Australian Government

REVIEW INTO THE GOVERNANCE, EFFICIENCY, STRUCTURE AND OPERATION OF
AUSTRALIA'S SUPERANNUATION SYSTEM

PHASE THREE
STRUCTURE

Issues Paper
14 December 2009

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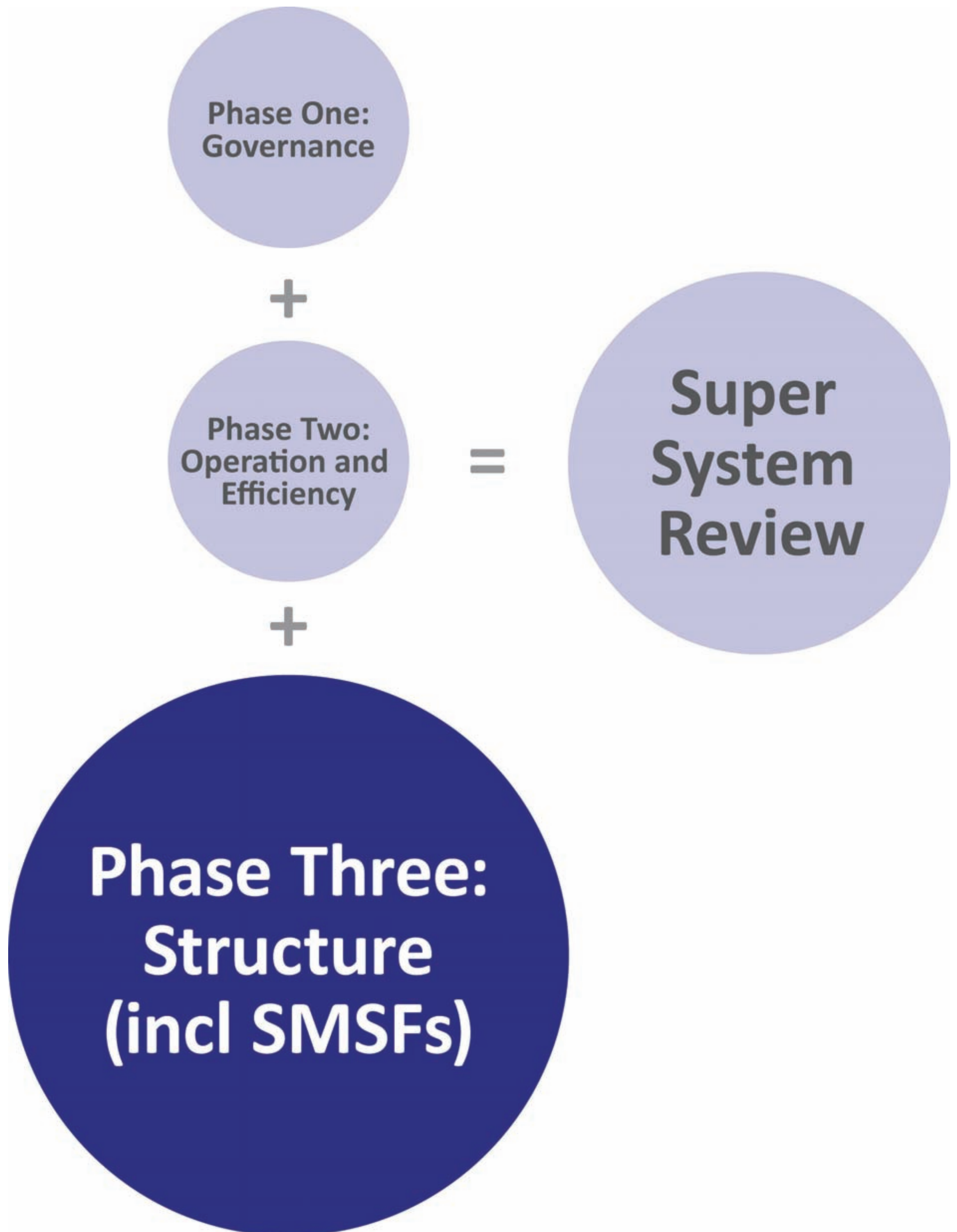
Phase Three: Structure



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1. INTRODUCTION

On 29 May 2009, the Government announced a comprehensive review of Australia's superannuation system: the Super System Review (**Review**).

The Review has broad **terms of reference**.[1] It has been charged with examining and analysing the governance, efficiency, structure and operation of Australia's superannuation system. The Review is focused on achieving an outcome that is in the best financial interests of members and which maximises retirement incomes for Australians.

The Chair of the Review is Jeremy Cooper, a former Deputy Chairman of the Australian Securities and Investments Commission (**ASIC**). Jeremy is supported by a Panel of seven part-time members: Mr Kevin Casey, Mr Greg Evans, Mr Sandy Grant, Dr David Gruen, Ms Meg Heffron, Mr Ian Martin and Mr Brian Wilson. Short **biographies** for each of the Panellists are on the Review website.[2]

2. SCOPE OF THE REVIEW

The Scoping Paper entitled '*The Scope of the Review — a three phased consultation*', released on 25 August 2009 and available at www.supersystemreview.gov.au, explains the scope of the Review.

3. KEY DATES

Phase Three: Structure (including SMSFs)		
Release of Issues Paper	**Closing date for submissions**	**Release of preliminary recommendations**
14 December 2009	*19 February 2010*	*April — May 2010*

Submissions for this phase of the Review close on 19 February 2010. Section 23 explains how to make a submission.

4. INTERFACE BETWEEN THIS PAPER AND PHASE ONE — PRELIMINARY REPORT

This *Phase Three: Structure* Issues Paper has been issued concurrently with the Review's *Phase One — Preliminary Report*. The *Phase One — Preliminary Report* sets out the Panel's

1 http://www.supersystemreview.gov.au/content/terms_of_reference.aspx.
2 http://www.supersystemreview.gov.au/content/the_review_panel.aspx.

current thinking on governance and provides an early indication of the direction the Panel is considering on the governance phase of the Review.

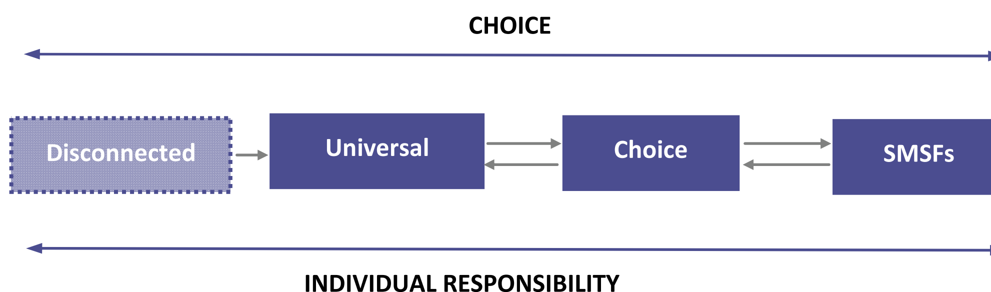
A key proposition put forward by the Panel in the preliminary report is that the one-size-fits-all approach to superannuation employed under the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) and the *Corporations Act 2001* (**Corporations Act**) is no longer appropriate. The Panel instead posits an enhanced architecture for super starting from a member, rather than a product or industry sector, focus.

Clearly, this alternative model has implications for the future of the superannuation industry and the Panel **strongly recommends** those intending to make a submission in response to this *Phase Three: Structure (including SMSFs)* Issues Paper read both the preliminary report and, to the extent applicable, frame their submission in the context of the observations made in that report. A summary of the model is provided below.

4.1 Overview of the Panel's enhanced architecture for super

The model proposed by the Panel classifies members on the basis of whether or not they have made a choice about their superannuation, using the following taxonomy: disconnected, universal, choice and self-managed. It recognises that direct engagement in superannuation decision-making is not currently a priority for a large portion of the population. However, it also recognises the value of choice to some individuals and to the superannuation system as a whole. Regard is also had to the practical reality, hopefully declining, that some individuals can be temporarily 'disconnected' from some or all of their superannuation assets.

Diagram 1: A choice architecture model for Australia's superannuation system



Some of the design features envisaged for each category of member are summarised in the table below and include:

- **Disconnected member:** Must be placed in a fund with the following features: low cost, conservative investment strategy, minimal information or disclosure, low cost facility to aid member identification so as to expedite relocation, consolidation, and transfer to other categories.

- **Universal member:** Must be in a fund with a single diversified investment strategy (including a life-cycle strategy) overseen by trustee with traditional duties, insurance offered, but few other 'bells and whistles'. Limited role for advice because advice is 'embedded' in the product and no choices need to be made by the member.

- **Choice member:** Will be in a fund with potentially unlimited menu of options for investment, insurance etc, though still subject to sole purpose test, trustee responsible for

reasonable due diligence on investment and insurance options offered, but limited liability for choices made by individual members, effective disclosure of paramount importance. Members likely to rely on advice or disclosure and other information about their options.

- **Self-managed member:** Because SMSFs are dealt with in Part B of this Issues Paper, it is too early to suggest possible changes to the SMSF sector.

Diagram 2: Key features of fund models under choice architecture

	Disconnected	Universal	Choice	Self-Managed
Investment strategy	Conservative	Single strategy (incl. lifecycle)	Supermarket	Self-directed
Governance philosophy	Trustee-centric	Trustee-centric	Disclosure-based	Self
Ability to change option/fund	N/A	Less frequent	More frequent	N/A
Insurance	N/A	Death & TPD	Member decision	N/A
Reporting	-	Minimal	Comprehensive	Compliance based
Product Disclosure Statement	-	Streamlined perhaps on-line only	Comprehensive	N/A

5. BACKGROUND TO PHASE THREE

In the *Scope of the Review* Paper issued on 25 August 2009, the Panel indicated that in Phase Three of the Review, it would consider several issues, including the following:

- SMSFs;
- defined benefit funds;
- embedded insurance; and
- superannuation in the post-retirement phase.

The Review has also taken the opportunity in this final phase to raise other issues that do not fit neatly into any particular phase, but which require discussion, such as how to preserve the integrity of the system.

This *Phase Three: Structure (including SMSFs)* Issues Paper is divided into two parts:

Part A: Structural Issues; and

Part B: SMSFs Issues.

