

SUBMISSION

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

**“Inquiry into the Structure and
Operation of the Superannuation
Industry”**

September 2006



Self-Managed Super Fund Professionals' Association of Australia Limited (‘SPAA’)

SUBMISSION to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the structure and operation of the superannuation industry

PURPOSE OF SUBMISSION

SPAA is recognised as being the Self Managed Superannuation Fund (‘**SMSF**’) industry’s peak umbrella organisation for SMSF specialist advice within the SMSF Industry. As such SPAA represents advisors providing expert advice and services to a significant component of the Australian superannuation system with current SMSF numbers estimated at approximately 320,003 (entities), with total assets totalling approximately \$209.9 billion (or 23%), ranking SMSFs second only to Retail superannuation funds by assets in a superannuation pool totalling approximately \$913.9 billion as at June 2006¹.

SPAA believes that it is therefore imperative that after having sought comment from its Membership that it make a formal submission to the Committee.

SPAA seeks to enhance the integrity of the superannuation system so that retirement savings of Australian’s is maintained in a secure environment.

¹ Source APRA Quarterly Superannuation Performance Statistics June 2006 (issued 27 September 2006)

ABOUT SPAA

1. SPAA is the leading and peak professional association for all SMSF professional advisors within Australia, including but not limited to auditors, actuaries, tax agents, accountants, financial planners, lawyers, risk providers, administrators, barristers, and educators.
2. SPAA is an independent association which represents the needs of its members. The SPAA constitution is built around the 'association' being an umbrella association of "Professionals' caring for Professionals". SPAA has developed and is currently maintaining professional standards for the SMSF advice industry. As such the association provides vital support, independent certification of education, dissemination of regulatory and other industry specific technical information to professional advisors seeking to ensure that their competency is at the very pinnacle of knowledge and skills. Through a stringent professional accreditation designation, SPAA members are endorsed as 'SMSF Specialists' in their field regardless of their existing professional accreditation, qualifications or affiliations, after having proved their competency in SMSF advice.

Through this formal professional accreditation programme, SPAA aims to establish its members as the consumer's 'adviser of choice' when it comes to advice and services relating to SMSFs. The SPAA specialist accreditation designation is to be seen as a symbol of authority and expertise in what is a highly complex and specialised sub-industry within the financial services industry.

3. SPAA has as its objectives the following:
 - 3.1. Representation of SMSF professional advisers regardless of other affiliations;
 - 3.2. To constantly improve & develop educational standards;
 - 3.3. To liaise with Regulators to achieve industry best practice;
 - 3.4. To provide industry networking opportunities for professional SMSF advisers;
 - 3.5. The provision of 'Specialist Accreditation' and endorsement by the 'Peak Body' for advice in SMSF within the financial services industry. Endorsement and accreditation that is easily recognised within the SMSF consumer marketplace as a symbol of 'Quality Standards' providing consumer protection through self-regulation;
 - 3.6. Independence and an independent accreditation processes; and
 - 3.7. Complementary best practices for existing industry professionals.
4. Our national board is comprised of the following people:
 - Mr. Peter Hogan SSA - Chairman (Avenue Capital – Sydney)
 - Mr. Peter Fry SSA - Vice Chair (Peter Fry & Associates - Melbourne)
 - Mr. Graeme Colley SSA - (Super Concepts – Sydney)
 - Mr. David Ruddiman SSA - (Professionals' Choice Wealth Management – Brisbane)
 - Mr. Nick Aston SSA - (Brentnalls NSW - Sydney)
 - Ms. Michelle Crosby SSA - (ComSuper – Canberra)
 - Ms. Sharyn Long SSA - (Sharyn Long Chartered Accountants – Perth/Melbourne)
5. Our Chief Executive Officer is:
 - 5.1. Mrs. Andrea Slattery SSA - (Adelaide)

6. Importantly SPAA engages all industry participants in the raising of advisory standards within what is a critically important sub-industry within the superannuation services industry, supporting the future financial well-being of many hundreds of thousands of Australians. SPAA recognises the significance of establishing the highest possible industry standards, and ongoing professional development of all industry participants in the attainment of excellence, and to the future 'integrity' of the industry.
7. SPAA has as part of its objectives the role of working with the Regulators to provide a self regulatory role in the SMSF Industry. We intend to assist the Regulators in the development and maintenance of professional standards and integrity of the industry.

