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DBR:bt

18 February 2010

Mr Jeremy Cooper
Chair, Review Panel
Super System Review
GPO Box 9827
MELBOURNE VIC 3001

Pitcher Partners is an association of Independent firms
| Melbourne | Sydney | Brisbane | Perth | Adelaide

Dear Mr Cooper

**SUPER SYSTEM REVIEW
PHASE THREE STRUCTURE**

We welcome the opportunity to contribute to the review into the governance, efficiency, structure and operation of Australia's Superannuation System.

We attach our submission in relation to Phase Three.

Our submission focuses on the issues raised in relation to self managed superannuation funds.

If you have any queries regarding the matters raised or if we can be of further assistance, please contact Brad Twentyman, Director – Superannuation, on (03) 8610 5540 or myself.

Yours faithfully
PITCHER PARTNERS

D B RANKIN
Managing Partner

Encl



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Australia's Superannuation System

Pitcher Partners Submission – Phase 3 Structure

18 February 2010

Pitcher the difference



Australia's Superannuation System

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Australia's Superannuation System

Executive Summary

Our submission focuses on the issues in relation to self managed superannuation funds. We summarise the key points of our submission below:

- The fundamental policy test against which any reform must be assessed is whether the system would be materially improved without adding undue complexity.
- A range of the detailed proposals outlined in the discussion paper, and which are currently being advocated by other organisations, would not meet this policy test.
- It is our position that one or possibly two simple reforms of the existing system would satisfactorily address the problems raised in relation to self managed funds.
- We recommend introducing a graduated penalty system as a universal and simple means of improving behaviour in the self managed fund sector.
- If it is determined that it is necessary to regulate participation in self managed funds, we would favour the introduction of a minimum viability threshold as a universal and simple reform option.
- Our approach ensures the system is designed from the perspective of the majority who voluntarily choose to comply with appropriate oversight and penalties for those who move outside of the system boundaries.
- Our approach minimises complexity and provides participants with the best opportunity to fully comply.
- Our approach allows the regulator to focus on identifying and penalising non-compliance instead of being burdened with the administration of an unnecessarily complex regulatory system.

We address the three broad policy questions raised in relation to self managed funds by the discussion paper in our detailed submission.

We address the specific issues raised in the discussion paper as they relate to self managed funds at Appendix 1.



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Pitcher Partners' Superannuation

Pitcher Partners is an association of full service accounting, audit and advisory firms with a long standing reputation for providing expert advice and services to clients with a particular focus on the middle market.

With 83 partners and more than 800 staff, we have the resources and depth of technical expertise few others can match. We are also an independent member of Baker Tilly International, represented by 145 firms in 110 countries with combined fee income of US\$2.95bn and more than 25,000 people worldwide.

Superannuation is one of our key specialisations. We have a team of approximately 50 dedicated superannuation specialists providing accounting, audit and consulting services to in excess of 1,500 self managed superannuation fund clients. We also provide accounting, audit and consulting services to APRA regulated superannuation funds.

We have extensive practical and technical expertise in self managed funds from a client base with diverse backgrounds which should be of assistance to the review panel.



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Introduction

We welcome the opportunity to contribute to the review. Our submission focuses on the issues raised in your paper in relation to self managed superannuation funds.

We have summarised the issues into three broad policy questions:

- What can be done to improve compliance behaviours in the self managed fund sector;
- Is it necessary to introduce barriers of entry to the market excluding participants where self management may not be appropriate; and
- Is it necessary to introduce additional rules to promote good decision making on the part of self managed fund trustees.

We address these matters in turn in our submission.

We strongly support the approach that there should be appropriate mechanisms to protect the public interest in the tax concessions afforded to superannuation funds. We also agree that there are areas of the system where improvements can be made and we address these in detail in our submission.

From our perspective some of the perceived problems associated with self managed funds represent situations where a minority of participants operate outside of the boundaries of the current system. We do not support the blanket conclusion that these compliance matters necessarily indicate major weaknesses with the existing system.

