6. Achieving consistency in regulating superannuation

Introduction

6.1. This chapter considers the differences in the regulation of different types of superannuation schemes and the possible justification for those differences. It examines the validity of applying different solvency, investment, disclosure and reporting requirements to schemes which appear to be conceptually similar. It stresses the importance for the efficiency of the financial system of achieving consistency in regulation of comparable financial services. The question of a single regulator is also considered.

Different regulation

6.2. There are two main reasons why different operating conditions apply to different superannuation schemes. First, because of the different ways that schemes are funded (defined benefit versus defined contribution) and secondly, because they are offered by institutions with different regulatory arrangements, for example, life insurance companies and trusts.[1] These differences mean that some schemes which appear to be conceptually similar are subject to different regulatory regimes and in some cases to quite different requirements. The five most important areas in which there are differences in regulation are:

- solvency requirements
- investment controls
- reporting requirements
- liability
- standards for participants.

These differences are compounded by the fact that the industry is administered by a variety of regulations administered by different agencies.

Solvency

6.3. *Personal schemes.* Life insurance companies are subject to minimum solvency ratio requirements determined by the ISC.[2] This is because their business includes schemes that involve mortality risks, for example, annuity products. Consequently, DAs offered by life companies are offered against a

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1. Including employer related schemes.
2. A life insurance company must maintain $10M in capital and have net assets of $5M; see para 5.10.

background of solvency requirements imposed on the offering institution. Life insurance companies are also subject to an actuarial investigation every year. However, the offerors of personal superannuation schemes, PSTs and ADFs that are accumulation schemes providing a lump sum are not subject to any solvency or capital requirements under the Corporations Law or under OSSA. The Review accepts that solvency requirements are unnecessary for these schemes because they do not involve any sort of guarantee or insurance risk.[3]

6.4. *Employer related schemes.* Employer sponsored defined benefit schemes are subject to solvency-like requirements. Like life insurance companies, they are subject to actuarial investigation, but only every three years.[4] However, in the case of a defined benefit superannuation scheme, the actuarial report does not relate to the need to maintain minimum capital requirements. Rather it is designed to ensure that such schemes will have sufficient net cash flows over a period to meet future expected liabilities, as members resign or retire.[5] This difference in approach to the actuarial assessments of life insurance companies and defined benefit schemes is justifiable on the basis that a defined benefit scheme generally does not bear the mortality risk directly. Accordingly, the Review makes no further comment on this.

Investment controls

6.5. *Insurance companies.* Life insurance companies are also subject to investment controls for prudential reasons. However, they are different controls to those imposed by OSSA. The assets of a life insurance company's statutory fund (or funds) may not be invested in a related company (other than a subsidiary)[6] or under a trust scheme[7]. Nor may a life insurance company mortgage or charge any of the assets of any statutory fund otherwise than to secure a bank overdraft.[8] This restriction does not prevent a life insurance company from investing by way of loan to, or deposit with, shares in or debentures of, a bank[9] or by way of loan to, or deposit with, a prescribed dealer in the short term money market.[10] Consequently, superannuation offered through a trust operat-

3. If a scheme like this did offer an annuity, it would probably be purchased from a life company, not provided by the scheme.
4. OSS Regulations reg 17(1).
5. The mortality risk of such a scheme, that is, the risk that the scheme will become liable for death benefits, is usually underwritten by a life insurance company through the purchase by the scheme of a group life policy.
6. *Life Insurance Act* 1945 (Cth) s 39(2)(a).
7. *Life Insurance Act* 1945 (Cth) s 39(2)(b). Up to 5% of the value of a statutory fund may be invested in trust schemes without breaching this requirement: s 39(4).
8. *Life Insurance Act 1945* (Cth) s 38(3).
9. *Life Insurance Act 1945* (Cth) s 39(3)(a).
10. *Life Insurance Act 1945* (Cth) s 39(3)(b).

ed by a life company and invested in the life company is subject to the investment controls imposed by OSSA (when the funds are invested in the superannuation scheme) and then those prescribed by the *Life Insurance Act 1945* (Cth) (when the funds are in the hands of the life insurance company). DAs, however, are only subject to controls under the *Life Insurance Act 1945* (Cth).

