Benefits and costs of the regulation of superannuation

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Executive summary

The existing literature on compliance costs and benefits related to the regulation of Australian superannuation funds and trustees would make up a very slim volume. Apart from partial and large unquantified assertions in the Explanatory Memorandums of various pieces of amending legislation, very little material is available.

This research paper attempts to fill this void by presenting an analytical framework for evaluating the costs and benefits of superannuation legislation and also by reporting recent and previously unpublished survey results on the costs of regulation.

Rationale for regulation

The rationale for government intervention basically rests on there being some sort of market failure. In the financial sector, the main sources of possible market failure are:

- Anti-competitive behaviour (providers ganging up on customers and/or exercising monopoly power)
- Market misconduct (such as insider trading, or telling fibs about your product)
- Information asymmetry (buyers making bad decisions because they know less about the product than sellers, thereby losing money when an investment unexpectedly goes bad)
- Systemic failure (where confidence is lost in part or whole of the financial system because of the failure of one or more financial institutions)

Benefits of regulation

Evaluating the benefits of regulation is not an easy thing to do either conceptually or numerically. One of the reasons for this is that outcomes after regulation need to be compared to a projection of how things would be without the regulation. This reliance on a comparison with a counter-factual outcome makes any evaluation problematic. Even when the nature of changes is well understood, it can be difficult to attach values to things like improved disclosure.

These conceptual and quantification difficulties might explain why in a recent survey of superannuation fund trustees by Queensland University of Technology researcher Sue Taylor some 42% of respondents indicated that no benefits were expected for members of funds from the APRA licensing process. However, the majority of fund trustees indicated that there were benefits.

Benefits include better documentation of risk management processes and in some cases the introduction of better risk management processes. There also have been improvements in fund governance, particularly through the removal from the sector of the small minority of very small corporate funds that were not acting in the best interests of all members. The extent of improvements in the governance of larger funds is more debatable, but it is clear that funds have been required to give more formal attention to matters of fitness and propriety of trustees. There also has been additional training for both trustees, along with training for staff that have contact for members.

Disclosure by funds has also become more comprehensive and comparable, but no studies are available as to whether this additional information is understood and has been used by consumers.

Another important benefit of regulation is the putting in place of effective mechanisms for dealing with actual or potential conflicts of interest.

Costs of regulation

The need to comply with regulation has led to superannuation funds incurring costs over and above what they would in conducting a business activities in the absence of such regulation. There also are additional costs brought about by uncertainty, unintended consequences, and inconsistency and duplication brought about by regulation.

Ongoing costs of APRA and ASIC recovered through **the supervisory levy** are running at an amount in excess of $42 million a year. Since APRA and ASIC came into existence in 1998 levies have grown substantially, with exponential growth in the levies paid by large funds. Very large funds have experienced a 650% increase in levies since 2001-02. No decrease in levies is in sight despite the much reduced number of funds remaining in operation being better run.

An ASFA Research Centre survey of ongoing compliance costs suggests that on top of the levies funds incur aggregate costs of the order of $135 million a year. Compliance costs range from $50,000 to $100,000 for a small fund to over $10 million a year for a large retail fund with an extensive adviser network.

Compliance costs for the funds responding to the survey typically amounted to between 10% and 20% of their total administration costs.

Overall, the most substantial costs incurred by the funds surveyed were for internal compliance staff, legal, actuarial and audit costs, and training of staff. The bulk of compliance costs would appear to be attributable to prudential requirements administered by APRA, but there also are significant costs relating to breach reporting and training of staff attributable to Corporations Act requirements administered by ASIC.

In addition to ongoing compliance costs there were also direct and indirect costs for funds and trustees in obtaining APRA and ASIC licences. Calculations by ASFA suggest that trustees spent more than $50 million in aggregate on the direct and indirect costs of obtaining RSE licences with the bulk of this on outside legal and consultancy costs. Another survey conducted by Sue Taylor at the Queensland University of Technology has found reported costs to be between zero and $900,000, with a mean of around $130,000. Due to confidentiality concerns there was a lack of data about the size of the funds covered in this survey, so it is not possible to use the results of this survey to estimate aggregate costs for the entire sector. However, costs of $10.5 million were recorded for the 81 trustees responding.

Overall conclusion

Aggregate ongoing compliance costs are substantial, and have increased rapidly in recent years. Compliance costs now amount to on average around 10% of the total administration costs of the funds they relate to. Increased compliance burdens have made a substantial contribution to the 10% or more a year increase in administration costs experienced by a range of funds in recent years.

However, the relevant question is whether there is value for money from the current compliance regime. The evidence and analysis in this paper suggests that there have been benefits delivered, but not all regulatory interventions have benefits exceeding the compliance costs. The regime of breach reporting to both APRA and ASIC is one where the costs of compliance appear to now exceed any benefits that accrue to fund members. Given that the cost of compliance is ultimately paid by fund members this is a matter of concern.

The paper also points to the dangers of regulatory contagion, where prudential arrangements appropriate for insurers or approved deposit takers are imposed without very good reason on all superannuation funds.

The paper also points to the benefits of improved disclosure by funds, but here too the costs of compliance have become significant. Any opportunities to reduce compliance costs while maintaining meaningful and relevant disclosure for fund members should be fully explored.

1. Introduction

As the Commonwealth Treasury (Treasury, 2006) noted in its recent submission to the Parliamentary Joint Committee Inquiry into the Structure and Operation of the Superannuation Industry, it is important that regulation represents an appropriate and measured response to the problem being addressed. Treasury went on to state that compliance costs associated with regulation are a concern for all businesses and especially small businesses, and that the Government is committed to reducing the burden of red tape to improve the economic environment further so that all businesses can prosper and grow, while at the same time maintaining a strong and effective prudential regulation and consumer protection framework that ensures financial sector entities such as superannuation funds are able to meet their promises to consumers.

The Treasury also noted that any increase in costs to funds should be "balanced against the greater confidence members can have that their retirement savings are being managed in a manner consistent with best practice and the significant benefits for consumers through the introduction of consistent basic standards for financial advice and disclosure across the industry, including to allow consumers to compare like products" (page 20).

Apart from demonstrating a Treasury commitment to somewhat overlong and balanced sentences (something I also have a tendency to), this indicates that determining the optimum level of regulation is no easy thing. Benefits need to be estimated, and then set against both direct and indirect costs associated with new and existing regulations.

Such estimates are supposed to be provided as part of the Regulation Impact Statement required to be included with every new piece of legislation. This paper would have been easier to write if more relevant information had been provided in the supporting documentation for several key pieces of legislation, such as that establishing the Australian Prudential Regulatory Authority (APRA), or the Safety of Superannuation amendments. It would have been a very easy paper to write if comprehensive and accurate forecasts of costs and benefits had been provided.

