

Super System Review – Phase Three: Structure (incl. SMSFs)

ASFA Submission

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The Association of Superannuation Funds of Australia is pleased to provide this submission in response to Phase Three – Structure (including SMSFs), of the Review by the Australian Government into the Governance, Efficiency, Structure and Operation of Australia’s Superannuation System (the Review).

ASFA is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, has as members over 90% of the approximately 12 million Australians with superannuation.

Our Constitution requires that we promote and protect the interests of superannuation funds, their trustees and their members. As such we conduct extensive research, engage our membership in debate and offer what we believe is sound public policy which rises above vested interests.

ASFA’s response to the proposed choice architecture model for super (Phase One)

On 14th December 2009, the Review Panel released their Phase One – Preliminary Report entitled “Clearer Super Choices – Matching Governance Solutions” (the report).

While ASFA is supportive of a superannuation system that focuses on member needs rather than product or industry sector perspectives, ASFA does not support the proposed choice architecture model as we believe there are significant issues with what has been proposed.

In general terms ASFA questions:

- whether the choice architecture cannot in fact be accommodated within the existing system which allows for default funds;
- how significant the cost savings for members in “Universal funds” driven by the choice architecture will really be compared to the efficiencies to be gained by improved electronic commerce or by funds achieving greater scale; and
- whether the purported benefits of the proposed choice architecture would outweigh the costs and disruption to the industry of transitioning from the current system.

Further, ASFA would be unequivocally opposed to the choice architecture model if this model requires trustees to set up new funds as this would involve considerable establishment costs for superannuation funds as well as increased ongoing administration costs, which would ultimately be borne by the fund members.

This being said, amending SIS to enable trustees to be subject to member directed investments (possibly within specified parameters) would be very welcome and would allow trustees to offer individually managed accounts within their fund, which would be beneficial for a number of reasons. Firstly, this would create a level playing field between APRA regulated funds and SMSFs. Secondly, it would cater for the increasing appetite for SMSF style funds but provide the protection of APRA regulation.

For further details on our response to the Phase One – Preliminary Report, please refer to Appendix 2.

Phase Three – “Top 5” key initiatives / recommendations

ASFA has made a range of recommendations in our submission to the Review. A summary of these recommendations can be found at the end of this submission, with the detailed responses contained in Appendix 1. However, there are five key issues which we believe are the most important and are outlined below.

1. Insurance

In responding to the insurance issues being raised, ASFA has taken into account the tension between super balances being eroded by premiums with the need for increased level of insurance. There is clearly an issue in regard to members’ retirement savings being eroded by excess or unnecessary insurance premiums and this is made worse where people have multiple superannuation accounts from which premiums are being deducted. However, on balance, ASFA considers that the benefits that default insurance cover provides outweigh the downside of the erosion of superannuation balances.

In relation to insurance matters, ASFA recommends that:

- There should be a minimum level of death and TPD insurance cover in a default (or 'universal') fund, but the level of default cover should be determined by trustees based on their perception of adequacy levels and their knowledge of the needs of their members.
- Members should generally be permitted to opt out of death and TPD insurance cover. Whilst an opt-in arrangement could reduce the instances of small balances being significantly eroded by insurance premiums, we believe that such an arrangement would only serve to exacerbate the current under insurance problem. Also, an opt-in arrangement would be substantially more complex (and costly) to administer and would raise the cost of insurance (due to increased risk associated with an opt-in arrangement).
- Although self insurance would not be suitable for many funds, there may be some circumstances where trustees might consider it advantageous to do so (eg. if their funds are large enough and have the appropriate processes in place). ASFA considers that the decision of whether or not to self-insure should be left to trustees to consider, subject to the prudential supervision of APRA and the trustees having appropriate pricing, management and risk framework in place to effectively operate a self-insurance arrangement.
- It could be argued that income protection insurance is just as important, if not more so, than death cover (particularly for younger individuals without dependants). Whether and on what basis to provide income protection insurance should be a matter for the trustee. That is, trustees should be able to offer income protection insurance as an opt-in arrangement. However, income protection should not be required to form part of a fund's default arrangements as the cost of income protection insurance premiums (i.e. compared to death and TPD cover) would significantly erode members' superannuation balances, particularly smaller balances.
- No volume based commissions should be allowed to be paid on default insurance cover. As with advisory fees, ASFA supports payments based on a fee-for-service basis rather than in the form of commissions.
- Trustees should undertake insurance reviews, just as they do in relation to the fund's investments (eg. every three to five years) to ensure appropriate cover continues to be provided for its membership as a whole, at competitive premiums, and it continues to meet the regulated minimum levels.

2. Contribution caps

The current superannuation system by its very design is most beneficial for full-time employees with a 35 – 40 year working time horizon. Yet today's work patterns look very different for many people (including migrants and those who undertake part-time employment at various points in their life), so it is important that the system has the flexibility to allow those with broken work patterns to fund an adequate retirement income. The current system of annual contribution caps should be reviewed to enable "catch-up" contributions. In particular, we recommend:

- The reinstatement of the \$100,000 annual concessional contribution cap for those aged 50 or over. This could be done for a certain period of time, say 10 to 15 years, on the basis that the next cohort of individuals will have had a longer exposure to the SG contribution regime and so would likely to be less involuntarily under-funded.
- The \$25,000 annual concessional contribution cap for people under age 50 should be increased to \$50,000. That is, in conjunction with the previous bullet point, at the end of the 10 to 15 year extension period for those aged 50 and over, the annual concessional contribution cap would be \$50,000 for all individuals.
- The existing system for transferring pension money from other countries should be reviewed.
- The \$450 threshold for the payment of SG contributions should be removed. However, a minimum dollar payment such as \$10 should still apply for practical purposes.