PART A: STRUCTURAL ISSUES

6. STRUCTURE OVERVIEW

When the Review talks about the 'structure' of the industry, it means the way in which superannuation is organised, being comprised of a number of unique sectors and products.

At the end of June 2009, there were 416,622 superannuation funds, of which only 463 had more than four members. Issues regarding the 99 per cent of funds which are SMSFs are covered in **Part B** of the issues paper. Total superannuation assets at June 2009 were $1.08 trillion, which is about the same as Australia's annual gross domestic product (**GDP**).

Table 1: Superannuation assets and number of funds by sector, June 2009[3]

Fund Type	Number of entities	Assets ($ billions)
Corporate	190	54.8
Industry	68	191.1
Public sector	40	151.6
Retail[4]	165	306.0
Pooled superannuation trusts (PSTs)	82	69.9
Small APRA funds (SAFs)	4,277	2.4
Single-member ADFs	112	0.1
SMSFs	411,688	336.1
Total funds	416,622	1,080.5
Retirement savings account providers (non-trust structure)	10	6.2

A registrable superannuation entity (**RSE**) licensee may act as trustee for more than one superannuation entity.

Table 2: Superannuation trustees and number of entities under trusteeship, November 2009[5]

Number of funds under trusteeship	0	1	2-4	5-9	10-20	>100
Number of trustees	12	208	30	16	5	3

Many of the key structural features of the current superannuation system are a product of the incremental development of occupational superannuation in Australia. Superannuation

3 APRA, June 2009 Quarterly Superannuation Performance, September 2009.
4 Includes 16 ERFs with assets of $5.5 billion at June 2008.
5 APRA, listing of RSE licensees and RSEs, November 2009.

funds are commonly categorised according to their profit status and relationship to an industry sector or employer.

To that end, the *Phase One — Preliminary Report* proposes a new structure based on member action or inaction and not based on the current methodology for determining sectors.

7. ISSUES RELATING TO STRUCTURE (NOT INCLUDING SMSFS)

The issues set out in this Paper are not intended to be exhaustive and submissions are not limited to the issues identified. The Review may or may not make recommendations on all of the issues raised. **You do not have to answer all the questions.**

8. SUPERANNUATION SECTORS IN LIGHT OF THE CHOICE ARCHITECTURE FRAMEWORK

8.1 Defined benefit funds

In 1982, defined benefit members comprised 82 per cent of super fund accounts. By June 2006, only 2 per cent of members were in 'pure' defined benefit funds, 28 per cent were in hybrid funds and 70 per cent were in accumulation funds.[6] For purposes of this paper, when we refer to defined benefit members and funds, we include the defined benefit portions of hybrid funds.

The Panel believes that it is clear that defined benefit fund membership will continue to decline in coming years as the vast majority of defined benefit funds are closed to new members. That said, it is also clear that defined benefit funds remain significant to the industry as those funds contain $154.1 billion of defined benefit assets and $618.2 billion of accumulation assets.[7]

It seems that there are a number of reasons for the move away from defined benefit funds, but the most obvious are:

- employers' decisions to no longer underwrite investment risk; and
- the need for more flexibility as employees began to change jobs more frequently.

The major issue for defined benefit funds is the employer's exposure to investment risk. Generally, when investment markets are under pressure, relevant employers are also under financial pressure.

6 Wilson Sy, 'Pension Governance in Australia: An Anatomy and an Interpretation, Rotman International Journal of Pension Management, Vol 1, issue 1, Fall 2008, page 32.

7 APRA, *Annual statistics*, 30 June 2008, table 16.

The SIS Act has, relative to many other regulatory regimes in the world, taken a soft approach to defined benefit funding requirements and has given APRA a rather 'light touch' enforcement role. Between 2000 and 2009, there were at least two sustained periods of market turmoil that affected the funding status of most defined benefit funds. While APRA was in a position to request information, it had no power to intervene directly with the employer. During those periods, APRA did engage with trustees and urged them to seek a speedy resolution of the funding problems with the employers but was not empowered to do so itself.

*Should there be stricter funding standards set out in part 9 of the Superannuation Industry (Supervision) Regulations 1994 (**SIS Regulations**) so that there is greater protection for members and so that APRA could have a direct role in working with the employer to remedy the deficit?* For example, when a fund is in an 'unsatisfactory financial position', there is no prescribed schedule according to which the trustee and the employer are required to remedy the funding position. Even when the fund is technically insolvent, the trustee and the employer are given five years under SIS Regulation 9.17 to reverse the deficiency. It seems that five years is too prescriptive and that, depending on the circumstances, five years could be too long or too short.

Should actuarial reports be required more frequently than every three years? Should a mechanism be provided under the SIS Act with a view to protecting members' benefits against employer sponsor insolvency?

As employers have a particular interest in defined benefit funds, should trustees of defined benefit funds (or sub-plans) be required to have employer representatives on their boards (assuming that equal representation is not otherwise required for that trustee board)?

There have been several occasions where defined benefit funds have not been appropriately taken into account when new legislation has been promulgated. The Review is aware that there are problems for defined benefit funds with respect to the 'dollar disclosure' regime in the Corporations Act as well as that Act's requirements for historical fund performance to be provided to members and disclosure more generally (eg significant event disclosure). *Are there other examples of legislation in recent years which has resulted in problematic application for defined benefit funds?*

8.2 Small APRA funds

*Why have small APRA Funds (**SAFs**) proven so much less popular than SMSFs? Why do SAF members choose these vehicles over SMSFs? What are the additional trustee responsibilities in managing SAFs and how are the risk management frameworks in place appropriate for managing the risks of governing multiple SAFs? Do SAFs offer advantages for the retirement income system by comparison with SMSFs or other APRA-regulated funds? Are there structural impediments to their take up? If so, what are they and how could they be removed?*

8.3 Retirement Savings Accounts

At 30 June 2008, there were approximately 120,000 Retirement Savings Accounts (**RSAs**) with $1.2 billion in assets, making up 0.32 per cent of assets in the retail sector.[8] The asset base jumped dramatically to $6.2 billion by June 2009 due to the attraction of their capital guaranteed nature during the global financial crisis. Currently, there are ten institutions offering RSAs, most of which are credit unions.[9]

RSAs have generally not been a success for two main reasons. The first is that they are only a capital guaranteed product and there is currently no scope in the RSA framework for adding a market-linked investment where the risk of loss is borne by the holder. They are thus suitable only for individuals with an extremely low risk tolerance, and are essentially unsuitable for much of the accumulation phase of retirement saving. Equally importantly, there has been little incentive for issuers to create and distribute them using the existing product distribution model because of the low balances involved. Also RSAs do not lend themselves to the charging of contribution or ongoing management fees and hence there is no source of revenue from which to pay incentives to advisers to recommend them. At the same time, they are very expensive for holders.

The interest rate spread[10] is used as a measure of the implicit fee in an RSA as the explicit account keeping fee is usually very low (typically between $0 and $30 a year). Implicit fees for balances less than $5,000 are, on average, 1.2 per cent and generally fall as the account balance increases.

Rice Warner estimate RSA expense charges for the year to 30 June 2008 as 2.3 per cent of assets. Of this, 0.60 per cent is attributable to administration and 1.7 per cent to investment management. Rice Warner explains the relatively high costs as a reflection of the low average account balances of RSAs.

Could RSAs be enhanced by removing the capital guaranteed nature of the product and allowing any prudentially regulated entity to provide an RSA? What would be the advantages and disadvantages of an enhanced version of this product playing a larger part in the superannuation system?

8.4 Approved Deposit Funds

At June 2008, there were only 140 Approved Deposit Funds (**ADFs**), of which 136 were single member ADFs. Total assets in this class are only $0.3 billion.[11] At June 2009, the number of single member ADFs had fallen to 112.

Do ADFs serve any residual purpose? In the interests of simplification, should this institutional class be closed to new members and the capacity to create new ones removed?

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8 IFSA and Rice Warner Actuaries, *Superannuation Fees Report – Market Segment Analysis at 30 June 2008*, December 2008.

9 APRA, June 2009 *Quarterly Superannuation Performance*, September 2009.

10 Essentially, the difference between the return offered to the holder and the return available to the institution in its lending and investment activities.

11 APRA, *Annual Superannuation Bulletin*, June 2008, tables 1 and 9.

8.5 Public sector

Most public sector superannuation is already prudentially supervised by APRA under the SIS Act. The 'exempt public sector schemes' established under arrangements specified in Schedule 1AA to the SIS Regulations are subject to a Heads of Government agreement between the Commonwealth and the States, under which the schemes are operated, to the extent practicable, in accordance with the core requirements of the SIS legislation.

Should the Government accept the choice architecture model proposed in the Review's *Phase One — Preliminary Report*, there would need to be discussions between the Commonwealth and the States about the implications, if any, for exempt public sector schemes.

9. GETTING AND PAYING FOR ADVICE ABOUT SUPER

The Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into financial products and services in Australia (**Ripoll inquiry**) reported on 23 November 2009 on the issues associated with recent financial product and services provider collapses, such as Storm Financial and Opes Prime. The report made a number of recommendations in relation to financial advisers, although not specifically in a superannuation context.

The Review said in its *Phase Two: Operation and Efficiency* Issues Paper that it would defer a discussion on issues relating to advice and distribution of superannuation products until after the Ripoll report had been handed down.

After considering the Ripoll report and the role of advice in super more generally, the Panel has decided that it wants to gather more data and other information, rather than raising issues for comment and submissions at this stage. This will enable the Review to do some further analysis on how advice would fit into the proposed choice architecture model summarised above in section 4.1. It therefore does not propose to raise any additional issues about advice, distribution or payment for advice at this stage.

10. INSURANCE AND SUPERANNUATION

10.1 Compulsory or voluntary insurance

In order to qualify as an 'eligible choice fund' under section 32C of the *Superannuation Guarantee (Administration) Act 1992* (**SG Act**), a fund must offer a minimum level of death cover at a prescribed price. These funds are usually referred to as the employer's 'default fund'.

Should the minimum level of cover required in a default fund (or a 'universal fund' under the choice architecture model) be tailored to other factors such as family situation and financial circumstances? Should the amount of cover be maintained or indexed, presumably with the cost of cover increasing with age, or should a constant insurance fee be applied with the insured benefit decreasing with age?

