act.

Financial advice delivers significant benefits for individuals, families and the Australian economy. For this reason, IFSA supports reforms, such as uniform tax deductibility, that increases the affordability and access to advice.

Stability and certainty

A predictable and secure environment in which all participants in the system can more easily understand their risks, benefits, duties and obligations is critical to members maximising their retirement savings.

In what otherwise is a well working governance structure, too much complexity, unnecessary inconsistencies and overlap in the governing legislation and regulatory framework creates uncertainty for product providers, advisers and service providers, in turn leading to difficulties in communicating to members in the most succinct and clear manner possible.

Equally, continual changes to the superannuation tax and regulatory regime tend to undermine consumer confidence in superannuation, leading to bewilderment and disengagement. Consumer engagement is dependant upon legislative certainty and regulatory consistency.

Promotion of competition and a level playing field

IFSA strongly believes in the promotion of competition through an open and level playing field in all parts of the superannuation system. Competition promotes innovation and helps to maintain a diversity of offerings, styles and products that continue to make the existing superannuation system world-leading by ensuring that it is best calibrated to member needs and demands.

Competition is good for superannuation members. The 2008 Rice Warner Superannuation Fee Research report has conclusively established that competition drives down fees. Overall, fees for the industry (including administration, platforms, investment management and advice) averaged 1.21% in the year to June 2008, down from 1.26% in the year to June 2006. This continues the trend observed since 2002 when fees averaged 1.37%. Indeed, in arguably the most competitive sector, large Corporate Super Master Trusts, these costs averaged 0.79% in the year to June 2008, down from 1.24% in June 2002.

Competition and diversity is particularly important in the default fund market. Open and competitive default fund offerings will continue to encourage fee, service and investment level improvements and innovation in default fund offerings for the benefit of members.

Greater transparency in all areas

Transparency and consistency in the reporting of performance of all superannuation fund investment options is vital in enabling members, research houses and analysts to make reliable performance comparisons.

Under IFSA's Superannuation Member Charter, released on 17 November 2009, IFSA member superannuation funds will be required to publish on their websites and make available to research houses or regulators performance data for all investment options that are open to new superannuation members.

Past performance will be required to be disclosed at least once a quarter based on end of quarter data, illustrating the returns delivered by the investment option over the medium to long term (10, 5, 3 and 1 years). Many IFSA members already publish such information.

This enhanced performance reporting will result in increased scrutiny of returns across asset classes and investment managers by research houses, analysts and members. IFSA believes that this increased transparency will in turn drive increased competition – ensuring that superannuation funds are even more rigorous in the selection and appointment of investment managers and investment strategies.

Accurate and concise disclosure documents also play an important role in a member's ability to make good investment decisions. Product Disclosure Statements (PDS) should include sufficient transparency to enable meaningful assessments and comparisons between funds on performance, operational efficiency and governance.

IFSA supports the Government's initiative of simplifying the existing PDS requirements for superannuation products in favour of shorter, more concise documents.

IFSA strongly believes that any disclosure regime should contain minimum requirements for relevant and detailed information that enables comparability of fund performance. Importantly, flexibility should be retained to allow disclosure to be more effectively tailored to relevant member segments rather than a one-size-fits-all approach.

Adoption of technology and electronic transactions

IFSA sees great opportunities for the employment of new technologies to improve efficiency within the system.

IFSA has suggested that employers should be strongly encouraged to use existing mediums such as direct credit and BPAY. In the longer term, legislation may also be required to mandate the use of electronic payments for all superannuation contributions from employers, and to mandate an electronic payment standard for the superannuation industry to address the issues of the integrity of contribution data.

Further, the adoption of tax file numbers (TFNs), as the standard member identifier in the industry will enable greater operational efficiency, significantly reduce lost members and allow greater member consolidation of accounts. The funds management industry already collects TFNs for taxation identification purposes while the extension of the use of TFNs for identification purposes in a superannuation context is in the best interests of fund members.

We note that the Government has proposed a review by the Office of the Privacy Commissioner of the Tax File Number Guidelines and support an extension within this context.

IFSA sees further potential for the use of technology in the area of product disclosure and member statements. Electronic disclosure is the most efficient and effective form of disclosure and one which offers the consumer the greatest level of engagement.

Customer-friendly mechanisms such as key word searches in documents and links between relevant sections lead to disclosure documents becoming both easier to read and easier to understand. The move toward electronic disclosure is also in-step with increased internet usage, particularly among the retiree age-bracket.

Self Managed Super Funds

IFSA recognises that Self Managed Super Funds are an important part of the superannuation system, exemplifying the principle of choice and encouraging personal responsibility. Since their introduction in 1999, Self Managed Super Funds (SMSFs) have grown to represent the largest sector of the superannuation industry (30.8%) and, as such, represent a highly significant proportion of total superannuation assets.

Similar to the superannuation system as a whole, IFSA believes the regulatory regime governing SMSFs to be fundamentally sound. IFSA has taken Phase Three of the Review as an opportunity to examine particular areas where the governance of SMSFs could be enhanced without the imposition of an undue regulatory burden.

IFSA's approach has been to recommend enhancements to the regulatory oversight of the main service providers (also known as gatekeepers) to the sector. This is considered an appropriate regulatory response given the very large number of SMSFs (in excess of 400,000) and the resulting inability of any regulator (ATO, ASIC or APRA) to comprehensively monitor compliance with the SIS Act and other regulatory obligations.

Specifically, IFSA strongly advocates that the removal of the current Australian Financial Services Licence exemption for accountants would provide significantly higher levels of consumer protection through the provision of licensed advice and ASIC oversight, as well as the extension of protections afforded under the Corporations Act such as access to external dispute resolution services and cooling-off rights. Removal of the exemption will not only provide a level playing field for all providers of advice to the SMSF sector, but will also serve to increase the integrity of the system.

Another area for regulatory enhancement involves increasing the regulatory oversight of auditors of SMSFs and administrative service providers. Enhancing this aspect of SMSF regulation is both necessary and appropriate given the SMSF regulatory regime relies heavily upon external service providers, in particular auditors.

IFSA believes that registration of both auditors and administrative service providers should be introduced to ensure appropriate consumer protection mechanisms are in place.

We recognise the importance of auditors, particularly as the ATO relies heavily upon auditors in a regulatory capacity. IFSA believes standards in this area should be raised and that justification for raising the standards is present in the ATO data collection. Accordingly, the registration of auditors should be accompanied by statutorily provided minimum competency standards and strengthened independence provisions for all SMSF auditors.

2. Cooper Review: Phase 3 – Summary of Recommendations

PART A: Structure

Recommendation 1

IFSA recommends that the Government commits to issuing further longer-dated, CPI-linked bonds specifically designed to support the annuity market, as well as reviewing regulatory capital requirements to ensure they do not present an inappropriate barrier to the provision of retirement income products.

Recommendation 2

IFSA recommends that:

a) the process for selecting default funds for award-covered employees should be reviewed and modified;

b) employers should be required, for award-covered employees, to choose a default fund on the basis of a specified list of criteria; and

c) competition among default funds should be further enhanced – not diminished.

Recommendation 3

IFSA recommends that the Government endorses the current structure, operation and governance of Australia's superannuation system and:

a) reviews capital requirements for superannuation trustees;

b) reviews payment, portability and asset valuation requirements under SIS; and

c) introduces uniform unit-pricing standards for all public offer APRA regulated superannuation funds.

Recommendation 4

IFSA recommends that all fees (up-front and ongoing) for financial advice should be tax deductible.

Recommendation 5

If the Review recommends legislative reform concerning the provision of financial advice in superannuation, IFSA recommends that the Review Panel specifically acknowledges the intent, operation and effect of IFSA's Superannuation Member Charter which will come into effect on 1 July 2010, and which is mandatory for IFSA members from 1 July 2012.

Recommendation 6

IFSA recommends that default funds should be required to offer a minimum level of TPD cover to members in addition to death cover.

Recommendation 7

IFSA recommends that superannuation funds wishing to self-insure death and disability benefits for their members must be subject to the same prudential regulation requirements as insurance companies – including meeting capital and reserving requirements. Such protections serve the best interests of their members.

PART B: Self Managed Superannuation Funds

Recommendation 8

IFSA recommends that the financial licence exemption granted to members of professional accounting bodies when establishing SMSFs be abolished.

Recommendation 9

IFSA recommends that providers of administrative services offered to SMSF trustees be registered with the ATO

Recommendation 10

IFSA recommends minimum SMSF auditor competency standards be prescribed in statute.

Recommendation 11

IFSA recommends that auditor independence provisions be strengthened to prevent conflicts arising for firms and individual auditors of SMSFs.

Recommendation 12

IFSA recommends that approved auditors be registered through ASIC's auditor registration process.

Recommendation 13

IFSA recommends the ATO establish a best practice standard of voluntary education for SMSF trustees.

Recommendation 14

IFSA recommends a wider range of graded penalties be introduced for trustees of SMSFs.

Recommendation 15

IFSA recommends that industry and regulators support the Australian Payment Clearing Association's project to modernise the payments system to include superannuation in an industry-wide solution encompassing SMSFs.

3. The Review

ISSUES

PART A: STRUCTURAL ISSUES

8.1 Defined Benefit Funds

Should there be stricter funding standards set out in part 9 of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) so that there is greater protection for members and so that APRA could have a direct role in working with the employer to remedy the deficit?

For example, when a fund is in an 'unsatisfactory financial position', there is no prescribed schedule according to which the trustee and the employer are required to remedy the funding position. Even when the fund is technically insolvent, the trustee and the employer are given five years under SIS Regulation 9.17 to reverse the deficiency. It seems that five years is too prescriptive and that, depending on the circumstances, five years could be too long or too short.

IFSA would support enabling APRA to have a more direct role in working with the employer to remedy any deficit of the fund. While funding of defined benefit funds is the obligation of the employer, APRA does not have jurisdiction over employers and would use the trustee as conduit. We believe that more direct involvement by APRA is important particularly in circumstances where the trustee has made the request.

There have been several occasions where defined benefit funds have not been appropriately taken into account when new legislation has been promulgated. The Review is aware that there are problems for defined benefit funds with respect to the 'dollar disclosure' regime in the Corporations Act as well as that Act's requirements for historical fund performance to be provided to members and disclosure more generally (eg significant event disclosure).