3. Accountants licensing exemption

The existing accountants' licensing exemption causes confusion around the extent to which the exemption applies and has the potential to produce sub-optimal results for individuals who may be considering establishing an SMSF and should therefore be abolished. Accountants or any other person providing a recommendation in relation to the establishment or ongoing management of an SMSF (or becoming a member of an SMSF) should have appropriate training and be subject to the Australian Financial Services License (AFSL) requirements.

4. SMSF auditors

The current minimum level of expertise required in order to become an SMSF auditor is too low (i.e. essentially anyone with accountants' qualifications can audit an SMSF). The absence of specific requirements to have superannuation knowledge and auditing skills is a weakness in the system. It is particularly important that SMSFs are well audited as, due to their very large number, it is not possible for the Regulator to review more than a small proportion of SMSFs each year. As such, the audit is the only form of oversight which most SMSFs will realistically receive.

To address this, we recommend:

- The introduction of an appropriate mandatory level of expertise in superannuation matters for auditors to maintain. Ideally, the stipulated competency standards for auditors should be an amalgamation of the standards issued by the professional accounting bodies in 2008, the SPAA Specialist Auditor accreditation and the standards issued by the AUSAB in Guidance Statement GS009 Auditing SMSFs.

- SMSF auditors should be placed on a Register of Approved SMSF Auditors that is administered by the ATO. Like tax agents, the ATO will then be able to determine membership of the register and ultimately increase its confidence in the quality of audit.

5. Naming convention for SMSFs

The absence of naming conventions for SMSFs needs to be addressed. As it currently stands, anybody can set up an SMSF with the same name as an APRA regulated fund, thus “mirroring” a well known and fully compliant APRA regulated fund. As with business name registers which do not permit the registration of similar business names, so too names of SMSFs should not be allowed where they are similar to an existing superannuation fund. A mechanism needs to be established that enables the ATO as regulator of SMSFs to prevent such a fund name from being used.

A summary of all of the recommendations is provided at the end of this main submission. However it is important that **this submission be read in conjunction with Appendix 1**, which contains our responses to the consultation questions, and includes more detailed analysis and discussion around the various issues and our recommendations which flow from them.

Appendix 2 contains our response to the Phase One – Preliminary Report issued by the Review Panel on 14th December 2009.

Summary of Recommendations

Our key propositions / recommendations from the above submission are listed below under various relevant headings. It is important that the **recommendations below be read in conjunction with Appendix 1**, which contains the detailed analysis and discussion around the various issues. The references in square brackets relate to the section numbers in Appendix 1 where further details of our responses can be found.

Part A – Structural Issues

Defined Benefit funds [8.1]

- The current approach whereby the actuary is responsible for determining the funding requirements to bring the fund back to a satisfactory/solvent position (up to a maximum of 5 years prescribed by SIS Regulation 9.17) remains appropriate. ASFA considers that this approach provides the flexibility needed to properly address the rectification of solvency issues on a case-by-case basis.
- The three year requirement for formal actuarial valuations is adequate and should be retained, particularly given the costs involved and the time taken for the actuary to prepare the valuation reports (often in the vicinity of 9 months). Also, the formal triennial requirement is supported by an informal monitoring of vested benefits that is undertaken annually for fund accounting purposes.
- Whilst it would be reasonable for employer representatives to be involved in boards of corporate funds, it would not be appropriate to require employer representatives on the boards of all defined benefit funds, particularly given the practical difficulties in implementing such a requirement where funds have multiple sponsoring employers.

Retirement Savings Accounts (RSAs) and Approved Deposit Funds (ADFs) [8.3]

- ASFA notes that RSAs have not been particularly popular as a superannuation vehicle due to their lack of suitability as a long term investment. Notwithstanding this, we do not believe that removing the capital guaranteed nature of RSAs would lead to them playing a larger part in the superannuation system. RSAs are a niche product and the removal of the capital guaranteed nature would remove what is one of the main features of the product. Removing this distinguishing characteristic could potentially lead to greater consumer confusion in regard to exactly what sort of financial product they are.
- Legislation to close ADFs to new members is not required, particularly given the low (and ever declining) number of such accounts remaining. ADFs were introduced in 1984 as an 'approved' fund for receipt of superannuation lump sum payments. However, due to subsequent legislative changes, superannuation funds can accept lump sum or rollovers and, as such, ADFs have become less relevant. The latest APRA statistics indicate that there are only 112 ADFs remaining, with the number declining by around 10 to 20 each year.