In our experience self managed funds are almost universally well managed by trustees and the dominant culture in the sector is one of genuinely saving for retirement in a compliant manner.

It is our position that one or possibly two simple reforms of the existing system would satisfactorily address the problems raised in relation to self managed funds.



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Recommended Policy Approach

The fundamental policy test against which any reform must be assessed is whether the system would be materially improved without adding undue complexity.

We are concerned that a range of the detailed proposals outlined in the discussion paper, and which are currently being advocated by other organisations, would not meet this policy test. We expand on our specific concerns in more detail in our submission.

We caution against adopting the view that the only approach available to improve the operation of the small funds sector is to introduce a number of additional layers of regulation and therefore complexity.

It is our position that the better approach is to design the system from the perspective of the majority who voluntarily choose to comply with appropriate oversight and penalties for those who move outside of the system boundaries.

Our preferred approach minimises complexity and provides participants with the best opportunity to fully comply. Our preferred approach would also allow the regulator to focus on identifying and penalising non-compliance instead of being burdened with the administration of an unnecessarily complex regulatory system.



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Summary of Recommendations

In summary, we recommend:

- Introducing a graduated penalty system as a universal and simple means of improving behaviour in the self managed fund sector;
- Allowing a graduated penalty system to mature before considering the introduction of additional regulatory measures aimed at improving compliance, such as imposing mandatory trustee training standards;
- The introduction of a minimum viability threshold as a universal and simple reform option if it is determined that it is necessary to regulate participation in self managed funds;
- Maintaining the general consistency in treatment between the large and small fund markets;
- Self managed fund trustees continue to have the flexibility to pursue investments which they regard as being the most suitable in their circumstances;
- The existing requirement for all members to be trustees and for all trustees to be members be retained;
- Increasing the maximum number of self managed fund members above the existing limitation of four;
- Compliance oversight continue as the preferred method of regulating self managed funds;
- The Tax Office continue as the preferred regulator;
- Resisting the push to introduce comprehensive mandatory training or accreditation standards as they would be unnecessary under our model and unduly add to complexity in the system;
- Considering the introduction of mandatory training or accreditation standards as a part of the compliance remedies available to the regulator if a trustee contravenes regulatory requirements and the contraventions arise as a result of a lack of knowledge;
- Reforms to remove existing barriers to a self managed fund member transferring to another superannuation provider;
- Reforms to control superannuation benefits moving into a self managed fund as opposed to additional regulation at the establishment/registration stage;
- That accountants be treated no differently to other advisors participating in the self managed fund market in terms of the provision of superannuation advice;



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- Using existing processes within the professional associations to impose and monitor professional standards necessary to conduct self managed fund audits.

We discuss each of our recommendations in detail in the body of our submission.



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Improving Compliance Behaviour

A broad policy question raised by the discussion paper relates to whether changes are needed to improve compliance behaviours in the self managed fund sector.

We recommend introducing a graduated penalty system as a universal and simple means of improving behaviour.

Graduated penalty regime

In our view one of the major weaknesses in the current regulatory regime as it applies to self managed funds is the lack of appropriate penalties available to the regulator where reckless or deliberate contraventions occur. We believe by extension that the current system does not necessarily promote good compliance behaviours.

We would support a review of the existing penalty regime with the view of introducing a graduated system of penalties based on the conduct and compliance history of the trustee.

As the availability of tax concessions drives participation and the desire to comply, we believe an appropriate penalty regime may be to consider the removal of tax concessions on a graduated basis where trustee conduct is determined to be reckless or deliberately disregards regulatory requirements.

We note that a system of graduated tax penalties would fit within the Tax Office's existing practices.

We emphasise that any graduated penalty system should be flexible enough to ensure that where technical or minor contraventions occur no penalty is applied or the Tax Office practice with appropriate legislative authority would be to remit any penalty to nil.

