



Confidential
Submission to:

Committee Secretary
Parliamentary Joint Committee on Corporations
and Financial Services

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Prepared by Association of Financial Advisers Ltd

Mr David Sullivan

The Secretary

Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Mr Sullivan,

Submission – Inquiry into the structure and operation of the
Superannuation Industry

The Association of Financial Advisers Ltd (AFA) provides this submission by way of our membership's collective view.

With over 1,000 practitioner members, who are quite senior by way of experience and time in this industry, we recognise that there are some changes needed. All of our members are working advisers in the Financial Services Industry and thus our submission is based on practical application.

We therefore commend to the committee our representation on behalf nearly 1,000,000 Australians we represent, who are our clients.

The AFA is concerned that any changes should follow the ASIC focus for consumers and thus be clear, concise and effective.

Yours sincerely,

Richard Klipin
CEO

Our submission follows your terms of reference thus:

Association of Financial Advisers Ltd – September 2006

Page 2 of 12

Response to:

**Parliamentary Joint Committee on
Corporations and Financial Services**

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1. Whether uniform capital requirements should apply to trustees

Our members take the view that the primary duty of regulation should be that all providers of superannuation funds that are classed as public offer funds should be required to have the same standards of capital adequacy. This in our view means that if a minimum APRA standard for a public offer fund is trustee capital of \$5m at startup, then this should apply to all funds. The need to have funds provide capital reserves for the management of operational risk should be paramount.

No discrimination is to be allowed as this may cause a future failure and thus undermine public confidence in the regulator and the whole program of retirement savings.

Uniform capital requirements for all public offer funds mean that each is understood to be adequate, has proper basis for such offer of superannuation savings to the public and can be the basis of proper advice with confidence, by financial advisers who are our members.

Such minimum capital adequacy is perhaps a starting point.

We refer the committee to the excellent Credit Union Stabilisation Fund system. We further recommend that each superannuation fund contribute not less than 5% of trustee funds, (min of \$5m) to such a stabilization fund for the superannuation industry.

These funds are recommended to be held in the Government's Future Fund and the interest capitalized for use in stabilizing any prospective fund problem.

Our summary view is that all commercial super funds be required to have the same capital adequacy requirements of their trustees for the future well being of members and the superannuation system.

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

Our members are of the view that any trustee of any public offer superannuation fund should be a public company. We take the further view that SMSF trustee provisions are adequate and require no change.

This provides exposure to the reporting and transparency requirements of a public company, requires the company to operate within the corporations laws and ensures that both ASIC and APRA have firm foundations for regulatory action should this become necessary.

Our view is that exposure by way of reporting, is the best guarantee of compliance and the provision of a total focus to member benefit, not trustee benefit.

Too often simple administrative changes such as this, that may produce long term consistent benefits, do not take place. It is incumbent on the whole industry to ensure that benefits of members are protected, and therefore any change that would reduce the prospect of any fund having a potential for failure, or sub par performance due to trustee wrong doing, should be reduced.

We therefore recommend that all trustees be public companies.

3. The relevance of Australian Prudential Regulation Authority standards

We believe that the Australian Prudential Regulation Authority standards are absolutely crucial to the integrity of superannuation funds. This statutory authority sets the rules which govern the conduct of these funds, and simply put, the standards are the guarantee that trustees do follow the regulators standards.

The AFA asserts that all public offer funds should comply with APRA standards and that those standards should apply by regulation to all public offer funds in order to provide for the safety and security of members funds. It is this point, the safety and security of member's funds that is crucial to public confidence. We would recommend to the Committee that a high priority for funding allocation in 2007-8 be given the revision of the standards.

4. The role of advice in superannuation

The members of the AFA provide advice each and every day.

This is our role in the financial services industry.

The role of an adviser in superannuation is not dependent on the size of the member's fund account, but more importantly, what value can be added to ensure the member has the best possible standard of living in retirement, within the means that the member has.

We take the view ethically, that this focus on adding value to each and every client is an extremely important point that is missed in the broader view taken of superannuation as the retirement income source for the Australian community.

Some superannuation fund members will seek advice upon starting a superannuation savings plan, others will seek it just prior to retirement, and yet others who may have thought they knew all they needed to know seek advice when the complexity or difficulty grows.

The reasons for advice are multi-faceted, and not dependent upon any one factor.

What our members feel is that the underlying need is for greater public education about the need to save for retirement, be adequately insured against misfortune and have a reasonable personal legal position with a valid will.

We too often are requested to assist people who are in trouble with one or all of these issues. This is the role of advice in superannuation.