Insurance and superannuation [10]

- In responding to the insurance issues being raised, ASFA has taken into account the tension between super balances being eroded by premiums with the need for increased level of insurance. There is clearly an issue in regard to members' retirement savings being eroded by insurance premiums. This issue is made worse where people have multiple accounts. However, on balance, ASFA considers that the benefits that insurance cover provides outweigh this issue. We believe there should be a minimum level of cover in a default (or 'universal') fund, however it would be impractical to link this cover to members' family situations and/or financial circumstances. The level of default cover should instead be determined by trustees based on adequacy levels and their knowledge of the needs of their members.
- Whether or not the amount of insurance cover is maintained or indexed each year should be left for the trustee of each fund to consider.
- Trustees should undertake insurance reviews, just as they do in relation to the fund's investments (eg. every three to five years) to ensure appropriate cover continues to be provided for its membership as a whole, at competitive premiums, and it continues to meet the regulated minimum levels.
- Members should generally be permitted to opt out of death and TPD insurance unless the employer is paying for the cover.
- No commissions should be payable on default insurance cover. As with advisory fees, ASFA supports payments based on a fee-for-service basis rather than in the form of commissions.
- ASFA considers that the decision of whether or not to self-insure should be left to trustees to consider, subject to the prudential supervision of APRA and the trustees having appropriate pricing, management and risk framework in place to effectively operate a self-insurance arrangement.
- Whether and on what basis to provide income protection insurance should be a matter for the trustee. That is, trustees should be able to offer income protection insurance as an opt-in arrangement. However, income protection should not be required to form part of a fund's default arrangements.

Super in the post-retirement phase [11]

- ASFA does not recommend that it be compulsory for retirees to purchase an income stream to mitigate against longevity risk for a number of reasons, including their general lack of popularity, the perception (or reality) that they are very expensive and the risk that this may act as a disincentive for people to contribute more money into superannuation and ultimately result in lower retirement balances. Instead, the Government should introduce incentives for retirees to take them up (eg. an Age Pension means test concession for those who invest more than, say, 25% of their superannuation savings in a longevity insurance or lifetime income stream product).
- There should be no compulsion in relation to the investment strategy applied to post-retirement assets. Retirees should be able to choose based on their level of investment risk appetite. ASFA does not support “lifecycle” or “glide path” fund structures being mandated as a default investment option. Research undertaken by Griffith University suggests that age-based default options have serious flaws and can compromise retirement adequacy by investing people’s retirement benefits too conservatively. Further details regarding our opposition to “lifecycle” or “glide path” structures are contained in our response to Phase 2.
- In order to improve the availability of retirement income stream products, ASFA recommends that the current legislation which restricts product development be reviewed with a view to:
 - o Amending the Income Tax Assessment Act to address the issues covered by the 1988 Income Tax Ruling IT 2480: Variable Annuities.
 - o Modifying or repealing SIS regulations 1.05(2) and 1.06(2) (standards for pensions and annuities) to remove legislative restrictions on the features of qualifying annuities and pensions.
 - o Removing any remaining legislative roadblocks eg. the tax disadvantage for “variable annuity” flowing from the position taken in IT 2480.
- ASFA recommends that there be co-operation between the Regulators in terms of approving new retirement products. Currently product developers must deal with APRA, ASIC, the ATO and Centrelink. This will facilitate the introduction of “new generation” retirement products which would enable retirees to retain the investment risk (as they do now through account based pensions) but share the longevity risk through pooling. It will also provide certainty to members/retirees regarding the treatment of retirement products for social security purposes.
- We also recommend the following measures to improve the availability of retirement income stream products in the Australian market:
 - o A retirement default into a “new-style” product (with access to advice) that has access to growth investment returns and provides both downside market protection and longevity protection.
 - o Training of financial planners to be able to better understand the benefits and role of guaranteed products.
 - o Removal of impediments to product innovation to make retirement income stream products more attractive (eg. capital, re-insurance, availability of Government bonds etc).
 - o Exploration of methods to achieve the weight of numbers purchasing these products to improve their cost effectiveness (low demand makes them expensive).
- It should not be mandatory for trustees to manage pension and accumulation assets separately. By pooling these assets, trustees are able to have larger mandates and hence incur lower investment management costs. Mandatory segregation would lead to smaller mandates and may in turn result in higher investment costs being incurred. Decisions regarding the best way to structure their investments, having regard to the different tax treatment of accumulation and pension assets, should be left to trustees as part of their fiduciary responsibility.

Integrity / security of the superannuation system [12]

- As stated in our response to Phase One of the Review, ASFA supports APRA being granted a prudential standard-making power or a power to give directions in relation to superannuation, however there would need to be appropriate checks and balances in place. Whilst there is no evidence to suggest that the current regulatory regime is particularly inflexible or inefficient or that specific problems exist in the use of Section 31 of the SIS Act (which allows APRA and Treasury to prescribe operating standards for superannuation funds), ASFA supports the need for a strong and pro-active regulator.
- An additional measure to assist in addressing financial risks to the system would be for the Government to fund financial literacy in schools (including literacy on superannuation related matters) in order that future generations may be more informed when engaging with their superannuation.
- ASFA does not support a super guarantee corporation or other statutory insurance to cover a fund failure. Importantly, the establishment of a statutory insurance fund has the potential to create “moral hazard” for trustees. That is, they may reduce their risk evaluation, monitoring and detection activities on the basis that fund members are insured against losses. ASFA supports the current system of determinations of compensation made by the relevant Minister, with an industry levy used to recover the costs of such payments where appropriate.
- There is an urgent need for the adoption of consistent industry wide standards for the labelling of investment options and risks, the definition of investment terms and the classification of assets in terms of risk. In the absence of an industry agreement on an investment terminology standard, ASFA recommends that ASIC or APRA develop and promulgate a set of standards.
- To address the risks inherent in the current manual and electronic processes, ASFA recommends the establishment of a central database of information about superannuation entities. The database could contain information such as the name of the fund, the products it offers, its contact details and its bank account(s) for receiving monies.