Should all members be able to opt out of insurance? Should funds be permitted, for example, to offer life insurance as an opt-in default for young, single members? Should commissions be payable on default fund life insurance? If so, why?

APRA data indicate that the annual cost of life and total and permanent disability (**TPD**) insurance exceeds $2.4 billion for APRA-regulated funds with more than four members.[12] *Should default funds also be required to offer TPD cover in addition to death cover?*

Over the four years to June 2008, the ratio of proceeds (that is, proceeds of claims paid to super funds) to net premiums for all funds averaged around 44 per cent (**proceeds ratio**). This means that about 44 cents was paid to the super fund in satisfaction of claims for every $1.00 of premiums paid.

In the table below, a higher proceeds ratio indicates that a fund received more insurance proceeds per dollar of premium, than a fund with a lower ratio. Of course, proceeds on insurance policies may not be attributable to the premiums paid in that financial year or reflect the full extent of payments attributable to claims arising in that year. In addition, premiums are used to cover administration, commissions and claims handling costs as well as funding reinsurance cover.[13]

Table 3: Ratio of proceeds to net premiums by fund type[14]

	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
	$m	$m	$m	$m	$m
All funds					
Total proceeds on insurance policies ($m)	619.0	632.0	730.0	912.0	1069.0
Net premiums ($m)	1322.0	1507.0	1755.0	2117.0	2458.0
Ratio of proceeds to net premiums (%)	46.8	41.9	41.6	43.1	43.5
By functional classification					
Corporate					
Total proceeds on insurance policies ($m)	77.0	70.0	55.0	68.0	66.0
Net premiums ($m)	127.0	111.0	96.0	115.0	128.0
Ratio of proceeds to net premiums (%)	60.6	63.1	57.3	59.1	51.6
Industry					
Total proceeds on insurance policies ($m)	222.0	231.0	266.0	354.0	464.0
Net premiums ($m)	380.0	472.0	536.0	720.0	886.0
Ratio of proceeds to net premiums (%)	58.4	48.9	49.6	49.2	52.4
Public sector					
Total proceeds on insurance policies ($m)	8.0	9.0	20.0	17.0	22.0
Net premiums ($m)	12.0	12.0	64.0	72.0	133.0
Ratio of proceeds to net premiums (%)	66.7	75.0	31.3	23.6	16.5
Retail					
Total proceeds on insurance policies ($m)	312.0	322.0	389.0	474.0	517.0
Net premiums ($m)	803.0	911.0	1060.0	1211.0	1312.0
Ratio of proceeds to net premiums (%)	38.9	35.3	36.7	39.1	39.4

Source: APRA

12 APRA, *Annual Superannuation Bulletin*, June 2008.

13 APRA, *Annual Superannuation Bulletin, Death and disability insurance in Superannuation,* June 2007.

14 Source: APRA Annual Superannuation Bulletin 2007: *Selected feature Death and Disability Insurance in Superannuation and APRA Annual Superannuation Bulletin 2008*, table 8.

What are the drivers of a fund's proceeds ratio? Are there ways that death and TPD insurance could be provided more cheaply to members? Are the apparently wide variations in proceeds ratios between fund types explained solely by occupational, socio-economic and demographic factors?

10.2 Self-insurance

When certain funds changed from being exempt public sector schemes to APRA-regulated funds, they were given special dispensation to continue to self-insure death and disability benefits for their members. These were generally defined benefit funds and self-insurance was permitted on the basis that the funds included some hazardous occupational groups such as fire-fighters and police who could not get commercial cover at all, or at a reasonable price, and that a state or local government 'underwrote' the promised benefits.

Given the lack of capital and insurance expertise available to superannuation funds, in contrast to life insurers, having defined contribution funds self-insure opens the risk that members will bear an inequitable cost of establishing insurance reserves or funding insurance payouts. *Is it in members' best financial interests for certain superannuation funds to continue to be allowed to self-insure death and TPD benefits? Should defined contribution funds ever be allowed to self-insure death and TPD benefits?*

Is there any reason that defined benefit funds (and sub-plans) shouldn't be allowed to self-insure death and TPD benefits so long as actuarial advice is obtained on the funding needed and APRA is satisfied as to the financial strength of the employer? Would this lead to costs savings for employers and members?

10.3 Income protection

There is a range of views as to whether and to what extent income protection insurance should be embedded in superannuation. *What is the right approach here?*

10.4 Other pooling ideas

Given the apparent cost of life and TPD insurance to the superannuation sector as a whole, are there more radical ways to address the need for super fund members to have life insurance? How could super funds create sufficient risk pools to be able to underwrite such insurance themselves?

11. SUPER IN POST-RETIREMENT PHASE

The Australian Bureau of Statistics has estimated that of the approximately 2 million living Australians who had received or were receiving a superannuation benefit in 2007, 55 per cent had taken their superannuation benefit entirely as a lump sum, 35 per cent as a pension and 10 per cent as a combination of the two.[15]

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15 ABS, *Employment Arrangements, Retirement and Superannuation, Australia April to July 2007*, 2 June 2009 (6361.0.55.004).

Of those who had received a lump sum in the past four years, only 21.2 per cent had received $60,000 or more. It is therefore not surprising that for 50 per cent of those Australians the primary use of a lump sum benefit was to clear debt and set them up for retirement. They then invest the balance of the funds or draw down income streams. This post-retirement investment is of critical importance to an individual's retirement benefits.

Mercer estimates that as little as six per cent of a person's superannuation benefits in retirement will be sourced from contributions over their working life, with the majority of benefits — 66 per cent — sourced from post-retirement investment returns.[16] Russell Investments similarly estimates that a little less than 60 cents of each dollar drawn down in retirement comes from post-retirement investment earnings.[17]

The large proportion of retirement benefits funded by post-retirement investment earnings highlights the importance of retirement income management (and sound investing) in the post-retirement phase.

In Australia, individual investment-linked products, known as allocated or account-based pensions, are the most popular form of income streams taken by retirees. However, this approach can leave the value of retirement assets vulnerable to market downturns. The Organisation for Economic Co-operation and Development (**OECD**) argues that governments should encourage retirees to take out annuities that offer a guaranteed retirement benefit to reduce the vulnerability of retirement income to financial market turmoil.[18]

The Australia's Future Tax System (**Henry**) review is considering the types of products available and the appropriate role for Government in assisting with the development of products which insure against longevity risk. *Should more be done to address financial risk in retirement, rather than just longevity risk? Alternatively, should more be done to ensure that post-retirement assets are not invested too conservatively?*

In the United States, the Government is considering options to protect retirees from market volatility through encouraging the take up of annuity products on retirement. Proposed strategies to achieve this include making annuities the default retirement product and making the decision to take out an annuity less daunting through increasing flexibility. Canvassed options include having a portion of contributions to 401(k) plans invested in deferred annuities, with a periodical opt-out facility; having an annuity paid on retirement for a minimum 24 month period before a lump sum conversion option became available; and permitting conversion of part or all of the annuity stream to a lump sum at future dates.[19]

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16 Mercer (August 2009) *Securing Retirement Incomes: Risks and opportunities for Australia's retirement income system in a post-Henry environment.* Assumptions: 9% contributions, from age 21, 4% pa wage increases, no employment break, 7.5% pa net investment return pre-retirement, 6.5% pa net investment return post retirement from age 67 retirement draw-down 60% of pre-retirement salary thereafter increased in line with inflation of 2.6% pa (p.22, footnote 6, Mercer Report).

17 Ezra, D, Collie, B and Smith, M 2009, *The Retirement Plan Solution – The Reinvention of Defined Contribution*, Wiley, p 44.

18 OECD, Australia – Highlights from OECD, *Pensions at a Glance: Retirement-Income Systems in OECD Countries 2009*.

19 Iwry, J M and Turner, J 2009, *New Behavioural Strategies for Expanding Lifetime Income* in 401(k)s.

The United Kingdom imposes compulsory annuitisation after age 75. Would similar measures be useful in Australia to protect retirees from market fluctuations?

In Chile, retirees with lump sums are able to get quotes from an online blind auction system (SCOMP)[20] where up to 23 insurers can submit proposals of annuity terms specific to that retiree (ie based on age, amount to invest, gender and so on). The retiree can then compare the best proposals against other options, including a staged drawdown of their lump sum. The system is aimed at fostering competition between providers and better transparency for consumers. *Would a similar system in Australia increase the attractiveness of guaranteed annuities for retirees?*

What else can be done to improve the availability of retirement income stream products in the Australian market (such as indexed annuities and deferred annuities)?

11.1 Collective pension schemes

The collective pension scheme pools risks between the members and operates more like a defined benefit scheme, aiming at a certain level of annuity in retirement.

In the Netherlands, industry-wide collective pension schemes offer an attractive option between defined benefit schemes and defined contribution schemes to supplement a flat rate public pension. Collective pension schemes are independent entities where assets are pooled and owned collectively by all members, young and old. In these schemes, members earn benefits in the form of a lifetime annuity based on their average career salary and duration of membership. Both the initial pension level as a percentage of average salary and the extent of price indexation are the subject of publicly stated ambitions, dependent on fund performance, rather than any guarantee. These schemes are designed to provide similar levels of benefits as defined-benefit plans, but with investment risk borne by members rather than an employer sponsor, and members are not subject to the risk that an employer will be unwilling or unable to meet its obligations.

Investment risk is borne by the overlapping generations of pension plan members. Surpluses or deficits in the funding process are shared among young, old and future generations by adjusting either contributions, benefit levels or both, which leads to intergenerational transfers.

Collective pension schemes allow risk pooling, enabling them to address selection issues with longevity insurance while allowing members to exchange risks that are not (yet) traded in financial markets. Younger members share in longevity risks faced by older members. For example, if older members live longer than expected, the resulting drawdown of fund assets must result in lower pension indexation rates, reduced initial benefits for those still in the workforce and or a call for increased contribution levels from employers.[21] The collective model lends itself to self-insurance by the fund because of its ability to pool risk.

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20 Mitchell, O and Ruiz, J 2009, Pension Payouts in Chile: Past, Present, and Future Prospects http://repository.upenn.edu/cgi/viewcontent.cgi?article=1025&context=parc_working_papers.

21 http://www.oecd.org/dataoecd/44/58/43779957.pdf.

Is there room for another model in Australian superannuation, being a model that sits in between the defined benefit model on the one hand and the defined contribution model on the other? Is such a model viable in the face of an ageing population?

