

5. Regulation of superannuation under other laws

Introduction

5.1. Chapter 4 examined the extent to which the Corporations Law applies to superannuation activities. This chapter briefly outlines the general law and legislation (in addition to the Corporations Law) that governs the activities of superannuation schemes. The legislation discussed includes State and Territory legislation governing trustee companies,¹ the *Occupational Superannuation Standards Act 1987* (Cth) (OSSA), the *Income Tax Assessment Act 1936* (Cth) (ITAA) and the *Life Insurance Act 1945* (Cth). Table 2 (at the end of this chapter) summarises the laws that apply to each type of superannuation scheme. A detailed discussion of these laws is provided in later chapters. Accounting standards and actuarial issues are also considered.

Trust law

General principles

5.2. Superannuation schemes are, typically, trusts. The deed or other instrument establishing the scheme is either a trust deed or imposes trustee obligations on the persons in charge of the scheme. This is so even for statutory schemes, such as those for public servants. The trustee must not only comply with the provisions of the relevant trust deed or other instrument, but is subject to common law principles of trust law. The centre-piece of trust law is the fiduciary obligation to act honestly and in good faith and in the best interests of the members of the scheme. This finds expression in a number of quite specific duties for trustees.² Superannuation schemes sometimes employ a professional trustee such as a trust company. In performing its duties a professional trustee is subject to a higher standard of care than a non professional.

[A] higher duty of care is plainly due from someone like a trust corporation which carries on the specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals . . . Just as, under the law of contract, a professional person possessed of a particular skill is liable for breach of contract if he neglects to use the skill and

1. *Trustee Companies Act 1964* (NSW); *Trustee Companies Act 1968-1984* (Qld); *Trustee Companies Act 1953* (Tas); *Trustee Companies Act 1987* (WA); *Companies (Trustees and Personal Representatives) Act 1981* (NT); *Trustee Companies Act 1984* (Vic); *Trustee Companies Act 1947* (ACT); *Trustee Companies Act 1988* (SA).

2. These are set out in ch 9.

experience which he professes, so I think that a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.³

Trustee companies

5.3. Almost all superannuation schemes to which OSSA applies are trusts. Schemes that fall under the prescribed interest provisions of the Corporations Law often have a trustee company as trustee.⁴ Trustee companies operate under State or Territory trustee companies Acts.⁵ While these vary from jurisdiction to jurisdiction, they all set out the powers, responsibilities and accountability of trustee companies.⁶ The concept of an 'approved trustee' is raised in OSSA only in relation to ADFs.⁷ Statutory trustee companies are 'approved trustees' for the purposes of OSSA.⁸

Federal statutes

Income Tax Assessment Act

5.4. A major statute governing the operation of superannuation schemes is the ITAA. It specifies the income tax treatment of contributions to superannuation schemes, of the income of the schemes and of the benefits paid by schemes. Tax concessions are available if certain conditions are met. The Act was amended in 1989 to provide for tax on contributions and investment income, with effect from 1 July 1988. Currently, investment income of a 'complying superannuation fund' (discussed below) is taxed at a rate of only 15%,⁹ instead of the

3. *Bartlett v Barclays Bank Co Ltd* [1980] Ch 515, 534 (Brightman J).

4. These schemes must have a trustee approved by the ASC. They are more likely to appoint a trustee company as trustee.

5. *Trustee Companies Act 1964* (NSW); *Trustee Companies Act 1968-1984* (Qld); *Trustee Companies Act 1953* (Tas); *Trustee Companies Act 1987* (WA); *Companies (Trustees and Personal Representatives) Act 1981* (NT); *Trustee Companies Act 1984* (Vic); *Trustee Companies Act 1947* (ACT); *Trustee Companies Act 1988* (SA). As trustees, trustee companies are also subject to State and Territory Trustee Acts.

6. At the Special Premiers' Conference held in Canberra on 31 May 1991, Heads of Agreement were signed in which it was agreed that a working group on Non-Bank Financial Institutions (NBFIs) would be established to develop proposals for a system of supervision of building societies, credit unions, friendly societies, co-operative housing societies and trustee companies. The working group has established a sub-committee on trustee companies. The sub-committee is expected to report in 1992 on ways to achieve consistency between State and Territory Trustee Companies Acts.