We recommend allowing a graduated penalty system to mature before considering the introduction of additional regulatory measures aimed at improving compliance, such as imposing mandatory trustee training standards.



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Barriers of Entry

The discussion paper also poses whether it is necessary or desirable to introduce barriers of entry to broadly regulate participation in the self managed fund sector.

As a general rule our preference would be to continue to rely on the advice provided by professionals as the optimal viability safeguard to apply to the self managed fund market.

The public debate would indicate that the Government and regulators may have lost confidence in the existing viability safeguard. Recommendations that individuals establish a self managed fund where the member has a low member balance is an example used as an indicator that existing safeguards may need to be reviewed.

If it is determined that reform of existing arrangements is required to better regulate who should be participating in the self managed fund market, we again emphasise that as a matter of good policy any reforms should materially improve the system without adding undue complexity.

Minimum viability threshold

Of the proposals that would appear to be under consideration to regulate market participation, we would favour the introduction of a minimum viability threshold as a universal and simple reform option.

We understand that our support of a minimum viability threshold is likely to contradict the views expressed to the panel in other submissions. However we consider that a viability threshold has the potential to have a significant impact in terms of improving market behaviour as it would specifically target the area of the market where it would appear that most issues arise.

We believe that a minimum viability threshold as a universal and simple reform option is preferable to the multiple layers of additional regulation suggested by some opposed to such a threshold.

We note that we do see some practical problems in designing a workable minimum threshold but we believe that the difficulties can be overcome. For example, the option is often criticised as it may result in someone near the threshold from being excluded from participation. If the Government sees this as a legitimate concern, it would be possible to provide the regulator with the ability to determine that the minimum viability threshold is satisfied in prescribed circumstances.

In terms of where a minimum viability threshold should be set, from our perspective somewhere in the order \$200,000 would appear to be appropriate.



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Improving Trustee Decision Making

The discussion paper also raises issues in terms of whether it is necessary to introduce additional rules to promote good decision making on the part of self managed fund trustees.

Our view is that as a general principle the goal should be to maintain consistency between the large and small fund markets.

We contend that it is imperative that superannuation fund trustees are provided with the flexibility to pursue investments which they regard as being the most suitable in their circumstances. We would also be uncomfortable if the ability for self managed fund trustees to react to changing investment markets was limited or removed.

On that basis we do not support reforms aimed at regulating trustee decision making and investment decisions or behaviours.

In our view earlier recommendations would satisfactorily address concerns raised in this area and additional reforms would not be necessary.



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Appendix One – Specific Issues

We address specific issues raised in the discussion paper in detail below.

Self managed fund structure

We recommend that the existing requirement for all members to be trustees and for all trustees to be members be retained.

In our view the existing definition is a key concept that places important controls on who can participate in a self managed fund and controls in terms of who can manage their own superannuation jointly with other parties. Significant controls in the existing self managed fund definition include:

- A requirement that all members be involved in trustee decision making;
- A requirement that anyone wanting to manage their own superannuation knowingly accepts legal responsibility for their actions in the trustee role; and
- The exclusion of any member who is not in the legal position to protect their own interests or who may be subject to undue influence.

The existing definition appropriately places the compliance burden on individuals voluntarily electing to participate in the system and excludes individuals who may not be in a position to always ensure that the actions of the trustee are carried out in a compliant manner.

We would not support amendments which would diminish the core controls inherent in the existing definition.

Limitation requiring less than five members

We recommend increasing the maximum number of self managed fund members above the existing limitation of four. The existing limitation restricts ordinary families who may wish to include more than one generation from electing to manage their superannuation on a pooled basis.

From the policy perspective the intent underlying the basic definition could continue to be maintained while allowing an increase in fund membership. Amendments of this nature would also simplify current complexity when a fund member dies.