11.2 Pension components of super funds

The number and proportion of Australians drawing pensions from superannuation funds has increased steadily over the past five years, albeit from a very low base.[22]

Table 4: Pension Members in APRA-regulated Funds with more than four members

8	2004	2005	2006	2007	2008
Number of accounts	24,380,516	25,966,194	26,952,436	28,261,950	29,781,552
Number of pensioners	399,486	447,769	519,115	581,564	689,158
% of pensioners	1.64	1.72	1.93	2.06	2.31

Note: These figures exclude exempt public sector superannuation schemes

The *2007 Intergenerational Report*[23] identified the relationship between increasing assets within the super system and a reduced reliance by retirees on the age pension.

Table 5: Projected percentage composition of age pensioners

	Projected superannuation assets as % of GDP	Full pension	Part pension	No pension
2009-10	112.61	55.12	27.94	16.94
2014-15	127.83	50.82	29.51	19.67
2019-20	141.46	45.75	32.83	21.43
2024-25	153.28	41.86	35.78	22.36
2029-30	162.01	39.3	37.36	23.34
2034-35	168.11	38.39	38.18	23.43

The risk profile, tax treatment and liquidity needs of those drawing a pension from a superannuation fund are all likely to be different from those of members in the accumulation phase. *Should it be mandatory for trustees to manage pension assets separately from accumulation assets? If not, why not? If yes, what are the specific benefits that would be derived and what additional costs might be incurred? Should there be limits to ensure member level diversification in order for income streams to be paid as required?*[24]

12. THE INTEGRITY OF THE SUPERANNUATION SYSTEM

12.1 Security of super

Concerns are often raised about the security of superannuation. One area of risk lies with the possibility of catastrophic failure of an administrator or custodian which could give rise to either a direct loss of assets or substantial financial and reputational costs in recreating fund records. Losses stemming from the conduct of external service providers may not be

22 APRA, Superannuation Fund Level Profiles and Financial Performance, December 2008.
23 http://www.treasury.gov.au/contentitem.asp?navid=&contentid=1480.
24 In the recent GFC, a number of pensioners were 100 per cent allocated to investments that became illiquid and were unable to receive their pension.

addressed in the fund's contractual arrangements, may not be covered by the provider's insurance or may simply take an extended period to recover.

What, if any, additional measures should be adopted to enhance the security of superannuation funds? What is a suitable definition of fund failure? Do we need a super guarantee corporation or other statutory insurance to cover a fund failure?

12.2 Impact of superannuation fraud and theft

Inevitably, the trillion dollar value of the superannuation industry means that it will be subject to attempts at fraud and theft. Fortunately, to date, most of these losses — while devastating to the members concerned — have been small relative to the size of the industry. However, with the evolution of a larger and more concentrated prudentially supervised part of the industry, with ever larger investment flows, the attraction to criminals of large scale fraud is increased.

What are the areas of greatest vulnerability of superannuation funds to fraud or theft? How is the industry best protected from systemic risk arising from a loss of confidence in the security of retirement savings?

12.3 Use of superannuation for criminal purposes

Some functions of prudentially supervised funds are subject to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (**AML/CTF Act**) as designated services, but trustees of SMSFs are excluded. The rollover of a superannuation benefit to another fund, including SMSFs, is not captured as a designated service under the AML/CTF Act.

Should rollovers to SMSFs be designated services for the purpose of the AML/CTF Act? What mechanisms could be established to inhibit the repatriation of criminally obtained funds from overseas into an Australian SMSF under the guise of extraordinary foreign investment returns?

13. PARTICIPATION IN THE SYSTEM

Even though the SG Act extended superannuation coverage to many Australians, there are still those who do not participate in the super system. The Panel is interested in ways of addressing the lack of participation by certain segments of the population.

13.1 Indigenous Australians

Indigenous Australians as a group display cultural attributes and patterns of workforce participation, disability and longevity that are significantly different from those of the population at large. There are indications that levels of general and financial literacy are likely to be lower than that for the population as a whole. *Are there ways in which the superannuation system could better accommodate the needs of indigenous Australians?*

13.2 Women

Excluding issues of adequacy resulting from broken workforce participation and lower average incomes (which fall within the scope of the Henry review) are there specific issues

which disadvantage women in their interaction with the superannuation industry? If so, how could these be addressed?

Are there other clearly identifiable groups for whom specific provision could and should be made within super?

14. OTHER STRUCTURE ISSUES

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

Under the SG Act's 'choice of fund' regime, if an employee does not specify which fund they would like their super contributions paid to, the employer is required to make their superannuation contribution to a super fund selected by the employer (as described in section 32C of the SG Act). The employer may be constrained in its selection of a default fund if one has been nominated under an industrial award or certain other industrial arrangements. However, an employee's choice of another fund will prevail over the default fund.[25]

In August 2008, 39.8 per cent of employees had their pay set by a collective agreement, 38.7 per cent by a registered or unregistered individual arrangement and 16.5 per cent of employees had their pay set by award or pay scale only. Working proprietors of incorporated businesses accounted for approximately 5 per cent of employees.[26]

Modern federal awards are able to stipulate default funds for the purposes of the SG Act. Most commonly, the default fund named is from the industry fund sector and employers must make compulsory superannuation contributions in the absence of the employee nominating another fund.

The Australian Industrial Relations Commission (**AIRC**) decided that all super funds to which an employer contributed as of 12 September 2008 would continue to be available as a default fund for that employer. [27] By preserving the status quo, the AIRC has ensured that disruption and cost for employers and employees were minimised.

It is common for employers to adopt the default super fund stipulated in an award relevant to the particular industry for all its employees in that industry (whether or not those employees are covered by the award). Consequently, nomination as a default fund in an award carries an influence disproportionate to the employees directly covered by the award.

It is often argued that the compulsory SG Act contributions represent employees' deferred wages, and so are properly subject to industrial relations arrangements.

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25 Section 32Z of the SG Act.

26 Australian Bureau of Statistics, *Australian Labour Market Statistics*, Oct 2009.

27 ASFA 2009, *Implications of award modernisation for super*, March.

At the same time, concern has been expressed that some super funds nominated as default funds under awards have underperformed over an extended period.[28] Concerns have also been expressed that the default fund selection process lacks transparency and a competitive element; concerns that were dismissed by a Senate Committee Inquiry into the Fair Work Bill 2008.[29]

Is the industrial relations mechanism the best way to allocate employees to a default superannuation fund? If not, what other mechanisms might be adopted to improve outcomes for members?

14.2 Dispute resolution

A variety of structures currently exists to resolve disputes between participants within the superannuation industry. Trustees of APRA-regulated funds are required to have an internal dispute resolution mechanism, and members may access the Superannuation Complaints Tribunal (**SCT**) if dissatisfied with the outcome of that process. Trustees dissatisfied with decisions of a regulator may in most instances have those decisions formally reviewed internally by the regulator and, if dissatisfied, appeal to the Administrative Appeals Tribunal (**AAT**). Certain issues may be referred to the Federal Court, for example using the provisions of the *Administrative Decisions (Judicial Review) Act 1977* (Cth). Guidance may in some circumstances be sought from State Supreme Courts.

The Financial Ombudsman Service (**FOS**) also handles superannuation related disputes which are outside the SCT's jurisdiction. The disputes that the SCT does not have jurisdiction to examine usually involve whole of fund issues and provision of advice by persons who are not trustees. The FOS examines these complaints.

However, some suggest that, of these institutions, only the SCT and FOS have sufficiently frequent exposure to superannuation issues as to become expert in the topic area.

Would there be value in the creation of a specialist superannuation court under Commonwealth legislation? Possible roles for such a court could include:

- consideration of trustee proposals to facilitate mergers of funds where complex member rights issues were involved;
- legacy product rationalisations;
- power to give directions to trustees seeking determination of complex issues; and
- resolution of disputes with regulators.

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28 The Hon N Sherry 2008, *Choosing not to Choose*, 16 December.

29 Senate Standing Committee on Education, Employment and Workplace Relations – Fair Work Bill 2008 [Provisions], February 2009, [3.37] – [3.45].

14.3 Risk-sharing

Currently, the investment risk in the accumulation phase of superannuation rests mostly with the individual. *Should the Government assume some of this risk, given that it largely underwrites both investment risk and longevity risk in retirement by way of the age pension? Should the Government provide some additional certainty to alleviate individual anxiety in volatile financial markets? How could this be offered without representing an undue burden on the Budget?*

Should the structure of superannuation include some defined benefit features, rather than solely an accumulation approach? Who could underwrite the defined benefit component?

Could default funds be required or encouraged to incorporate an investment fluctuation reserve into their default investment option, so as to allow a more aggressive investment approach without a commensurate increase in volatility? How might they address free-riding, where individuals select a fund after its investment reserve had been built up? How costly would it be to administer a scheme whereby entitlement to share in reserve distributions vested progressively over a period of, say, five years?

14.4 Capital requirements

One unique feature of the superannuation system is that there has not been a high threshold for entry. This means that non-public offer funds can be established without any capital backing.

At present, even for public offer funds, there is no link between the risks faced by the fund and the amount of capital required. For example, the capital requirements for a public offer trustee would be the same whether the trustee acts for one SAF or for many large defined benefit funds. When there are losses as a result of operational error (which are not recoverable from third parties), those losses must be met from fund earnings. In other words, members pay.

Given the important societal role that superannuation plays and the significant operational risks that all trustees must manage, as a matter of protection for members, should capital be required for all trustees of super funds other than SMSFs?