7. See OSSA s 3(1), definition of ADF, which requires that it be a continuing fund maintained by an approved trustee.

8. OSS Regulations reg 19(e).

9. ITAA s 285; *Income Tax Rates Act 1986* (Cth) s 26(1)(a).

maximum tax rate applying to individuals.¹⁰ The specific tax requirements that relate to superannuation are beyond the scope of this report.¹¹ The importance of tax law is that taxation concessions are the main vehicle for the exercise of Commonwealth power.¹² To obtain a tax concession, most superannuation schemes, ADFs and PSTs (but not deferred annuities) must advise the ATO that a notice stating that the scheme has complied with OSSA and its regulations during the relevant financial year has been received, or is expected to be received, from the ISC. The ISC gives such a notice when a scheme lodges a return containing the required statistical data and summary financial information for the scheme. Deferred annuities are automatically taxed at concessional rates as a specific class of life insurance business.¹³

Occupational Superannuation Standards Act (OSSA)

5.5. *'Complying funds'*. OSSA and the OSS Regulations specify a number of operating standards for superannuation schemes, ADFs and PSTs. A scheme must satisfy all standards and conditions imposed by OSSA if it is to qualify as a 'complying fund' for the purposes of the ITAA.

5.6. *Standards imposed*. The principal prudential standards imposed by OSSA and the OSS Regulations are

- equal numbers of member and employer representatives on trustee boards of schemes that have 200 or more members¹⁴
- a prohibition on borrowing by schemes other than for temporary finance for the purpose of paying member benefits (that is, a prohibition on gearing)¹⁵

10. Non complying funds are taxed at the maximum tax rate applying to individuals: ITAA s 286; *Income Tax Rates Act 1986* (Cth) s 26(2).

11. The Review notes that the Treasurer, Mr Dawkins, indicated recently in a speech to the Conference of Major Superannuation Funds in Wollongong that the simplification of the tax treatment of superannuation, in particular the taxation of lump sum benefits, would be undertaken only after consultation with the industry.

12. See ch 7.

13. ITAA Pt III Div 8.

14. OSS Regulations reg 13, 15. This rule applies to a scheme's management board or committee if it exercises actual control over the policies of the scheme. This regulation is subject to some transitional provisions. Exemptions are granted to personal schemes.

15. OSS Regulations reg 16(1)(b), 16(5).

- a requirement that investments other than investments in the sponsoring employer (so-called in-house assets) must be made at arm's length (that is, they must be made on commercial terms)¹⁶
- a restriction on investments in in-house assets, to 10% of the historic value of the scheme's total assets¹⁷
- a requirement that the rights of members to benefits be fully secured and not subject to lien¹⁸
- a prohibition on a scheme lending money to members¹⁹
- a requirement that the scheme's accounts be audited once a year by an independent auditor²⁰
- in the case of defined benefit schemes, a requirement that actuarial reports be prepared at least once every three years²¹
- requirements for reporting to members when they join a scheme, annually during membership, on termination of membership and on request²²
- a prohibition on reduction of accrued benefits, other than with the approval either of all members of the scheme or of the ISC.²³

5.7. *Reporting requirements.* The existing requirements for the provision of information to members of superannuation schemes include the following

- when joining a fund, a written statement containing details of the kinds of benefits provided to members, the conditions relating to those benefits and the method of determining entitlements to members;
- once a year, subject to some variations depending on the type of fund
 - the amount of benefit vested at the beginning of the year;
 - the amount of benefit vested at the end of the year;
 - the method of determining the latter amount;
 - the amount of vested benefit required to be preserved;
 - the amount of member contributions;
 - the amount or rate of net earnings allotted to the member; and
 - the amount of any current death benefits;

16. OSS Regulations reg 16(1)(c). In-house investments do not include policies of insurance covering employees (in the case where the employer sponsor is a life assurance company) or investments in securities issued by Commonwealth, State or Territory governments or investment in a public authority (where the employer sponsored scheme is a public sector scheme).

17. OSS Regulations reg 16A(17). This regulation is subject to some transitional provisions.

18. OSS Regulations reg 5, 5AB(2).

19. OSS Regulations reg 16(1)(a). This regulation is subject to some transitional provisions.

20. OSS Regulations reg 17(1)(c).

21. OSS Regulations reg 17(1)(a).

22. OSS Regulations reg 17.

23. OSS Regulations reg 17(d)(ii).

- on ceasing membership
 - the amount of benefit entitlements including any amounts which are required;
to be preserved;
 - the method of determining those entitlements; and
 - except on death, disablement or retirement from the workforce, the information set out in the previous point;
- on request by the member
 - the information required by the standards to be included in any actuarial report;
 - a copy of the auditor's report;
 - a copy of any return to the ISC and any certificates or notices required to be provided under sections 12 and 13 of the OSS Act; and
- where the governing rules of the fund are altered, a statement explaining the nature and purpose of the alteration and effect (if any) on benefit entitlements.²⁴

5.8. *Coverage and compliance mechanisms.* OSSA applies to all superannuation schemes constructed as trusts. It also applies to superannuation bonds offered by life insurance companies. Deferred annuities (DAs) do not come under OSSA's definition of 'superannuation fund',²⁵ although those parts of the Act and Regulations dealing with reasonable benefit limits, preservation and portability apply. The efficacy of OSSA controls depends upon the persuasive force of tax advantages. The only sanction that is available to the regulator in respect of a scheme which fails to comply with one or more of these standards is to disallow the tax concession. There are no civil and criminal sanctions that the regulator can impose on those who contravene the standards.