SUBMISSION

This submission provides comments in the same order as the Terms of Reference of the Inquiry which was released on 30 June 2006.

1. Whether Uniform Capital Requirements should apply to trustees.

SPAA does not support the extension of uniform capital requirements to self-managed superannuation funds. The *Superannuation Industry (Supervision) Act 1993* (the SIS Act) recognises there is no requirement for self-administered superannuation funds to satisfy the prudential standards of the legislation. It is only where there is less transparency in the relationship between the trustees and the members of the superannuation entity that more stringent rules apply. This occurs in situations where the trustee is a professional who is paid for the services provided as trustee of the fund. Trustees of self-managed superannuation funds act in a voluntary capacity and are prohibited from receiving remuneration as trustee of the fund.

SPAA considers little would be achieved by requiring a trustee of a self-managed superannuation fund to satisfy minimum capital requirements. The provisions of the SIS Act applying to the operation of a self-managed fund include rules which ensure the safety of the member's balances and provide significant disincentives and penalties for any breaches of the legislation¹.

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

SPAA would not support the requirement that trustees of superannuation entities become directors of public companies. Under the current legislation where the trustee of a superannuation fund is a corporation it is subject to the provisions of the Corporations Law. To require trustees of funds to be public companies would seem to be an onerous overlay which does not provide a level of additional security for fund members.

The role of a public company is generally considered to relate to a commercial trading enterprise with equity that is available to be traded in a market. A trustee of a superannuation fund acts as a fiduciary in relation to the fund members.

It is considered that the SIS Act and the Corporations Law already provide significant penalties for trustees who breach the relevant rules. These include financial and custodial penalties. In addition, the legislation permits the Australian Prudential Regulatory Authority (APRA) and the Australian Taxation Office (ATO) to disqualify trustees of superannuation funds in certain circumstances.

3. The relevance of Australian Prudential Regulation Authority standards

SPAA considers that the APRA standards continue to be relevant and appropriate and assist in building and maintaining integrity in the operation of superannuation entities in Australia. However, there are issues surrounding the administration of the legislation by APRA and the ATO.

Under the SIS Act the ATO is responsible for the administration of self-managed superannuation funds and APRA is responsible for all other types of superannuation entities. Where a superannuation fund initially qualifies as a self-managed superannuation fund it is the responsibility of the ATO. If it is subsequently unable to meet the requirements of the definition of self-managed superannuation fund in the SIS Act the fund then becomes the responsibility of APRA.

Sometimes there is a lengthy delay in the transfer of the responsibility of the fund between regulators at a time when the fund can be in a most vulnerable position. In some cases this

¹; SIS Act S55, S218, S193 etc

leads to a fund not being effectively regulated. SPAA considers that the position of the regulators should be clarified in these situations to ensure the fund has proper regulatory supervision during any transition. SPAA would support the transfer of the administration of the operation of small funds currently administered by APRA to the ATO. As small funds administered by APRA are required to have an approved trustee it is considered the actual approval of the trustee should remain with APRA. APRA would continue to have responsibility to approve the trustees of all funds which have professional trustees.

In relation to the costs of administration of self-managed superannuation funds, it is considered that the regulators should be required to report separately to Parliament the revenue collected from supervisory fees and the costs associated with the regulation.

Under the SIS Act a limit is placed on the number of members who can be members of a self-managed superannuation fund. It is considered that this should change so that all members of a family or business group, such as partners of a partnership, are able to be members of the same self-managed superannuation fund. Refer appendix A

4. The role of advice in superannuation

Any advice that is provided for superannuation is highly specialised and involves a range of disciplines. This requirement will continue after the government's current reforms on the simplification and streamlining of superannuation are in place. This is due to the need for trustees to invest member contributions and the compliance issues surrounding the continued operation of the fund. Anecdotal evidence suggests that those trustees of superannuation funds that obtain and apply advice tend to have better results than those who act in an ad hoc manner and do not seek advice.

SPAA considers now, in particular, that the provision of self managed superannuation advice is a complex matter as a considerable number of parties are involved in the advice process. The membership of SPAA is the peak professional association representing SMSF professional advisors includes auditors, actuaries, tax agents, accountants, financial planners, lawyers, risk providers, administrators, barristers, and educators. This is indicative of the professions that are involved in providing advice to trustees and members of superannuation funds.