If so, what sort of risk factors ought to be considered in setting capital requirements? What amount of capital should be required? Should a public offer trustee without capital of its own be able to continue to rely on an approved guarantee or the fact that its custodian may have the $5 million capital backing? Should a custodian be required to have the minimum capital requirement in its own right, rather than being able to continue to rely on an approved guarantee? Currently, the same $5 million is required for the custodian whether they are being relied upon by one trustee or many. *Should the capital required for custodians be related to the number of fund trustees that rely on that custodian in meeting the trustee's capital requirements, and the assets they hold?*

14.5 Source of permanent capital

Would it assist super funds to be able to create a listed entity or entities which could hold longer-horizon assets, such as infrastructure, providing permanent capital for such investments? Under such a model, the constitution of the entity could require that the

founding fund(s) must retain (say) a 50 per cent stake in the listed entity for an extended period. The advantages would be:

- some of the apparent difficulties with infrastructure ownership, such as illiquidity and difficulty with regular valuation, could be ameliorated while retaining exposure to assets that match the fund's 'liability' profile;
- the availability of transparent valuation and price signals by the market, thereby overcoming unit pricing and arbitrage problems that affect such assets if held directly by a super fund;
- investors wanting to trade actively in the entity could do so outside superannuation because the entity would not, itself, be a superannuation fund;
- SMSFs would be able to gain easier exposure to infrastructure and other illiquid assets by acquiring an interest in the entity;
- the entity would be subject to the continuous disclosure, governance and other disciplines of Australian Securities Exchange (**ASX**) listing; and
- there would be an incentive on the part of analysts and rating agencies to rate the entity; a feature not currently applying to super funds.

Are there impediments to this sort of structure under current settings? What other issues arise?

14.6 Legacy products

'Legacy products' are drivers of increased cost and operational risk throughout the financial services industries. *To what extent are they a problem in superannuation? What measures can be taken to facilitate elimination of legacy products (and movement of legacy members) without material disadvantage, in circumstances where a successor fund transfer might not be available?*

14.7 Innovation

As the superannuation industry continues to grow and super funds increase in size, it will be important for funds to be at the forefront of innovation with respect to investments and products.

Super funds might find that they are better placed to develop products that suit members, rather than waiting for other parts of the financial services industry to do so. Super funds have not, generally, been active in this regard. There are many possible reasons for this, but it seems that super funds may have to (or should) take a more active role in product innovation in the future. *For example, is there any reason why super funds shouldn't be able to compete in the 'reverse mortgage' market (as this seems peculiarly compatible with the retirement income function of super funds)?*

Are there any specific impediments at present to super fund trustees developing new product offerings? If so, what are they?

PART B: SMSF ISSUES

15. SMSF OVERVIEW

The Review recently released a publication titled '*A statistical summary of self-managed superannuation funds*',[30] which provides a broad overview of the SMSF sector. The summary provides information on topics including: SMSF member demographics, investment performance, operating expenses and compliance issues and is intended to inform submissions relating to SMSFs.

A significant number of Australians have opted to control their own superannuation via an SMSF. SMSF members are on average older, earn a higher income and have larger superannuation balances, compared to members of APRA-regulated superannuation funds.

SMSF trustees have primary responsibility to ensure their superannuation money is invested appropriately. Like trustees of APRA-regulated funds, they continue to be responsible for investment decisions they make, even when they pay for professional help. However, unlike APRA-regulated funds, there is no agency issue because the trustees and members are one and the same. As such, SMSFs are subject to a less onerous prudential regime than APRA-regulated funds on the basis that the members are in a position to protect their own interests.

There is a certain degree of increased risk for the average SMSF member compared to belonging to an APRA-regulated fund. This 'do-it-yourself (**DIY**) risk' revolves around the fact that an SMSF is essentially a DIY solution and is not necessarily connected with any professional services, although high proportions are established with the assistance of accountants. SMSF members are therefore exposed to risks such as not arranging life insurance and having (slightly) more freedom to make ill-advised/uninformed investment decisions than in other sectors. Also, the potential impact of inter familial, marital and business disputes poses additional risks.

Early wind up is another potential DIY risk that could increase the cost to members where an SMSF is established and subsequently found to be unsuitable.[31] Early wind-up can also occur involuntarily, such as when an SMSF member/trustee becomes a disqualified person — a factor that would not normally affect the benefits of members of APRA-regulated super funds — that person must exit the SMSF or the SMSF must be restructured as a SAF.

There is also the risk that SMSF and personal assets might become intermingled,[32] potentially resulting (intentionally or otherwise), in the loss of the SMSF assets. The risk of non-compliance with the preservation and investment standards under the SIS Act is higher

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30 Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009.

31 Of those SMSFs established since 2000, 0.8 per cent (approximately 268,000 SMSFs) wound up in their first year of establishment. After two years, this percentage grew to 1.5 per cent. [Source: ATO unpublished data].

32 As at 30 June 2009, the ATO had received 1,094 Auditor Contravention Reports in relation to separation of assets contraventions for the 2008 audit year – with an average contravention value of $230,000. [Source ATO unpublished data].

for SMSFs because trustees are potentially the financial beneficiaries of a breach. However, the ATO has strong indicators that compliance levels remain relatively high.[33]

16. ISSUES RELATING TO SMSFS

The issues set out in this paper are not intended to be exhaustive and submissions are not limited to the issues identified. The Review may or may not make recommendations on all of the issues raised. **You do not have to answer all the questions.**

17. SMSF GOVERNANCE

While members are clearly the primary stakeholders in SMSFs, in view of the substantial tax concessions enjoyed by the sector, there is a strong public interest in their proper governance and compliance with statutory requirements. Preliminary Treasury estimates[34] suggest prospective tax concessions for 2010 for SMSFs of over $6.3 billion (approximately $8,000 per SMSF member), compared with over $17.5 billion for the non-SMSF sector.[35] The suggestion that there is little role for supervision of SMSFs on the basis that the fund balance is the members' own money tends to overlook this public interest aspect.

17.1 Trust model

Is the trust model appropriate for SMSFs? Does it still deliver the best outcomes for trustees, members and the broader community? Are the current membership requirements in the SIS Act, requiring trustees to be members and all members to be trustees, still appropriate for SMSFs? Does the trust model work effectively for single member SMSFs?

17.2 SMSF trustees

SMSF trustees are responsible for managing their fund's affairs and are also the members whose retirement savings are directly influenced by their management. *Should their responsibilities be less onerous than for trustees of APRA-regulated superannuation funds? If so, which of their current responsibilities should be changed? Does it remain appropriate to prohibit individuals in an employer/employee relationship from being members of the same SMSF except when they are relatives?*

17.2.1 Trustee education

Given the obligations of being a trustee and the minimal barriers to entry, should there be some minimum level of financial and compliance knowledge required? Is there another way of addressing the issue of low trustee financial literacy,[36] such as a mandated limitation on

33 In the year ended 30 June 2009, approximately only 2 per cent of all compliance activities resulted in significant sanctions such as the fund being made non-complying. [Source: Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009].

34 Retirement & Intergenerational Modelling & Analysis Unit, Department of the Treasury, unpublished data.

35 Note that these figures do not take into account the direct expenditure of the superannuation co-contribution for low to middle income earners.

36 ASIC research report: Australian investors at a glance, 08-85 Investor research report: 24 April 2008.

the products in which SMSFs, or some sub-set of SMSFs, are permitted to invest? Should trustees of SMSFs require some minimum level of training? Should SMSF members undergo some ongoing level of formal education and training or accreditation to become better educated on their trustee obligations and how to invest? If mandatory education is not required for SMSF trustees (as ATO questionnaire data might suggest is the case — see below), should voluntary training be encouraged? If so, how would this best be achieved? Should the ATO have the powers to impose training or accreditation requirements on SMSF trustees where they have breached SIS Act requirements?

ATO activities, structured as a questionnaire, specifically targeted at new trustees[37] of recently established SMSFs, assessed 96 per cent of new trustees as having a medium or high level of knowledge.[38]

17.3 Complexity

Do the current compliance requirements for SMSFs impede an individual's choice to manage their superannuation given the perceived complexity in operating an SMSF? If so, how could this be improved? Alternatively, given the complexities of managing a person's retirement savings, do the perceived complexities amount to a useful barrier of entry to the sector?

Is the complexity facing SMSFs any greater than super funds generally? If so, can you suggest any simplifications?

17.4 Regulatory framework

17.4.1 Regulation

Should there be separate Acts for ATO-regulated funds and APRA-regulated funds?

17.4.2 Role of the ATO and other regulators

APRA and the ATO are responsible for applying many of the same provisions to two sectors of the superannuation industry with very different risk profiles and perspectives. Shared administration can give rise to inconsistency in interpretation and regulatory approach.

Are the ATO's regulatory powers strong enough, or appropriate, in the SMSF sector? Should the Commissioner of Taxation be able to issue directions to SMSFs (for example, to rectify contraventions)? Should the ATO have a prudential role similar to APRA? Is the ATO the appropriate regulator for SMSFs? And if so, does the ATO have any conflicts in fulfilling this role? If not, who would be the appropriate regulator?

The regulatory arrangements for SMSFs come under the SIS Act and there are no provisions in this Act for the use of agents or intermediaries as there are for other aspects of the ATO's dealings (such as tax agents). Could the current regulatory regime be improved by the introduction of similar arrangements for SMSF administrators, auditors and others? Given the current widespread use of service providers with delegated powers in both the SMSF and

37 The questionnaire, conducted in the 2009 financial year, was sent to 3,000 trustees and 2,423 responses were received. The population of respondents consisted of both random and risk based selected SMSFs, 37 and 63 per cent respectively.

38 ATO assessment of the levels of knowledge: High – 66.2 per cent; Medium to High – 23.1 per cent; Medium – 6.6 per cent; Low to Medium – 2.3 per cent; Low 1.8 per cent.

APRA-regulated sectors, what advantage would accrue from such a change? Would it be in the interest of SMSF members to legislate that responsibility for some actions rested with parties other than the trustee or is the current structure where trustees are ultimately responsible for their actions the right setting?

APRA is responsible for the regulation of SAFs, while the ATO is responsible for the regulation of SMSFs. *Is this segregation efficient and appropriate? Could efficiencies be achieved if the ATO were responsible for SAF reporting and data collection activities, and APRA and ASIC continue to regulate approved trustees of SAFs?*

17.4.3 Dispute mechanisms

Unlike members of APRA-regulated superannuation funds, SMSF members do not have recourse to the SCT because it is argued that the member who is also a trustee would appear on both sides of the dispute.[39] This argument would not apply in relation to people who are not members of the SMSF, but who believe that they are entitled to part or all of the death benefit attributable to a member of the SMSF. *Should the SCT's jurisdiction be extended to resolve disputes between SMSFs and third parties affected by a decision of the SMSF trustee?*

There is no automatic external dispute resolution mechanism — such as the FOS — available to an SMSF member where the member has a complaint about the fund itself. *Given that all SMSF members are also trustees, is there any need for an external complaint mechanism other than a court?*

In the event of fraud or theft, SMSF trustees may sue an SMSF provider/adviser who provided negligent advice. Where the claim relates to a licensed adviser, trustees can access external dispute resolution processes (such as FOS).