Are there other examples of legislation in recent years which has resulted in problematic application for defined benefit funds?

IFSA is not aware of other areas that have resulted in the problematic application of defined benefit funds.

8.3 Retirement Savings Accounts

Could RSAs be enhanced by removing the capital guaranteed nature of the product and allowing any prudentially regulated entity to provide an RSA? What would be the advantages and disadvantages of an enhanced version of this product playing a larger part in the superannuation system?

IFSA believes there is presently sufficient flexibility in the system for a range of superannuation and retirement products to be offered. It is therefore unclear what benefits any enhancements to regulation around RSAs would have.

9. Getting and paying for advice about Super

While the Phase Three Issues Paper does not expressly seek comment on getting and paying for advice about superannuation, we have nonetheless outlined our views in order to assist the Panel in it's consideration of this critical aspect of our retirement income system.

In considering the "Ripoll report", IFSA supports the introduction of a codified fiduciary duty for financial advisers. We have also specifically welcomed the Ripoll report's recommendations for ASIC to adopt a risk-weighted approach to the supervision of licensees, and for the Government to consider making all payments for financial advice tax deductible.

We also acknowledge that the Review Panel is gathering more data and information concerning advice about superannuation. In this regard, we provide the following references to existing data concerning financial advice that may be of interest to the Review Panel.

Parliamentary Joint Committee Report

In respect to the "Ripoll report", IFSA supports the introduction of a statutory, fiduciary duty for financial advisers. We have also specifically welcomed the Ripoll report's recommendations for ASIC to adopt a risk-weighted approach to the supervision of licensees, and for the Government to consider making all payments for financial advice tax deductible.

IFSA Superannuation Member Charter & advice fees in superannuation

IFSA's Superannuation Member Charter, released on 17 November 2009, stands to have a profound impact on member fees in superannuation. Under the Charter, fees for financial advice or advice related services will be unbundled from superannuation products.

As a consequence of this separation, super fund members will be able to opt in or out of advice – enabling them to reduce the fees they pay as a super fund member if they choose not to receive financial advice or advice related services.

While IFSA strongly supports the value of advice, these industry-driven reforms will focus consumers on the value they receive in exchange for advice fees they pay in superannuation. They will be better able to assess the value of that advice or services and will be in a position to agree how they wish to pay for that advice or services.

The significance of these industry led reforms can be seen from Table 1 of the 2008 Rice Warner Superannuation Fees Report[1] Table 1 of the report, copied below, shows that those choosing not to receive any financial advice or advice related services will, on average, be able to reduce their fees by between 2 basis points and 53 basis points. The reduction in fees will naturally depend on the type of advice or service they are receiving and the type of superannuation fund/plan they belong to.

[1] This report was attached as Attachment 3 to IFSA's submission to this Review in response to the Phase 2 Issues Paper.

IFSA has now drafted and approved standards and guidance for members to give effect to IFSA's Superannuation Member Charter. In particular, IFSA Standard 19 covers adviser fees in superannuation. This Standard implements arrangements for the Member Advice Fee, and the Plan Service Fee under the Charter, and it establishes a framework for payments by a trustee of a superannuation fund to a financial adviser, where a fund member has elected to pay for advice from their superannuation account

Table 1. Fees and Expenses 2008

Fees and Expenses By Superannuation Segment – Year to 30 June 2008							
Sector	Segment	Administration %	Platform %	Investment Management %	Administration, Platform & Investment Management	Cost of Advice %	Total Fees %
Wholesale	Corporate	0.24	-	0.47	0.71	0.02	0.73
	Corporate Super Master Trust[1] (large)	0.20	0.01	0.56	0.78	0.02	0.79
	Industry	0.38	-	0.67	1.05	0.02	1.07
	Public Sector	0.21	-	0.46	0.67	0.02	0.69
Retail	Corporate Super Master Trust[2] (small)^	0.41	0.43	0.81	1.66	0.46	2.12
	Personal Superannuation	0.17	0.61	0.70	1.47	0.53	2.00
	Retirement Income	0.20	0.42	0.69	1.31	0.53	1.84
	Retirement Savings Accounts	0.60	-	1.70	2.30	-	2.30
	Eligible Rollover Funds	2.03	-	0.47	2.49	-	2.49
Small Funds	Self Managed Super Funds	0.31	-	0.52	0.83	0.15	0.98
Total		**0.28**	**0.14**	**0.59**	**1.02**	**0.19**	**1.21**

* Expressed as a % of *average* assets over the year to 30 June 2008.

^ The difference between the 2008 values and 2006 values is the result of better data.

- **Commissions**

The 2008 Rice Warner Superannuation Fee Research report estimated that approximately $400 million was paid in advice fees in respect of Superannuation Guarantee (SG) contributions. Importantly, Rice Warner further noted that the bulk of these fees were paid by members in the personal superannuation and SMSF segments.

In our view, this indicates that those paying fees for advice from their SG contributions are therefore far more likely to be receiving that advice by choice, rather than by default. This is a critical point as it contradicts the popular notion that the majority of people paying for advice from their SG contributions are not aware they are doing so.

It is also important to recognise that advice is not a free service. To the extent that any superannuation fund claims to provide “free advice” to members, it is in reality subsidised by higher fees elsewhere.

Importantly, as outlined above, the application of IFSA’s Superannuation Member Charter will result in advice fees being separated from superannuation fund fees, such that only those wishing to receive and pay for advice will do so going forward.

Under the Charter, which comes into full effect from 1 July 2012, payments out of a new member’s account will only occur where agreed between the member and their

adviser. Further, the member will be able to turn off the payment and cease receiving the service at any point.

While IFSA's Superannuation Member Charter significantly reforms the payment of advice within super, it also supports members paying for advice out of their superannuation. This recognises that for most Australians, paying directly out of their superannuation is often the most effective means of funding advice, because it does not require the consumer to fund the cost of advice directly out of their disposable income and the cost of the advice can effectively be paid for pre-tax where an equal or greater level of concessional contributions are also being made.

Value of financial advice for individuals, and national economy

We also note recent research released by IFSA (prepared by KPMG Econtech) that has revealed that those who receive advice from a financial planner save an additional $2457 each year, compared to a similar individual who does not have a financial planner (attached to this submission as **Attachment 1**).

This research was based on data covering over 840,000 individual accounts for the 2007/08 financial year for customers with FUM greater than $1000. The data set covers a wide demographic.

The researchers also undertook economy-wide modelling to estimate the impact of more Australians receiving financial advice, and found that if an extra 5 per cent of Australians were to receive financial advice, there would be a 0.5 per cent of GDP gain in national savings by 2014/15, compared to the status quo.

The research also estimated that, under the increased national savings scenario:

- an increase in national saving leads to less dependence on foreign financing of domestic capital, and in the long run, foreign liabilities would be approximately 1.5 per cent of GDP lower;
- lower reliance on foreign investment could lower the risk premium for investment in Australia, so that gains in business capital are sustained in the longer term; and
- GDP is 0.6 per cent above the baseline in 2014/15, supported by gains in business capital and employment of 0.4 per cent and 0.1 per cent respectively.

The significance of this research should not be underestimated. The current economic environment and the ageing population in Australia mean that Australians must be given as much as possible to provide for their current financial security, and to save for their retirement.

Investment Trends planner remuneration data

An assessment of the types of remuneration received by financial planners is covered in Investment Trends' 2008 Planner Business Model Report, which is based on a survey of 1,380 financial planners in October 2008. This report found that financial planners have increasingly turned to fee-for-service remuneration models over the last three years and it provides specific figures for asset-based fees for service, fixed fees for service and upfront and trailing commissions.

According to this report, asset based fee-for-service grew from 16% in 2006 to 23% by 2008, while fixed or hourly rate fee-for-service rose from 15% to 16%. However, upfront commissions fell from 32% in 2006 to 26% by 2008, while trailing commissions experienced a drop of 1% to 35%.

Mark Johnston, Director of Investment Trends, has been quoted in the media as saying that at the end of 2008, planners expected revenue from fee-for-service models to rise to 47% of their total revenue by 2011. This is likely to be significantly accelerated as a result of IFSA's Superannuation Member Charter.

Further, the trade media has recently reported that the IBISWorld report, *Financial Planning and Investment Advice in Australia*, found that trailing commissions account for 35% of revenue in the financial planning industry - consistent with the Investment Trends report.

In summary, we wish to emphasise the value of financial advice for fund members, and the need to ensure that a framework is in place for fund members to have easy access to affordable and quality financial advice, and choice and control over the provision and payment of advice.

In this regard, we make the following specific recommendations concerning the framework for financial advice about superannuation:

Recommendation: If the Review recommends legislative reform concerning the provision of financial advice in superannuation, IFSA recommends that the Review Panel specifically acknowledges the intent, operation and effect of IFSA's Superannuation Member Charter, which will come into effect on 1 July 2010, and which is mandatory for IFSA members from 1 July 2012.

Recommendation: IFSA recommends that all fees (up-front and ongoing) for financial advice should be tax deductible.

10.1 Compulsory or voluntary insurance

Should the minimum level of cover required in a default fund (or a 'universal fund' under the choice architecture model) be tailored to other factors such as family situation and financial circumstances? Should the amount of cover be maintained or indexed, presumably with the cost of cover increasing with age, or should a constant insurance fee be applied with the insured benefit decreasing with age?

Superannuation has proved to be an important vehicle through which a majority of working Australians are able to economically access some level of life insurance cover. Group life insurance sold in conjunction with superannuation funds accounts for approximately 80 per cent of life insurance business in Australia.[2] Further, a survey of IFSA members showed that in 2009 there were 8130 claims paid totalling more than $730m.

IFSA believes that, at a minimum, there should be a default level of life insurance for those in the default fund category. However, consideration of other factors such as family situation and financial circumstances should not be mandated in any fund. In default fund arrangements generally there is insufficient information about the

[2] Austrade, *Insurance in Australia*, 2009, p.19

member to determine the appropriate benefit and/or level of cover. In other cases, the fund membership can be so diverse as to make this ineffective and potentially cost prohibitive to implement.