We disagree to some extent with the Parliamentary Joint Committee on Corporations and Financial Services which recommended in August 2007 that the maximum number of trustees be increased from four to ten. Our view is that an appropriate maximum number would be in the order of eight trustees.



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Trust model

We do not have a strong view in terms of whether the trust model is appropriate for the sector.

From our perspective maintaining the trust model would be the simpler option and therefore preferred. The model provides flexibility in forming a set of rules specific to an individual fund's circumstances which could not be mirrored by legislation.

Market oversight

We support the policy rationale that by requiring all members to be involved in fund decision making and to share a commonality of interest the focus of regulatory oversight changes from a prudential role to a simpler role of determining whether trustees have complied with their legal obligations and should be afforded superannuation tax concessions.

We do not support the notion that altering the basis of regulatory oversight to include prudential aspects would necessarily protect people from loss or from making poor decisions in practice.

On the basis that we view appropriate regulatory oversight as determining trustee compliance with regulatory requirements and that an appropriate penalty in situations of reckless or deliberate non-compliance is the gradual removal of tax concessions, in our view the Tax Office is the appropriate regulator to oversee self managed funds.

Trustee education

We would contend that under a graduated penalty regime sufficient motivation on trustees and advisors to improve knowledge and thereby avoid the loss of tax concessions would exist.

On that basis we do not support the introduction of mandatory training or accreditation standards as we believe they would be unnecessary and unduly add to complexity in the system.

We would however support imposing mandatory training or accreditation standards as a part of the compliance remedies available to the regulator if it is identified that a trustee has contravened regulatory requirements and the contraventions arise as a result of a lack of knowledge on the part of the trustee.

Moving out of a self managed fund

In our view the existing regulatory and taxation framework provides a significant barrier if individuals want to move from a self managed fund member into a large fund or into another self managed fund. Principally the issue results from the general prohibition on the acquisition of assets



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from related parties and from tax consequences resulting from such a decision.

In effect, the current restriction either forces the sale of fund assets with a likely tax cost to the detriment of the fund member seeking to move or prohibits the member from transferring assets into a new superannuation provider.

We note that the Regulator currently has discretion to allow a fund to acquire assets from a related party. However, it is not always practical or possible to receive approval from the Regulator.

In our view the system should be flexible enough to allow a superannuation member to change providers if needed. We recommend reform to achieve this outcome. We note that tax matters would have to be considered as a part of this process.

Establishments/Registrations

In our view imposing additional layers of complexity at the establishment and registration stage of the fund life cycle would not address issues associated with early access.

In our view the better approach is to impose additional controls on superannuation benefits moving into a self managed fund, either as a rollover from a large fund or an employer making superannuation guarantee contributions. The panel should consider the practices outlined in the APRA's Letter to Trustees dated 5 February 2010.

We would argue that individuals involved in early access would find a means of accessing preserved benefits despite the additional checks proposed. The additional complexity and compliance costs would not be justified.

Costs

We would caution against drawing firm conclusions regarding the costs of running a self managed fund. In our view, the existing data is not capable of adequately distinguishing between different types of costs.

We note that in our experience self managed fund trustees are in a far stronger position to understand the real costs associated with their superannuation in comparison to members of larger superannuation funds as they pay the bills.

Accountants and auditors

Our view is that accountants should be treated no differently to other advisors participating in the self managed fund market in terms of the provision of superannuation advice.



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We do not support a specialist category of self managed fund advisors being created. In our view the professional associations are best placed to impose standards on their members at levels required to provide superannuation advice and services.

We recommend using existing processes maintained within the professional associations to impose and monitor professional standards necessary to conduct self managed fund audits. We would contend that it is the profession who is best placed to conduct this role.

We note that the professional associations have been taking on the concerns being expressed in the market place and we would recommend allowing this process to mature before considering the introduction of additional regulation in this area.

We do not recommend the Tax Office be given jurisdiction to oversee self managed fund auditors. We would question whether the Tax Office has the resource capability to undertake this role.

