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Identity-theft fraud and illegal early release cases

The Association of Superannuation Funds of Australia (ASFA) has released a Best Practice Alert on the issue of identity fraud and illegal early access in the superannuation industry. The Alert provides case studies and suggestions for trustees on the issue might be addressed by superannuation funds.

Overview

The police and ASFA members have confirmed an increasing level of identity fraud occurring in the superannuation industry. ASFA adds that hard core criminals are now deliberately targeting superannuation funds.

In addition, the global financial crisis has triggered a significant increase of illegal early access to superannuation benefit cases.

Combined, identity theft and illegal access cases pose real challenge for superannuation funds and their administrators.

Identity theft and illegal early release are related because they may both involve money laundering activity.

What is identity theft?

Identity theft occurs when a person assumes another person's identity.

The benefits could be accessed by either rolling them over to another fund or by seeking direct payment.

Case study

An APRA regulated fund issued member benefits statements, one of which was stolen from a fund member's letter box. Using this information on the statement, the thief proceeded to create a range of documents relating to the member including a passport, drivers licence and council rate notice.

Earlier the thief had established a self-managed fund (SMSF) and an associated bank account in the name of a fund regulated by the Australia Prudential Regulation Authority (APRA).

Using the falsified documentation the thief lodged a rollover request to move the member's benefits to the SMSF. The APRA regulated fund, acting on the request and the supporting documents, rolled over the benefits by way of a cheque made payable to the fund. The fraudster banked the cheque and then transferred the money to an overseas bank account.

What indicators to look for to identify the fraud?

- ⌵ Use of false documentation.
- ⌵ Funds withdrawn from overseas account through ATMs in Australia.

What is illegal early release?

Illegal early release occurs where a member gains access to their superannuation benefits without satisfying a condition of release. This generally occurs in one of the following ways:

- ⌵ The member rolls over their benefits to an SMSF that has been established by an illegal early access scheme promoter. The promoter, for a fee, releases the benefit to the member without the member providing evidence that they have met the condition of release.
- ⌵ The member provides falsified Centrelink or APRA documents to the fund trustee and the fund releases benefits based on the falsified documents.
- ⌵ The member establishes an SMSF, transfers their benefits to the SMSF and then, in breach of the SIS Act and Regulations, incorrectly releases benefits to themselves.

Case study

A network of individuals established an unlicensed financial services business offering clients early access to their superannuation funds. This business acted as trustee for an SMSF.

It is alleged that the preserved superannuation benefits of 121 clients, worth more than AUD3.5 million, were deposited into the SMSF's bank accounts. These funds were rolled over from 11 legitimate superannuation funds. The SMSF managers then allegedly obtained early access to these benefits and withdrew and distributed the funds to the clients. As part of this process the fund managers retained commissions totalling more than AUD685,000 from the clients' funds.

What indicators to look for to identify the fraud?

- ⌵ Common bank accounts that identify and link superannuants, facilitators and organisers.
- ⌵ Significant cash withdrawals from superannuation accounts.
- ⌵ Unusual bank account activity into and out of superannuation accounts.

What are the challenges for super funds?

ASFA explains that identity fraud must be treated as a real threat by trustees. Advances in technology have made the preparation of forged documents easier and the risk of identity substitutions greater.

Do your communication processes assist theft and fraud?

ASFA indicates that one of the key sources of information used by fraudsters is obtained by accessing a member's mail. This raises the following questions:

- ⌵ What information is contained on member statements and other communications?
- ⌵ Is the information provided necessary, or required by law?
- ⌵ Could the information on the documents be used to rollover or otherwise claim a benefit without requiring further information?

ASFA suggest that superannuation funds should consider whether the information contained in fund communications (i.e. member statements) is sufficient to enable the fraudster to falsely create other documents to support their adopting the member's identity.

Accordingly, ASFA recommends that funds should question whether it is necessary to include on the annual statement information such as the member's date of birth and contributing employer details.

What checks do you make on the destination fund?

The ATO has indicated that there is an increasing number of SMSF registrations using the same name as an APRA regulated fund.

ASFA explains that if a super fund's rollover process is one of recognising the name and then paying to the address on the rollover form then this may provide an opportunity for the fraudster.

ASFA recommends that, as a minimum, the following steps should be taken when processing a rollover.