Trustees, with their knowledge of fund style and membership, are in the best position to determine the appropriate default benefit design (beyond minimum life insurance levels) and additional features that members may wish to add on to ensure cover is both appropriate and affordable. This ensures there is a balance between retirement savings accumulated through investment and protection of those savings and/or earning capacity prior to age-based retirement.

Trustees also have access to expertise in the insurance, consulting and actuarial markets to optimise benefit design. In this respect Trustees will determine whether default cover includes indexation and other benefits such as the level of TPD or income protection, premium rate structure. This will be based on the membership profile including risk factors such as occupation, previous claims experience, demographic mix and what the insurance market will support.

Should all members be able to opt out of insurance? Should funds be permitted, for example, to offer life insurance as an opt-in default for young, single members? Should commissions be payable on default fund life insurance? If so, why?

A fundamental premise behind low cost, easily accessible group insurance cover is that everyone is insured thereby eliminating the need for individual underwriting. The default approach eliminates any anti-selection and therefore reduces the likelihood that only those with a high probability of claiming will retain insurance which would in turn increase premium rates and make cover less affordable. However, it is also recognised not everyone needs insurance cover or they may have cover sourced through other means and therefore members should be able to opt out of insurance.

Importantly, an “opt in” approach without underwriting has a number of risks. Generally only those who think they might claim will take up the cover and more often members, particularly those in a default fund, don’t exercise that right and therefore are uninsured despite having a need. While there are some younger people who may not have a need for life insurance there are many who do. An “opt in” option for young members would likely result in many younger people not maintaining cover and therefore not getting used to the discipline of having cover as they get to a point where it is needed. The “opt in” approach therefore introduces selection risk, dramatically increasing the need for insurers to require member health information before agreeing to provide cover. This is likely to result in higher premium costs and a lower take-up of insurance cover.

All payments whether they are fees or commissions for advice should be fully disclosed to members ensuring a transparent advice process. Commission may be the only practical way an adviser can be remunerated for their services. Generally they will work with the Trustee to facilitate the selection of the most effective group insurance cover and often provide services in the event of a claim.

In these circumstances the Trustee in negotiating the group insurance arrangements, has a fiduciary obligation to act in the best interests of the members and should be able to negotiate direct with the adviser or insurer and agree appropriate fee or commission arrangements.

APRA data indicate that the annual cost of life and total and permanent disability (**TPD**) insurance exceeds $2.4 billion for APRA-regulated funds with more than four members.

Should default funds also be required to offer TPD cover in addition to death cover?

TPD cover is already offered by many funds today and it is our view that it could be a compulsory insurance component in default funds. It is a relatively low cost benefit and one for which significant benefits have been paid, illustrating its relevance to members. A survey of IFSA members revealed 5901 claims were paid in 2009 in TPD benefits worth over $350m. TPD is a product which is of most relevance to younger members as they are generally exposed to greater risk of accidents. Yet it is this demographic group which is most likely to not take it up if it is optional.

If TPD were to be a compulsory benefit component in default funds it could be mandated in the same way as life cover is currently as per the requirements prescribed in regulation 9a of the Superannuation Guarantee (Administration) Regulations 1993. This provides that an employer's default fund must offer the minimum death cover prescribed by either an age based scale or a minimum premium per week.

Recommendation: IFSA recommends that default funds should be required to offer a minimum level of TPD cover to members in addition to death cover.

What are the drivers of a fund's proceeds ratio? Are there ways that death and TPD insurance could be provided more cheaply to members? Are the apparently wide variations in proceeds ratios between fund types explained solely by occupational, socio-economic and demographic factors?

The Issues Paper at page 9, states that over the four years to June 2008 the ratio of proceeds to net premiums for all funds averaged around 44 per cent. This statement was taken from "Table 3: Ratio of proceeds to net premiums by fund type" which has been drawn from data contained in APRA publications.

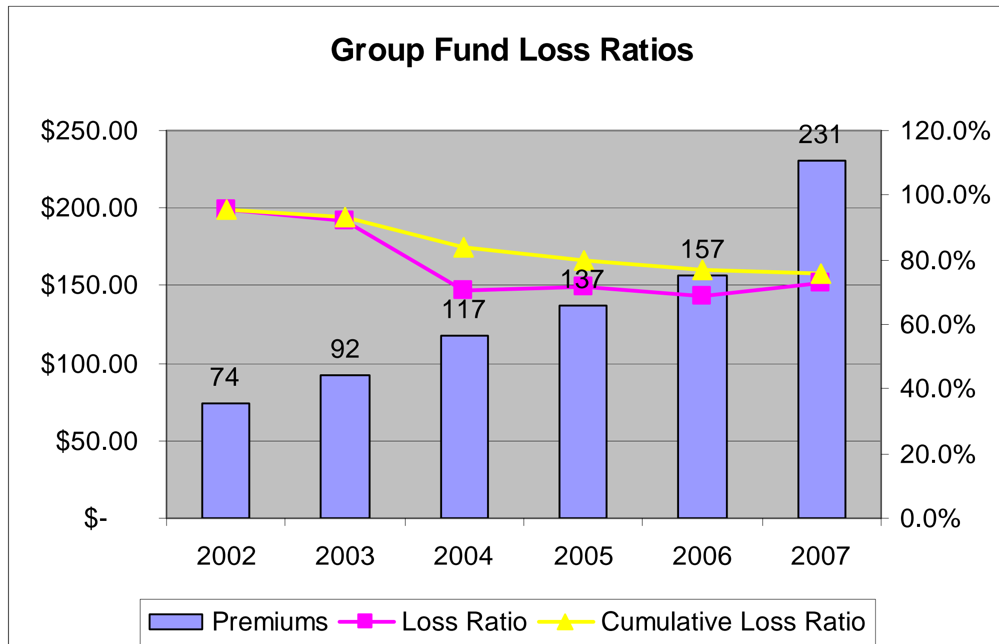
IFSA believes that the 44 per cent "proceeds ratio" statement highly is misleading. As the Issues Paper rightly points out, this table compares the gross premiums received with claims paid, however, it should be noted that there is a mismatch in the timing of premiums/claims as they may not reflect the payments attributable to each of the financial years. Additionally, the gross premiums received should include an allowance for the fund's administration fees, costs, expenses and may also comprise a profit share component. It appears that these components have not been included in the calculations in Table 3 in effect, overstating the proceeds ratio.

In addition to the above point, there does not appear to be any allowance for incurred but not reported (IBNR) claims. The claims reporting delay of funds run as long as one year for death and two years for TPD (sometimes significantly longer). It is not clear if this table includes Group Life, Group Salary Continuance (GSC) insurance or both. This is also likely to impact the overall loss ratio result.

As part of this exercise, IFSA has reviewed the Group Life loss ratios of thirteen random group insurance funds. These are a mixture of funds of various size, industries, sectors (corporate/public/government) and geographical locations. Most of these funds were tendered in the market in the last two years and hence most of the required assumptions (such as IBNR provisions) form part of determining the overall loss ratio.

Summary of the thirteen funds:

- As at 2008, more than 2.3 million insured members with $236b Death & TPD sum assured. Average sum assured per member of approx $100k.
- 6 year FY02-FY07 loss ratio of 75.8%.
- Premiums are net of fees, commissions, expenses and profit share loadings where the information was available.
- Claims include an allowance for IBNR - Approximately 11% of the total claims cost.
- The largest 5 funds account for 86% of the total premium volume. The FY02-FY07 loss ratio for these top five funds was 77.4%.
- The FY02-FY07 loss ratio for the other 8 funds was 66.3%.



Based upon the above data the proceeds ratio of the funds reviewed was in excess of 70 per cent which, in IFSA's view, represents a reasonable level. Generally, premium costs are driven by competition and statistical volatility but are also affected by short term issues such as economic cycles and demographic changes.

Ultimately the best way to reduce premium rates is to improve access and flexibility for insurers and to expand the pool of insured members.

10.2 Self insurance

Given the lack of capital and insurance expertise available to superannuation funds, in contrast to life insurers; having defined contribution funds self-insure opens the risk that members will bear an inequitable cost of establishing insurance reserves or funding insurance payouts.

Is it in members' best financial interests for certain superannuation funds to continue to be allowed to self insure death and TPD benefits? Should defined contribution funds ever be allowed to self insure death and TPD benefits?

IFSA does not believe that self insurance should be encouraged within superannuation funds – be they defined contribution or defined benefit funds.

Capital & Reserving Requirements

Registered Life Insurers are subject to strict capital and reserving requirements and are at all times required to have sufficient funds to meet all potential liabilities. Insurers are required to hold reserves sufficient to meet solvency requirements and are required to notify APRA if their reserves fall below certain levels. Most insurers have a buffer above the minimum solvency requirement in order to meet unexpected liabilities.
The way insurers invest reserves is also subject to regulation and insurers are not, for example, allowed to invest reserves in high risk asset classes. They are required to have liquid investments in order to meet liabilities.

Consistent Regulation and Protection

If self insurance is to be considered as a viable option for superannuation funds, those funds should be subject to the same regulation and consumer protection requirements that apply to ordinary insurers. Any self insured fund should be required to hold catastrophe reinsurance cover, capital reserves, meet the same capital and reserve requirements as insurers, and have in place pandemic risk plans etc.

IFSA believes that because a self insured fund (or their employer sponsor) is acting as an insurer, they should be subject to the same regulation and capital requirements as an insurer. To ensure a level playing field they should also be subject to the same tax and stamp duty imposts as insurers, and be required to quarantine capital and reserves in statutory funds set up solely for that purpose. This will ensure that members' interests are protected from financial failure of the employer, but will also make the high costs of entry prohibitive for smaller employer sponsors as significant amounts of capital will be tied up as part of the protection mechanisms required to ensure that liabilities can be met when they arise.

Registered Life Insurer required for Public Offer funds

APRA requires a superannuation fund to be insured by a registered life insurer if the fund is to be a public offer superannuation fund. Allowing self insurance would go against this directive or would mean that members who leave employment would have to join another fund rather than become a retained member within the public offer section of the employer-sponsored fund.

Expertise and Resourcing

The level of insurance expertise required to run an effective insurance arrangement does not generally exist within superannuation funds or large employer entities that operate funds on behalf of their employees.