- ASFA questions whether the SIS Regulations currently strike an appropriate balance between the right of an individual to be paid a benefit quickly, and the duty of a trustee to ensure that a benefit is appropriately payable and is paid to the owner of the account. ASFA recommends that the SIS regulations be amended to support a fund delaying payment where there are genuine concerns about the identity of the applicant.
- Although SMSFs are currently exempt from the operation of the AML/CTF Act, the Government has indicated its intention to extend the legislation to include SMSFs in the future. During initial industry consultations which have been conducted, ASFA recommended that the AML/CTF Act should be amended to include as a designated service the rollover of a superannuation benefit to an SMSF. ASFA's concern surrounds the ability of a person to become a member of an SMSF using a false identity. By making a rollover to an SMSF a designated service funds would be able to verify the identity of the member (rather than just confirm that the person making the rollover owned the account).
- ASFA recommends that the Government progress the more general inclusion of SMSFs in the AML/CTF regime.
- In our response to Phase Two of the Review, ASFA called for the licensing of administrators who provide services to APRA regulated funds. Given the critical role played by administrators (either in-house or third party) to the integrity and security of the superannuation system, our position in this regard remains unchanged. We believe this licensing requirement should be extended to include administrators of SMSFs.

Participation in the system [13]

- ASFA does not support the introduction of early access to preserved superannuation accounts by Aboriginal and Torres Strait Islander peoples in recognition of the life expectancy gap. The gap in life expectancy at ages around which retirement benefits are generally taken is not very large (around 4.5 years at age 65), and there are similar differences in life expectancy at such ages between high and low income groups, smokers and non-smokers and between men and women. There would also be very substantial administrative issues for funds involved in allowing earlier release of superannuation benefits based on declared ethnicity.
- Please refer to ASFA's recommendations in our response to Phase 2 in regard to better identification of employees when they are enrolled in superannuation funds by employers, which would provide considerable benefits for Indigenous Australians.
- The diagnosis of the problem in regard to imbalances in superannuation entitlement between men and women is reasonably straightforward (refer to our response to 13.2 in Appendix 1 for further discussion and statistics around this issue), but finding solutions to address this imbalance are not as easy. However, ASFA believes that enhancing the co-contribution would assist many women to build their superannuation savings. We are hopeful that the temporary reduction in the co-contribution implemented in the 2009 Budget will be reversed as soon as possible, and ASFA continues to advocate for this to occur.
- As stated earlier in this submission, it is important that the system has the flexibility to allow those with broken work patterns to fund an adequate retirement income. ASFA recommends that the current system of annual contribution caps be reviewed to enable "catch-up" contributions. In particular, we recommend:
 - o The reinstatement of the \$100,000 annual concessional contribution cap for those aged 50 or over. This could be done for a certain period of time, say 10 to 15 years, on the basis that the next cohort of individuals will have had a longer exposure to the SG contribution regime and so would likely to be less under-funded.
 - o The \$25,000 annual concessional contribution cap for people under age 50 should be increased to \$50,000. That is, in conjunction with the previous bullet point, at the end of the 10 to 15 year extension period for those aged 50 and over, the annual concessional contribution cap would be \$50,000 for all individuals.
 - o The existing system for transferring pension money from other countries should be reviewed.
 - o The \$450 threshold for the payment of SG contributions should be removed. However, a minimum dollar payment such as \$10 should still apply for practical purposes.

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

- ASFA supports superannuation being an allowable matter in industrial awards. ASFA also acknowledges that employers and unions contribute to negotiating increases to superannuation contributions in wage negotiations as part of that process. However, as stated in our response to Phase Two, there should be an open and transparent process for selecting a default superannuation fund in industrial awards or through individual selection by employers. ASFA's view is that, where there is discretion for an employer in the selection of a default fund (i.e. where employees are not covered under an award), an effective and efficient method would be for the employer to determine the three or four key features that it perceives as being important for their employees. These key features should then be evaluated and ranked in order to select a default fund eg. investment performance, costs, investment options, insurance arrangements.

Dispute resolution [14.2]

- ASFA does not support the formation of a specialist superannuation court. A stand alone court has the potential to complicate access to remedies by adding a formal, complex and potentially expensive legal layer to resolving disputes. ASFA supports the ongoing operation of the SCT in view of its cost effectiveness and conciliatory approach and its acceptance by members and industry alike. A shift toward a court structure would, we believe, be a retrograde step as it would lead to additional costs and potentially marginalise consumers who have little by way of financial resources. A court system would also introduce an element of adversarialism whereby 'weaker' parties are limited by their access to

quality legal advice. The current dispute resolution model is far more efficient and equitable to all parties (especially fund members) and has been responsible for enhancing the resolution of disputes.