However, the information provided in regard to a number of legislative measures has been on the scant side. For instance, the supporting documentation for the legislation establishing APRA claimed that its establishment would not impact on industry costs given that APRA would be administering existing powers under the Superannuation Industry (Supervision) Act. Subsequent developments in both the level of levies paid and in compliance costs of funds indicate that this assumption was somewhat heroic although a number of factors have been at work. More specifically, APRA soon developed an appetite to develop and implement improvements to the prudential and legislative framework for superannuation so as to enhance trustee accountability and safeguard member interests.

There may have been moves in this direction even without the establishment of APRA, but APRA stated at the time that the APRA licensing and Safety of Super proposals were being developed that "this project primarily reflects APRA's desire to bring the supervisory system for superannuation into greater alignment with that of other

supervised industries" (APRA, 2003). Establishing just one prudential regulator for all financial institutions subject to regulation had the consequence of bringing about pressures (at least from the regulator) for uniformity in regulation across sectors. Whether such uniformity is justified is an issue addressed later in this paper.

The Regulation Impact Statement for the Superannuation Safety Amendment Bill 2003 also was remarkably bereft of any numbers, instead making a variety of qualitative statements about the costs and benefits of the measures proposed. One of the few hard numbers in the Statement was that in the ten years since the inception of the SIS Act in 1993 the Government had paid out approximately $33 million in grants of financial assistance under Part 23 of the Act for losses resulting from theft or fraud. This represented less than 0.00006 per cent of the then superannuation assets, a very small percentage.

The Regulation Impact Statement anticipated that in terms of the costs and benefits for superannuation fund members, the new framework would reduce the risk of loss to superannuation fund members from a superannuation fund failure and that members would benefit from expected improvements in the quality of trustees and fund management.

As to the costs to members, it was anticipated that there might be increased compliance costs which might be passed on to members. The impact on members was anticipated to depend on the size of the entity and how well it was managed. Trustees that already were following best practice were expected to face a smaller increase in compliance costs in order to meet the new requirements compared to those trustees not following best practice. Reference was made to anecdotal evidence from APRA that it was trustees of small employer sponsored funds that would need to devote the greatest level of attention to meet new processes. APRA also indicated that it was amongst these sort of funds, generally those with less than $5 million in assets under management, that most of past APRA enforcement action had been directed.

There also has been other significant regulatory reform of superannuation, including the disclosure requirements under legislation administered by the Australian Securities and Investments Commission. The Explanatory Memorandum for the Financial Services Reform Bill 2001, which introduced the requirement of point of sale disclosure through a Product Disclosure Statement for all financial products, was similarly optimistic about the relative benefits and costs of what was being proposed.

More specifically, consistent disclosure across the spectrum of financial products provided in the market was seen as being beneficial for product providers as "many entities that now offer several financial products, currently subject to different regulatory regimes, will benefit from having the same disclosure requirements apply to all products". It was also considered that "this will ultimately decrease compliance costs, although industry will probably incur some costs in the initial stages". The part about incurring some costs in the initial stages has certainly proven to be true, but some of the other predictions are more questionable in the light of actual experience.

Consumers were also seen by the drafters of the Explanatory Memorandum to benefit from the new regime "as a consistent standard of disclosure will allow consumers to compare functionally equivalent financial products, and lead to increased consumer

confidence and participation in the financial sector". Whether this statement has proven to be correct could be tested by an empirical study, but this would be a very costly exercise as a very large population study might be required to find a consumer who had used the new standard of disclosure to compare superannuation products with other financial products which arguably could be regarded as equivalent.

However, it would not be fair to judge recent regulatory changes impacting on superannuation based on claims made in Explanatory Memorandums. Such documents are often prepared in the context of the political process and are subject to significant time constraints, and not every cost (or benefit) is foreseeable.

The next sections provide a theoretical framework for evaluating benefits and costs, before moving on to survey and other quantitative estimates of the benefits and costs of recent regulatory changes. Attention is also given to recent and prospective supervisory levies paid by superannuation funds and ultimately by superannuation fund members.

2. Rationale of regulation

The rationale for the regulation of financial services was set out quite succinctly in a paper by Steve Somogyi, a then member of APRA (Somogyi, 2004).

As he pointed out the primary rationale for regulation of financial markets is the existence of market failure. The need in a political context for government to be seen to do be doing something also can be a factor, but this was not explored at all in his paper.

In the financial sector, the main sources of possible market failure are (with my translations in brackets):

- Anti-competitive behaviour (providers ganging up on customers and/or exercising monopoly power)
- Market misconduct (such as insider trading, or telling fibs about your product)
- Information asymmetry (buyers making bad decisions because they know less about the product than sellers, thereby losing money when an investment unexpectedly goes bad)
- Systemic failure (where confidence is lost in part or whole of the financial system because of the failure of one or more financial institutions)

As Mr Somogyi also noted, the need for intervention is generally greater in retail rather than wholesale markets, because in wholesale markets there is a greater balance in knowledge amongst buyers and sellers. On the other hand, for a retail purchaser of a product like home insurance it would be unrealistic to expect such a buyer to undertake comprehensive due diligence. Regulation may be needed to ensure that there is high probability, if not certainty, of promises being delivered to consumers. The need for this is especially so given the consequences for an individual of non-payment of insurance following a catastrophic event will be dire.

The descriptions of market failure set out above are fairly easy to follow, but generally the case for increased or enhanced regulation of superannuation is put even more simply. Often the analysis amounts to little more than the assertion that superannuation should be safe. The notion that superannuation should be safe is difficult to argue with.

It is a bit like getting agreement to the goal of world peace. Most people are in favour of this, but there can be debate about exactly how to go about it. Sometimes the claimed means to achieve world peace can be more unpleasant than the initial warfare.

A number of reasons are normally recited as justifying the regulation of superannuation, although the link to specific regulatory measures can be tenuous. A principal reason normally given is that compulsory superannuation, as the second pillar of our retirement income system, is the key policy initiative to meet the coming age crisis. A well-funded and well-run superannuation system will enable Australia to meet this crisis, by providing an adequate retirement income to Australians (more than the Age Pension alone) and avoiding a future blowout in Age Pension costs and resulting taxes.

Superannuation is also important to individual Australians. As noted by numerous commentators (including me) in a variety of contexts, it is now the second most important personal asset for most Australians, after their home, and is often their only form of liquid savings (subject of course to the rules relating to preservation and release of benefits). The argument goes that as superannuation is compulsory and aimed specifically at providing a retirement income, ensuring the safety of an individual's superannuation is all the more important. Assurances of adequate security also promote community confidence for compulsory superannuation.