Industry-funded financial assistance may be available to funds, excluding SMSFs, which suffer loss due to fraudulent conduct or theft.[40] The rationale for excluding SMSFs was that members, who are also the trustees, would be exposed to 'moral hazard' if they were to be protected from the results of their own conduct. *Is the exclusion of SMSF members from the financial assistance provisions of SIS still appropriate?*

For disputes with the ATO, is there a need for a simpler resolution mechanism than the initial internal ATO review followed by access to the Administrative Appeals Tribunal if still dissatisfied? If so, what model could be adopted?

17.4.4 Penalties

The enforcement regime is often seen as insufficiently graduated, where the ATO may allow rectification with no penalty, freeze the fund's assets while undertaking an investigation, disqualify a person from being an SMSF trustee or trustee director or, in extreme cases, declare a fund non-complying (where potentially almost half of the SMSFs assets will be lost to tax)[41] or prosecuting the trustee members. *Is the existing penalty regime that applies to SMSFs appropriate? Would a sliding scale of administrative penalties, that are applied*

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39 See section 5 of the Superannuation (Resolution of Complaints) Act 1993 (Cth).

40 Section 228, SIS *Act*.

41 When a fund is made non-complying, an amount equal to the market value of the fund's total assets (less any contributions the fund has received that are not part of the taxable income of the fund) will be included in the fund's assessable income. This amount is taxed at the highest marginal tax rate, currently 45 per cent.

against the trustees (jointly and severally), or enforced third party custody of fund assets, be more appropriate or useful adjuncts to the existing powers?

17.4.5 Compliance coverage

Given the significant portion of retirement benefits under the control of an ever-increasing number of SMSF trustees, what level of oversight is required? In 2009, over 3 per cent[42] of the SMSF population was affected by some type of ATO compliance activity. *Should this be higher? Given the community interest in the efficient operation of SMSFs, should the supervisory levy, currently set at $150, be increased to, say $500, to match the level applying to SAFs to fund higher levels of regulatory oversight?*

17.4.6 ATO binding rulings

Due to the operations of the SIS Act, SMSFs fall outside the private binding ruling system administered by the ATO in regard to tax matters. While they can request binding rulings in relation to their tax matters, they cannot get these in relation to their SIS Act obligations. *Would there be any benefit in extending the legally binding ruling system to the SIS Act, which would be equivalent to the private ruling system for income tax? Should this extension also be applied to products marketed to SMSFs?*

18. SMSF OPERATION AND EFFICIENCY

18.1 Economies of scale

One potential issue with SMSFs is their lack of scale. This lack of scale could result in SMSFs being unable to access the sort of wholesale pricing that is offered to bigger investors. Also, lack of scale limits diversification opportunities. Around half of SMSFs with a fund size under $200,000 in 2008 had 90 per cent of their investments in a single asset class.[43]

Are SMSFs disadvantaged compared to APRA-regulated funds by their lack of scale because they cannot adequately defray fixed costs and cannot access certain investment products or markets or can only do so at uncompetitive prices? If so, are there measures that could be taken to reduce this disadvantage?

18.2 Technology

Can more technology be applied to the operation of SMSFs to drive down costs, improve efficiency in administration and improve regulation? If so, how could it be applied?

The Clearing House Electronic Subregister System (**CHESS**) has been instrumental in the growth and efficient operation of Australia's listed equities markets and many SMSFs will have sponsored and non-sponsored holdings within that system. A CHESS or universal platform-like solution to the ready identification of all SMSF assets could have similar outcomes for Australia's SMSFs. It could address custody, portability, valuation and audit issues. It might act as a mitigating strategy for illegal early release schemes and reduce SMSF

42 14,579 compliance activities were undertaken by the ATO during the 2009 financial year. [Source: ATO].
43 Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009.

administration and compliance costs. *Could such an environment be developed for SMSFs? If so, what would it look like? Who could develop it, and how could its uptake be driven?*

18.3 Data

It is essential that the quality and availability of data relating to the SMSF sector be dramatically improved. This would allow policy-makers and analysts to compare SMSFs with other superannuation sectors. It would also enable existing and prospective SMSF members to access the type of information that might enhance their decision-making.

Could more comparable questions be incorporated into the ATO and the APRA annual returns to enable better comparisons to be made, such as in the classification of asset classes and operating and performance figures?

SMSF annual returns must be lodged within 11 months of financial year-end, while APRA-regulated funds must file their returns within four months. *For SMSF data to be meaningful, how quickly does it need to be reported? Would a shorter timeframe be achievable or appropriate?*

The Review recently released a publication titled '*A statistical Summary of self-managed superannuation funds*'. *What other data or research on SMSFs is required and who should provide this?*

Is the ATO or APRA the most appropriate entity to collect and provide data in the marketplace, or should other market participants (non-government) be collecting and publishing data?

18.4 Accounting standards

SMSFs are non-reporting entities for accounting purposes, on the basis that all end-users are able to get clarification of matters disclosed in the accounts direct from the trustee. On this basis, SMSFs are only required to prepare special-purpose financial reports, enabling assets to be either recorded on a historical cost basis or market value.

Valuation of some assets at historical cost might place members at risk if the tax effect of changing asset values is not properly taken into account. The use of different accounting valuation methodologies makes it difficult to make conclusive comparisons between the SMSF and APRA-regulated fund sectors. It might also distort trustee views of the performance of their SMSF. However, anecdotal evidence suggests that market value reporting is becoming more common for SMSFs — particularly for those funds invested substantially in listed shares, managed funds and cash assets. *Should SMSFs be required to complete general-purpose financial reports so that assets are annually marked-to-market?*

18.5 SMSF costs

The average annual SMSF operating expense in 2008 was $6,500. While the dollar cost has been increasing, the average cost, as a percentage of assets, has been trending downwards to approximately 0.69 per cent in 2008. Overall, 62 per cent of SMSFs had an operating expense ratio of less than 1 per cent.[44] However, the average operating expense ratio for

44 Super System Review 2009, Statistical summary of self-managed superannuation funds, 10 December 2009.

SMSFs with $200,000 or less in assets (a quarter of the SMSF population) was significantly higher than SMSFs with greater than $200,000 in assets.

Table 6: Average operating expense ratios by SMSF size

	$1 - $50K	>$50K - $100K	>$100K - $200K	>$200K - $500K	>$500K - $1M	>$1M - $2M	>$2M
2006	5.39%	2.69%	1.92%	1.35%	0.91%	0.70%	0.47%
2007	5.29%	3.35%	2.34%	1.36%	0.86%	0.65%	0.43%
2008	6.42%	5.32%	2.85%	1.50%	0.89%	0.56%	0.36%

Source: ATO

Are SMSF trustees aware of the cost of operating their SMSF and do they understand the cost of alternative structures? What is the best method of comparing the cost of running an SMSF with the cost of other options? Is there appropriate disclosure of costs by service providers or through other avenues?

Perceptions also exist that cross subsidisation is occurring within accounting practices, which obscures the true costs of running SMSFs — is this true in your experience?

Are establishment and ongoing compliance and maintenance requirements inefficient for SMSF trustees? If so, in what areas, and what could be changed or improved?

19. SMSF INVESTMENTS

19.1 Custody

A key feature of SMSFs is the fact that the trustee members are 'given the cheque book' for the fund which can raise questions about the existence, valuation and use of the fund's assets. This can make SMSFs harder to regulate. The lack of structural control over the custody of fund assets and expenditure is unlike similar entities found in the United States (Individual Retirement Accounts),[45] Canada (Registered Retirement Savings Plans)[46] and the United Kingdom (Self-invested Personal Pensions).[47] Similarly, SAFs are broadly comparable to SMSFs, except that custody of assets is held by external trustees.

Would third party custody of fund assets have a role to play in removing the instances of illegal early release (and other breaches of the SIS Act) in the industry? For new SMSFs, should custodial arrangements be mandated for at least an initial period, or universally? Alternatively, could SMSFs that contravene compliance requirements be required to place the fund's assets into custody (ie transition to a SAF) for a certain period or indefinitely?

19.2 Asset allocation

Some SMSF members do not access professional asset allocation and investment advice. As at 30 June 2008, 59 per cent of SMSF assets were held in Australian listed shares and cash

45 Internal Revenue Service 2008, Publication 590, http://www.irs.gov/publications/p590/ch01.html.

46 Canada Revenue Agency 2008, RRSPs and Other Registered Plans for Retirement, Publication T4040(e) Rev.08m, http://www.cra-arc.gc.ca/E/pub/tg/t4040/t4040-08e.pdf.

47 HM Revenue & Customs 2000, Personal Pension Schemes Guidance Notes, Publication IR76 (2000), http://www.hmrc.gov.uk/pensionschemes/ir76.pdf.

and term deposits. Overall, 20 per cent of SMSFs had all their investments in a single asset class.[48] SMSFs in pension phase also show very similar asset allocations to SMSFs in accumulation phase.[49] *Is this optimal for SMSF members given the different liquidity requirements of the two phases? If not, what could be done about it?*

What can be done to improve the access of SMSF members to quality information and advice? Would it assist SMSF members if there was more information available to help them understand asset allocation, diversification and other investment concepts? If so, how could this be delivered?

SMSFs have been over-represented among the creditors to several high profile corporate failures such as Westpoint, while the balance of the superannuation industry had very little exposure.[50] *Does this reflect a particular vulnerability for SMSFs in the face of commission-driven marketing by financial advisers? Does it reflect a structural weakness in SMSF operations or simply the different risk appetite of SMSF investors?*

19.3 Restrictions

Should SMSFs be required to invest funds in a certain manner within a specified time period or should it be left to the judgment of the trustees? Should there be restrictions on the investments that can be held by SMSFs? If so, should restrictions be mandatory or encouraged through incentives?