Capital requirements [14.4]

- Currently, the capital requirements as set out in the SIS Act and Regulations apply to trustees whose licence conditions include a requirement to meet specified capital conditions – ordinarily those with licences to operate either public offer or extended public offer funds. ASFA's view is that the imposition of capital requirements for all trustees (i.e. other than trustees of public offer superannuation funds) is not warranted.
- Instead, ASFA supports the imposition by way of a licence condition of an additional amount of liquid assets (i.e. greater than the minimum \$100,000 in cash or cash equivalents) required to be maintained by all trustees to cater for higher levels of operational risk – in effect requiring trustees to maintain adequate operational risk reserves.
- ASFA's view is that it is inappropriate for the custodian to hold the same \$5 million in respect of multiple funds. Instead, we believe there is a need for the existing capital requirements backed by custodians to be linked more directly to the number and size of the funds that rely on the custodian. That is, capital requirements for custodians should be based on a combination of factors relating to the number of clients, funds under custody, complexity of investments as well as a requirement that specific insurances be held by the custodian (eg. professional indemnity – covering negligence, willful misconduct etc). For example, the amount of capital required to be held by a custodian could be based on a formula determined as a percentage of total funds under custody or a multiple of total quarterly operational costs of the funds (eg. twice the total quarterly operational costs).

Legacy products / systems [14.6]

- There is a need in some cases for targeted relief to enable individuals in expensive legacy structures to be assisted to move to alternative (i.e. non-legacy) products. That is, legislative change is required in order to remove these impediments without diluting consumer rights, such as the introduction of a single legislative mechanism to enable financial product rationalisation and the amendment of State Stamp Duty laws to provide tax neutrality where product rationalisation has been undertaken. Please refer to our response to 14.6 in Appendix 1 for the full list of ASFA's recommendations which we believe would facilitate the elimination of legacy products.
- Legacy systems are also a big issue across the industry and are an impediment to further consolidation of super funds. ASFA believes that specifically targeted tax incentives are required to encourage the rationalisation of legacy products and closure of legacy systems. For example, a tax deduction could be provided on genuine expenditure incurred (over the course of a specified period – say the next 3 to 5 years) in the course of rationalising legacy products and closing legacy systems.

Part B – SMSF Issues

ASFA believes that, for the effective operation of the superannuation system, there needs to be a level playing field between APRA regulated funds and SMSFs (wherever possible). Examples of where there is currently not a level playing field include, amongst other areas, tax effectiveness when a member moves from the accumulation phase to the draw down phase and the ability to offer individually managed accounts.

Trust model [17.1]

- ASFA believes the trust structure remains appropriate for SMSFs, including single-member SMSFs, and should be maintained. It safeguards the fund's assets from the member's external liabilities and requires decisions to be made in the best interests of all members. It is also important that SMSF assets be clearly distinguishable from the personal assets of an SMSF member/trustee. This in turn is arguably in the best interests of trustees, members and the broader community.

SMSF trustees [17.2]

- ASFA believes the current restriction which prohibits employer/employee relationships within SMSFs, unless the employer and employee are related, is still appropriate. Where employees are related to the employer; the familial relationship still in theory offers some protection that might not otherwise exist in the case of unrelated individuals.

Trustee education [17.2.1]

- SMSF trustees should have the knowledge to understand the rules. However, given the depth and complexity of superannuation laws, any trustee education should be limited in scope to the SMSF trustee's basic obligations and should not attempt to make all SMSF trustees an expert across superannuation, taxation and trust law.
- There needs to be clear evidence that all individuals who act as a trustee of an SMSF have sufficient knowledge to understand their roles and exercise their duties as trustee. Any education program needs to be mindful of the overall cost to the trustee. By design any basic skills course should be a half day course, presented in a non technical format that is available online.
- The Government should offer incentives for trustees to undertake education/training. This could take the shape of, say, the SMSF requiring to be audited every 2nd year where it can be established that the SMSF trustee has undertaken certain continued trustee development as provided by a suitable Registered Training Organisation (RTO). Having undertaken a suitable course could also act as a mitigating factor in the event of a breach occurring. Conversely, additional trustee education could be mandated where breaches are serious or repeated.

Regulatory framework [17.4]

- It may be useful to provide the ATO with some 'directive' powers so that it has some immediate measures that it can employ to promote and encourage compliance. Giving the Commissioner the power to direct SMSF trustees would streamline the ATO's ability to rectify breaches.
- Insofar as trustees of SAFs are RSE holders, APRA regulation of SAFs is appropriate. To move the regulation of SAFs to the ATO would be to also move a prudential requirement for the ATO in regard to SAFs.
- We do not believe that there would be any discernible efficiencies to be gained if the ATO were responsible for SAF reporting and data collection activities.

Dispute mechanisms [17.4.3]

- ASFA does not believe an external dispute resolution mechanism is required to address complaints involving SMSF members/trustees. Such disputes should be resolved in the relevant courts rather than SCT. The court system is better equipped to handle these disputes. However, for disputes involving disenfranchised 3rd parties (eg. death benefit distribution to beneficiaries who are not trustees), there is an argument that these should be considered/resolved through the SCT.
- Without the prudential supervision that applies to APRA regulated funds, it would not be appropriate to put in place financial assistance provisions similar to those which apply to APRA regulated funds. There would be considerable moral hazard issues involved in that the trustees/members of SMSFs could invest in risky ventures in the knowledge that compensation could be paid if the investment fails.
- For disputes involving the ATO, ASFA does not believe there is a need for a revamp of the current resolution mechanism for SMSFs. It is arguable whether the cost and complexity involved in establishing an alternate process would in fact lead to improved outcomes for SMSF members with respect to the resolution of complaints. We believe the current process involving an initial internal review by the ATO followed by access to the AAT should be retained.