Insurers employ numerous specialist staff including actuaries, claims assessors, underwriters, insurance lawyers and product specialists. There is a finite number of skilled resources such as these in the Australian market and a shortage of appropriately skilled and trained talent often occurs within the insurance industry itself as insurers vie for skilled resources. Were large employer groups to self insure, this finite group of skilled resources would be further stretched.

In addition, these resources generally operate co-operatively in designing the product, pricing and service offerings provided by insurers. The experience in one sector of expertise informs the other in order for insurers to provide the type and level of service that they offer. These groups cannot operate independently of one another.

Skilled resources are also expensive and aside from the limited availability of resources such as insurance actuaries the funds who received approval to self insure would suffer a significant increase in costs if they were to employ staff in-house. Alternatively, their costs for using consultants would increase significantly. Insurers on the other hand are able to utilise these resources across large client bases benefiting from broader economies of scale and scope.

Pooling of Risks

Concentration risk is a key issue that requires consideration when self-insuring. Insurers ‘pool’ risks from multiple sectors of the labour market and are thus able to absorb poor experience in some sectors as other sectors will perform well. Insurers are able to ride out downturns through reserving, diversification, and appropriate use of reinsurance.

Large employer groups who run their own superannuation funds generally operate within one segment of the market (e.g. manufacturing, health, sport & tourism, food) so a downturn in that one sector could have catastrophic effects on the ability of the self insured trustee to meet their obligations to members.

Equity issues also arise in that ‘surpluses’ from good years would be distributed to current members, whereas losses from poor years would be funded by members who were perhaps not members at the time the losses were incurred, thus reducing their retirement benefits.

In addition to the stringent capital requirements that insurers are subject to, insurers generally have other sources of available capital to meet liabilities. An employer run superannuation scheme may not have sufficient capital to prop up any financial shortfall or may be unwilling to do so in the event that high claim costs are experienced.

Competition

It has been contemplated by the industry funds sector that self insurance may lead to better pricing for members, especially when funds combine their membership under one pool of lives.

Interestingly, because industry funds compete amongst themselves based on various criteria, one of which is their differentiated insurance offerings, where a generic arrangement was to be set up, the differentiation provided by different funds negotiating different deals with their insurers, would cease to exist.

Large employer-sponsored superannuation funds and industry superannuation funds are able to command highly competitive insurance arrangements because of their size and competition amongst insurers. The number of insurers competing in the group market means that insurers compete amongst themselves for business and the past three years in particular have seen some very competitive arrangements negotiated.

The costs of providing insurance needs to be viewed over a business cycle of at least ten years to allow for ups and downs in experience and adequate provision needs to be made for reserves for later reported claims. For this reason, competition needs to be allowed to take place within strict regulatory bounds.

Is there any reason that defined benefit funds (and sub plans) shouldn't be allowed to self insure death and TPD benefits so long as actuarial advice is obtained on the funding needed and APRA is satisfied as to the financial strength of the employer? Would this lead to costs savings for employers and members?

Even if the financial strength of the employer is sufficient to support self insurance, the risk of failure of the employer remains. Unless the employer is subject to the same regulatory requirements as an insurer (see previous section), then there remains a higher chance of an employer being unable to meet liabilities that arise from Death or TPD claims by members.

Most superannuation funds also offer income protection cover and the reserving requirements for this type of business are very high. Insurers are potentially required to replace a person's income for up to forty five years in the case of long term income protection cover and unless self insurance was also contemplated for this type of cover (in addition to the Death and TPD cover mentioned above), then defined benefit funds would still need to deal with an insurer in any event.

The risks of self insurance outlined in the previous section, combined with the competitiveness of the Australian insurance market are unlikely to result in any significant cost savings to employers or members. The capital and reserving requirements which these funds should also be subject to (allowing for high concentration risk, little diversification), are likely to make the costs for employers and members higher than they are at present. This significant cost, combined with the additional costs of employing resources or instructing third party consultants, is likely to make self insurance a very unattractive proposition for an employer, irrespective of their size.

Aside from the financial issues discussed above, employers are not experts in insurance. They run supermarkets or manufacture products or provide services, and lack expertise in claims management, pricing, legal and product. A lack of skilled resources would most likely lead to an increase in claims costs and higher 'premium costs' for members or employers because claims costs will rise where the expertise in assessment is not available.

Innovation in product design and service levels is also likely to suffer from a more fragmented insurance market.

Recommendation: IFSA recommends that superannuation funds wishing to self-insure death and disability benefits for their members must be subject to the same prudential regulation requirements as insurance companies – including meeting capital and reserving requirements. Such protections serve the best interests of their members

10.3 Income protection

There is a range of views as to whether and to what extent income protection insurance should be embedded in superannuation.

What is the right approach here?

IFSA believes that income protection insurance should remain as one of the options available to members to meet their needs in the event of serious incapacity which constrains their income earning ability.

Income protection insurance is currently provided both as an "opt in" and as "default" by a number of funds. It is seen by many of those members as a valuable part of their superannuation, protecting their savings pool for retirement or, in the event of a prior disability, a continuation of their income for specified periods which may extend to retirement.

Income protection insurance can provide an income for short term incapacities as well as in cases where the member is permanently incapacitated.

Depending upon personal circumstances, IFSA acknowledges that current tax treatment of disability income premiums can make the provision of income benefits through superannuation less attractive to some members than provision outside the superannuation system.

Premiums for non-superannuation disability income insurance are tax deductible whether they are paid by the employer or the employee. Where provided through superannuation, the premium is deductible to the employer but is not deductible to the employee unless they are self-employed, earn less than ten per cent of their total income from employment, or can arrange to pay the contribution via salary sacrifice.

In a significant number of cases insurance costs in superannuation are met from deductible employer premiums, deductible superannuation contributions for those who are eligible to claim, or those who can salary sacrifice. In both super and non-super arrangements the income stream payable is tax assessable to the recipient.

Even for those where income protection insurance through superannuation is less tax effective than outside, this is often outweighed by the fact that, without the option of funding the cost of insurance through superannuation, they will not be protected. When a member is ill or injured, their income would run out after cessation of their accrued sick leave. They would then be reliant on the government's Disability Support Pension or Sickness Allowance thus placing a strain on public revenue.

Furthermore, where group arrangements are in place, premium rates are often discounted due to scale. Trustees also have the capacity to offset premiums with the value of deductions so, for many (including those on low marginal rates, who may also qualify for a co-contribution for personal non-deductible contributions) the provision of insurance through super can be both socially important and relatively tax effective.

Income protection insurance usually provides a benefit of up to seventy five per cent of salary. Another advantage of this type of insurance is that the benefit can be structured to specifically allocate a portion of the regular benefit (say, five per cent) to help grow the member's superannuation fund account balance whilst they are out of the workforce due to disability. This then ensures that the member is still saving for later retirement even whilst on claim.

For the reasons outlined above IFSA believes that income protection should remain as an option available to fund members in the event of accident or illness that constrains their income earning ability.

10.4 Other pooling ideas

Given the apparent cost of life and TPD insurance to the superannuation sector as a whole, are there more radical ways to address the need for super fund members to have life insurance? How could super funds create sufficient risk pools to be able to underwrite such insurance themselves?

According to APRA there are currently thirty-two registered life insurers operating in Australia, which has resulted in a highly competitive and therefore efficient market. IFSA believes the high contestability of this market has resulted in the provision of both life and TPD insurance at levels which are reasonable and appropriate for reasons already discussed.

We consider that whilst some superannuation funds may already be large enough to underwrite insurance themselves, the issues outlined in our response to paragraph 10.2 would need to be carefully considered.

Indeed, self-insurance will not necessarily unlock the full difference between the premiums currently paid and the claims proceeds as additional administrative costs will be incurred and an allowance for future claim payments of current claims and those incurred but not yet reported needs to be made.

11. Super in post-retirement phase

The Australia's Future Tax System (**Henry**) review is considering the types of products available and the appropriate role for Government in assisting with the development of products which insure against longevity risk.

Should more be done to address financial risk in retirement, rather than just longevity risk? Alternatively, should more be done to ensure that post-retirement assets are not invested too conservatively?

IFSA supports modifications to the regulatory framework to better facilitate product development in managing longevity risk and other financial risks risk (e.g. – guaranteed lifetime withdrawal benefit products, otherwise referred to as variable annuities, deferred annuities and other capital protected products) while maintaining competitive neutrality between different product offerings and regulatory requirements.

In the area of longevity risk, the following changes could be considered to facilitate product development in the interests of members:

- Modification or reduction of the capital standards for annuities to recognise developments in risk management approaches and hedging;
- APRA could change the amount that can be ceded to a reinsurer for longevity protection without restrictive capital requirements, for example from 25 per cent to 50 per cent;

- Government could issue long duration, longevity bonds to facilitate asset-liability matching requirement; and
- Tax rules could be modified to extend the current pension asset tax exemption to a portion of assets set aside to fund longevity insurance, such as a deferred income stream which commences at a future age.

In addition to product innovation, IFSA believes that one of the keys to appropriate investment decisions/asset allocation during retirement is access to personal financial advice. It is our view that financial advice will necessarily play a vital role in ensuring that individuals make informed decisions about how best to manage the drawdown phase of their superannuation.

In Chile, retirees with lump sums are able to get quotes from an online blind auction system (SCOMP)20 where up to 23 insurers can submit proposals of annuity terms specific to that retiree (i.e. based on age, amount to invest, gender and so on). The retiree can then compare the best proposals against other options, including a staged drawdown of their lump sum. The system is aimed at fostering competition between providers and better transparency for consumers.

Would a similar system in Australia increase the attractiveness of guaranteed annuities for retirees?

IFSA does not support direct Government intervention in the market for annuities. Should the market for annuities evolve (subject to the enhancements suggested above and below) we believe an efficient market mechanism will emerge. In any event, such a website will always be limited as it cannot provide individually tailored financial advice to ensure individuals take out an appropriate product, understanding the risks and benefits of that product.

What else can be done to improve the availability of retirement income stream products in the Australian market (such as indexed annuities and deferred annuities)?

IFSA supports allowing retirees to choose whether or not to insure themselves against longevity risk.

The private sector has successfully provided annuity products to Australian retirees for many decades. While in recent years there has been a significant decline in demand for these products, this does not mean that the private sector is unable to, or unwilling to meet longevity risk demands in the future. Indeed, presently there are private sector offerings in the market place available from a number of different providers.