19.3.1 SMSF assets

Should SMSF investments be restricted to what might be regarded as 'financial assets', such as listed equities and managed funds? This could make valuing, auditing and regulating SMSFs much simpler and potentially less costly. It would also be easier to assess whether an SMSF was investing in non-complying assets.[51] *On the other hand, why should SMSFs be restricted when a wider range of investments is available through APRA-regulated funds?*

Concerns have also been expressed about the ability of SMSFs to invest in assets such as artwork and collectibles. As at 30 June 2008, approximately 1.6 per cent of SMSFs invested in these assets, representing 0.1 per cent of total SMSF assets.[52] *Should SMSFs be permitted to continue investing in these assets or should they be phased out over time?*

19.3.2 Leverage

A number of leveraged investment products are available to SMSFs. While the initial uptake of these investments appears low (as at 30 June 2008, only 0.9 per cent of SMSFs had a derivative or instalment warrant),[53] the question arises whether instalment warrants over property, contracts for difference, and other products involving embedded leverage should be accessible to SMSFs.

48 As per ATO asset classes in the SMSF annual return.

49 Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009.

50 SAFs have also had notable exposure to publicised collapses.

51 Managed funds can be tracked through their APIR code while securities could be tracked via their HIN.

52 Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009.

53 Super System Review 2009, *Statistical summary of self-managed superannuation funds*, 10 December 2009.

Should leverage which places at risk an amount greater than the initial capital investment be permitted in SMSFs? If so, are the current exceptions to the borrowing prohibition suitable or have the most recent changes,[54] *which have allowed for instalment warrant arrangements for assets other than shares, gone too far?*

19.3.3 In-house assets and dealing with related parties

Should the in-house asset investment concessions, allowing trustees limited investment in related parties, continue within SMSFs? Are there benefits to the superannuation system or the broader economy in allowing SMSFs to partially finance trustee's related businesses?

19.3.4 Acquisition of assets from related parties

SMSF trustees are generally prohibited from acquiring assets from related parties, so as not to release economic value from their SMSF back to themselves. However, exceptions do apply, such as acquiring listed shares, business real property and in-house asset investments that do not cause the SMSF to exceed the in-house asset investment limit. *Are these exceptions, generally where an unambiguous market valuation can be established, still appropriate for SMSFs?*

19.4 Investment strategies

Currently, investments strategies do not need to be in writing and can vary greatly in quality and detail. For many SMSFs, investment strategies are a ‘tick the box’ exercise. *Is there benefit to be gained in seeking to increase the regulatory burden here or should it be presumed that self-interest will prevail to see the appropriate investment strategies undertaken?*

20. SMSF SECTOR PARTICIPANTS

20.1 Accountants

20.1.1 Accountants’ licence exemption

Currently, accountants are able to establish and provide background advice about SMSFs, but not about financial products (that is, the investments to be made by the SMSF) without an Australian financial services licence.[55] This means SMSFs can be created without any connection with a licensed adviser and hence no source of investment advice. *Should all SMSFs be required to use at least one key service provider licensed by ASIC? Is the existing accountants’ exemption appropriate and should it be maintained, or should it be broadened as per the recommendation by the Parliamentary Joint Committee on Corporations and Financial Services (***PJC***) report?*[56]

PJC Recommendation 31

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54 Section 67(4A) of the SIS Act inserted by No 143 of 2007, section 3 and Schedule 3, item 1, effective 24 September 2007.

55 *Corporations Regulations* 7.1.29A, 7.1.35A and 7.1.40(h).

56 Parliamentary Joint Committee on Corporations and Financial Services 2007, *The structure and operation of the superannuation industry*, August 2007.

8.61 The committee recommends that the accountants' exemption be broadened in keeping with its previous recommendation 1 to amend subregulation 7.1.29A. This would enable accountants to advise clients on the structure of any superannuation fund, rather than being limited to advising on the structure of self-managed funds only.

20.2 Auditors

The ATO estimates that there were approximately 11,500 approved auditors who conducted an SMSF audit for the 2007 financial year. Half of those auditors audited less than five SMSFs, covering around 3 per cent of the SMSF population.[57]

Approved auditors play a key role in regulating SMSFs because, between them, they have 100 per cent annual coverage of the SMSF sector — undertaking an annual financial and compliance audit of each and every SMSF.

20.2.1 Timing

The interaction of approved auditors with trustees often occurs months after the end of the financial year being audited (due to SMSF lodgment dates). Potentially, a contravention could occur between seven and 22 months before an audit takes place.[58] *Should this time period be reduced or should administrators, who could have more active involvement with SMSFs, play a greater role?*

The frequency of SMSF audits has been questioned on a number of occasions. The PJC[59] recommended that audits be less frequent.

PJC Recommendation 30

8.45 The committee recommends that SMSFs run by qualified accountants be audited annually for three years from their commencement and, subject to no irregularities, thereafter every five years. SMSFs found to be non-compliant are to be audited annually for three further years.

Should the requirement for annual audits be retained or should they be less frequent? Would this have any impact on cost, given that approved auditors would, under the PJC recommendation, need to review multiple years at a time instead of a single year? In other words, after the eighth year, presumably the auditor would have to reconcile the preceding five unaudited years in order to carry out the five-year audit.

20.2.2 Competence

The ATO considers most approved auditors to be compliant and competent. However, 80 per cent of the ATO's 2009 compliance activities targeting high-risk[60] approved auditors resulted in some type of education or higher compliance outcome. Thirty-one per cent of those auditors were assessed to have poor or unsatisfactory auditor working papers and 11 per cent of them had audited their own SMSF. Overall, 39 approved auditors were

57 Super System Review 2009, Statistical summary of self-managed superannuation funds, 10 December 2009.

58 New funds are required to lodge by the end of February in the following financial year whereas existing funds are required to lodge by the middle of May in the following financial year.

59 Parliamentary Joint Committee on Corporations and Financial Services 2007, *The structure and operation of the superannuation industry*, August 2007.

60 Auditors were selected based on risk based criteria and not random sample.

referred to their professional association's disciplinary committee and four approved auditors were disqualified (the first time the ATO has exercised this power).[61]

For the majority of auditors who audited only a few SMSFs, it is difficult to see how it could be economically viable to invest the time and effort required to maintain an appropriate level of expertise in superannuation matters. *Are current professional requirements and audit competency standards adequate? Should minimum standards be mandated or should the accounting bodies continue to develop them? Do approved auditors in general have the necessary level of skill and expertise to audit SMSFs? Do the existing Codes of Ethical Conduct and Australian Auditing Standards provide the appropriate framework for audits of SMSFs? Should it be mandatory to be a member of a professional accounting association in order to conduct SMSF audits? Should the category of membership be tightened to recognise the specialised competency required of SMSF auditors?*

20.2.3 Independence

From information disclosed by SMSFs in their 2008 annual returns, 18 per cent of SMSFs auditors provided other services, such as acting as a tax agent, accountant, financial adviser or administrator.[62] The ATO's 2009 compliance activities targeting high-risk approved auditors identified 29 per cent of auditors who were an SMSF's accountant and who had materially prepared its financial statements. Additionally, 28 per cent of auditors exhibited evidence of a relationship or conflict of interest that might impact the auditor's ability to be independent and had no safeguards to mitigate this risk.

Given the key role auditors play, how independent should auditors be from those who administer SMSFs, prepare their financial accounts or annual returns, or provide financial advice? Do the current independence standards provide sufficient guidance or protection for members and other stakeholders?

20.2.4 Registration

Approved auditors are not required to be registered. This makes it difficult for the ATO to identify approved auditors, limiting its ability to educate and regulate them.

Should approved auditors be registered? If so, which organisation should have responsibility for registering and regulating approved auditors? Should registration also involve competency and training requirements?

20.2.5 SMSF establishment

Would the SMSF system benefit by having an approved auditor verify that a fund was appropriately established before it could be registered with the ATO? Would there be value in having an approved auditor attest that the fund's deed satisfied the SIS requirements, that all members were trustees or trustee directors, and that none of the members was a disqualified person? Would this reduce the number of new illegal early release schemes?

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61 The compliance results should not be viewed as a reflection of the overall population, rather indicative of the ATO's risk based selection approach.

62 This figure is potentially understated; anecdotal information from accounting professionals indicates accounting practices are providing multiple services in addition to the audit service. However, this is not disclosed in the SMSF annual return because those services are carried out by others within the practice. The ATO's 2009 compliance activities targeting high-risk approved auditors identified that 51 per cent acted in other roles for the SMSFs they audited.

20.2.6 Penalties

Are the current penalties applicable to approved auditors who breach their obligations appropriate? The ATO is able to accept enforceable undertakings, refer auditors to their professional associations for the association to consider sanctions,[63] or it can disqualify the auditor, which would prohibit them from undertaking SMSF audits. *Is a more flexible penalty regime, such as the imposition of administrative penalties or time-limited suspensions, warranted?*

20.2.7 Compliance audits

The audit is designed to attest that the financial accounts present fairly the financial position of the SMSF and its operations and cash flow, as well as whether it complied with the relevant SIS provisions for the financial year under review.[64] Anecdotal evidence suggests there is insufficient emphasis being given to the SIS compliance component of the audit. *Is this observation correct? If so, how could the compliance component of the audit be improved?*

20.3 Advisers

Should competency standards be increased (ie beyond ASIC Regulatory Guide 146 standards) for financial advisers who provide advice to SMSF members? The justification for this would be that an SMSF is a special vehicle and not directly prudentially regulated. Under such a proposal, if an adviser wanted to provide advice to an SMSF, they would need to have a higher standard of training and be licensed accordingly. This could increase the cost of SMSF advice, but the average SMSF has substantial assets[65] and therefore could afford to pay for higher quality advice. The question then arises whether remuneration for advice to SMSFs (that is paid for out of the fund) should be restricted to a fee-for-service model (subject to the sole purpose test). That way, the true cost of the advice could be determined at the time it is given and it would be more likely to be in the best interests of the members. *Is there justification for a different charging model for advice to SMSF members?*

21. SMSF STRUCTURE

21.1 Existing structure

SMSFs, like other superannuation entities, are trust (and tax) structures that are governed by their trust deed and the SIS Act, which also specifies obligations of trustees that automatically form part of the SMSF's governing rules. An alternative model would be for SMSFs (and the rules that govern their operation) to be created by legislation, rather than by private instrument. A SMSF could then be created simply by completing an approved form and paying a prescribed fee to the ATO.

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63 Though the ATO notes a potential limitation exists in referring approved auditors who are registered company auditors and who are not members of one of the associations as there is no specific provision in the SIS Act that applies to the referral of registered company auditors to ASIC.