Penalties [17.4.4]

- A flexible range of penalties should be developed that provides the ATO with the ability to adequately and quickly respond to non-compliance as well as drive behavioural change. A sliding scale of penalties that allows the ATO to impose penalties by way of smaller amounts of fines or extra tax for minor infringements all the way to making the fund non-compliant and the loss of all tax concessions is, we believe, more in line with modern regulation.

Compliance coverage [17.4.5]

- From a practical perspective, the ATO cannot possibly review every single SMSF, even on a rolling basis. The ATO currently engages approx 3% of the current SMSF population in some form of compliance activity. This equates to approx 12,000 funds a year whereas registrations have averaged 25,000 new funds a year for several years now. Even though registrations have slowed, the numbers are still imposing. It is therefore imperative that SMSF approved auditors become a more central player with respect to compliance (discussed further below and in section 20.2 of Appendix 1).
- The supervisory levy applied to SMSFs should also be increased to reflect the actual cost of the regulatory activities that the ATO experiences in doing this compliance work, similar to the manner in which APRA levies APRA-regulated funds. However, any increase in supervisory levy must be justified by the ATO on the basis of a significantly enhanced regulatory review framework.

ATO binding rulings [17.4.6]

- There would be benefit in extending the legally binding ruling system to the SIS Act and, in so doing, create an equivalent to the private ruling system for income tax. Providing such guidance would increase clarity, consistency and confidence of the SMSF sector in its management of its day to day activities. The current rulings regime that is administered by the ATO is enabled by legislation under the Taxation Administration Act 1953 (TAA) and does not extend to the SIS Act. For the ATO to be able to deliver binding advice, by way of either a public or private ruling, an appropriate amendment will be needed to the TAA.
- Rulings could also be extended to apply to products marketed to SMSFs. Product rulings would enhance the regulatory framework.

Data [18.3]

- At present the industry is struggling to agree on consistent labelling to use when comparing APRA regulated funds i.e. definitions for fees and investment returns. Therefore, ASFA believes it is premature to expect current day data to allow a comparison between APRA funds and SMSFs. In order to enable better comparability between funds, there needs to be a compulsory standardised way of categorising assets into “growth” and “defensive”. There is also a need for compulsory rules for placing investment options into the categories of “growth”, “balanced” etc. ASFA is currently working with APRA, ASIC and IFSA on standardised classification of assets. However, if agreement on definitions cannot ultimately be reached, ASIC should mandate compulsory definitions which the industry would need to adhere to.
- The Review Panel’s recently released publication ‘A statistical summary of self managed superannuation funds’ was an improvement on the statistics which the ATO has issued and should form the basis for the standard information published on SMSFs going forward.
- ASFA believes that the ATO and APRA are the most appropriate entities to collect and provide data to the industry as they are already the repositories of the data (since funds are required to provide information to the regulators in the course of lodging their statutory returns). Unless clearly demonstrable benefits to the industry can be established by other market participants (non Government bodies) collecting and publishing data, this function should remain with the ATO and APRA.

Accounting standards [18.4]

- In ASFA’s view it makes prudent sense to require SMSFs to complete general purpose financial reports so that assets are annually marked to market, as is currently required by APRA regulated funds. However, we believe that external valuation of the assets should not be required.

SMSF costs [18.5]

- The issue of comparing costs within the superannuation industry has proved problematic. For any comparison to be worthwhile there needs to be a standardised methodology so that all relevant costs are presented on a consistent basis. For SMSFs, the issue of cost allocation is particularly problematic since each SMSF is essentially unique and, depending on the assets which the funds invest in, costs could vary significantly. As such, determining the best method of comparing the cost of running an SMSF with the cost of other fund types is difficult. However, for the purposes of industry-wide comparability and consumer protection (and to provide a level playing field in terms of the requirements of APRA regulated funds), SMSFs should be required to report their total costs, split between administration and investment costs, as well as investment returns in their annual accounts.
- ASFA considers that, in general terms, the current compliance and maintenance requirements for SMSF trustees reflects the importance of preserving the integrity of the sector, and the superannuation industry as a whole, and the need to comply with the law. The number of service providers that SMSFs are required to interact with (lawyers, financial planners, accountants, auditors etc) makes for a complex process. However, this does not mean the establishment and ongoing compliance/maintenance process is necessarily inefficient. Where a subset of the industry such as SMSFs are unlicensed and self managed, it is only reasonable that checks and balances be established to ensure integrity and compliance with the system.

Custody of SMSF assets [19.1]

- There is no evidence of custody problems in regard to SMSFs. Third party custody of SMSF assets would not assist in removing instances of illegal early release. ASFA does not believe that the mandating of custodial arrangements, for an additional period or universally, is appropriate (or required). Also, the requirement for SMSFs to have their assets custodially held would only serve to add another layer of costs (for little or no discernible benefit).