However, a recognition that both superannuation and the safety of superannuation are important should not be taken as implying that measures in force at any given time were necessarily inadequate, or that more regulation is better, because safer is better. Nothing comes without a cost. Care needs to be taken that the costs of a course of action do not outweigh the benefits that might be achieved or indeed that there are some benefits from the course of action adopted.

In improving safety, it also needs to be recognised that our system attempts to blend the benefits derived from compulsory saving with the dynamism of the free market. Superannuation contributions are made to privately administered and invested funds rather than into a central government fund. International experience has shown that national superannuation schemes are generally costly to administer and open to political involvement, to the detriment of investment returns. Alternatively, a private system produces better returns and, if regulated properly, can keep costs down and investment returns up.

However, a privately administered system does necessarily raise issues of safety. The need to deal with the tension between safety and returns is recognised in the OECD's Selected Principles for the Regulation of Investment by Insurance Companies and Pensions Funds which notes:

> "The regulation of investment must pursue the twin goals of the security and profitability of the funds invested ie. they must guarantee commitments but generate financial income as well. Regulations that promote only one of these objectives would not be effective."

Safety has to do with the elimination or in most instances the reduction of risk or danger. As such, any changes to improve the safety of superannuation must be based on a thorough assessment of the realistic risks. Arguably such a risk assessment was not

undertaken in a full and thorough fashion in the development of the current regulatory regime for superannuation. For instance, as ASFA pointed out at the time (ASFA, 2002), the Options Paper of the Superannuation Working Group did not provide a detailed risk assessment of the superannuation industry. Instead there was a smattering of vaguely worded paragraphs, largely based on the general views of the regulators, making up the extent of the Options Paper's risk assessment. Only very limited specific cases or examples were referred to, with these also often of marginal relevance to the regulation of superannuation. The fact that in the past regulation of general insurers and specifically the supervision of HIH were not well done does not imply that there should be more regulation of all superannuation funds, regardless of the specific circumstances of each type of fund and the nature of superannuation benefits.

As ASFA pointed out back in 2002, the greatest risks in the superannuation sector involved agency risk. Specifically, incidences of fraud and theft had occurred in situations where there was poor fund governance, usually involving the dominance by an employer sponsor or sponsors or a service provider in a very limited number of small funds. In larger funds with well developed governance structures which ensured meaningful input by representatives trustees such problems are extremely uncommon. Similarly where Approved Trustees were associated with very substantial financial institutions this ensured the adoption of appropriate management systems and controls.

The failure of funds for which Commercial Nominees of Australia Limited was a trustee was a superannuation safety matter, but it could be argued that the powers in place should have been sufficient to deal with such cases. Commercial Nominees was an Approved Trustee, and there was in effect licensing and screening of the Trustee before it commenced business. There also should have been a capital requirement for that Trustee, but it never has been clear what exactly happened in that regard. However, there are many things about that episode that still are not very clear, including to those who were intimately involved.

In fact strict reliance on the principles for intervention specified by Mr Somogyi would give rise to regulation of superannuation which was relatively light, at least in regard to most areas of superannuation. Possible grounds for intervention are addressed in turn below.

Anti-competitive behaviour

There is little evidence of anti-competitive behaviour by superannuation funds. Even after the impact of APRA licensing on fund numbers, there are still over five hundred funds, with over 200 of these public offer funds open to any employer or any person wishing to contribute to superannuation. Competition is fierce both in the retail sector, and most importantly in the provision of bulk superannuation arrangements for medium to large employers.

There is no evidence of collusion or exercise of monopoly power. Even if there were prudential regulation of the type currently exercised by APRA would not have an impact on the exercise of monopoly power other than to entrench it through creation of barriers of entry to new players. Similarly, current regulation by ASIC in regard to disclosure and market conduct would appear to be of little relevance to the control of anti-competitive behaviour even if it existed. Choice of fund legislation and the

regulations permitting portability of account balances also would largely negate the need for any further regulatory action if there were any evidence of monopoly behaviour.

Market misconduct

In regard to market failure brought about by market misconduct, there is some case for regulations designed to promote confidence in the efficiency and fairness of markets by ensuring that markets are sound, orderly and transparent. However, given the nature of superannuation funds their involvement in insider trading and market manipulations is unlikely, and even if this did happen it would be to the benefit of members through enhancing investment returns.

Agency risk, where a provider of services may not act in the best interests of the customers of a service, is a major potential form of market failure. Accordingly, there are well developed legal mechanisms which seek to deal with such market failure. These are contained in trust law, in the SIS Act, and in the Corporations Act.

Trust law and governance arrangements can provide powerful mechanisms for avoiding conflicts of interest and dealing with them when they arise. This is particularly the case where there is both member and employer representation on trustee boards.

ASIC in Policy Statement 181, Licensing: Managing Conflicts of Interest, sets out the Corporations Act obligations of licensees which are in addition to any obligations under the general law. The three mechanisms that licensees are generally expected to use to manage conflicts of interest are:

(a) controlling conflicts of interest
(b) avoiding conflicts of interest
(c) disclosing conflicts of interest

The conflicts management obligation is more than simply a disclosure obligation. The obligation is to have adequate arrangements in place to manage conflicts of interest.

Comments made from time to time by the regulator and by at least some politicians suggest that representative trustees without prior relevant experience in the financial sector are a negative factor for a trustee board. However, effective representation of both members and employer sponsors can add significantly to the effectiveness of fund governance and the avoidance of agency risk. In fact the greatest losses due to theft and fraud in the superannuation sector occurred as a result of decisions and actions by the highly professionally qualified members of the board of Commercial Nominees.

A case for regulatory intervention might also arise in regard to requiring disclosure to be clear and accurate (and consistent across funds). This objective has been strongly supported by ASFA. If consumers are to make meaningful choices between funds and about options available within funds they need to have easy access to relevant information that is presented in a form that is understandable to them.

Clearly ASIC and the government (and all political parties) share these sentiments. However, the implementation of improved disclosure requirements has not been without significant flaws. In particular, the "Clear, Concise and Effective" disclosure regime in

many instances has turned disclosure into a lawyers' and compliance officers' picnic. This is in part due to the design of the legislation and in part due to the way it has been enforced. "Name and shame" enforcement action in regard to what at least some trustees would regard as only arguable or minor breaches leads to risk averse trustees devoting considerable resources to compliance. This has also been a factor in the strong tendency of trustees to provide comprehensive rather than concise and effective communication.