6.6. *Discussion.* To the extent that the personal superannuation schemes offered by life insurance companies compete with those offered by other providers, and DAs compete against ADFs for the same business, it is argued by some that they should be subject to identical controls. It may be argued that, if a life insurance company offers an investment linked superannuation scheme that does not bear mortality risk, there is little point in imposing on such a scheme investment controls designed primarily to apply to statutory funds that do bear such a risk, such as those containing premiums paid in respect of whole of life endowment policies. On the other hand, it is argued that the fact that the provider of a DA may be subject to mortality risk (because the DA may not be commuted to a lump sum) and the provider of an ADF is not (because the ADF is only available as a lump sum), justifies different investment controls. The Review is inclined to accept this justification for what appears to be an anomaly.

6.7. *OSSA.* All superannuation schemes subject to OSSA are also subject to a variety of investment controls imposed for the purpose of prudential supervision.[11] The controls extend to ADFs but not to PSTs, even though both PSTs and ADFs may only accept funds from tax preferred sources. As noted in chapter 3, the need for consistent legislation for like financial services is vital to the efficiency of the financial system. The issue of investment controls, in particular whether the apparent inconsistency means that there is a need for such prudential regulation of PSTs, is dealt with in chapter 11.

Disclosure and reporting requirements

6.8. *Areas of inconsistency.* There are two main areas of inconsistency in the disclosure requirements imposed on superannuation schemes

- inconsistency in disclosure requirements that apply to different personal schemes
- inconsistency in disclosure requirements between personal schemes on the one hand and employer related schemes on the other.

The sources of these inconsistencies and proposals to remove them are discussed below.

11. These are listed in para 5.6.

6.9. ***Personal schemes.*** The inconsistency in disclosure requirements among personal schemes arises from the different approaches to disclosure taken by the *Life Insurance Act 1945* (Cth) (in relation to superannuation schemes marketed by life insurance companies) and the Corporations Law (in relation to schemes marketed by other corporations). A potential investor in a superannuation scheme covered by the prescribed interest provisions of the Corporations Law must be supplied with a prospectus containing

> all the information that investors and their professional advisers would reasonably expect to find in the prospectus, for the purpose of making an informed assessment of:
> (a) the assets and liabilities, financial position, profits and losses and prospects of the ... scheme; and
> (b) the rights attaching to the securities; and
> (c) the merits of participating in that ... scheme and the extent of the risks involved in the participation.[12]

A potential investor in a superannuation scheme marketed by a life company, on the other hand, is not provided with a prospectus. He or she will receive an offer document or 'promotional brochure' which may (but is not required to) adhere to standards determined by the ISC.[13] The Review understands that circulars 290 and 291, developed in consultation with the NCSC, contain a significantly higher standard of disclosure than life insurance companies had previously provided. They follow closely the former requirements for prospectuses under the Companies Code. However, to the extent that the Corporations Law established a new standard for disclosure in prospectuses, this comparability of disclosure requirements no longer exists.

6.10. ***Employer related schemes.*** Employer related schemes are exempt from the disclosure requirements of the Corporations Law.[14] It may be argued that these schemes should not be subject to the same information disclosure requirements as other superannuation schemes because the member often has no choice about being a member of the scheme. On the other hand, members of all superannuation schemes need adequate information to make an informed assessment as to the merits of their participation in the scheme. The Review does not accept that, because employer related schemes are in many cases compulsory and are open only to people who are connected to the particular employer or industry, the members of those schemes are not entitled to the same level of

12. Corporations Law s 1022; Corporations Regulations reg 7.12.12.
13. See ISC circulars 276, 290, 291.
14. Corporations Regulations reg 7.12. 06(c).

disclosure as potential members of personal schemes. However, the Government has announced that employer related schemes will be required to provide members with an annual report or notice containing

> all such information as members of superannuation funds would reasonably require, and reasonably expect to have provided, for the purpose of making an informed judgement as to the financial condition and administrative arrangements of the fund.[15]

The Review understands that this will make the disclosure requirements for employer related schemes virtually identical to those for personal schemes subject to the Corporations Law. The appropriate level of disclosure for superannuation schemes, ADFs, PSTs and DAs and the need for consistency between different offerors of superannuation schemes is discussed at length in chapter 10.

Liability

6.11. The Corporations Law provides criminal, civil and administrative penalties for breaches of its disclosure provisions. It also imposes liability directly on advisers and others who assist in the preparation of prospectuses.[16] Because the ISC guidelines issued to life insurance companies are not binding on them, there appears to be no sanction which can be imposed on a life insurance company that does not conform to the standards contained in circulars issued by the ISC other than perhaps to prosecute a company under the *Trade Practices Act 1974* (Cth) should it not only fail to comply, but also engage in misleading or deceptive conduct.[17] OSSA is also severely lacking when it comes to penalties for breach of its disclosure provisions. There are no criminal or civil penalties available. The removal of a scheme's tax concession is virtually the only means available to the ISC to enforce the disclosure requirements contained in the OSS Regulations. It has been acknowledged for some time that this situation is unsatisfactory. The Treasurer announced that the issue of a better targeted enforcement mechanism would be investigated.[18] This is a major issue for the Review.

