REGULATING SUPERANNUATION: THE REFORM AGENDA

by Russell Agnew

By the end of the decade the superannuation industry may be bigger than the banking sector. The federal Government has requested a review of the laws underpinning superannuation in Australia.

Introduction

It is now ten years since the Campbell Committee handed down its report which ushered in the deregulation of much of the financial system in Australia. Unfortunately the experience of the deposit taking institutions — banks, building societies and credit unions — during that decade, as they struggled up the financial deregulation learning curve, has not been a happy one. The banking system is now suffering the after effects of the dramatic increase in their loan book exposure to borrowers who, with the added benefit of hindsight, were clearly the sort of customers prudent bankers should not have let through the door, let alone advanced vast sums.

The State-based Non-Bank Financial Institutions (NBFIs — building societies, credit unions and friendly societies) fared much worse. Their capacity to deal with large exposures to poor quality investments was not as great. Nor was the regulatory regime capable of dealing with the consequences. As a result of the collapse of the Farrow group and merger of OST and IOOF friendly societies, the Premiers have agreed to the establishment of a new, national and more rigorous regulatory regime. Hopefully this system will result in a safer, more secure system of regulation of this important sector of the finance industry.

On 20 August 1991 the Treasurer, The Hon John Kerin, MP, announced the introduction of the superannuation guarantee levy (SGL) and a gradual increase in the level of compulsory employer funded superannuation to 9% of earnings by the year 2000.

It has been estimated by various commentators that, as a result of the Government's initiative, there will be up to $600 billion invested in superannuation products by the end of the decade — possibly making superannuation as big, in dollar terms, as the banking sector. Regrettably, whenever a sum of money this large is accumulated, the sharks and the charlatans are attracted by the prospect of relieving innocent people of their money. Whereas in the banking and NBFI sectors some of these people have had to be weeded out of the system, the objective in superannuation would seem to be to keep them out before they have a chance to get in.

The Collective Investments Review was announced by the Attorney-General, the Hon. Michael Duffy, MP on 24 May 1991. Following the Treasurer's statement on superannuation, the issue of the regulation of superannuation was referred by the Attorney-General to the Australian Law Reform Commission and Companies and Securities Advisory Committee on 4 September 1991 with a request that an interim report be prepared urgently on the matter.

Aims of the Review

The Review has identified three policy goals in relation to collective investment schemes generally. They are:

- To promote commercial stability and efficiency in capital raising and in long term investments.
- To ensure that there is appropriate protection for investors/beneficiaries.
- To ensure that the legal framework harmonises with the regulation of similar investment vehicles.

The Review's interim report on superannuation is principally designed to overcome a number of deficiencies in the current regulatory regime which must be addressed if superannuation is to be properly and effectively regulated as it expands during the 1990s consistently with those policy goals. Clearly, the second and third aims will be of particular relevance to this interim report.

Some of the more significant issues of concern to be addressed by the Review include:

- The limited power of the Insurance and Superannuation Commission (ISC) to deal with breaches of the Occupational Superannuation Standards by the trustees of a complying fund. Whether the breach is accidental or intentional, the only response available to the ISC is either to exempt the fund or withdraw the fund's 'complying fund' status, resulting in an increase in the tax paid on the fund's earnings, thus disadvantaging the fund beneficiaries rather than punishing the fund trustees.
- The level of prudential control. The further measures foreshadowed in the Treasurer's statement of 20 August need to be implemented quickly to enhance the security of the funds invested.
- The inconsistencies and deficiencies in the disclosure requirements of superannuation services. For example, it is not always possible to compare superannuation services provided even though they may be essentially the same.
- The lack of a clear, readily understood outline of the duties of superannuation scheme trustees. This must be resolved if members are to be able to effectively participate in the management of their superannuation.
- The inability of fund members to practically exercise their rights to seek appropriate remedies in the court system. The complexities of the legal system and the difficulties encountered when trying to take action in situations where beneficiaries of superannuation schemes have suffered loss must be minimised if member control of funds is to hope to be fully effective.

Issues to be addressed

The Review has issued a Discussion paper which contains draft proposals for comment to enable the Review to respond to the Attorney-General by March 1992. The Discussion Paper encompasses the following issues.

What is superannuation?

The Discussion Paper includes a review of the range of superannuation services available. All too often the legal system takes a narrow view when defining an issue. In the case of superannuation the result is that not all the competing products face the same regulatory framework. The lack of a level playing field will distort competition between these products.

The regulatory powers

Concern has been expressed at the lack of effective sanctions possessed by the ISC when dealing with funds which breach the Occupational Superannuation Standards. Charles Williams, Deputy Chairman of the Australian Securities Commission has said of the current sanctions mechanism that it is like trying to cure child abuse by executing the child.

A principal concern of the Review is to ensure that the regulatory regime is adequately able to deal not just with those breaches but the more fundamental breaches of the law by those responsible for the retirement savings of their fellow citizens.

The current regulatory framework will be reviewed to ensure the opportunities for fraud and maladministration are minimised to enhance the integrity of the Government's retirement incomes policy as superannuation is now the central element of that policy. As I said at the outset, it is difficult to believe that this much money can be drawn into the system without the sharks and the charlatans following close behind. The Review aims to produce a system which can keep them at bay.