Information asymmetry

The amount of information needed and available to consumers will vary with the type of product, and hence the need for regulation will vary with type of product. As Mr Somogyi put it, some financial promises are very onerous, with the creditworthiness of products such as insurance contracts and bank deposits difficult for consumers to assess. The need for prudential supervision of insurance becomes even clearer when you have regard to the description of insurance by some colourful participants in the industry as a product where the provider takes your money and then gives you a bit of paper which is backed only by the promise of the provider. With superannuation the promise to the consumer is backed by specifically described assets held on a trustee basis.

Trust arrangements where assets are managed on behalf of the customers are financial promises that are relatively easy to honour in that they contain very general and flexible obligations, and also are easy to assess for creditworthiness. In essence, the higher the intensity of the promise the greater the need for prudential regulation. The corollary of this is the lower the intensity of the promise, the lesser is the need for prudential regulation. A lack of any fiduciary duty between the provider of a financial service and the customers of such a service also can increase the need for prudential supervision.

While defined benefit superannuation promises fall more within the onerous and not very transparent category, most superannuation products and most superannuation fund members are involved in arrangements which are relatively simple and for which promises are easy to keep. Consumers bear the investment risk with accumulation accounts, and provided there is adequate disclosure there is little objective need to prudentially regulate such products.

Fiduciary duties associated with trust arrangements also play an important role. A trustee structure brings with it all of the legal and practical protections flowing from such arrangements. On the other hand, there may be a need to regulate defined benefit superannuation schemes because of the nature of the promise made, and the dominance of employer sponsors in the governance arrangements for such funds. At the very least there may be a need for defined benefit fund promises to members to be backed by actual financial assets rather than just by promises by an employer sponsor.

Systemic failure

Third party or systemic risk occurs where failure of one financial institution to honour its promises leads to a general panic as individuals fear that similar promises made by other institutions may be dishonoured. The knock-on effect on the counterparties of a failed financial institution is another situation where contagion and systemic failure can occur.

However, given that there are many superannuation funds, most superannuation contributions are made by employers in response to their Superannuation Guarantee obligations, and there are preservation requirements restricting ready access to account balances, the risk of systemic failure in the superannuation sector is very low. As well, funds in almost no instance will be exposed to transactions where there is a counterparty risk attributable to dealing with another superannuation fund.

The possibility of systemic failure as a justification of regulation of superannuation is more a matter of rhetoric than reality.

It could also be argued that the main risk of systemic failure faced by superannuation funds is that failure in a regulated entity such as an insurance company (think HIH) can lead to the regulator and the government applying a regulatory framework that might be appropriate for deposit taking institutions and insurance companies to all prudentially regulated entities, including superannuation funds.

Other causes of systemic failure in regulation through over-regulation of superannuation include the regulatory contagion of notions in the Wallis Committee report that financial products and providers of financial products are steadily converging. Adoption of such ideas leads to policy positions which seek to impose similar prudential obligations on all providers of financial products. A related concern can be that it would provide competitive advantages to superannuation if superannuation faces a less onerous regulatory regime than, say, that faced by deposit taking institutions such as the banks.

Such regulatory contagion is not peculiar to Australia. For instance the Prime Minister of the United Kingdom has stated that "In my view, we are in danger of having a wholly disproportionate attitude to the risks we should expect to see as a normal part of life. This is putting pressure on policy making and regulatory bodies ….. to act to eliminate risk in a way that is out of all proportion to the potential damage. The result is a plethora of rules, guidelines, responses to 'scandals' that ends up having utterly perverse consequences" (Blair, 2005). While that speech was made in the context of damages claims for personal injuries, the argument is also relevant for the regulation of financial institutions.

3. Evaluating the benefits of regulation

Evaluating the benefits of regulation is not an easy thing to do either conceptually or numerically. One of the reasons for this is that outcomes after regulation need to be compared to a projection of how things would be without the regulation. This reliance on a comparison with a counter-factual outcome makes any evaluation problematic. While in some cases the future in the absence of intervention might be a reasonably straight line projection of the past, in other cases the future might be very unlike the past for a variety of reasons. As well, outcomes achieved might be despite rather than because of a regulatory intervention. In other instances, regulation might have unexpected or not very well understood consequences either good or bad.

Particular care needs to be taken in order to avoid the perils of *post hoc, ergo proctor hoc* type evaluations. Using a trivial and not altogether relevant example, the efficacy of wearing a bright yellow hat in warding off rogue elephants is not tested by the

absence of elephants in Pitt Street (or Queen Street) Mall it you stroll along wearing a bright yellow hat. On the other hand the absence of rogue elephants (or rogue trustees) might have something to do with controls over the entry into the areas concerned by rogue elephants (or trustees). However, even in this latter case judgements need to be made about the incidence of rogue behaviour and the cost effectiveness of checking every entrant to the street or sector concerned. The evaluation of the efficacy and efficiency of ongoing monitoring also needs to take into account the impact initial screening activities which reduce the likelihood of an event happening.

But enough of these philosophical wanderings. Actual evidence and structured evaluation is far more worthwhile than speculation.

One potential source of evidence on the benefits of regulation is to undertake a survey asking those that who should know what the benefits of regulation of superannuation have been. This was done by Sue Taylor of the Queensland University of Technology earlier this year in a survey of some 90 holders of a Registrable Superannuation Entity licence. This was a reasonably representative sample of the just over 300 holders of RSEs in existence.

While the responses of trustees were clearly subjective views, it is interesting to note that out of the trustees surveyed 42% of responses indicated that no benefits were expected for members of funds from the APRA licensing process. However, the majority of respondents indicated that there would be benefits, with better governance and improved risk management the most commonly mentioned benefits (Table 1). Some respondents appear to have named more than one benefit from APRA licensing.

Table 1: Benefits of APRA licensing volunteered by respondents

Benefit	Frequency of response	Percentage of responses
None	38	42%
Better governance	18	20%
Improved risk management	14	14%
Improved prudential standards	9	10%
Compliance	6	7%
Other	33	28%

Source: Preliminary results of a survey of RSE holders, 2006

A survey of APRA staff involved in the regulation of superannuation funds might give even more positive views on the impact of licensing and enhanced supervision of funds. Again there would be some subjective elements in any such evaluations.

In terms of the objective evidence available a number of benefits can be clearly identified. It is clear that all funds now have much **better documentation** of their various policies and procedures, especially those relating to the **management of risks**. In some cases this will have involved funds for the first time systematically addressing all the risks they face and developing appropriate responses and policies dealing with such risks. In other cases the practices and policies would already have existed, but what is new is the documentation meeting APRA's requirements.