Confirming the bona fides of the fund

- Search for the fund name on the Australian Business Register's Super Fund Lookup site (<http://www.abn.business.gov.au>).
- If the fund is not listed, do not process the rollover.
- If the fund is listed then verify the type of fund. Is it an SMSF or is it an APRA-regulated fund?
- If it is an APRA-regulated fund then does the address on Super Fund Lookup match the address on the rollover form? If it does not, confirm the address with the fund prior to processing the rollover.

ASFA recommends that if the fund is an SMSF, then the address should be compared to that on the rollover application form and the ABN history file should be checked. The ABN history will show when the ABN was first issued and whether the fund has had any recent changes of name. The more recent the registration date, the greater caution should be shown.

ASFA explains that when using Super Fund Lookup, trustees should access the data direct each time. This is preferred to downloading the database to use as a reference tool.

Confirming the bona fides of the member

- For large value transactions, or where the fund has concerns, contact the member by phone or write to the member requesting they contact the fund.
- Confirm the identity of the member, or the validity of the transactions by seeking information that would reasonably only be known to the member and the fund. Funds generally possess a wide range of such information.

ASFA remarks that anecdotal evidence suggests a trigger for suspicion is where a rollover request is received and the identification material provided is in excess of the minimum requirement. (That is, the applicant is trying too hard to get it right the first time.)

What checks do you make when processing changes of address?

ASFA suggests that trustees consider whether additional processes should be put in place for verifying address changes. ASFA indicates that some trustees send a re-confirm letter to the 'old' to confirm the address change.

Who pays for identity fraud?

ASFA explains that there are very slim chances of recovery of misappropriated funds in a well-executed identity fraud case.

However, if there is evidence of negligence by the trustee, the trustee may be required to bear the cost.

Who do you report suspected cases to?

AUSTRAC

Fund trustees are required to report to AUSTRAC suspicious matters and actual and suspected cases of money laundering and terrorism financing.

ATO

If a fund suspect they have encountered an illegal early release scheme, they should contact the ATO via email at super-IER@ato.gov.au.

ASIC

Information about illegal release can be provided to ASIC's infoline on 1300 300 630.

APRA

Where a fund is impacted by these cases, it is suggested that the matter be brought to the attention of the fund's APRA supervisor.

How you need to communicate with members?

ASFA states that funds should give detailed consideration as to what they tell members that have been impacted.

An issue is whether an identity theft fraud has been facilitated by the members being a willing participant in an illegal early release scheme.

ASFA indicates that it may be necessary to have an affected member provide information by way of a statutory declaration.

Funds should also consider communicating the increased risk of identity theft fraud with their membership.

Sources

Association of Superannuation Funds of Australia, Identity-theft fraud and illegal early release cases, September 2009.

Australian Transaction Reports and Analysis Centre, Typologies and Case Studies Reports 2009

http://www.austrac.gov.au/typologies_2009.html

APRA draft guidance for superannuation trustees

Australian Prudential Regulation Authority (APRA) has released draft guidance on a number of prudent practices for APRA-regulated superannuation trustees:

- ⊘ draft Superannuation Prudential Practice Guide – SPG 110 – Capital;
- ⊘ draft Superannuation Prudential Practice Guide – SPG 200 - Risk Management;
- ⊘ draft Superannuation Prudential Practice Guide – SPG 230 - Adequacy of Resources; and
- ⊘ draft Superannuation Prudential Practice Guide – SPG 520 – Fitness and Propriety.

The aim of the four prudential practice guides is to address measures that might be employed by a trustee and its directors to satisfy obligations imposed under legislated licence conditions, various operating standards and other provisions under the Superannuation Industry (Supervision) Act 1993 (SIS Act) and its regulations.

APRA proposes to issue a final version of each of the guides later in 2009 which will replace the current Superannuation Guidance Notes and information previously contained in 'Frequently Asked Questions' prepared in the context of the licensing of superannuation trustees, as well as the earlier Superannuation Circulars.

Please see below for the new additions to the current guidance.

Draft SPG 110 – Capital

Maintenance of capital

Any failure to maintain the capital requirements at any time will constitute a breach of a licence condition, and, if significant, should be reported to APRA within 10 business days of its identification.