64 ATO 2009, Approved auditors and self-managed super funds, *Your role and responsibilities as an approved auditor*, (NAT 11375-11.2009).

65 Super System Review 2009, *A Statistical Summary of Self-Managed Superannuation Funds*, 10 December.

Alternatively, a standard trust deed could be provided by the ATO at no cost. Trustees could elect to opt-out of the standard trust deed and use their own if they wished.

Would either of these approaches save costs and benefit new SMSF members?

21.2 Other structures

21.2.1 Small APRA Funds

SAFs offer an alternative to people who wish to have a greater degree of control over their retirement savings, as they can with an SMSF, but do not have the skill, time or desire to fulfill all trustee responsibilities. Unlike SMSFs, custody of SAF assets is held by external trustees who hold an RSE licence. SAF members retain access to the SCT. While SAFs are comparable to SMSFs, their popularity appears to be decreasing. From 2001 to June 2009, the numbers of SAFs decreased by almost half to 4,227.[66]

Could aspects of the SAF model be incorporated into SMSFs, such as a hybrid structure where trustees are comprised of both members and an independent external trustee? Potentially, this could be structured on a permanent basis or for an initial defined period, such as a one or two year 'probationary period'. The external trustee could assist member trustees to develop the requisite knowledge and skills, such as appropriate investment strategies, compliance and governance. External trustee involvement at the establishment of an SMSF could also potentially ward off new illegal early release schemes that depend on SMSFs.

Instead, should all SMSFs be registered with an SMSF administrator, rather than having an external trustee? Currently, there are number of SMSFs that employ the administrative services of SAF trustees, as well as other dedicated professional SMSF administrators. SMSF administrators could be mandated responsibility for certain SMSF administrative obligations such as lodgment, record keeping, and ensuring that trustees have appropriate investment strategies. Potentially, this could enhance governance practices, technology, and result in improvements to compliance. For example, the annual income tax return lodgment rates by due date for SAFs, over the four years to 30 June 2008, were typically over 95 per cent, while SMSF annual return lodgment rates were around 70 per cent (ie SMSFs were 26 per cent less compliant than SAFs).[67] Such a move could also result in a change in the regulated population from over 400,000 funds to the much more concentrated administrator market. In other words, concentrating SMSFs into larger administrators could see accounting, audit and tax returns being done more centrally and with economies of scale; leading to the regulator interacting primarily with the administrators and only individual SMSFs on an exceptions basis.

21.2.2 Separately Managed Accounts and wraps

Similar to SMSFs, separately managed accounts (**SMAs**) and participation by SMSFs in wraps offer many advantages over large superannuation funds. New members do not buy into unrealised, and hence untaxed, capital gains that get triggered during their ownership and the individual account can trade in and out of positions much more easily than with a large fund. SMAs and wraps, however, also offer additional benefits such as increasing the level of electronic administration. These platforms also result in custody of the assets being under

66 APRA 2009, *Quarterly Superannuation Performance*, June 2009.
67 ATO unpublished data.

the control of a licensed intermediary, typically a bank or bank-related entity. Some SMSFs already invest through these platforms.

Could these be viable alternative structures to SMSFs? If so, what would need to be done?

21.3 SMSFs in later life

Many SMSF members are close to retirement or have already retired. As at 30 June 2008, 53 per cent of members were 55 and over, while 22 per cent of all members and 27 per cent of all SMSFs, were fully or partially in pension phase. These SMSFs owned 47 per cent of all SMSF assets.[68] *As trustees age, is the potential impact of them becoming mentally incapacitated greater in the SMSF sector than for other superannuation funds and other types of financial products?*

Is there an age where the trustees of an SMSF need to be encouraged to move their retirement income arrangements out of their own hands or at least into simpler products needing less active management?

21.4 Number of members

Currently, SMSFs can have no more than four members. The data show that about 90 per cent of funds have only one or two members. It is not clear whether or not the current limit has a causal effect on this outcome.

Table 7: Distribution of members per SMSF

Membership size	Per cent
1 Member SMSFs	23.0
2 Member SMSFs	67.9
3 Member SMSFs	4.5
4 Member SMSFs	4.6

Source: ATO

What purpose does the current limit serve? Is four members the right number? Why not seven or ten? An alternative view is that SMSFs should be limited to one member. I*f SMSFs are truly a matter of personal choice and personal responsibility for financial wellbeing in retirement, why have any pooling? If the membership limit were to be increased, should other conditions such as family relationships be imposed on fund membership?*

21.5 Barriers to entry

SMSFs are a financial product where almost no barriers to entry exist. In other words, there is no particular licence or other qualification needed to establish and recommend that a person acquire an SMSF and there is no qualification or other requirement imposed on a person wanting to become a member/trustee of an SMSF. *Should there be barriers to entry in either sense? If so, what barriers?*

68 Super System Review 2009, Statistical summary of self-managed superannuation funds, 10 December 2009.

21.6 Minimum monetary balance

A common belief is that an SMSF needs to have at least $200,000 in assets to be cost competitive with APRA-regulated funds.[69]

From the 2004 to 2008 financial years, the proportion of SMSFs with $200,000 or less in assets, decreased from 42 per cent to 26 per cent. Over the three years ended 30 June 2008, the average performance of SMSFs with $200,000 or less in assets was significantly less than those of larger SMSFs and potentially other superannuation funds.

Table 8: 2006 — 2008 Average returns on assets by SMSF size

	$1 - $50K	>$50K - $100K	>$100K - $200K	>$200K - $500K	>$500K - $1M	>$1M - $2M	>$2M
2006	-1.62%	4.02%	7.19%	9.80%	11.73%	13.34%	15.27%
2007	0.41%	7.65%	10.29%	13.10%	15.15%	17.02%	19.76%
2008	-18.26%	-13.50%	-11.34%	-9.10%	-7.98%	-6.57%	-4.24%

Source: ATO

Expenses for SMSFs with $200,000 or less in assets appears to be increasing over the three years to 30 June 2008, which is in contrast with the overall SMSF population. Table 6 on page 27 shows that SMSFs with a fund size of less than $200,000 had proportionately higher average operating expense ratios in 2008 of between 6.42 per cent for funds below $50,000 and 2.85 per cent for funds between $100,000 and $200,000.

In light of these figures, is there any justification to mandate a minimum balance for establishing an SMSF, perhaps by imposing controls on the persons authorised to establish SMSFs? If so, what is the appropriate level and why? Alternatively, can this issue be addressed through education and the publication of better data?

22. OTHER SMSF ISSUES

22.1 Early release on hardship grounds

In APRA-regulated funds, members must get approval from the trustees of their fund (who are independent of the member) to be entitled to early release of their superannuation on hardship grounds. This independence does not exist in the SMSF sector. *Should SMSF members in these instances be required to get regulator approval before accessing their superannuation on hardship grounds?*

22.2 Illegal early release

Illegal early release occurs when people access their superannuation before they meet a condition of release, in other words before they are entitled to it. As there are few barriers to entry, SMSFs are the preferred model for illegal early release schemes. Promoters of these schemes often take a large cut of the superannuation money that is released (sometimes as high as 20 to 30 per cent). Individuals in lower socio-economic groups or in particular communities can often be targets of these schemes.

69 ASIC Media Release 05-133, *Four key questions about self managed super funds*, 22 May 2005.

There has been some recent publicity about SMSFs due to a number of instances of identity fraud. In 2009, the ATO identified 15 scheme promoters and 1,055 participants; suppressed 500 SMSFs from 'Super Fund Lookup'[70] because of suspected illegal early release; and froze 17 bank accounts containing around $1.5 million. All of these activities were aimed at protecting people caught up in illegal early release schemes. ASIC is also active in seeking to prevent such schemes and punish their promoters.[71] The ATO, APRA and ASIC continue to work closely with the superannuation industry and AUSTRAC to develop an integrated approach to address the issue of illegal early release of superannuation. The regulators consult regularly with the superannuation industry on the issue of identity fraud in superannuation.

What weaknesses exist in the governance framework and what controls could be implemented to reduce the likelihood of such frauds continuing to occur?

22.3 Registration process

As an administrative response to the use of SMSFs for illegal early access, the ATO has recently announced to the industry a new system of registration of SMSFs planned for introduction in January 2010.[72]

Are there still too few barriers to SMSF establishment, which benefit scheme promoters? Can the SMSF registration process be further improved to mitigate the risks of illegal early release? If so, how?

22.4 Super Fund Lookup

Can 'Super Fund Lookup' be expanded to provide member details to enable APRA-regulated funds to verify that a requested rollover is to an SMSF of which the transferring member is a trustee? If available, should this information only be provided on a confidential basis so that the general public cannot access the member details? Would verification of bank account details, such as a bank audit confirmation by the recipient institution, act as a significant deterrent to would-be offenders?

22.5 Penalties — scheme promoters

While the ATO is able to apply tax penalties to illegal scheme participants affecting SMSFs, scheme promoters are generally outside its reach[73] and it requires ASIC's intervention to prosecute the promoters. *Would it be more appropriate for the ATO to deal with both the participants and promoters? Can tax penalty promoter laws be amended to include promoters of illegal early release schemes?*

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70 This is part of the Australian Business Register.

71 See, for example, ASIC media advisories – AD09 -121 and AD09-172 relating to recent prosecutions of illegal early access scheme promoters - www.asic.gov.au.

72 http://www.ato.gov.au/superfunds/content.asp?doc=/content/00221644.htm.

73 Promoters may be subject to ATO action where they have undeclared income or where they have contravened the SIS Act as a trustee of an SMSF.

22.6 Life insurance default

The SIS Act does not require an SMSF to offer death or disability insurance to its members. Does there need to be an insurance default in the SMSF sector, for example similar to the minimum insurance cover required for default funds? How could this be achieved? Would compulsory death or disability insurance be inconsistent with the self-managed character of an SMSF? Could the extra scale and reduced distribution costs that such a default could deliver enable the super industry as a whole to strike a better bargain on insurance? How many SMSFs currently have life insurance for one or more of their members?

23. MAKING A SUBMISSION

There is no set structure for submissions and participants may comment on any matter they consider relevant to the topic. **You do not have to answer all the questions**. This could range from a short letter outlining your views on the topic to a more substantial document covering a range of issues. Where possible, you should provide data and/or documentation to support your views.

We ask that submissions follow these guidelines:

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