Prudential supervision

An issue of vital importance to the security and stability of the superannuation savings being encouraged by the Government is the development of a comprehensive regime of prudential controls. As I have already noted, the issue of investor protection is also one of the central policy aims of the Review. The Treasurer, in his press statement of 20 August, announced a significant expansion in the range and scope of prudential controls on superannuation. That statement raises a number of issues which will need to be considered by the Review. These include:

- disclosure
- obligations of Industry Participants, and
- investment controls.

Disclosure

In an Issues Paper, published last September, the Review notes at para 2.26 'the goal of investor protection requires, as a minimum, adequate disclosure to enable the investor or potential investor to make an informed judgment about his or her investment'. An informed membership is a central element of the government's superannuation policy. The fundamental importance of disclosure cannot be underestimated. The Review will examine several aspects of this issue including:

- the need for consistency in the disclosure rules applied to similar competing products to enhance competitive neutrality. This includes consistency in the reporting requirements imposed by the regulating authorities on the providers of superannuation scheme
- the applicability of the enhanced disclosure regime, developed recently by the Companies and Securities Advisory Committee, and
- the appropriate regulation of advertising by the providers of superannuation services to ensure that the information provided to individuals is not only comprehensive but also comprehensible. Members of superannuation schemes need to understand the real purchasing power of the lump sum or pension they will receive on retirement and not be lured into false expectations of a 'pot of gold'.

Obligations on industry participants

A key feature of the Issues Paper was the discussion of the roles of the trustees and managers in collective investments generally. As many superannuation schemes are also established as trusts the issues are equally relevant.

Accordingly, the Review will be examining the roles and duties of the various participants, including, but not only, the trustees and managers of superannuation schemes and addressing issues such as

- The need to codify the duties of the trustees and managers; and

- The need for 'barriers to entry' for the superannuation industry which would prevent individuals or corporations from serving as trustees of superannuation funds or corporations from managing or advising on the management of superannuation funds.

Investment controls

The issue of investment controls cannot be excluded from any sensible or comprehensive discussion of prudential supervision. Unfortunately the debate in relation to the appropriate prudential role for any investment controls on superannuation funds has been clouded by the somewhat premptive claims by various sectional interests for their share of the cake, which, it seems to me, is fast coming to be perceived as a modern-day 'magic pudding'.

The Review will examine critically the calls for 'earmarking' of superannuation. Very persuasive arguments would need to be put to the Review to convince it to travel down this path.

The issue of investment controls for prudential purposes will also be attracting the attention of the Review.

The acceptance of the need for such controls is clearly indicated by the current prohibition on gearing by superannuation funds, the prohibition on loans to members and the restrictions on 'in-house' investment in the sponsoring organisation.

Submissions to this Review and those on the public record submitted to the Senate Select Committee have indicated a desire for changes in these controls. Those arguing for greater prescription of the asset allocation of superannuation funds have, a genuine concern for the safety of the funds invested. However, there are dangers in imposing such restrictions, including distortion of investment patterns as funds acquire assets to meet the asset allocation rules rather than for their value to the fund as part of a diversified portfolio.

However, there is clearly a need to ensure that each superannuation fund has adequate liquidity to meet its liabilities, particularly unexpected payments to members transferring to another fund or

early retirees. While funds are allowed to borrow for short term purposes such as this, borrowings are unlikely to be the only source of liquidity for a prudently managed fund.

The consequences for asset selection by a fund arising from the need to maintain adequate liquidity levels will obviously increase if the ability for fund members to transfer benefits between funds increases. The Review will be carefully considering the impact on liquidity requirements of any of its recommendations relating to transferability of benefits.

Funds and their members

As superannuation coverage spreads throughout the workforce, more and more people will have to deal with a superannuation fund for the first time and it is possible that the likelihood of disputes between fund members and employers such as the recent dispute over the surplus of the Westpac Superannuation Fund will increase.

The Review believes that now is the time to consider developing mechanisms to minimise the likelihood of such disputes occurring in the future, such as the inclusion of clear provisions in trust deeds relating to the distribution of surpluses and the establishment of an ombudsman, or other dispute resolution mechanism which can provide a cost effective alternative to the courts to resolve other disputes between members and fund trustees.

Another emerging aspect of the relationship between members and their fund is the question of so-called 'lost members'. Industry funds in particular are likely to find that many members will move out of the industry leaving behind part of their superannuation savings. The Review believes it is important to develop cost-effective mechanisms to match lost members and benefits to help the government's superannuation policy achieve its retirement income aims.

Superannuation and family law

For many divorcing couples the most important financial assets they own are the family home and their superannuation (if they have any). As superannuation coverage extends across the workforce this situation will increasingly arise. At present the Family Court has limited powers to deal effectively with the superannuation 'assets' of the marriage. If one partner has a large superannuation benefit the only equitable solution under the current circumstances may be to give *all* or nearly all the 'current' assets of the marriage to the other partner leaving one with 'the money' and the other with 'the box'. Surely it would make much more sense to consider each class of asset separately.

Clearly if such a system is seen as more desirable a number of changes to the law would be required to enable the Family Court to make orders binding on the trustees of superannuation funds. The Review will need to consider the implications of these changes as it explores the options in relation to superannuation and family law.

Conclusion

The ALRC and CASAC have some significant issues to deal with and very little time. The entire Collective Investments Review is due to be completed by 1 November 1992. However, the Attorney-General has requested that superannuation take priority. Your input to the process would be most welcome. The Discussion Paper is available now from the ALRC and your comments and submissions are most welcome. □