In order to facilitate the greater availability of retirement income stream products in the market, IFSA supports removing inappropriate barriers to the development of such products. These changes could include:

a) Maximum drawdown limits for superannuation income streams should be introduced in a product neutral way;

b) Drawdowns above the maximum drawdown limit should be subject to penalties (rather than being prohibited). However, all retirees should retain the flexibility to withdraw a lump sum up to a fixed amount without penalty; and

c) Any approach should maintain the current consistency of treatment between superannuation pensions and annuities.

Access to investments and regulatory capital requirements

The long-term nature of annuities and the regular income payments to be made mean that accessing stable and secure assets are crucial for the product provider to manage asset and liability mismatch risk as effectively as possible. The recent financial crisis highlights the difficulty in finding suitable quality, long dated assets to support the provision of annuity products.

IFSA therefore recommends that the Government consider issuing, on an ongoing basis, additional longer-dated, CPI-linked bonds specifically designed to support the retirement income stream products, as well as reviewing regulatory capital requirements.

Recommendation: IFSA recommends that the Government commits to issuing further longer-dated, CPI-linked bonds specifically designed to support the annuity market, as well as reviewing regulatory capital requirements to ensure they do not present an inappropriate barrier to the provision of retirement income products.

11.1 Collective pension schemes

Is there room for another model in Australian superannuation, being a model that sits in between the defined benefit model on the one hand and the defined contribution model on the other? Is such a model viable in the face of an ageing population?

IFSA does not see a role for this approach given the success of the current system. The existing superannuation system has near universal coverage and the market provides a broad range of appropriate superannuation products.

11.2 Pension components of super funds

The risk profile, tax treatment and liquidity needs of those drawing a pension from a superannuation fund are all likely to be different from those of members in the accumulation phase.

Should it be mandatory for trustees to manage pension assets separately from accumulation assets? If not, why not? If yes, what are the specific benefits that would be derived and what additional costs might be incurred? Should there be limits to ensure member level diversification in order for income streams to be paid as required?

Given increasing life expectancies, asset allocation in retirement should not differ substantially than during accumulation in many cases. IFSA members already manage pension and accumulation assets separately. We would not support this proposal if it meant disrupting the industry's ability to interfund into the same underlying wholesale pool, although it is not clear that this is what the paper is proposing.

14.1 Allocation of members to default funds: role of industrial awards

Is the industrial relations mechanism the best way to allocate employees to a default superannuation fund? If not, what other mechanisms might be adopted to improve outcomes for members?

IFSA's view is that specific superannuation funds should not be nominated as the default superannuation fund in modern awards. This would ensure maximum flexibility to allow employees and employers to determine the most appropriate superannuation fund for their workplace without having their choice limited by industrial awards.

IFSA fundamentally believes that competition drives improvements in superannuation fund offerings and efficiency and puts significant downward pressure on fees. The current arrangements for default fund selection and approval are anti-competitive and there is now increasing evidence that fund members are not receiving optimal outcomes under these arrangements.

Recommendation: IFSA recommends that:

a) the process for selecting default funds for award-covered employees should be reviewed and modified;

b) employers should be required, for award-covered employees, to choose a default fund on the basis of a specified list of criteria; and

c) competition among default funds should be further enhanced – not diminished.

14.3 Risk-sharing

Currently, the investment risk in the accumulation phase of superannuation rests mostly with the individual.

Should the Government assume some of this risk, given that it largely underwrites both investment risk and longevity risk in retirement by way of the age pension?

Should the Government provide some additional certainty to alleviate individual anxiety in volatile financial markets? How could this be offered without representing an undue burden on the Budget?

Should the structure of superannuation include some defined benefit features, rather than solely an accumulation approach? Who could underwrite the defined benefit component?

Could default funds be required or encouraged to incorporate an investment fluctuation reserve into their default investment option, so as to allow a more aggressive investment approach without a commensurate increase in volatility? How might they address free-riding, where individuals select a fund after its investment reserve had been built up?

How costly would it be to administer a scheme whereby entitlement to share in reserve distributions vested progressively over a period of, say, five years?

Superannuation funds already diversify their investments across different classes of assets with different risks and different rates of return. Members also have the option of choosing an investment option that reflects their risk profile – thus managing their exposure to investment risk.

A key factor for individuals is that they receive good financial advice so that they make good decisions in the face of market fluctuations and to alleviate individual anxiety. Further, a financial advisor can ensure that individuals choose an investment option that reflects their views on risk and return. In this way, they can choose an option that minimises their anxiety around market fluctuations.

Investment fluctuation reserves are inequitable and would be open to miss-use through arbitrage. Individuals could join the fund when the actual rate of return is below that offered by the fund due to the fluctuation reserve and move in and out of funds to take advantage of fluctuations in returns relative to the fluctuation reserve.

14.4 Capital requirements

Given the important societal role that superannuation plays and the significant operational risks that all trustees must manage, as a matter of protection for members, should capital be required for all trustees of super funds other than SMSFs? If so, what sort of risk factors ought to be considered in setting capital requirements?

What amount of capital should be required? Should a public offer trustee without capital of its own be able to continue to rely on an approved guarantee or the fact that its custodian may have the $5 million capital backing?

Should a custodian be required to have the minimum capital requirement in its own right, rather than being able to continue to rely on an approved guarantee?

Currently, the same $5 million is required for the custodian whether they are being relied upon by one trustee or many.

Should the capital required for custodians be related to the number of fund trustees that rely on that custodian in meeting the trustee's capital requirements, and the assets they hold?

Superannuation funds face a number of risks which must be managed. Operational risk is one of the most significant of these risks and this includes the risk of errors with unit pricing or crediting rates when striking regular valuations and allocating earnings for members' interests in the fund, fraud or business disruption.

The capital requirements contained in the SIS legislation include a requirement for trustees to hold, or have access to, $5 million in net tangible assets. However, this is simply a base level capital requirement and is arguably insufficient. As a result of other regulatory obligations, large financial institutions must also assess and quantify each of the risks associated with running its various businesses (including operational and institutional risk of running a superannuation fund). This then informs the level of economic capital necessary for the institution to access in case it is necessary to meet claims as a result of a failure to effectively manage these risks.

IFSA therefore considers that the existing $5 million capital requirement is inadequate and that economic capital should be assessed and allocated by considering the following components:

(1) operational & regulatory risk;

(2) market risk;

(3) credit risk;

(4) insurance risk;

(5) strategic risk; and

(6) fixed assets.

By way of example of how significant operational risks can be, in 2007 APRA reported that the compensation bill for unit pricing errors had reached a total of $750 million for the industry. At the time Deputy Chairman of APRA, Ross Jones, commented that to that point in time all unit pricing errors which had been discovered had involved retail funds with the capital backing of institutions.[3] This capital backing meant full and proper restitution was able to be provided to members at no cost to them. The losses were effectively covered by the capital of those institutions rather than cross-subsidisation between members.

Given the discussion above, the Panel should carefully consider recommendation 1 from IFSA's submission to Phase 1 of the Review: that the Government endorse the current structure, operation and governance of Australia's superannuation system and:

(a) reviews capital requirements for superannuation trustees;

(b) review payment, portability and asset valuation requirements under SIS; and

(c) introduces uniform unit-pricing standards for all public offer APRA regulated superannuation funds.

Recommendation: IFSA recommends that the Government endorses the current structure, operation and governance of Australia's superannuation system and:

a) reviews capital requirements for superannuation trustees;

b) review payment, portability and asset valuation requirements under SIS; and

c) introduces uniform unit-pricing standards for all public offer APRA regulated superannuation funds.

14.5 Source of permanent capital

Would it assist super funds to be able to create a listed entity or entities which could hold longer-horizon assets, such as infrastructure, providing permanent capital for such investments?

Are there impediments to this sort of structure under current settings? What other issues arise?

Superannuation funds already invest billions of dollars in infrastructure, in Australia and overseas. As far as we are aware there is no market failure or impediment that needs to be rectified for superannuation funds to invest in infrastructure. We are therefore uncertain that there is a need for the type of structure suggested in this question.

[3] PJC into Corporations and Financial Services, Review of the Operation of SIS, Hansard p 43, testimony of Andrew Gale, Trowbridge Deloitte

PART B: SMSF ISSUES

Introduction to Self Managed Superannuation Funds

IFSA supports the availability of Self Managed Superannuation Funds (SMSFs) as we believe in the value of choice and competition in the superannuation system. We also note that IFSA members provide a wide range of products and services directly to the SMSF sector.

Since their introduction in 1999, SMSFs have grown to represent the largest sector of the superannuation industry (30.8%).[4] The sector has experienced rapid growth over that period but there is now some evidence that it may have peaked as a proportion of the total sector, with its share estimated to decline to 26.3% by June 2014.[5]

Despite this decline, market projections report SMSFs continuing to grow at a compound annual growth rate of 13.9%[6] over the next 10 years, remaining the second fastest growing sector in the market.

This still represents a highly significant proportion of total superannuation assets and needs to be monitored accordingly.

Whilst IFSA's overarching view is that the regulatory regime governing SMSFs is largely sound, there are some areas where the integrity of the system could be significantly improved without imposing an undue burden on trustees.

Specifically, removing the current Australian Financial Services License exemption for accountants would provide significantly higher levels of consumer protection through the provision of licensed advice and ASIC oversight, as well as the extension of protections afforded under the Corporations Act, such as access to external dispute resolution services and cooling-off rights.

Removal of the exemption would also provide a level playing field for all providers of advice to the SMSF sector.

Another example of a regulatory gap is the lack of regulation of auditors of SMSFs and administrative service providers. This is particularly concerning given the SMSF regulatory structure relies heavily upon external service providers, in particular upon auditors.

IFSA believes that registration of both auditors and administrative service providers should be introduced to ensure appropriate consumer protection mechanisms are in place.

[4] APRA Superannuation Statistics December 2009
[5] Rice Warner Actuaries Superannuation Market Projections (as at June 2009)
[6] Dynamics of the Australian Superannuation System, The next 20 years: 2009 – 2028 Deloitte Actuaries and Consultants March 2009

17.1 Trust Model

Is the trust model appropriate for SMSFs? Does it still deliver the best outcomes for trustees, members and the broader community? Are the current membership requirements in the SIS Act, requiring trustees to be members and all members to be trustees, still appropriate for SMSFs? Does the trust model work effectively for single member SMSFs?