The Association's members consider that Australian citizens should have access to advice at a reasonable cost, appropriate to their needs and such advice should be paid for by choice. A free market is a much greater guarantor of competition than a regulated market for advice.

Lastly the Association's members consider that the ASIC approach to active regulation with superannuation presents an adequate outcome.

We endorse Chairman Lucy's approach to clear concise and readily understood statements of advice. We recommend further work in this area to make sure convoluted and legalistic advisings are eliminated.

Members of funds may choose to have need of such advice, and if they wish to avail themselves of this, clear disclosure making this fully transparent, will prevent abuse into the future.

5. The meaning of member investment choice

The AFA endorses the Government's policy of choice of funds.

It is the subsequent factor of the opportunity to choose where and how individual member's funds are invested, that is the ultimate guarantor of member involvement.

Too often members are provided with no choice or choice that is imposed on them by trustees which they may not wish to accept.

This present "no choice" policy should be regulated to a choice policy. The member must be allowed to choose from more than simple asset allocation groupings such as conservative balanced or aggressive.

It is our view that all members should be able to choose at least 35 investment options ranging across the whole of the asset type spectrum, for each public offer fund, but that default funds should place member's funds into an age based investment choice package using the ASIC guidelines.

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

The AFA believes that trustees need to recognize that if a member makes a choice, then that choice is the member's decision and that the responsibility of the trustee is limited to the trustee function.

It has been seen in recent times, that trustees are beginning to act as promoters of their own funds, making it administratively difficult for a member to rollover their funds to another complying fund.

Trustees should be compelled to rollover funds within 14 days to reduce the disadvantage to member's funds.

Some funds even use the excuse that the trustees only meet monthly and that it can therefore not be in the member's interest to retain funds for 60 days where the member can be financially worse off. It is of no concern to the AFA what the fund is.

It is in the member's interest that simple rules apply and that funds are released to the new complying fund within 14 days. With proper proof of identity and a standard form this is administratively achievable without additional costs to funds. However it is also necessary to ensure that members are not disadvantaged and thus a simple letter asking for a rollover should also suffice.

We further recommend that the legislation should be clarified to mandate that trustees must offer investment choice, but must make clear to members the risk factors in such decisions. Such advice should come from a qualified and licensed adviser, after the member's situation is documented on a "know your client" basis.

In this case one size cannot fit all.

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

The primary reason for the growth of self managed super funds is freedom of choice, both with investments made by the fund and with the operation of the fund.

This is the overt reason that commences members to consider this option.

The second and more concerning reason is that accountants offer self managed super funds with a package of services they offer to their clients. It is a locked in future stream of accounting fees for the accounting of the fund. It is self interest.

The ATO and ASIC have stated that a minimum level of \$225,000 of funds is necessary before a SMSF is competitive on fees with a public offer fund.

This requirement may need to be mandated if adequate cost information is not provided to intending trustees prior to the start up of an SMSF.

Further disadvantage to member's retirement funds may occur if this is not reinforced by education or regulation.

Lastly the growth of self managed super funds is a by-product of failures such as HIH, Westpoint and other large corporate activities that receive high levels of public attention. Trust dissipates.

The AFA is aware that SMSFs today have a far higher proportion of cash and fixed interest investments than do public offer funds. We are also aware of the high proportion of SMSFs that have been considered by the ATO, in its recent audits, to be non-complying due to the lack of investment plans or inappropriate purchase of assets.

We would urge the committee to ensure that a requirement of an SMSF is to have an investment plan documented by an Authorised Representative qualified in SMSF advising, be regulated more formally and reported annually.

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

The Association sees this as evolutionary, not revolutionary, and is based on the experience of successive governments and large corporate businesses in endeavoring to maintain such funds in the face of longer-living pensioners and retirees.

The experience in the United Kingdom and the United States where pension fund liabilities are now booked directly to the balance sheet of enterprises has quickened this change.

This is now starting to happen in Australia with a revision to the accounting standards.

Organisations are unlikely to continue to report to shareholders that the reason for low or no dividends on the shares that they hold is an under-performing defined benefit superannuation plan for the company's employees.

In Australia, the fundamental reason for the Future Fund is to offset liabilities that the federal government has with its own employee's superannuation, in such a way as to not be an escalating liability to recurrent expenditure. It is by far the largest federal liability even eclipsing debt instruments.

All state governments are moving in the same direction and in effect all have closed defined benefit schemes to new members and moved all current liabilities to the accumulation scheme type.

The AFA takes the view that governments across Australia should move out of the business of running superannuation schemes and allow present members to rollover to public offer schemes whatever the type.