APRA most likely has also stimulated superannuation trustees to address some risks at a level of detail they would not have otherwise undertaken. Whether all this activity is worthwhile is not self evident, as it relies on a balancing of costs and benefits. For instance, the APRA 2006 Annual Report indicates that APRA, while not wanting to overstate the potential risk for Australia, believes it is prudent for financial regulators to ensure that Australia's financial system is as prepared as practically possible for a pandemic – whether arising from Avian flu or another source. As a result of this concern by APRA, considerable resources have been devoted by APRA and the range of regulated financial entities to this issue.

The creation of barriers to entry to the superannuation sector inherent in the licensing regime has led to some specific benefits. One area in particular has been the elimination of practices adverse to the interests of at least some members and to tax collections that were carried out by trustees of some very small corporate funds and hence **reducing the incidence of agency risk.** Certain such funds, never members of ASFA, had assets of less than $2 million, with these assets in some cases being applied more to the benefit of the employer sponsor than necessarily to members of the fund generally. There even have been suggestions that some small corporate funds were originally set up as a sort of unofficial tontine, where the owner/manager of the company was angling to take the greatest share of the fund assets after the departure of assorted unfortunate employees. The owner manager also had considerable control over the departure of the staff even in pre Work Choices times. Some such funds also dabbled in or even specialised in related party transactions, which seldom benefited non-related parties or tax revenue.

Even before APRA licensing such behaviours were being dealt with by the regulators, and a number of funds closed down of their own accord or as a result of regulator enforcement action. In some cases, funds continued in existence, but with new trustees. For instance, the Tunstall Bond Superannuation Fund and the Wall and Ceiling Superannuation Fund were two relatively small funds where the courts found that related party transactions at non-market prices disadvantaged members of the funds, with various trustee directors of the funds being disqualified for their efforts with some even facing criminal prosecution. See http://www.apra.gov.au/media-releases/05_27.cfm and http://www.apra.gov.au/media-releases/05_41.cfm for further details.

The reduction in diversity in the sector from the members of such funds being transferred to better run superannuation funds certainly is not a loss for the sector. The introduction of vesting requirements as part of the compulsory superannuation regime also reduced the opportunities in small corporate funds for owner managers to take a disproportionate share of benefits.

Such opportunities have in practice been eliminated by the introduction of trustee licensing. The hurdles involved in becoming licensed have meant that there are no trustees with assets under their trusteeship of under $2 million, as the costs of obtaining a trustee licence in such circumstances far exceed the potential benefits for the employer sponsors concerned. While only a small minority of very small corporate funds engaged in improper practices and the number of affected fund members was numerically small, elimination of this problem area delivers benefits for fund members and the sector more generally.

More generally the legislation and regulations administered by ASIC and APRA provide benefits in the form of **management of conflicts of interest**. Both APRA and ASIC licensees have responsibilities to control the inevitable actual or potential conflicts of interest that arise during the course of business. This requires the identification of actual or potential conflicts of interest and the assessment and evaluation of those conflicts. Appropriate responses might range from disclosure of the conflict, to an individual or individuals withdrawing from a decision making process, to a fund deciding not to be involved in a transaction. The required response will vary with the circumstances of each actual or potential conflict of interest. Informed consent by an affected party after full disclosure can be a powerful tool for dealing with conflicts of interest but it will not always be effective.

The requirement for each RSE to address the **fitness and propriety** of trustees and key staff may also have led to benefits for funds in terms of improved governance in funds both small and large. However, passing a more comprehensive police record check merely indicates that a person has not yet been convicted of an offence. The criminal justice system would not have very many customers if a previous clean record indicated that no crime would be committed in the future.

In this context it is interesting to note that the largest losses due to theft and fraud that have occurred in the superannuation sector have been in funds which had Approved Trustees who presumably had to satisfy APRA of their fitness and propriety. Both Commercial Nominees and EPAS had numerous trustee directors with commercial and other relevant professional qualifications (see the (then) Senate Select Committee on Superannuation and Financial Services, 2001 for further details). In these cases certain trustee directors had their own private business opportunities which they pursued, so a commercial or financial services background is not necessarily an indicator of fitness or propriety. An honest but initially unskilled representative trustee will provide more protection for members of a superannuation fund than a highly skilled but corrupt professional. While APRA clearly wants to screen out the corrupt, it can be argued that there is a continuing role for representative trustees who may not have professional skills but are willing to participate in training and to ask the hard questions of the professionals who do the day to day work of the fund.

Going forward one indication of the efficacy of the regulatory regime will be the incidence of losses due to theft and fraud, and the subsequent incidence of compensation paid to affected funds which is financed out of Financial Assistance Levies. The year 2006 has already seen a dramatic falling away in the amount of compensation paid or recovered from funds, but this is largely due to the case of Commercial Nominees now having been substantially dealt with, at least in a compensation sense. Around $3 million was collected in compensation levies in 2005-06 compared to $32.7 million in 2004-05 (APRA, 2006). The bulk of compensation paid actually happened in 2002-03 with the requirement to pay compensation in sharp decline since then.

Hopefully the RSE regulatory regime will keep the incidence of theft and fraud very low through better regulating superannuation entities. It should be particularly effective in preventing the sort of thefts and frauds that occurred in very small corporate funds, as there no longer are any very small corporate funds. Its effectiveness in preventing theft

and fraud like that which occurred in Commercial Nominees can only be tested by experience over time.

It is also likely that both SIS and Corporations Act requirements have led to better or certainly more formal **training** trustee directors and staff of funds. This should have favourable outcomes in terms of better governance and improved customer service, but the extent of such benefits is difficult to quantify. Training requirements as described in ASIC Policy Statement 146 have now become pervasive throughout the financial sector, including superannuation. ASIC has sought to ensure that AFSL licensees have staff and representatives that are adequately trained and competent to provide the services covered by their licence.

Clearly customer service representatives are now better trained and/or have more closely supervised scripts for their interaction with fund members. The downside to this is a reluctance by staff, particularly those that are not licensed, to venture into any area which might conceivably be regarded as provision of advice although on most reasonable assessments amounts to no more than the provision of information or education. When personal or general advice is being given now it most likely is more soundly based and better supervised, but most likely less information and advice is being given. There is no longer scope for an enthusiastic but untrained amateur to provide advice.