IFSA considers that the trust model remains appropriate for members and trustees of SMSFs.

17.2.1 Trustee education

Given the obligations of being a trustee and the minimal barriers to entry, should there be some minimum level of financial and compliance knowledge required? Is there another way of addressing the issue of low trustee financial literacy, such as a mandated limitation on the products in which SMSFs, or some sub-set of SMSFs, are permitted to invest? Should trustees of SMSFs require some minimum level of training? Should SMSF members undergo some ongoing level of formal education and training or accreditation to become better educated on their trustee obligations and how to invest? If mandatory education is not required for SMSF trustees (as ATO questionnaire data might suggest is the case — see below), should voluntary training be encouraged? If so, how would this best be achieved? Should the ATO have the powers to impose training or accreditation requirements on SMSF trustees where they have breached SIS Act requirements?

IFSA believes that it would be more efficient and effective for regulators to ensure that the providers of services to SMSFs are appropriately trained and aware of trustee responsibilities, as opposed to focusing solely upon SMSF trustees.

In essence, resources would appear best directed at improving the training and competency of the approximately 10,000 service providers, as opposed to in excess of 400,000 fund trustees.

This should not deter the ATO from providing educational materials to trustees as they form a valuable part of the educational framework that SMSF trustees can access voluntarily. IFSA notes that the ATO is increasingly issuing voluntary materials for trustees.

Accordingly, IFSA submits that trustees of SMSFs should, as a voluntary measure, be offered a short course by the ATO along with a “best practice” education standard for SMSF trustees which could be overseen by the ATO or ASIC.

The best practice standard should include content on:
- superannuation and financial literacy competencies;

- the obligations for trustees under the SIS Act'
- the importance of appropriate investment strategies and fund objectives, including a basic understanding of asset allocation and diversification; and
- consideration of the costs involved in running the fund.

Additionally, where a trustee has been found to have materially breached their obligations under the SIS Act, IFSA believes that the ATO could impose a compulsory education requirement as a penalty mechanism aimed at improving future compliance.

Recommendation: IFSA recommends the ATO establish a best practice standard of voluntary education for SMSF trustees.

17.4.1 Regulation

Should there be separate Acts for ATO-regulated funds and APRA-regulated funds?

IFSA does not believe separate Acts for ATO-regulated funds and APRA regulated funds is required or desirable.

IFSA believes that the key provisions within the SIS Act, such as the covenants deemed to apply to all superannuation funds, combined with the general fiduciary support provided by the trust model, lead to appropriate outcomes for all types of superannuation funds.

Given the large number of funds that the ATO is regulating and the resources available to it for conducting audits, it is appropriate that the regulator rely on other parties (e.g. auditors) to ensure that the sector is compliant.

17.4.4 Penalties

Is the existing penalty regime that applies to SMSFs appropriate? Would a sliding scale of administrative penalties, that are applied against the trustees (jointly and severally), or enforced third party custody of fund assets, be more appropriate or useful adjuncts to the existing powers?

IFSA notes that the statement in the issues paper that the only penalties available are "rectification with no penalty, freeze the fund's assets …disqualify a person from being a trustee …or declare a fund non-complying or prosecuting the trustee members," appears somewhat outdated.

A new regime of administrative penalties was implemented from 1 July 2007 for various administrative breaches (e.g. failing to lodge returns on time).

The application of the administrative penalties is also combined with the ATO's risk assessment methodology, where greater penalties apply for severe or recurrent

breaches. While this gives the ATO some improved flexibility, it may still not be a sufficient deterrent in all cases – especially where the fine which can be imposed is only $5,500.

Presently, the ATO prefers issuing "undertakings" to SMSF trustees, where further penalties only apply if the undertaking is not actually complied with. IFSA believes that the present practice of issuing undertakings may therefore not be achieving its intended aims due to a lack of appropriate sanctions.

IFSA submits that streamlining trustee penalty provisions so that some become strict liability offences could be an effective approach. This should be considered as part of a program to enhance the penalty provisions to provide the regulator with an even broader range of penalties to apply.

IFSA supports penalty measures which may impact a trustee's control of their fund. For instance, where ongoing breaches have occurred, enforced third party custody of assets such as conversion to fund with a professional trustee could be an effective way in which to implement this proposal.

The Review Panel may also wish to consider measures that include greater use of orders preventing SMSFs from taking further contributions. For instance, where a breach occurs, acceptance of any further contributions would result in non-complying fund status.

As stated earlier in response to 17.2.1 Trustee Education, where a trustee has breached significant SIS provisions, IFSA believes it is reasonable that the ATO impose compulsory education requirements upon trustees.

Recommendation: IFSA recommends a wider range of graded penalties be introduced for trustees of SMSFs.

17.4.6 ATO Binding Rulings

Would there be any benefit in extending the legally binding ruling system to the SIS Act, which would be equivalent to the private ruling system for income tax? Should this extension also be applied to products marketed to SMSFs?

Provided that such a ruling system improved flexibility and certainty overall, IFSA believes that it should be extended to all forms of superannuation and not simply to SMSFs.

IFSA notes that such a ruling system would arguably be ineffective if it did not also extend to products offered to SMSFs.

18.1 Economies of Scale

Are SMSFs disadvantaged compared to APRA-regulated funds by their lack of scale because they cannot adequately defray fixed costs and cannot access certain investment products or markets or can only do so at uncompetitive prices? If so, are there measures that could be taken to reduce this disadvantage?

Based on ATO data and independent research, it does not appear that SMSFs, on average, are disadvantaged by their lack of scale. According to Rice Warner Actuaries, the average total expense ratio for SMSFs is 0.98% (2008).[7] This figure is competitive when compared to other market sectors.

IFSA believes that economies of scale in the sector would be best driven through the registration of administrative service providers – referred to in 21.5 Barrier to Entry.

18.2 Technology

Can more technology be applied to the operation of SMSFs to drive down costs, improve efficiency in administration and improve regulation? If so, how could it be applied?

In enhancing the technology underpinning SMSFs and the superannuation industry in general, considerably broader questions than those posed in the issues paper need to be considered. The prevailing processes and technology used throughout the superannuation industry for employer, employee and government contributions, along with rollovers, is outdated, inefficient and unnecessarily costly.

It remains the case that the regulatory settings preventing electronic transactions have hampered the development of a sophisticated payments clearing system which includes superannuation.

Instead of electronic transactions which can be found across other sectors of the banking and financial system, superannuation funds are almost completely reliant upon paper-based transactions. This is primarily because there is no architecture to support electronic clearing and contribution processing (unlike the banking payment clearing system or stock exchange).

Superannuation is in need of new architecture or 'plumbing' which is electronically based and capable of meeting the needs of all stakeholders.

IFSA supports the Australian Payment Clearing Association's (APCA) Low Value Payment Project (LVPP) which should, if delivered as planned, significantly enhance the sophistication of the payment system in Australia.

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[7] Rice Warner Actuaries Superannuation Fees Report December 2008

IFSA is working with APCA to ensure that the new system is sufficiently improved to withstand superannuation contributions and rollovers. The current payments system is not sophisticated enough to manage the complex data validation challenges posed by superannuation as compared to standard banking transactions.

The LVPP is based on a more sophisticated payment system which draws on the global ISO 20022 initiative. Importantly, the LVPP will provide for straight-through processing and represents an opportunity to move super payments around the system in a “point-to-point” manner, the most efficient method, rather than through a central hub or “clearing house”.

This is also a non-proprietary solution which is based on uniform electronic data standards being implemented across the superannuation industry.

Recommendation: IFSA recommends that industry and regulators support the Australian Payment Clearing Association’s project to modernise the payments system to include superannuation in an industry-wide solution encompassing SMSFs.

18.3 Data

Could more comparable questions be incorporated into the ATO and the APRA annual returns to enable better comparisons to be made, such as in the classification of asset classes and operating and performance figures?

SMSF annual returns must be lodged within 11 months of financial year-end, while APRA-regulated funds must file their returns within four months. ***For SMSF data to be meaningful, how quickly does it need to be reported? Would a shorter timeframe be achievable or appropriate?***

The Review recently released a publication titled ‘*A statistical Summary of self-managed superannuation funds*’. ***What other data or research on SMSFs is required and who should provide this?***

Is the ATO or APRA the most appropriate entity to collect and provide data in the marketplace, or should other market participants (non-government) be collecting and publishing data?

Data collection is an important element in informing, monitoring and the reporting of Australia’s financial services industry to interested parties. It should be noted that participants within the industry require data for varying purposes – i.e. participants’ needs will vary depending on their role in the industry.

Currently, the industry deals with AUSTRAC, the ABS, APRA, ASIC and the ATO in their respective data collection processes. IFSA’s view is that the government should consider minimising data collection duplication and the cost of providing data to regulators and government bodies.

The current quality and availability of SMSF data is generally sufficient for the purposes of sector analysis. The ATO publishes data based on annual returns on asset allocation, population size (members and funds), and size of fund and average assets.

In terms of enhancing the current collection of data, IFSA believes that the collection should be expanded to median fund size, whether advice is provided and levels of insurance cover.

However, if enhanced data in an SMSF context is desired by the regulator to improve supervisory capacity, IFSA submits that the ATO, as the regulator of SMSFs, would be best positioned to collect the data. However, it would be desirable for broader comparison purposes if APRA could include SMSF data in their publication of superannuation statistics.

Considering the risk of illegal early access schemes, data collection and analysis at the time of establishment and beyond is of vital importance to the integrity of the superannuation system. By referring to information of previously identified illegal early access funds, for example, trustee names, addresses and bank account details, at the time of setting up new funds, further incidents may be avoided. In addition, appropriate access to the collected information by other superannuation funds through the Super Fund Lookup tool will assist funds to prevent rollovers to funds being used to provide illegal early access.

18.4 Accounting standards

Should SMSFs be required to complete general-purpose financial reports so that assets are annually marked-to-market?

In relation to accounting standards and timing, the requirement for SAF trustees to complete the financial accounts for funds by the end of October in the same calendar year, rather than March of the following calendar year, presents problems for trustees. This is because often information required to complete the tax calculations for the fund are reliant on tax and financial accounts being finalised for the members of the fund and any private entities in which the fund invests.