Life Insurance Act

5.9. *The Act.* The activities of all life insurance offices operating in Australia (other than State Government insurance offices conducting life insurance business within the limits of the State concerned) are governed by the *Life Insurance Act 1945* (Cth).²⁶ The Act extends to superannuation arrangements

24. OSS Regulations reg 17.

25. See further para 6.5–6.

26. *Life Insurance Act 1945* (Cth) s 4(1). The Act originally did not envisage 'superannuation policies' and was intended to apply to 'ordinary policies' such as whole of life endowment policies. This was amended following the introduction of 'investment linked' policies during the 1960s. The proposition that 'superannuation policies' are a form of life insurance business remains untested, although in *Cutten and Harvey v Sun Alliance Life Insurance Ltd* (1986) 4 ANZ Ins Cases 74461 it was decided that a 'money accumulator bond' was not a life insurance policy.

entered into by life offices that are based upon life insurance products (that is, it applies to life products that are primarily personal superannuation arrangements).²⁷ The ISC is responsible for administering the Act, subject to directions from the federal Treasurer.²⁸ The ISC is currently in the final stages of a major review of the Act. This review is focusing upon three main areas

- solvency and capital adequacy requirements for life offices
- the content of financial statements
- enhanced disclosure requirements to current and potential policyholders.

5.10. *Controls imposed.* Only a company can carry on a life insurance business.²⁹ To carry on a life insurance business, a company must be registered with the ISC.³⁰ Prerequisites for registration³¹ include that a company

- has a paid up share capital, or paid up capital and share premium account, of not less than \$10 million³²
- satisfies the ISC that it is likely to be able to meet its obligations and comply with the requirements of the Act
- has at all times eligible assets in excess of liabilities of \$5m.³³

Life companies must lodge financial and statistical returns (including actuarial reports on their financial position) with the ISC at regular intervals. Additional powers of inquiry and investigation are available to the ISC. The formal requirements of the Act are supplemented by actuarial standards and practices, as well as by guidelines issued by the ISC.³⁴ These require life insurance companies to consider factors such as asset mix and reserve levels against their underlying liability profile and capacity to deal with market, credit and liquidity risks. The Act requires registered companies to establish and maintain one or more statutory funds which are subject to stringent actuarial and financial controls.

27. The *Life Insurance Act 1945* (Cth) was amended by the *Life Insurance Act 1961* (Cth) s 3 to include specifically superannuation policies: s 4. A large proportion of the superannuation policies issued by life offices are in the form of contracts between the life office and the policy holder. These are subject to the requirements of the *Insurance Contracts Act 1984* (Cth) which imposes (among other things) a 14 day free look period: s 58(2).

28. *Life Insurance Act 1945* (Cth) s 9.

29. *Life Insurance Act 1945* (Cth) s 14.

30. As at 30 June 1991 there were 56 life insurers registered under the Act.

31. Required under the *Life Insurance Act 1945* (Cth) s 19(2).

32. This was raised recently from \$2m: *Life Insurance Act 1945* (Cth) s 19. Life companies also have to maintain at all times net assets of \$5m: s 19A(5).

33. s 19A(5). An eligible asset is defined as an asset of the company other than an asset invested in a related company: s 4B(1).

34. eg. circulars dealing with investment accounts business and the management of risk exposures.

All the premium income received in respect of superannuation schemes promoted by a life insurance company must be deposited in the company's statutory fund. Assets of these schemes must also be maintained in the statutory funds.³⁵ The ISC also issues circulars to life companies on particular issues as they arise. These have included guidelines for disclosure in 'promotional brochures' offering superannuation schemes.³⁶ The returns that life insurance companies furnish to the superannuation group of the ISC to obtain concessional tax certificates are difficult to reconcile with the annual returns they furnish to the life insurance group of the ISC. There is a need to revise these returns so that overlaps and shortfalls can be identified and a reconciliation achieved.³⁷

Accounting and actuarial standards

Accounting standards

5.11. During August 1991 the Australian Accounting Research Foundation (AARF) issued an accounting standard which specifically relates to superannuation schemes.³⁸ The standard applies to superannuation schemes that are 'reporting entities' for reporting periods ending on or after 30 June 1992.³⁹ The standard deals with three main matters

- the way in which superannuation schemes should account for particular transactions and events
- the format of superannuation scheme financial statements
- information requiring disclosure in the financial report of superannuation schemes.