Assets and asset allocation [19.2 – 19.4]

- As a general rule, ASFA's view is that decisions around investments should not be prescribed, including decisions around asset allocation and investments 'in financial assets'. It should be left to trustees to decide the most appropriate asset allocation for their SMSF, whether in the accumulation or pension phase, particularly since the SMSF sector sits outside the paternalistic model (i.e. SMSF members are not like 'universal' members where the trustee of the fund acts as an investment fiduciary).
- ASFA believes that there is always room to improve the standard of preparedness of SMSF trustees regarding their role as trustee. This includes greater access to quality information and advice. An online training tool would greatly assist in this regard, including but not limited to information on investment concepts. ASFA is currently in the process of developing such a tool.
- SMSF trustees should be required to have a documented investment strategy. The current regulatory framework does not provide adequate regard to the importance of a sound and considered investment strategy. An investment strategy is fundamental to good governance and achieving adequate retirement outcomes. The investment strategy for SMSFs should be in writing to assist trustees in reviewing whether or not they are on track to meet their investment and retirement objectives.
- Investments by SMSFs in related parties should continue to be limited otherwise the potential risks to tax revenue from related party transactions as well as the risks to the security of the retirement benefits of SMSF members would be too great. The current arrangements which generally prohibit SMSFs from acquiring assets from related parties are appropriate and should be maintained.

Accountants [20.1]

- The existing accountants' licensing exemption causes confusion and has the potential to produce sub-optimal outcomes for individuals who may be considering establishing an SMSF and should therefore be abolished. The confusion has been heightened in part by a focus on the concession given to accountants under Regulation 7.1.29 of the Corporations Act, without regard to the overall intent and application of the licensing and disclosure requirements. ASFA's view is that accountants need to have appropriate training and hold an AFSL if they want to provide advice on matters regarding superannuation.

Auditors and the lodgement of returns [20.2]

- Consideration should be given to requiring the lodgement of returns at an earlier date where breaches have been reported in the prior year. This occurs to some extent already where a fund that has not lodged a tax return in the previous year needs to lodge both the outstanding return and the current return at an earlier date.
- The annual audit is the main compliance assurance mechanism for SMSFs. ASFA believes that it would be a risk to the system to move to an audit program that was less frequent than annually. As such the annual audit should remain, unless an appropriate incentive scheme that rewards compliant behaviour with less frequent audits (say every 2nd year) can be successfully implemented.
- ASFA also supports the specific SMSF auditing standards announced by the major accounting bodies that are mandatory for members of these associations wishing to audit SMSFs for financial years commencing on or after 1 July 2008. However, ASFA's preferred option would be to these standards made mandatory by law. The current mandatory requirements are insufficient requirement where to be an SMSF auditor the individual may be a registered auditor under the Corporations Act or be associated in a specific manner with a professional accounting association. The absence of specific requirements to have superannuation knowledge and auditing skills is a weakness in the system.
- Being affiliated with an appropriate professional body should be a mandatory requirement for SMSF auditors. However, the type of body should not be limited to professional accounting bodies. The biggest weakness with current requirements is that neither superannuation knowledge nor auditing skills are mandatory. This weakness in the system should be addressed through the introduction of an appropriate mandatory level of expertise in superannuation matters for auditors to maintain.
- Ideally, the stipulated competency standards for auditors should be an amalgamation of the standards issued by the professional accounting bodies in 2008, the SPAA Specialist Auditor accreditation and the standards issued by the AUSAB in Guidance Statement GS009 Auditing SMSFs.
- All SMSF auditors should be placed on a Register of Approved SMSF Auditors that is administered by the ATO. Like tax agents, the ATO will then be able to determine membership of the register and ultimately increase its confidence in the quality of audit. This in turn would free up compliance resources currently needed in "auditing auditors" to other more useful compliance tasks.
- The ATO registration process needs to be able to vet its registration process better so as to determine the legitimacy or otherwise of the individual seeking registration.

Advisers [20.3]

- Greater responsibility should be placed on those who provide advice to SMSF members (eg. financial advisers) to ensure comprehensive information is provided that is relevant to the member's personal financial circumstances. The competency standards of financial advisers who provide advice to SMSF members should be increased beyond RG 146, which is the minimum set of standards for the training of advisers.
- Advisers should have a fiduciary duty to ensure each individual trustee of the SMSF understands what they are getting themselves into (i.e. their roles and responsibilities) when advising individuals on whether or not to establish or acquire an SMSF. This duty should be elevated in regard to less sophisticated trustees (not just the 'dominant' trustee who generally has a greater level of knowledge than the other trustees).

Separately Managed Accounts [21.2.2]

- Amending SIS to enable trustees to be subject to member directed investments (possibly within specified parameters) would be very welcome and would allow trustees to offer Separately Managed Accounts within their fund, which would be beneficial for a number of reasons. Firstly, this would create a level playing field between APRA regulated funds and SMSFs. Secondly, it would cater for the increasing appetite for SMSF style funds but provide the protection of APRA regulation.

Number of members [21.4]

- There may some appeal from some quarters for increasing the number of members allowed in an SMSF. The Joint Parliamentary Committee on Corporations and Financial Services considered an increase to 10 members as appropriate. However, current ATO data shows that 89.4% of funds have 2 members or less. On face value, there appears to be no real pressure on the current restrictions with few funds today having 3 or 4 members. Also, four members or less provides the opportunity for all members to have a say. ASFA does not support an increase in the limit of the number of members in SMSFs. We do not believe there is any benefit to be gained from increasing the current SMSF membership limit. Nor do we see this as a significant issue for the industry, particularly given the many other issues that should be addressed to improve the structure and efficiency of the system.