Given that members and private entities are not required to complete their tax returns and/or financial accounts until March of the following calendar year, it would make more sense to align the reporting time frame for all DIY or small (i.e. both SMSFs and SAFs).

IFSA submits that the deadline could be brought forward from March to December to help spread the major reporting requirements across the year; however this would still pose some of the problems discussed above. Other types of superannuation funds are generally not as reliant on individual or private entity financial accounts to complete their tax and financial accounts, therefore their reporting time frames remain appropriate.

IFSA however supports any move to standardise the data requirements between all types of superannuation funds. This is on the provision it does not result in small funds becoming reporting entities required to complete general purpose financial accounts as opposed to special purpose accounts. We believe this would result in extra costs for small fund members and drive up average expense ratios.

We are of the view that the current practice of preparing accounts in accordance with market value ensures the financials are providing a true and fair view of the position of a fund to its members. Any further reporting requirements may in fact be counter-productive and confuse members, given the increasing complexity of financial accounting standards.

19.2 Asset Allocation & 19.3 Restrictions

What can be done to improve the access of SMSF members to quality information and advice? Would it assist SMSF members if there was more information available to help them understand asset allocation, diversification and other investment concepts? If so, how could this be delivered?

SMSFs have been over-represented among the creditors to several high profile corporate failures such as Westpoint, while the balance of the superannuation industry had very little exposure. ***Does this reflect a particular vulnerability for SMSFs in the face of commission-driven marketing by financial advisers? Does it reflect a structural weakness in SMSF operations or simply the different risk appetite of SMSF investors?***

Should SMSFs be required to invest funds in a certain manner within a specified time period or should it be left to the judgment of the trustees? Should there be restrictions on the investments that can be held by SMSFs? If so, should restrictions be mandatory or encouraged through incentives?

IFSA does not support any additional restrictions on the types of assets to be held within an SMSF. Members should be free to match their investment strategy to their risk profile and preferred investment vehicles whilst complying with requirements around in-house assets and related party transactions.

Given average life expectancy at retirement age and the liquidity of the types of assets held by the sector in general, i.e. listed equities and cash-like vehicles, IFSA does not see a high proportion of the sector being in the drawdown phase as a problem.

As indicated earlier, IFSA is supportive of any voluntary initiatives to increase trustee investment knowledge and awareness.

Finally, IFSA believes that removal of the AFS licensing exemption for accountants will likely increase the provision of financial advice to the SMSF sector by improving the access of SMSF members to regulated financial advice from the outset.

19.3.2 Leverage

Should leverage which places at risk an amount greater than the initial capital investment be permitted in SMSFs? If so, are the current exceptions to the borrowing prohibition suitable or have the most recent changes, which have allowed for installment warrant arrangements for assets other than shares, gone too far?

In respect of leverage the core question is not whether SMSFs should be allowed to have access to instalment warrants and other products, but whether a simpler manner of dealing with gearing could be adopted.

The ATO could provide further direction to SMSF trustees by including leverage guidance in the best practice standard for trustees as recommended in response to 17.2.1 Trustee Education.

Leverage parameters should be consistent with the investment strategy as set by the trustee. Trustees using leverage should therefore include their gearing intention in the investment strategy when establishing an SMSF.

19.4 Investment Strategies

Is there benefit to be gained in seeking to increase the regulatory burden here or should it be presumed that self-interest will prevail to see the appropriate investment strategies undertaken?

There is a clear requirement to have an investment strategy in an SMSF, however the current legislative settings provide unclear guidance as to whether an investment strategy needs to be documented in writing.

IFSA's view is that it should be unambiguous that investment strategies must be in writing. It would also assist trustees if the ATO could provide templates of what it considers to be appropriate examples of investment strategies.

20.1.1 Accountants' exemption

Should all SMSFs be required to use at least one key service provider licensed by ASIC? Is the existing accountants' exemption appropriate and should it be maintained, or should it be broadened as per the recommendation by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) report?

Removing the current Australian Financial Services License exemption for accountants would provide significantly higher levels of consumer protection through the provision of licensed advice and ASIC oversight, as well as the extension of protections afforded under the Corporations Act, including access to external dispute resolution services and cooling-off rights.

Removal of the exemption would also provide a level playing field for all providers of advice to the SMSF sector. IFSA believes that it is inappropriate for accountants to receive special treatment and continue to be allowed to provide unlicensed financial advice to SMSF trustees.

We note that the accountants' licensing 'carve out' was originally based on a position that the establishment of an SMSF regularly forms part of an overall business strategy, including other advice not covered by financial services regulation (i.e. business structuring and taxation advice). However, we submit that the decision to establish a SMSF (vis-à-vis another superannuation structure) is an investment decision and will impact an individual's retirement and future economic well being.

All participants in the broader financial advice sector require specialist knowledge, in particular knowledge of the SIS Act and Regulations and their application to SMSFs. Unless accountants have completed formal education in this area as part of, or in addition to, their basic qualifications in their field, they could be ill-equipped to comprehend the relevant requirements.

Similarly, financial advisers require specialist knowledge of the SIS Act and Regulations and the relevant taxation and taxation administration provisions which is beyond the legal requirements when providing advice on APRA regulated funds.

SMSFs are different for the following reasons:

- There are certain provisions in the SIS Act and Regulations which only apply to SMSFs (e.g. fund structure; trusteeship; membership; certain investment provisions);
- SMSFs are exempted from compliance with certain provisions in the SIS Act and Regulations (eg. Exercise of discretions (SIS Act s.59); internal and external complaints resolution requirements; benefit protection standards); and
- Certain provisions in the SIS Act and Regulations, while available to all superannuation arrangements, are more readily able to be implemented in a SMSF due to the structure of this type of fund (e.g. in specie contributions; direct property investments; complex death benefit nominations; limited recourse borrowings).

As a longstanding advocate of the value of quality advice, IFSA strongly supports the removal of the accountants licence exemption. Its abolition would deliver higher levels of consumer protection and a level playing field for providers of financial advice.

Recommendation: IFSA recommends that the financial licence exemption granted to members of professional accounting bodies when establishing SMSFs be abolished.

20.2 Auditors

The ATO estimates that there were approximately 11,500 approved auditors who conducted an SMSF audit for the 2007 financial year. Half of those auditors audited less than five SMSFs, covering around 3 per cent of the SMSF population.

Approved auditors play a key role in regulating SMSFs because, between them, they have 100 per cent annual coverage of the SMSF sector — undertaking an annual financial and compliance audit of each and every SMSF.

Comprehensive regulatory oversight and compliance coverage of superannuation funds is an integral element of Australia's retirement income system. It is for this reason that SMSFs must currently be audited on an annual basis without qualification.

As SMSFs must be audited annually, IFSA believes that it would be unnecessary to universally apply the ATO's compliance process across the broader SMSF population. It would be prohibitively expensive for the ATO to undertake extensive compliance activities on each and every SMSF. In any event, such activities would also be duplicative as auditors are already required to audit SMSFs annually.

Compliance coverage of the SMSF population is currently achieved through approved auditors undertaking annual audits, with the ATO subsequently relying upon the audits.
As auditing bears significant importance from a regulatory viewpoint, the quality of the auditing should be a key concern. IFSA's view is that auditors conducting SMSF audits should not be generalist auditors without appropriate SMSF related expertise.

According to ATO data quoted in the accompanying statistical summary of the Super System Review, 51% of auditors performed less than five SMSF audits in the financial year ending 30 June 2008.[8] The quoted figures demonstrate that it is unlikely that enough auditors possess the requisite specialisation to be undertaking SMSF audits.

IFSA therefore welcomes the competency standards jointly released by CPA Australia, the Institute of Chartered Accountants and the National Institute of Accountants in 2008 as an essential self regulatory initiative to begin improving the audit quality amongst auditors drawn from the traditional accounting bodies.

[8] Statistical summary of SMSFs (Super System Review) – Page 7

We further welcome the Self Managed Super Fund Professionals Association of Australia's (SPAA) work in the field of SMSF auditing amongst their members – SPAA has devised a rigorous training program for attaining SPAA Approved or Specialist status which is based on structured training, practical experience and continuing professional education.

Specifically, IFSA welcomes SPAA's work in enhancing audit standards through their requirement to abide by SPAA Standards, undertake examinations and carry out a minimum level of SMSF audits annually.

SPAA's work has led to the Minister for Financial Services, Superannuation and Corporate Law tabling a Regulation including SPAA registered auditors as approved auditors under the SIS Act.

IFSA believes that these self-regulatory initiatives are a good start. Under the competency standards issued by the accounting bodies and SPAA's work in improving auditor standards, those currently auditing SMSFs will develop better qualifications and increasingly more relevant experience of conducting SMSF audits.

In further enhancing audit quality and regulatory supervision of auditors, IFSA welcomes the ATO's intention to achieve 20% coverage of approved auditors.

Overall, IFSA's view is that SMSF audit quality would be enhanced through the government introducing minimum audit standards for SMSF auditors in respect of the relevant SIS audit requirements.

The minimum standards should be in line with competency standards issued by the accounting bodies' competency standards and SPAA. This initiative will provide a regulatory base and statutory guidance to complement the work of the accounting bodies and SPAA in improving essential audit standards.

In addition, IFSA recommends that SMSF auditors be registered through ASIC's auditor registration process – see 20.2.4 – Registration.

We are also concerned that generally accepted independence principles, held as essential elements of the auditing profession, could be compromised in relation to SMSF audits. We expand on this view in section 20.2.3 – Independence.

Recommendation: IFSA recommends minimum auditor competency standards be prescribed in statute.

20.2.3 Independence

Given the key role auditors play, how independent should auditors be from those who administer SMSFs, prepare their financial accounts or annual returns, or provide financial advice? Do the current independence standards provide sufficient guidance or protection for members and other stakeholders?

IFSA contends that auditor independence and management of conflicts in SMSFs can present problems. In our view, auditors should be prevented from preparing financial accounts and subsequently auditing them. This example can be seen in the issues paper with reference to the 2009 ATO compliance process where in 29% of cases, auditors prepared financial statements and also conducted the audit.[9]

Enhancing auditor independence should be a core regulatory objective, as should ensuring that auditors and other service providers are free of conflict when dealing with SMSFs.