There have also been benefits from **improved disclosure**, but these benefits are hard to quantify. For instance, there is little objective evidence that consumer decision making has been improved and/or that market failure has been reduced. This absence of evidence flows from a lack of structured evaluations being undertaken rather than there being an absence of benefits. However, it is certainly true that if a member or prospective member does want information about a fund, then it generally will be available from the fund's Product Disclosure Statement. Information about fees and charges and their impact also is disclosed on a consistent basis, but again a very large population survey might be required to find a consumer who has actually used fee tables in PDSs to compare superannuation products. If disclosure materials were easier to read then it might be easier to find someone who has read on of them.

That said, more comprehensive and consistent disclosure does assist both individual fund members and professionals in evaluating various funds. I certainly now find it much easier to collect information on fees, charges and other important characteristics of funds. The limited set of consumers wishing to make use of calculators and other tools for comparing funds also now have better access to data to enter into such calculators.

The more comprehensive (although not necessarily concise) disclosure also feeds into work by tender consultants, rating agencies and those responsible for putting together approved lists for financial planners. Most employees are in funds because of default and other arrangements entered into by employers, with professional advice contributing to this process. However, such professional advisers often continue to rely heavily on information provided to them directly by superannuation funds rather than by way of a Product Disclosure Statement.

Against these various benefits the costs of regulation need to be considered, and these are addressed in the next sections.

4. Costs of regulation

Regulation imposes direct compliance and administrative costs on superannuation funds, and administrative costs on government. In the case of superannuation these latter costs for government are recovered from the sector and ultimately from fund members through the supervisory levy. This recoups relevant regulatory costs of APRA, ASIC and the Australian Taxation Office. Trustees have also been required to pay up-front fees in order to obtain licenses from APRA and, where required, from ASIC.

Compliance costs comprise both the 'paper burden' of preparing and lodging various forms and returns, and the costs of having to change the way the operations of the fund are conducted. In the case of superannuation funds this can involve both the direct costs of doing additional things, and the potential reduction in investment returns brought about by certain investment activities being prevented or made more difficult to conduct.

A recent New South Wales Independent Pricing and Regulatory Tribunal draft report (IPART, 2006) provides a good typology of the costs of complying with regulation. Adapting this material to the circumstances of superannuation funds provides the following breakdown of costs:

- Salary and on-costs of employing compliance officers and others directly involved in compliance activities.
- Amount of salary and on-costs of other fund employees that is attributable to compliance activity.
- Cost of legal, auditing, actuarial and other services in regard to compliance over and above what would be required in normal commercial circumstances. For instance, external auditing of financial accounts is a normal commercial practice, but formal auditing of a risk management plan is a cost related to regulatory requirements.
- Cost of developing reporting and other systems in order to meet compliance requirements.
- Ongoing costs of breach reporting.
- Cost of preparing and distributing disclosure and member reporting material over and above that which would be required in the absence of regulatory requirements.
- Educating and training direct staff and those employed by any administrator that is used in order to meet ongoing compliance requirements.

This typology focuses on the **extra costs** brought about by regulation. It excludes costs attributable to prudent management of a business.

Other more general costs of regulation include:

- Uncertainty. Financial and other costs are incurred when the meaning of rules and regulations is uncertain, or regulations are interpreted inconsistently by officers of the regulatory agency concerned, or where inadequate guidance is provided on what is required to comply with the relevant regulations.

- Unintended consequences. Regulations can produce unintended consequences or indeed perverse outcomes.
- Inconsistency and duplication. This occurs where existing regulatory requirements of other agencies are not adequately considered when new regulation is being considered, leading to arbitrary variations in requirements.

Those familiar with the superannuation industry are all too aware of examples of each of this latter group of potential costs. However, they can be difficult to precisely cost.

The next sections of this paper provide quantitative estimates of the various major and more easily measured costs incurred by superannuation funds either directly or indirectly because of the requirement to comply with regulatory provisions.

5. Supervisory levies

Ongoing costs of APRA and ASIC recovered through the supervisory levy are running at an amount in excess of $42 million a year (APRA, 2006a). The bulk of this, around $32 million, goes to APRA for ongoing supervision work. There is also recovery in the current year for a past shortfall in costs recovered through more funds winding up than was assumed in past levy calculations, and for the shortfall in revenue relative to costs associated with APRA licensing. On top of all of this there is smoothing by APRA of its recovery of costs.

These assorted special items make year to year comparisons difficult, but basically the costs recovered through the supervisory levy have tended to increase or at least remain the same each year despite a fall in the number of trustees and funds being supervised.

Since APRA and ASIC came into existence in July 1998 the supervisory levy paid by superannuation funds has in almost all instances grown substantially. The increase has been greatest for the larger funds. For instance, prior to the establishment of APRA the maximum levy paid to the ISC by a superannuation fund was $14,000. In 2006-07 there will be some funds paying a supervisory levy in excess of $400,000. This is a massive increase.

Table 2 provides details of the levies paid by different sized funds in recent years. The largest increases in levies paid have been for the larger funds, where the incidence of fraud, theft and other prudential concerns has been quite low. Further substantial increases in levies for larger funds are anticipated to occur in 2007-08 following the cessation of certain transitional arrangements limiting the increases for larger funds.

Table 2: Supervisory levy by fund size, various years

Year	$50m	$250m	$5billion	$20 billion
2001-02	$12,500	$53,000	$53,000	$53,000
2003-04	$17,500	$85,000	$85,000	$85,000
2005-06	$21,500	$101,400	$146,800	$290,100
2006-07	$17,745	$88,725	$164,500	$397,000
% increase since 2001-02	42%	67%	210%	649%

Source: Assorted levy determinations, available from www.apra.gov.au/Superannuation/Levies.cfm

This growth in levies and continuing substantial expenditure by the regulators has not gone unnoticed. ASFA in its submission to the Government on the supervisory levies to apply in 2006-07 noted that the funding required by APRA in regard to the supervision of superannuation entities continues to increase in real terms despite a substantial decrease in the number of entities it supervises. ASFA noted that APRA has argued that funds are larger but the overall number of fund members and supervisory costs borne by members will remain the same. However, such an argument ignores the fact that APRA should be able to and should be attempting to reduce supervisory costs given the improvements in the risk profile of superannuation trustees now available following APRA licensing, and the more comprehensive documentation and policies that trustees and funds are required to maintain and apply. Having fewer entities to supervise must also decrease some costs.

On the other hand, attracting and retaining high calibre staff does not come cheap. This has been noted by the IMF in its recent Financial System Stability Assessment of Australia. The IMF in particular stated that "it will be important that both APRA and ASIC have the financial resources, and flexibility in deploying these resources, that are needed to ensure that sufficiently well-qualified staff are available to meet the challenges of implementing Basel II and effectively implementing principle-based approaches to supervision, especially of the large banks". As both APRA (APRA, 2006) and the IMF have noted, APRA has its cadre of experienced staff but turnover among more junior staff is relatively high. A number of funds have indicated to ASFA that there is both frustration and additional costs for funds arising from the actions of inexperienced junior regulator staff and from inconsistencies in approach from regulator staff based in different states.