It is important when providing advice on any superannuation matter, but in particular SMSFs, that all advisers have an understanding of the complexities that exist in relation to SMSFs. SPAA considers it is essential that any educational standard for advice to SMSFs is set at a higher professional level than that required under ASICs PS146 (Superannuation) or even the Industry Endorsed SMSF Advice Competency requirements set by FSEAA. SPAA would encourage that the issues of education standards and required minimums be fully reviewed and explored to achieve integrity in the industry². SPAA believes that any consideration for lowering of standards for advice may see the return to the unsatisfactory situation that existed prior to the changes to the Corporations legislation.

Importantly SPAA engages all industry participants in the raising of advisory standards within what is a critically important as a part of the superannuation services industry, supporting the future financial well-being of many hundreds of thousands of Australians. SPAA recognises the significance of establishing the highest possible industry standards, and ongoing professional development of all industry participants in the attainment of excellence, and to the future 'integrity' of the industry.

SPAA also acknowledges the important role that the Regulators ATO, ASIC & APRA play in their commitment to building integrity within the SMSF Industry.

Currently, there are professional advisors that have concluded a rigorous independent accreditation to achieve the status of SMSF Specialist Advisor® in the Australian advice industry. SPAA believes that these advisors should be seen as advisors of choice for any consumer seeking SMSF professional advice services.

² Refer Chris Pearce program towards 'Simpler Regulation System Bill – 1.26 Policy Statements 146 – training requirements' April 2006

5. The meaning of member investment choice

Under the provisions of the SIS Act a superannuation fund is required to have an investment strategy which takes into account a number of factors including the diversification of investments, risk and return, and the ability of the fund to pay liabilities as they fall due.

A member of a self-managed superannuation fund is able to influence or direct the investments of the superannuation fund. This is due to the fact that the member is required to be the fund trustee or a director of the trustee company in most cases. It is considered therefore that investment choice within a self-managed superannuation fund is not an issue as it is permitted by the legislation.

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

The responsibility of the trustee of a self managed superannuation fund in relation to investment choice is determined by the provisions of the SIS Act, the relevant trust deed and other governing rules of the fund. Therefore the trustee is responsible to ensure that the relevant rules are met and the members' interests are protected.

SPAA considers that it may be useful for trustees to undergo a level of training so they appreciate the significance of their role and what is expected of them under the relevant legislation.

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

The increase in the growth in self-managed superannuation funds has stabilised over the past year. If the last 5 year trend is reviewed, the growth has been consistent at approximately 2000 per month for new SMSF setups. According to statistics published by the ATO and APRA, the number of newly established self-managed superannuation funds is approximately 1800 per month.

It is generally considered that self-managed superannuation funds are attractive because of the control and flexibility they provide to members. These characteristics are generally consistent with the type of person who chooses to have a self-managed superannuation fund. These people include the self-employed, small business owners, management and professionals who prefer to control the investment of their retirement savings.

Self-managed superannuation funds are able to incorporate a wider range of features not readily available in other types of superannuation funds. Other funds may not wish to provide some of these features or may be slow to provide these features. Examples would include the introduction of transition to retirement pensions or superannuation contributions splitting.

SPAA encourages financial literacy within the Australian marketplace so that consumers are able to make more informed decisions about their future financial viability & retirement options.

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

There have been a number of reasons for the demise of defined benefit superannuation funds. Under a typical defined benefit arrangement an employer has an agreement to make contributions to a fund which defines the level of lump sum and/or pensions for members or as death benefits to dependants. In these circumstances the amount of the contribution is determined actuarially, thus placing the risk of the amount of contributions required to provide the benefits under the fund rules with the employer.

SPAA believes that the main reasons for the demise in defined benefit funds are:

- Poor investment performance of investment markets early this century which placed greater pressure on employers to increase contributions;
- Changes in work practices which result in fewer people staying with the one employer for nearly the whole of their working life;

- The evolution of Superannuation Guarantee which appears more suited to accumulation funds;
- The complexity and cost of operating a defined benefit fund compared to accumulation funds;
- The transparency of accumulation funds in relation to each members' account balance;
- Changes to the SIS Legislation in relation to licensing of trustees which has led to the cessation of defined benefit funds and the amalgamation of defined benefit funds with master trust arrangements.

9. Cost of compliance

The cost of compliance of a self-managed superannuation fund depends on a number of factors. The cost could be separated into:

- the accounting and record keeping requirements of the fund;
- the audit of those records; and
- the cost of regulation.

