



Super System has Grown like Topsy: Cooper Review Report

When the Federal Government introduced compulsory superannuation in 1993 it left the administration and investment largely to the private sector. Seventeen years later the system is dramatically different, managing over one trillion dollars of assets. The Cooper review is the first detailed examination of the system.

The following Term of Reference summarises the reasons for the Cooper Review:

“1.4 Operation: maximising returns to members, including through minimising costs, covering both passive defaulting members, who should receive maximum returns and value for money through soundly regulated default products, and active selecting members, who should not be negatively impacted by conflicts of interest that may inhibit advice being in the best interests of members.”

Stakeholders are reminded that the super system exists to enhance retirement incomes for working Australians, not simply to accumulate assets, which is its present focus. However, the review itself falls into the same trap and focuses on accumulation of assets under the compulsory Superannuation Guarantee scheme in large managed superannuation funds. It only considers the issues of managing funds in retirement superficially. Consequently, little attention is paid to the concerns of self-funded retirees.

Individual large managed super funds have increased assets under management dramatically and the number of funds has fallen through mergers and acquisitions. However, assets under management remain insufficient to achieve real economies of

scale. Back office systems are inefficient with inadequate technology and are account-

based rather than member-based. Stakeholder incentives to improve are virtually non-existent because of the underlying compulsory nature. Over 80% of employees take no interest in their funds, often moving between many jobs and building fragmented amounts of super; employers are forced by law to transfer funds. Competition between funds is virtually non-existent and there are no competitive pressures to reduce fees.

In contrast, the SMSF system, which has grown rapidly since 1993, is shown to be largely successful and well-functioning.

There are a very large number of recommendations (over 170), which are very specific and difficult to understand without reading the underlying rationale. Major proposals of interest to self-funded retirees are discussed below.

Radical Proposals for large managed superannuation funds

MySuper is proposed to cover members not interested in the accumulation of their super (over 80% of all members). Nevertheless, they are entitled to receive maximum returns and value for money through soundly regulated default products, which will also provide benchmarks for funds acting for active members wishing to have investment choice.

The report states that “MySuper should be a whole of life product and include a single type of retirement income stream product chosen by the trustee and not just cater for members in the pre-retirement phase. Trustees would have a duty to address longevity, inflation and

investment risks for retirement phase members in developing their strategies.” MySuper is a significant attempt to simplify the system for the majority of people and should result in significant reduction of fees. The recommendation has been heavily criticised by the industry who argue that it is unlikely to reduce fees.

Inefficiencies in the administration of super are significant and many manual systems exist. This has led to the problems of lost super, of many small super amounts belonging to one person attracting little growth. ‘SuperStream’ is proposed as a package of measures designed to enhance the current ‘back office’ of superannuation. It includes new standards to improve the quality of data provided by employers, to allow the use of tax file numbers (TFNs) as a primary identifier, and to require the use of technology to improve processing efficiency.

Greater freedom for a member to transfer funds between providers is recommended including making CGT relief permanent in such cases. A.I.R. believes that CGT relief should also apply for transfer of retirees’ funds into superannuation and should use this recommendation to press its position.

The existing complex legislative framework is identified as a problem but the review limits itself to recommendations to restructure the SIS Act. It does not call for action to reduce complexity. However, it proposes that the Productivity Commission should review the impact and implementation of MySuper and SuperStream and the functioning of the retirement product market five years after the Government’s response to the report. A.I.R. will need to continue its efforts to remove inequities and reduce complexities for self-funded retirees during this time.

If all recommendations are implemented the report suggests that fees should range between 0.3% and 0.4% for the MySuper default scheme and 0.6% and 0.8% for active funds with investment choice. Treasury estimates that an average wage earner paying average MySuper fees could benefit from around a 40 per cent fee cut, lifting their

final superannuation balance by around \$40,000 or 7 per cent.

In summary, self-funded retirees with super in large managed funds might expect to see lower fees, greater transparency about the performance of their fund, and more efficient and timely responses to their requirements. Further, they should expect an improved approach to retirement products. However, these changes are unlikely to happen overnight.

SMSF changes proposed will reduce flexibility

The report recognises that the SMSF sector is largely successful and well-functioning. It has not recommended restrictions on minimum fund size or prescribed specific trustee educational requirements. The recommendations largely relate to compliance and auditing.

Some trustees are capable of looking after all aspects of their SMSF, but most delegate some or all of the tasks to service providers. The report states that “In some respects, service providers in the SMSF sector have a unique role. They are, in a sense, the first line of defence for the community in a sector that is characterised by a do-it-yourself philosophy. Recognising this, the Panel believes that higher competency and advice standards are needed for SMSF service providers.” The reference to ‘first line of defence for the community’ arises from the proposition that retirees gain a tax benefit from superannuation and this benefit should not be misused.

Trustees continue to have the ultimate responsibility for compliance. Trustees rely heavily on accountants as their prime service provider. Experience has shown that many accountants lack knowledge and provide incorrect information. However, the report makes no recommendations about the training, expertise, responsibility and accountability of accountants. It simply leaves accountant competency to the professional bodies.