Barriers to entry / Minimum monetary balance [21.5 – 21.6]

- ASFA recognises that a substantial minimum balance is likely to be needed to enable the SMSF to be cost effective (anecdotally this amount is purported to be in the region of \$300,000–\$400,000). In order to minimise the instances of Illegal Early Release (IER) schemes, which typically target individuals with balances less than \$25,000, it could be argued that it would be beneficial to stipulate that an SMSF cannot be established with a rollover from a non-SMSF of less than say \$30,000. However, enforcing such a minimum requirement would be difficult from a practical perspective. The concept of a minimum monetary limit is sound, but unmanageable. ASFA does not support the mandating of a minimum monetary balance due to the practicality issues involved (please refer to our response to 21.6 in Appendix 1 for further details). We believe that having a substantial account balance at establishment is only part of the solution. What is also required to better, and more practically, address this issue is improved financial literacy and education of SMSF trustees/members as well as better publication of data around registered SMSFs on the Super Fund Lookup (SFLU) database (discussed further in 22.4 in Appendix 1). Also, advisers should be more accountable regarding advice provided to individuals to establish an SMSF. That is, they should have a fiduciary duty to ensure each individual trustee understands what they are getting themselves into (i.e. their roles and responsibilities) and should have to explain the reasons for establishing sub scale funds.

Early release on financial hardship grounds [22.1]

- There is some intuitive appeal for requiring regulator approval before allowing SMSF members to access their superannuation on hardship grounds as this would remove some potential opportunities that currently exist for individuals to illegally access their super without satisfying the strict criteria set out in the SIS Act. However, introducing requirements for regulator approval on financial hardship cases for SMSFs would involve additional responsibilities for the regulator and therefore increased compliance costs.
In our submission to the Senate Select Committee on Superannuation and Financial Services in December 2001 on their inquiry into early access to superannuation benefits, ASFA recommended that all claims for financial hardship (for both APRA regulated funds and SMSFs) should be processed by a centralised agency in order to achieve a cost effective and consistent approach across the industry. Centrelink already provides certification to trustees on whether an individual has been receiving an eligible income support payment for the requisite timeframe. It could conceivably fill the role of a single approving authority by also undertaking the evaluation process of whether an individual is entitled to an early release on financial hardship grounds as an extension of their current role. That is, subject to appropriate guidelines being established, Centrelink could potentially conduct the process of determining whether an individual is "unable to meet reasonable and immediate family expenses" rather than this role continuing to be undertaken by trustees. Not only would our proposed solution remove some potential illegal early access opportunities for SMSFs by having an independent third party making the final determination, but it would also remove the obligation to consider financial hardship claims from trustees of APRA regulated funds and would result in a consistent approach across the industry.

Registration process [22.3 – 22.4]

- The process for establishing and registering an SMSF is currently too simple. The registration of an SMSF should not be instantaneous, and based solely on the provision of a TFN. The ATO needs to do more to analyse who is behind the SMSF registrations with proper vetting of applicants.
- ASFA supports the ATO's initiative of strengthening the SMSF registration process with the aim of ensuring all new registrants are risk assessed prior to being allowed to operate. Whilst this would likely necessitate a small delay in the registration process to allow for effective risk profiling to occur, ASFA believes the benefits to the security of the entire superannuation system far outweigh any inconvenience caused by delays to the registration of SMSFs.
- There are currently no naming conventions for SMSFs which means anybody can set up an SMSF with the same name as an APRA regulated fund, thus "mirroring" a well known and fully compliant APRA regulated fund. As with business name registers which do not permit the registration of similar business names, so too names of SMSFs should not be allowed where they are similar to an existing superannuation fund. There is no mechanism within the current law that enables the ATO as regulator of SMSFs to prevent a name from being used. We believe that this flaw in the legislation should be addressed.
- There should be a requirement for a separate bank account for each SMSF and the ATO should obtain proof of same at the point of registration as part of its risk profiling process.
- The ATO should also work closely with industry associations, such as ASFA and the ABA, to ensure that proof of identity requirements are paramount when opening a bank account for SMSFs.
- The ATO needs to find a better way to describe the status of newly registered SMSFs on the Super Fund Lookup (SFLU) database. ASFA supports the ATO's initiative of allocating a new status of 'Registered – status not determined' to newly registered SMSFs until such time as the fund lodges its first annual return and has been assessed as either complying or non-complying.
- The ATO has removed approximately 500 SMSFs that were suspected of involvement in illegal early release (IER) schemes. ASFA believes that access to this list would be of great use to the industry, such that superannuation funds and administrators can cross check against the list and stop any pending payments to funds on the list (and investigate and report any payments that have already been made to any of these funds).

Life insurance default [22.6]

- Unlike default arrangements in APRA regulated funds (where a minimum level of insurance cover needs to be offered but not necessarily provided), ASFA contends that there is no need for an insurance default within the SMSF sector. The requirement for compulsory death or disability insurance is inconsistent with the self-managed character of an SMSF since all members are trustees and are capable of arranging insurance cover through the SMSF if they desire. Also, the proposed minimum level of insurance cover will almost certainly be inappropriate for this group, most of whom will have either a need for far higher levels of cover or believe they have no need for insurance cover.