Remuneration is always a factor in retaining staff, but other factors can be important as well. Salaries can be high in the financial sector, with challenges for regulatory agencies in meeting the market. However, APRA has increased the salaries it pays in recent years. For instance, in 2005-06 there were 28 APRA executives with remuneration in excess of $175,000 a year compared to 23 the previous year (APRA, 2006).

ASFA understands that an APRA paper on the impact of changes in the superannuation industry on supervision and the consequent costs recovered through the levies is due to be released soon. This paper is expected to address issues relating to regulatory costs in the period after 2006-07. Hopefully, the paper will indicate that there will be considerable scope for APRA to reduce supervisory costs relating to superannuation in the years following 2006-07, and that levies set for those years should reflect this.

However, it should be noted that APRA uses an averaging mechanism in allocating costs to each sector it supervises. Even if supervision costs for superannuation were to fall substantially in 2006-07 (a not very likely prospect it must be said given APRA is checking carefully on the performance of commitments made during the licensing process) it would be some years before this fully flowed through into the levies charged. As well, with the likely ending in 2006-07 of transitional arrangements limiting the maximum increase for a fund, the levies paid by the largest superannuation funds are set to increase to $500,000 or more, a ten fold increase on the levy they paid in 2001. Small funds might benefit from a future reduction in the levy they pay, but they are likely to be paying more than they did in 2001 in both nominal and real terms.

6. Ongoing compliance costs

Superannuation fund administration costs have increased markedly in recent years. Increases in administration costs of 20% or more per year have been recorded over the last two years by a range of funds. While this has at least been in part related to strong growth in membership for a number of funds, growth in compliance costs has been identified by fund trustees as an important contributing factor.

This has been borne out by survey results. Back at the turn of the century (the year 2000) an ASFA survey of fund administration costs found that legal expenses and other compliance related expenses amounted to not much more than 1% of fund expenses in most instances (Connor, 2001). However, by 2006 that proportion appears to have risen to between 10% and 20% of total administration expenses for many funds.

In October 2006 the ASFA Research Centre contacted each ASFA member fund seeking details of the compliance costs incurred by such funds in meeting the obligations administered by ASIC and APRA. The survey questionnaire employed the language and methodology described in Section 4 above in that what was sought was information on the "*additional expense incurred due to regulation*" rather than the total costs of an activity which is justified at least in part on commercial grounds. Initial costs in obtaining a licence and the ongoing supervisory levy payable by all funds are in addition to these surveyed compliance costs.

The survey results are still being compiled and analysed, but preliminary results indicate that ongoing and additional compliance costs are substantial:

- $50,000 to $100,000 for a relatively small fund, more if retail or defined benefit.
- For industry and corporate funds with assets around the $5 billion level, annual costs of between $300,000 and $600,000 were not unusual.
- For funds with assets in the $10 billion to $15 billion range annual costs of up to $3 million.
- For funds with assets in the $15 billion to $20 billion range annual costs of over $3 million.
- Over $10 million a year for very large retail funds.

Compliance costs tended to be higher for retail funds relative to other funds of similar size. This presumably reflects the compliance costs of maintaining an adviser network and the greater complexity of products offered in most instances.

Funds with very large membership numbers also tend to have higher compliance costs compared to funds with lower numbers of members but similar asset levels. This most likely reflects the impact of increased communication costs to members and the necessity for funds with very many members to have expensive reporting systems of various sorts. Larger funds also appear to be better at identifying compliance costs, especially when they have staff of the trustee with roles largely devoted to compliance tasks rather than paying third parties for a package of services which include compliance elements.

Defined benefit funds or funds with defined benefit divisions also incurred additional costs compared to accumulation funds with similar asset levels, often for actuarial services.

Table 3 sets out estimates of the distribution of trustees by assets under trusteeship. Applying ASFA Research Centre estimates of the average compliance costs for funds of various asset levels to the distribution shown below suggests total compliance costs of the order of $135 million a year. This is on top of the amount paid by funds in the form of supervisory levies. When such costs are included the total compliance costs for the sector are of the order of $180 million a year.

Table 3 - Structure of the superannuation sector after licensing

Asset Range ($)	**APRA 2006 Trustee Nos**	**Aggregate ongoing compliance costs for funds in each category**
<20m	40	$3 million
20-100m	80	$6 million
100-250m	38	$3 million
250-1,000m	64	$19 million
1-5b	53	$21 million
5-10b	19	$11 million
10-20b	11	$34 million
20b+	3	$39 million
Total	**307**	$135 million

Compliance costs for the funds responding to the survey typically amounted to between 10% and 20% of their total administration costs.

For a large fund (over $5 billion in assets) the costs of running an internal compliance unit typically are at least $150,000 to $250,000 a year. Such funds also typically have legal, audit and actuarial costs of at least $200,000 a year with some very large funds having costs well in excess of this amount. Some large funds can have costs for compliance officers and applicable salary and oncosts for General Counsel and/or Company Secretary in excess of $600,000, with costs related to compliance linked to the employment of a range of other staff as well.

Breach reporting is a relatively expensive process even when relatively trivial breaches are being reported. Costs for this can easily exceed $70,000 a year for a large fund (with small funds typically having rather lower expenses for this cost category). Where funds need to seek legal advice on whether events have to be reported as breaches, the costs can reach hundreds of thousands of dollars a year. Where a fund has faced regulator action leading to an enforceable undertaking the additional costs can be in excess of $200,000.

Reported costs of meeting enhanced disclosure requirements are less than $50,000 a year for a number of funds, but some large funds reported additional costs of $150,000 or more, with a figure of over $250,000 for one very large fund. A number of funds also reported significant costs for developing reporting and other systems to meet compliance costs, with one fund noting that estimated total development costs over the last five years had exceeded $3 million.

Training costs varied markedly between funds, not always related to the size of the fund concerned. This may have something to do with the incidence of the use of third party administration and other service providers. For funds that self administer and hold an AFSL the costs of PS 146 training can be substantial.

Overall, the most substantial costs incurred by the funds surveyed were for internal compliance staff, legal, actuarial and audit costs, and training of staff. The bulk of compliance costs would appear to be attributable to prudential requirements administered by APRA, but there also are significant costs relating to breach reporting and training of staff attributable to Corporations Act requirements administered by ASIC.

In addition to ongoing compliance costs there were also direct and indirect costs for funds and trustees in obtaining APRA and ASIC licences.