This then increases the width of the playing field. The existing defined benefit schemes should be put into "run off" and allowed to slowly diminish, and then to close with administration transferred to the private sector.

The use of public funds to operate superannuation funds for public sector employees, ahead of health and education funding, cannot in the longer term be supported.

9. Cost of compliance

The AFA believes that the cost of compliance is higher than it should be.

The basic misunderstanding of regulators is that for each action of the regulator there is a resulting cost. This for example, has led to the Statements of Advice being turned into corporate legal documents, rather than the clear concise and effective customer advice that the ASIC had intended.

A further example is the myriad of rollover forms, alteration forms and the variety of member statements, some good, but most uniformly un-informative. The cost is borne by the member in meeting the requirements of the trustee.

This cost of compliance is ultimately paid for by the member.

We recommend the committee move to reduce the cost of compliance in a number of ways:

1. Mandate that the advice to the member or client must be in the form of a readable letter that addresses their personal needs
2. All calculations, cash flows, and comparative tables be appended
3. Disclosure of costs be in a simple narrative form as well as a table, and that all further disclosures be appended
4. That the client have clearly outlined to them in simple concise English that if they wish to accept the advice that this will be the cost, either by way of fee for service or commission.

9. The appropriateness of the funding arrangements for prudential regulation

The AFA has no view on this matter.

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

The AFA expresses the view that the cost of advertising a retirement fund is the business of the fund.

Such costs are also costs of the fund but should be generated from fund profits and reported to members in clear and unambiguous terms.

This means it should be reported in whole dollars at the start of the annual report to members, noting the total cost of promotional expenditure of all kinds.

There needs to be greater vigilance by ASIC, the responsible entity for the application of the ACCC legislation in the financial services market.

Too often claims by not-for-profit funds and misleading statements to members when researched are proven to be false and misleading. If there is a fee for investing then this should be disclosed.

If the trustee fees are paid by the fund then these should be disclosed.

If public offer funds are to be all considered equal then not-for-profit funds should report a composite Management Expense Ratio (MER) just as all other public offer funds do.

To whom the trustee funds are paid and how much in whole dollars should also be a requirement of member reporting.

11. The meaning of the concepts "not for profit" and "all profits go to members"

The AFA is of the view that there are no "not for profit" funds and the statements that "all profits go to members" is simply an untruth.

All superannuation funds need to pay for administration and funds management, pay trustee fee's and meet the cost of member services.

Some funds are operated by related entities, but others purchase services from unrelated entities. All costs need to be disclosed transparently for the information of members without concern as to the relationship.

The simple way to ensure that this is adequate and fair is to regulate via APRA that all reporting to members is uniform. This then allows fair and frank comparison between funds by members.

We recommend to the committee that this be adopted.

12. Benchmarking Australia against international practice and experience

The AFA suggests that such a benchmarking process would be useful but not of a high priority in the administration by Government of the Superannuation Industry. Australia has a leading superannuation system and indeed could be a benchmark in its own right.

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

The AFA recommends that our proposed stabilization fund for theft or fraud by trustees will go part of the way to producing a comprehensive safety net for member's funds. In relation to employer theft, fraud and employer insolvency we are happy with the present arrangements.

14. Any other relevant matters

The AFA wishes to highlight to the committee, the following relevant matters that they may wish to consider.

1. **Disclosure** - The disclosure of payments between the product supplier of superannuation and the holder of an AFSL as a dealer in securities, to clients or members of the fund. In the interests of transparency we consider that if any over-rides are paid by Super Funds to dealers in securities and thence authorised representatives, that these payments be fully disclosed to the client prior to the authorization of the financial advising.
2. **Who owns the license** - We further take the view that disclosure of ownership of the dealer in securities be provided to the client in the Financial Services Guide.
3. **The present mess with forms** - The simplification of forms is an area where the committee may care to make some comment. The plethora of forms from each individual fund makes the decision of the member quite difficult and indeed quite constrictive. It should

be a simple matter to standardize all forms so that they are simple concise and effective.

4. **Advertising that obscures the message** - The elimination of advertising or self promotion in member statements for all funds. This is an area where in some cases the advertising of the fund itself over-shadows the essential information to the member. If funds wish to advertise then this should be separated from annual member statements and not included with those statements.

5. **External auditing of Product Descriptions for super funds** - We see the introduction of externally audited and certified PD's for all public offer superannuation funds with an ASIC website dedicated to making these available on-line to all Australians.

This auditing and web site to be funded by fees paid by proponent trustees of funds. This would assist in the education of members and allow ready access to fund details. It would also assist ASIC and APRA in regulating the funds without this cost being to the public purse.

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