Both APRA and the ATO suggest that it is not economic to have a self-managed superannuation fund which holds assets less than \$200,000. However, some people will have less than that amount in their self-managed superannuation fund for reasons relating to the control over investments. For many of these people cost is not the issue. The threshold of \$200K supports the critical mass issue in the Industry. Statistics show that there has been a significant reduction in balances less than \$100K in the last 2 years.

The cost of compliance may also depend on the type of investments chosen by the trustee on behalf of the fund.

Some benefits of SMSFs in relation to costs are;

- Costs are transparent and able to be easily measured
- Costs of SMSFs are a secondary issue for consideration while the primary issue of profiling of a member &/or trustee will determine if the SMSF vehicle is appropriate for consideration or another superannuation option is more appropriate
- Costs can be significantly reduced due to how the assets are invested in the fund eg via imputation credits
- The average SMSF member balance of funds under management is \$289,000³ and the larger the balances, the less impact the costs have on the fund.

10. The appropriateness of the funding arrangements for prudential regulation

SPAA considers that the current funding arrangements where superannuation entities pay for the regulation of the industry are appropriate for prudential regulation and for the regulation of self-managed superannuation fund. This is considered acceptable providing the revenue collected from the superannuation funds is accountable and matched to the costs of supervision of the industry and made available to the public on a timely basis.

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

There is no requirement for a self-managed superannuation fund to engage in promoting the fund as the members form part of a closely knit group, usually members of the same family or people who have something in common.

12. The meaning of concepts 'not for profit' and 'all profits go to members.'

In view of the fact members of self-managed superannuation funds are usually the fund trustees it is in their interests to ensure the costs of the operation of the fund is kept to a

³ APRA Statistics – March 2006

minimum. This will ensure that the balance standing to the member's credit in the fund is maintained at the highest level as all income goes to the member.

In regards to the definitional issues, concepts of 'not for profit' & 'profit' are not defined in SIS Act and SIS Reg. The terminology is instead that of income and expenses through the Corporations Law and that of investments, balances and benefits to members through SIS Act SIS Reg.

13. Benchmarking Australia against international practice and experience.

SPAA supports the benchmarking of Australia with international practice and experience for retirement income vehicles. However, it does have some concerns over whether overseas experience is directly transmissible to Australia particularly for self-managed superannuation funds. Overseas experience in that regard may provide a very limited range of funds which are not directly comparable.

Examples of private pension options overseas include SIPPs (UK), 401Ks & IRAs (Canada & USA). These options are different from Australia and provide different benefits & pitfalls in their usage.

The World Bank in its report 'Averting the Old Age Crisis' provided comments to the effect that Australia was a world leader in the provision of retirement incomes.

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

SPAA believes the current arrangements relating to the level of compensation in the event of theft, fraud or employer insolvency are adequate. It considers that compensation arrangements should not extend to self-managed superannuation funds due to the unique relationship that exists between the members and trustees.

15. Any other relevant matters.

SPAA considers that one of the most important aspects relating to superannuation is the knowledge levels of those who are associated with the provision of advice and are members of funds. SPAA welcomes the government's initiative with financial education and would like to see an increase in the level of education for anyone providing advice on superannuation. It believes that the PS146 education requirements under the Corporations legislation are not at a sufficiently high enough level to provide the specialised advice required in relation to self-managed superannuation funds and superannuation in general.

SPAA supports the use of co-regulation of the superannuation industry and the use of a combination of industry representative organisations and regulator to supervise the industry.

SPAA considers that the costs of administration of superannuation should be kept to a minimum. The recent announcement to amalgamate certain reporting obligations for self-managed superannuation funds is a step in the right direction.

SPAA recognises the need for security of the superannuation industry and considers that mandatory personal indemnity insurance should be introduced for trustees and advisers of self-managed superannuation funds. Under current arrangements many advisers do not have insurance cover in this regard. SPAA SMSF Specialist Advisors have access to PI insurance relevant to their advice and the client trustees also have access to PI insurance cover.

SPAA would like to include the SIS definition of 'dependency' and 'reversionary' in the new changes to superannuation rather than the ITAA 1936 definitions of dependent and reversionary so that there is one consistent definition to cover these concepts and legislation.

FURTHER INFORMATION

We would be pleased to provide you with any further information in support of our submission.