IFSA understands there are numerous ethical and professional standards applicable to SMSF auditors. However, standards imposed by the accounting and taxation bodies along with SPAA are not in universal existence. This has resulted in a fragmented set of standards across the various membership-based bodies.

Auditors perform the same services but have different guidelines as they belong to different professional organisations. Accordingly, IFSA supports a single, uniform and enforceable set of competency standards for SMSF auditors (including enforceable independence provisions).

Recommendation: IFSA recommends that auditor independence provisions be strengthened to prevent conflicts arising for firms and individual auditors of SMSFs

[9] Super System Review, Phase Three: Structure Issues Paper – Page 29

20.2.4 Registration

Should approved auditors be registered? If so, which organisation should have responsibility for registering and regulating approved auditors? Should registration also involve competency and training requirements?

As auditors of SMSFs occupy an essential role in monitoring compliance, which the ATO subsequently relies upon as the regulator, IFSA believes steps can be taken by government to improve the quality and integrity of this process.

One way of demonstrating expertise could take the form of registration, be they accountants, financial planners, administrators, trustees, etc. Some of these parties are already subject to demonstrable standards under licensing through ASIC (Australian Financial Services License) or APRA (Registrable Superannuation Entity).

One of the significant controls relied upon by the ATO in its oversight role of SMSFs is the requirement for all SMSFs to annually submit audited financial statements.

An audit of an Australian company, disclosing entity, registered scheme or Australian financial services (AFS) licensee for the purposes of the Corporations Act, may only be done by a Registered Company Auditor (RCA) or Authorised Audit Company (AAC). To achieve RCA or AAC status, an application for registration must be made to ASIC.

In order to successfully register, an individual is required to demonstrate that they have appropriate qualifications, skills and experience, and be a fit and proper person. However, as an SMSF is not an entity captured under the Corporations Act, it is not required to be audited by a registered company auditor.

Under SIS Regulations, an auditor of an SMSF needs to be an *approved auditor*. This is achieved through the mere membership of a professional accounting or tax body. The approved auditor is not required to demonstrate appropriate knowledge of complex SIS Act obligations applicable to SMSFs.

A consistent accreditation regime is desirable to ensure that those charged with a significant responsibility in the assessment of an SMSF's compliance with complex applicable regulations are sufficiently knowledgeable and competent to perform that role.

Given that a process for registration of auditors already exists within ASIC's remit, it is logical that this remit be extended to also include auditors of SMSFs.

IFSA therefore recommends that audit quality would be enhanced through the government requiring SMSF auditors to be registered with ASIC. This would complement the minimum statutory audit standards to be prescribed in respect of SIS Act Regulations which IFSA has recommended under 20.2 – Auditors.

Recommendation: IFSA recommends that approved auditors be registered through ASIC's auditor registration process.

20.3 Advisers

Should competency standards be increased (i.e. beyond ASIC Regulatory Guide 146 standards) for financial advisers who provide advice to SMSF members? **The justification for this would be that an SMSF is a special vehicle and not directly prudentially regulated. Under such a proposal, if an adviser wanted to provide advice to an SMSF, they would need to have a higher standard of training and be licensed accordingly. This could increase the cost of SMSF advice, but the average SMSF has substantial assets[10] and therefore could afford to pay for higher quality advice. The question then arises whether remuneration for advice to SMSFs (that is paid for out of the fund) should be restricted to a fee-for-service model (subject to the sole purpose test). That way, the true cost of the advice could be determined at the time it is given and it would be more likely to be in the best interests of the members.** ***Is there justification for a different charging model for advice to SMSF members?***

IFSA believes that entry level requirements and levels of professionalism for financial advisers providing advice to individuals with SMSFs or any other financial product should be improved over time.

IFSA understands many financial advisers see the minimum statutory requirements as barely a starting point as their qualifications exceed the requirements. A large number of financial advisers already have educational qualifications that go well beyond the requirements under the Corporations Act and those imposed by ASIC under Regulatory Guide 146.

In the move towards improving the qualifications of financial advisors, it is important to recognise that they are also being supported by the development of professional standards by associations such as the Financial Planning Association (FPA) and professional accounting bodies, as well as by the significant commitment of resources from financial advisory networks to improve compliance, research, quality assurance processes and professional development for their representatives.

Nevertheless, IFSA notes that, as with all professions, there will always be varying levels of qualifications, quality and experience. Any minimum entry level should not be set so high that it dramatically impacts on the cost of advice or the number of individuals that are able to provide financial advice – especially where the majority of advisers are trained to an appropriate level and operate within a robust regulatory structure that supports the advice they provide.

[10] Super System Review 2009, *A Statistical Summary of Self-Managed Superannuation Funds*, 10 December.

21.5 Barriers to Entry

Should there be barriers to entry in either sense? If so, what barriers?

In addition to enhancing the competency standards of auditors through registration, IFSA supports the registration of SMSF administrative service providers.

Most providers of services to trustees of SMSFs must meet certain standards before they can operate. For example, those lodging tax returns must be registered tax agents; investment advisers need to have an AFSL or be authorised representatives of a licencee; and lawyers, auditors or actuaries must meet minimum standards before they can offer their services.

However, no registration requirement or minimum standards apply to those offering administration services to trustees. We believe that it would be appropriate for any provider of administration services to be able to demonstrate that they can meet certain standards applicable to the receipt, recording and reporting of superannuation contributions and management of payments (including data required for tax purposes) before being registered.

Since administrators play a significant role in the operation and management of SMSFs, IFSA recommends that a new registration process be established for administrators with minimum standards. A central register of administrators should be made available to trustees to assist them in selecting a suitable administrator. The register would potentially allow the ATO to better identify systemic issues and better target audit programs.

Registration would allow the ATO to understand who it is regulating and the effect may be to reduce the number of providers into a more manageable group. In other words, registration would drive scale in the sector. Service providers could be corporations or individuals and could register in single or multiple categories.

Registration of SMSF service providers, accompanied with appropriate professional standards, will deliver enhanced regulation of the industry and ensure that the people working within the SMSF sector are competent.

The registration of service providers should be undertaken by the ATO as the regulator of the SMSF sector.

Recommendation: IFSA recommends that providers of administrative services offered to SMSF trustees be registered with the ATO.

21.6 Minimum Monetary Balance

Is there any justification to mandate a minimum balance for establishing an SMSF, perhaps by imposing controls on the persons authorised to establish SMSFs? If so, what is the appropriate level and why? Alternatively, can this issue be addressed through education and the publication of better data?

IFSA does not support the imposition of minimum balances on SMSFs. Fundamentally we do not believe that retail investors should have their choices in superannuation curtailed based on the size of their account balance.

The data supplied by the ATO demonstrates that many individuals build their account balances gradually over time – with significant one-off contributions often taking place following the sale of other assets.

To demonstrate this point, according to data quoted in the Issues Paper, the proportion of SMSFs with $200,000 or less in assets has decreased form 42% in 2004 to 26% in 2008. The same ATO data reveals that SMSFs with account balances of $100,000 or less have fallen from 25% in 2003-04 to 15% in 2007-08.[11]

IFSA believes that any concerns at the inappropriateness of an SMSF for particular individuals is best addressed through consistent AFSL obligations which ensure that any financial advice which is provided to retail clients (including concerning the establishment of an SMSF) is appropriate and based on the individual's needs and circumstances.

22.1 Early Release on Hardship Grounds

Should SMSF members in these instances be required to get regulator approval before accessing their superannuation on hardship grounds?

IFSA is not aware of any significant concerns in this area and therefore does not believe that a change to current practice is required.

22.2 Illegal Early Release

What weaknesses exist in the governance framework and what controls could be implemented to reduce the likelihood of such frauds continuing to occur?

IFSA notes the guidance provided by way of a letter to all trustees of APRA regulated superannuation funds on 5 February 2010.

[11] ATO Data September 2009

As stated in the letter, the guidance is intended to serve dual purposes:

1. Prevent fraudulent use of a member's identification by an unrelated party to steal the member's benefits without their knowledge; and
2. Prevent members from willingly participating with a promoter who is promising to access that member's benefit illegally.

We believe APRA's letter to trustees is unlikely to have any affect on the level of identity fraud leading to illegal early release. This is principally because it is unlikely that APRA's proposals will address the root causes of identity theft. Put simply, additional checks will not be effective where someone's identity has been stolen.

In relation to the initiative aiming to prevent fund members from willingly participating in illegally accessing their benefits, IFSA submits it is unreasonable to expect APRA regulated funds to absorb additional costs where integrity concerns are directed at SMSFs. If the concerns are material and widespread, measures to address these concerns should be directed at the relevant sector.

In improving the process of rolling over funds from an APRA regulated fund to an SMSF, IFSA welcomes the new categorisation of "Registered – not determined" in the ATO SuperFund Lookup application. The new status creates some welcome flexibility in the process of rolling balances into a different fund while the appropriate checks are completed.

IFSA notes that the ATO's SuperFund Lookup has flaws and missing information. It is particularly problematic for superannuation funds where the trust name is substantially different to the product naming conventions as is the case with The Universal Super Scheme (TUSS).

IFSA believes SuperFund Lookup should contain fund/trustee information - and the products contained within superannuation funds. Additionally, where an administrator address is different to the registered fund / trustee address, the administrator name and contact details should be displayed for the purposes of sending administrative correspondence.

The search and link mechanics within SuperFund Lookup should be improved to allow robust checks, but also to prevent unnecessary delays, for example, if an address for an administrator of a fund is different to the fund address.

The additional checks for "Registered – status not determined" suggested in APRA's letter to trustees including the age of the fund, amount to be transferred and if any previous rollover attempts were made should, if formally adopted, bolster the security of rollovers into SMSFs.

IFSA acknowledges that the enhanced security measures may present an additional compliance cost for superannuation funds. The cost attributable to superannuation funds will depend on the records individually maintained by the fund. For instance, it should be noted that while some superannuation funds will maintain registers of previous rollover requests, other funds will not.

The additional compliance procedures suggested by APRA are therefore likely to create new costs to superannuation funds which will ultimately be borne by individual fund members.

IFSA looks forward to engaging with APRA and the ATO in improving this compliance process without the creation of prohibitive costs to superannuation funds.