On the other hand, the report recommends that auditors should be registered through ASIC, which should determine the qualifications, competency standards, penalties, and

independence requirements. The ATO should police auditor performance. From the viewpoint of the majority of trustees the reality is that auditors are auditing the performance of accountants, not trustees.

The report recommends that the ATO should have a greater range of flexible penalties against trustees for breaches; such penalties should not be payable from fund assets and may include mandatory education.

Borrowing provisions were relaxed in 2007. The review expressed concern over this action believing that borrowing in SMSFs should be a minor aspect of fund management. It has recommended that the borrowing provisions be reviewed by government in two years to ensure that borrowing has not become, and does not look like becoming, a significant focus of superannuation funds.

Collectables and personal use assets, and the five per cent in-house investment limit will no longer be permitted; a five-year transition arrangement is recommended. Arrangements for transfers between related parties have been clarified.

The report recognises that other parts of the SMSF regulatory framework need to be improved. These include:

- Requirement for advisers to hold an AFSL where they provide advice on establishment of an SMSF; proof of identity checks for all people joining an SMSF, whether they are establishing a new fund or joining an existing fund.
- ATO given power to issue binding rulings in relation to SMSFs.
- SMSFs required to value their assets at net market value.
- Provision for criminal and civil sanctions to enable the ATO to penalise and discourage illegal early release scheme promoters.
- Automatically deem anything permitted by the SIS Act or a tax act to be permitted by SMSF trust deeds. (This is designed to remove the problem of continual pressure by lawyers and others to modify Trust Deeds).

A heartening recommendation is that the “Government, after appropriate industry consultation, should amend legislation to remove SMSF trustee administrative burdens that are identified as unnecessary.” This at least recognises that changes proposed by A.I.R. might now have the opportunity to be considered. However, it is noted that consultation is only proposed to be with the industry.

Barry Ritchie Chairman RIRG

A.I.R. writes to the Prime Minister about SMSF aspects of the Cooper Review

The President of A.I.R. has written to the Prime Minister, Julia Gillard, expressing concern over two major issues ignored in the Cooper Review recommendations for SMSFs and to seek representation in discussions proposed over aspects of the Report. The body of the letter is set out below.

“From the point of view of independent retirees the SMSF Section of the Cooper review has two major shortcomings which are so important as to make the recommendations of the SMSF section seriously deficient.

The two shortcomings are:

- SMSFs Costs

The Cooper Review has made cost savings a major theme but has made no recommendations on how this might be achieved in the SMSF sector. The Review papers show that the average SMSF is paying over double the administrative fees of a managed superannuation fund (around \$6,000 per year). Even more to the point is that if the SMSF could be truly self managed then the fees should be less than \$1,000. In fact some trustees do achieve this thereby saving approximately \$200,000 (accumulated fees and correspondingly lost income) over their expected 20 year period in retirement (much more when the accumulation period is added).

The major reason trustees pay fees is because they are not confident that they can manage the compliance and accounting burden imposed on SMSFs at present by the trust structure, the complex and unnecessary regulations, and the

unnecessary audit processes in the retirement phase. These were the issues causing both angst and anger when the Association canvassed its membership.

The Association firmly believes that these issues should have been much more thoroughly examined by the review.

- *SMSFs in the Pension Phase*

The Cooper Review has recommended the need for different approaches to the accumulation and pension phases for managed superannuation funds but has completely ignored the issue for SMSFs.

There are significant changes required when SMSFs convert from the accumulation to the pension phase in terms of not only what they do (receive and account for contributions to pay tax free pensions) but also in the complexity of accounting (simpler for the pension phase) including what they should have to account for to government. Earnings by the funds and pensions paid are tax free and therefore should not have to be reported in the detail currently required nor require auditing as the potential for error or malfeasance is almost completely removed.

Hence, the average trustee should be able to manage a fund in pension phase independently of accountants and other fee chargers thereby achieving the savings referred to above. An audit fee of about \$500 to check that a member has withdrawn the minimum pension of about \$10,000 in a fund with assets of \$200,000 is hardly justified.

The Association welcomes your Government's initial response to the Cooper Review, through press reports, that before any of the recommendations are implemented there will be extensive industry consultation. We trust that SMSF trustee groups (not those who garner fees from

them) would also be consulted. We have noted that nearly all of the references cited in the Cooper review for SMSFs were submissions from the SMSF industry and not those from individual trustee or representative trustee groups. We do not accept the proposition that because some review panel members have SMSFs they de facto represented SMSF trustees, particularly retirees.

The Association would welcome the opportunity to be involved in these discussions."

Volunteers sought to join the group that meets with the ATO SMSF Group

Bill Chidzey is seeking a couple of volunteers to replace retiring members of the group that meets with the ATO regularly on SMSF matters. The meetings are normally held three times a year in Brisbane and volunteers would need to be able to make their own way to the Brisbane meetings.

Please contact Bill on wchidzey@optusnet.com.au if you can help.

Federal Election 2010

As all Australians would be very well aware, the Federal Election will be held on Saturday, 21 August 2010.

The A.I.R. Pre-Election Submission was circulated to all Branches in June. All Branches are encouraged to seek opportunities to promote the views of A.I.R. as contained in the Submission to their local Members and Senators and candidates in the lead up to the 2010 Federal Election.