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Appendix A

SPAA is interested in recommending a change in the requirement for less than 5 members of an SMSF to include the definition of Family members

An SMSF is currently defined as:

S17A(1) Subject to this section, a superannuation fund, other than a fund with only one member, is a **self managed superannuation fund** if and only if it satisfies the following conditions:

- (a) it has fewer than 5 members;
- (b) if the trustees of the fund are individuals - each individual trustee of the fund is a member of the fund;
- (c) if the trustee of the fund is a body corporate - each director of the body corporate is a member of the fund;
- (d) each member of the fund:
 - (i) is a trustee of the fund; or
 - (ii) if the trustee of the fund is a body corporate - is a director of the body corporate;
- (e) no member of the fund is an employee of another member of the fund, unless the members concerned are relatives;
- (f) no trustee of the fund receives any remuneration from the fund or from any person for any duties or services performed by the trustee in relation to the fund.

A similar definition exists for a single member fund, allowing for an additional trustee not to be a member provided that person is a relative of the single member.

Recommendation for consideration

Definition be extended to less than 10 members, with a) above being amended to include:

- If <5, no requirement for a family or business relationship; or
- If >4 but <10, there must be a family or business relationship between ALL the members.
- Exclude non-arms length employees

Family relationship to include a relative as defined in the existing Section 17A(9) –

Meaning of relative.

In this section:

relative , in relation to an individual, means:

- (a) a parent, child, grandparent, grandchild, sibling, aunt, uncle, great-aunt, great-uncle, niece, nephew, first cousin or second cousin of the individual or of his or her spouse or former spouse; or
- (b) another individual having such a relationship to the individual or to his or her spouse or former spouse because of adoption or remarriage; or
- (c) the spouse or former spouse of the individual, or of an individual referred to in paragraph (a) or (b).

Business relationship – as per original Superannuation Legislation Amendment Act (No. 3) 1999:

at least one of the following:

- * Directors of a company, partners in a partnership, or trustees of the same trust, where the company, partnership, or trust is carrying on a business;
- * Directors of different companies where these companies are in a partnership that is carrying on a business;
- * Directors of a company that is the trustee of a trust that is carrying on a business; or
- * individuals who satisfied one of the above descriptions of a business relationship immediately prior to the retirement of one or both of those individuals but are not non-arms length employees

History

Reasons why definition limited to <5 members:

An SMSF was afforded less prudential requirements protecting member's interests, and so there was a requirement that all members of a SMSF were able to protect their own interests. This was achieved by having less than 5 members, in the belief no one person could dominate where there was a collective of a maximum of 4 people.

APRAs annual return data indicated that approximately 16% of excluded superannuation funds contained arms length members (i.e. members who are not relatives or associates of trustees of the fund), who are not in a position to look after their own interests. Despite this, these members do not have the protection of the additional prudential requirements that are designed to protect members in such a situation.

To overcome these problems, Superannuation Legislation Amendment Act (No. 3) 1999 proposed to amend the definition of an excluded superannuation fund (to be renamed a self managed superannuation fund). Requirements were included for both a commonality of interest between members (i.e. all members to be related or business partners) and a mechanism for all members of such funds to be involved in trustee decision making (i.e. all members to be trustees).

The proposed change were initially designed to ensure that excluded funds that currently contain arms length members in need of prudential protection and do not choose to transfer those members out of the fund will not be classified as self managed superannuation funds. However, Superannuation Legislation Amendment Act (No. 3) 1999 was amended to remove this commonality of interest and the final definition did not include a family or business relation requirement.

Reasoning

The current definition disadvantages families with more than 2 children at a time when the average number of children in a family exceeds 2. This is also at odds with the Treasurer's philosophy of "1 for Mum, 1 for Dad and 1 for the Country".

Defining a SMSF membership around family and business relationships alone could potentially lead to funds with so many members that an individual's ability to protect their own interest would be diminished. Hence an upper limit needs to be in place.

In determining the upper limit, SPAA was mindful of blended families. By allowing 9 members, this caters for each spouse having up to 3 or 4 children of their own, or up to 3 of their own plus more children with a new spouse.

The issue then become can 9 people work together and act for common interest of all parties? There may be an argument to introduce a system of appointment of decision makers based on shareholding of the trustee, or of member balances.

SPAA is available for further consideration on this issue.