A feature of the standard is that it requires superannuation schemes to record all assets included in their annual accounts on a net market (selling) value basis. An exposure draft of a further standard affecting superannuation was issued by the AARF during August 1991.⁴⁰ The draft proposes specific standards for measuring and disclosing all employee entitlements in employer sponsored or industry superannuation schemes as liabilities in the financial reports of the employers. It also proposes that any excess of defined benefit superannuation scheme assets over employees' accrued entitlements should appear as an asset in the financial

35. *Life Insurance Act 1945* (Cth) s 37, 39(2).

36. ISC circulars 226, 290, 291. These circulars do not have the force of law.

37. See recommendation 10.31.

38. Australian Accounting Standard 25 (AAS25) *Financial Reporting by Superannuation Plans*.

39. Under AAS25 (para 17), a superannuation scheme is a reporting entity where 'Members, or other users with a legitimate interest in financial information about a superannuation plan, may be unable to command the disclosure of financial information specific to their own needs'.

40. Exposure draft 53, *Accounting for employee entitlements*.

statement of the employer sponsor. Conversely, any excess of employees' accrued entitlements over defined benefit superannuation scheme assets should appear as a sponsor liability. Although the accounting standards issued by the AARF are not imposed by statute, they are required to be observed by all members of the accounting profession and will, therefore, be applied to audited superannuation schemes.⁴¹

Actuarial investigations

5.12. Currently actuarial investigations are required under the OSS Regulations for defined benefit superannuation schemes⁴² and under the *Life Insurance Act 1945* (Cth) for superannuation investment schemes offered by life insurance companies.⁴³ Actuaries assess whether the value of future contributions will be sufficient to cover the long term contingent liability to pay retirement benefits. This involves making assumptions about the value of, for example, future earnings and expenses, expected rates of exit from the scheme, interest rates and asset valuations, expected salary scales, the expected rate of growth and the distribution of new contributions made to the scheme over time. Using these assumptions, the actuary values the cash flow relationship of assets and liabilities over time and makes a recommendation about whether the current level and rate of contributions and benefits need to be adjusted over the next three years (in particular) and for the foreseeable future (in general). Actuarial investigations must comply with the professional standards issued by the Institute of Actuaries of Australia.⁴⁴

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41. An 'accounting standard' for life insurance companies has been issued by the ISC: circular 241, March 1986. This standard was developed in conjunction with the former NCSC but has not been accredited by the Australian accounting profession. It does not contain any specific requirements relating to the valuation or disclosure of superannuation schemes administered by life insurance companies. The general asset and liability valuation requirements contained in the circular would appear to be somewhat inconsistent with those contained in AAS25.
 42. OSS Regulations reg 17.
 43. *Life Insurance Act 1945* (Cth), s 48(1). Such investigations are only required in respect of the 'life insurance business' and not specifically for each superannuation investment product.
 44. Professional Standard No 1 covers investigations into the financial condition of a life insurance company. Professional Standard No 2 covers investigations of defined benefit superannuation schemes.

Table 2
Institutional framework affecting Superannuation Schemes

Type of Superannuation Scheme	Type of Institutional arrangement						
	Corporations Law	Life Insurance Act	OSSA	Specific accounting standards	Actuarial investigations	Tax related returns	State-based Trustee Acts
REGULAR CONTRIBUTION SUPERANNUATION SCHEMES							
• Publicly offered	X	X	X	X	X ¹	X	X ³
• Employer sponsored			X	X	X ²	X	X
• Industry			X	X		X	X
SINGLE CONTRIBUTION SUPERANNUATION SCHEMES							
• Superannuation schemes	X		X			X	X
• Superannuation bonds		X	X		X ¹	X	
ROLLOVER SCHEMES							
• Approved deposit funds	X		X			X	X
• Deferred annuities		X		X	X ¹	X ⁴	
RETIREMENT INCOME SCHEMES							
• Allocated pensions	X					X ⁵	X
• Immediate annuities		X			X ¹	X ⁴	
SIMPLIFICATION SCHEMES							
• Master funds	X	X	X			X	X
• Pooled super trusts	X		X			X	X
• Fund of fund arrangements		X ⁶			X ⁷		

1. Only superannuation schemes offered by life companies are subject to actuarial investigation as part of their 'life insurance business'.
2. Actuarial investigations apply only to defined benefit schemes.
3. Trustee companies subject to the various Trustee Companies Acts are often appointed as trustee, but not always.
4. A specific form of return does not have to be prepared for annuities as they are a specific class of life insurance business which is taxed at a concessional rate under Part III Division 8 of ITAA.
5. Allocated pensions are not currently eligible for tax concessions. This is under review by the ISC, the ATO and the Department of Social Security.
6. These cover arrangements under which small superannuation schemes place the contributions they receive into the statutory fund of a life insurance company. They are currently not specifically identified as such in the returns of the company receiving the deposit.
7. These arrangements would be subject to actuarial assessment as part of the insurance company's statutory fund only. They are not subject to specific actuarial assessment.