Standards for operators

6.12. There are no requirements imposed by the ISC on the trustees of superannuation schemes that are regulated by OSSA. It does, however, impose

15. Treasurer's statement, paper 2 para 9.
16. Corporations Law s 1006.
17. *Trade Practices Act 1974* (Cth) s 52.
18. Treasurer's statement, paper 1 para 22.

controls on the trustees of ADFs.[19] Because ADFs are also prescribed interests, the ASC imposes its own requirements on the trustees of ADFs. PSTs are also prescribed interests and consequently must meet the standard required by the Corporations Law. No standards are imposed on them by OSSA. The Review considers the need for a set of consistent and appropriate standards in chapter 8.

Reconciling the differences

6.13. The Review accepts that solvency requirements are of special relevance to superannuation schemes that provide defined benefits. Differences in solvency requirements may also be justifiable for deferred annuities on the basis that there is a mortality risk attached to the DA. However, there are anomalies in the different regulation of investment controls, reporting requirements, standards for participants and the availability of sanctions which do not appear justifiable on the face of it, having regard to the essentially similar nature of the schemes. The Review makes recommendations throughout this report which aim to eliminate differences which it believes cannot be justified.

Different regulators

6.14. The differences in the regulatory regimes are partly linked to the fact that the legislative regimes governing superannuation schemes are administered by different agencies. The *Life Insurance Act 1945* (Cth), OSSA and OSS Regulations are administered by the ISC, whereas the Corporations Law is administered by the ASC. They have different powers of enforcement. They also have a different approach to financial regulation, derived from the circumstances in which they operate. The ISC is faced with a relatively small number of life insurance companies to regulate. They are represented by a single industry association. In the case of superannuation schemes, on the other hand, there are over 100 000 schemes, ranging in size from one or two members to many thousands of members.[20] They are not represented by a single industry voice. Clearly this must influence the way in which the industry members and the ISC interact. There are also a large number of ADFs and PSTs with whom the ASC and the ISC must deal. The fact that two regulators are involved with ADFs and PSTs also opens up the possibility of inconsistencies and regulatory overlaps. This is an issue that is of some importance for the Review.

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19. OSS Regulations reg 19.
20. 87% of superannuation schemes have fewer than 5 members: ISC database for 1987-88.

Achieving consistency

6.15. The recommendations made by the Review in this report are intended to overcome the inconsistencies in these regulatory regimes and to establish appropriate powers for the regulator. The need for consistency in the approach to regulation of superannuation discussed in this chapter also has implications for the role of the regulator. Ideally, all the regulatory powers that are specific to superannuation schemes should be vested in a single regulator. Several submissions have suggested that the Review should recommend that a particular government agency have full responsibility for regulating superannuation schemes.[21] The Review is not disposed to do this. The agency or agencies to regulate superannuation schemes will be determined, ultimately, by Prime Ministerial decision on the allocation of portfolio responsibilities among Ministers. The focus of this report, and of the Review as a whole, is to make recommendations about the appropriate law and regulatory policies to ensure the stability and security of superannuation schemes. The recommendations in the report can be administered by whatever agency or agencies the Government decides should be responsible.[22] Nevertheless, in devising these recommendations, the Review has been guided by its perception of the goals that regulator should pursue. Chief among these should be to enhance their ability to exercise control over the scheme's operations. It will also be important for the regulator to make it clear that it does not regard its role merely as ensuring that schemes comply with the letter of the law. Several of the recommendations in the report are based on the notion that the regulator will be proactive, and act as a watchdog for members of schemes who will, in many cases, even with the enhanced prudential controls, still not be able fully to appreciate or enforce their rights.

21. eg LIFA *Submission* November 1991; IFA *Submission* November 1991; National Mutual *Submission* November 1991.

22. The Review notes that, in a statement on superannuation released with the 1991/92 Budget, the then Treasurer stated that the ISC was to be the 'lead regulator' in superannuation matters: Treasurer's statement, paper 1 para 23. The current Treasurer reaffirmed this in his speech to the conference of Major Superannuation Funds, Wollongong March 1992.