7. Costs of APRA and ASIC licensing

7.1 APRA licence

The direct costs for a superannuation trustee to obtain an APRA licence are not negligible but they also are not very large. All superannuation trustees require a Registrable Superannuation Entity (RSE) licence. Application fees were (and are) $20,000 for public offer and extended public offer licence applications, $5,500 for general non-public offer entity licence applications, and $3,500 for small non-public offer licence applications. This last category for small existing funds was pretty much a non-event as either none or just a few such entities applied.

In the Explanatory Memorandum for the Safety of Superannuation legislation it was anticipated that the total costs of the licensing process for APRA would be in the range of $8 to $15 million. By my reckoning APRA raised about $3.5 million from the 315 or so applicants. APRA has indicated that there was a $1.9 million shortfall in recovery of costs associated licensing. Given that the pricing of licence applications was based on the assumption that around 400 trustees would apply this sounds about right. The $1.9 million shortfall is being recovered through the supervisory levy arrangements. This effectively turns the $5,500 application fee into a total cost of around $10,000, and the $20,000 application fee for public offer applicants into a $30,000 fee. However, the exact fee paid in total by each trustee is a bit more complicated than this given the structure of the supervisory levy and the fact that it is paid by each fund rather than each trustee.

There also were substantial indirect costs associated with applying for an RSE licence given that it involved much more work than applying for, say, a season rail pass. Some organisations undertook in-house most of the required work for completing their

application, while others made extensive use of outside consultants and legal practitioners. Diversion of internal resources involves a substantial opportunity cost, while outside assistance did not come cheap. Anecdotal evidence and partial survey evidence compiled by ASFA suggests that some trustees of large funds incurred costs associated with licensing of $700,000 or more with expenditure of around $300,000 not uncommon. However, some trustees incurred considerably lower, but still substantial, external costs. Preliminary calculations by ASFA suggested that trustees spent more than $50 million in aggregate on obtaining their RSE licence, with the bulk of this for outside legal and consultancy costs.

Clearly the amounts spent by trustees were far in excess of the relevant application fee for a licence and should not be confused with that fee. Ross Jones, Deputy Chairman of APRA, in a letter to the editor of the *Australian Financial Review* published on 3 July 2006 clearly makes this distinction, as well as attempting to put the fees and levies collected by APRA into the context of overall fund and trustee expenses.

Fortunately there will be a much more structured and comprehensive account of the direct and indirect costs of obtaining an APRA RSE licence than the largely anecdotal reports to date. A survey of superannuation trustees was conducted by Sue Taylor at the Queensland University of Technology in mid-2006. The survey focused on the costs, benefits and outcomes that trustees experienced in the Registrable Superannuation Entity licensing process.

The full report of that survey is currently being finalised, but the author has kindly provided me with a summary of some of the main results. Due to confidentiality concerns the survey did not collect information about fund size, so it is not possible to use the data to estimate total costs for the sector or typical costs for funds of a certain size, if indeed costs were related to membership numbers or assets under trusteeship.

In regard to the reported costs incurred for meeting the RSE licence requirements, the 90 respondents reported costs of between zero and around $900,000, with a mean of around $130,000. There was significant clustering of costs in the range of $40,000 to $160,000. In regard to the type of relevant costs identified by respondents, 33% of respondents listed salaries and trustee time, 29% listed legal costs, 23% listed consulting costs, 21% listed application costs, 7% listed audit costs, 5% listed compliance costs, and 21% listed costs which were classified by the study's authors as "other".

Overall, for the 81 trustees that filled in their total costs, their expenditure on the licensing regime was approximately $10.5 million in aggregate. Many licensees added in the comments that their figures were included "at a very conservative estimate". The ASFA estimate referred to above of aggregate costs in excess of $50 million for the entire superannuation sector is not inconsistent with the QUT survey finding.

Estimated yearly costs for ensuring that the trustee meets the APRA licensing requirements ranged from zero to $600,000 in the QUT survey. The mean figure was $56,000. In regard to the type of relevant costs identified by respondents, 21% of respondents listed salaries and trustee time, 25% listed audit costs, 22% listed legal or consulting costs, 17% listed compliance costs, 5% listed APRA costs, and 12% of responses were classified as other.

It should be noted that the survey only sought information about compliance costs related to obtaining and maintaining a RSE licence from APRA rather than total compliance costs for the entity. There also appears to be under-reporting of costs as some respondents did not list the application fee for an RSE licence, or the ongoing supervisory levies paid by funds.

7.2 Licence from ASIC

The fee for applying for an AFSL licence from ASIC is substantially lower than for an RSE licence, being $270 for an application lodged electronically, and $540 for a paper based application. However, as with applying for an RSE licence, the application fee is normally the smallest component of the overall cost. Anecdotal evidence suggests that some funds incurred costs of $100,000 or even substantially more in the course of preparing their AFSL licence. The funds incurring large costs normally did so because of substantial training costs for many staff in order to meet PS 146 standards. Other funds without substantial training needs due to their mode of operation were able to pursue a more minimalist approach, and had substantially lower costs.

8. Conclusion

While it is a reasonably well developed tradition for conference papers to skirt round or diverge from the session topic, in the case of this paper it is reasonably easy to address the session topic "Will the Compliance and Regulatory Pressure Cooker Blow the Lid Off Super Fund Fees?".

On the basis of the survey and other evidence presented in this paper, the short answer is no. However, aggregate ongoing compliance costs at around $180 million are substantial, and have increased rapidly in recent years. Compliance costs now amount to on average around 10% of the total administration costs of the funds they relate to. Increased compliance burdens have made a substantial contribution to the 10% or more a year increase in administration costs experienced by a range of funds in recent years. There is more pressure in the pot, but the lid is yet to be blown off.

The more relevant question is whether there is value for money from the current compliance regime. The evidence and analysis in this paper suggests that there have been benefits delivered, but not all regulatory interventions have benefits exceeding the compliance costs. The regime of breach reporting to both APRA and ASIC is one where the costs of compliance appear to now exceed any benefits that accrue to fund members. Given that the cost of compliance is ultimately paid by fund members this is a matter of concern.

The paper also points to the dangers of regulatory contagion, where prudential arrangements appropriate for insurers or approved deposit takers are imposed without very good reason on all superannuation funds. This may lead to regulatory neatness, but it also leads to increased expenses and subsequent diminution of investment earnings of fund members.

The paper also points to the benefits of improved disclosure by funds, but here too the costs of compliance have become significant. Any opportunities to reduce compliance costs while maintaining meaningful and relevant disclosure for fund members should be fully explored.

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