RSE licensees satisfying the capital requirement by use of a custodian

- ⊘ APRA indicates that where, under standard public offer licence conditions, a trustee satisfies its capital requirements by reliance on a custodian to hold fund assets the trustee must itself still hold a minimum of \$100,000 in cash or cash equivalents with an additional amount to cater for risks arising from activities such as in-house administration.
- ⊘ Where fund administration is undertaken in-house, the indicative minimum amount of liquid assets APRA is likely to impose by way of licence condition is \$250,000, but this may be set at a higher level depending on the nature of the trustee's activities.

- APRA expects any new entrant to trustee operations applying for a public offer licence and using the custodian conditions to meet the capital requirements of s. 29DA of the SIS Act to have at least the minimum amount of \$100,000 in liquid assets.

Draft SPG 200 – Risk management

Risk management framework

- APRA indicates that trustees may wish to give consideration to issues of business resilience; that is, the capacity of the organisation to adapt to and conceivably benefit from significant events which materially change the business operating environment.
- APRA indicates that it would be sound practice for trustees to use a well-structured process to identify and assess risks, possibly with the aid of a facilitated risk workshop. A checklist approach may be sufficient in the simplest scenarios, provided the trustee could demonstrate that it had covered the field adequately; however, with the increasing sophistication of the industry, the use of more advanced techniques is recommended
- APRA expects that the Risk Management Plan (RMP) would detail the trustee's requirements in relation to the use of derivatives, whether directly or in pooled investments, and management of derivative risk:
 - It is open to the trustee to determine whether a Derivative Risk Management Statement is required and if so whether it should be prepared separately from the RMP, or whether it could be incorporated within the RMP.
 - It would be sound practice for such a decision to be formally considered and documented by the trustee.
- APRA expects that as part of a trustee's risk management framework, it would establish, maintain and document effective management information systems commensurate with the size and complexity of its operations.

Identifying risks

- A non-exhaustive list of the areas of risk that have been added in the draft guidance and would be considered in developing a sound risk management framework includes:
 - processes for project management including transitions when functions are moved between in-sourced and outsourced arrangements, or between outsourced service providers;
 - risks associated with remuneration structures, both for executives and for investment managers, which may skew their risk appetite towards higher but unsustainable short term outcomes which may be inimical to the interests of long term fund members.
- The following is a non-exhaustive list of risks that could be included in the RMP and that have been added in the draft guidance:
 - risks associated with benefit design, including particularly the investments underpinning any explicit or implied capital guarantee offered to members. In considering risks related with benefit design, trustees adopting sound practice would have regard to the potential for members to benefit from arbitrage opportunities if unit prices or crediting rates for members switching between investment strategies are set using historic rather than forward pricing¹⁹, and, for defined benefit funds, risks to the financial position of the fund, which will include risks associated with the solvency of an employer sponsor as well as those associated with the investments supporting the fund's defined benefit liabilities.
 - valuation risk – in particular, the risks that the frequency of valuation is inconsistent with the frequency of establishing crediting rates or unit prices, giving the opportunity for arbitrage; the risk of incorrect valuation of assets for which there is not a deep or liquid market; and the risk of incorrect assessment of the tax implications associated with particular assets.

Risk mitigation and control

- APRA envisages that any areas of potential conflicts of interest should be identified, minimised and subject to careful independent monitoring and review. Trustees engaging in sound practice would have regard to the risk inherent in moving staff over time from control to operational functions, where they may apply knowledge of control features in order to circumvent them.

- Risk register would usefully incorporate the risk management controls relevant to each identified risk, including identification of the officer responsible for implementing those controls, an assessment of the control effectiveness and an assessment of the likelihood and impact of the residual risks.
- APRA expects that as part of a trustee's risk management framework, it would establish, maintain and document effective management information systems commensurate with the size and complexity of its operations. These information systems assist in the management, communication and reporting of risk issues and outcomes and assist in informing the trustee so that it is better able to meet its responsibilities.

Draft SPG 230 – Adequacy of resources

- Trustee should substantiate evidence of appropriate due diligence which supports the trustee's satisfaction with the capacity of material service providers including satisfaction with:
 - Their financial capacity to remedy any failings in providing the contracted services; and/or
 - Agreements under which an employer sponsor or other party commits to providing on-going material support to the trustee.
- When operations are conducted in-house, APRA would expect a prudent trustee to demonstrate appropriate recruitment and induction processes, as well as succession planning roles.

Draft SPG 520 – Fitness and propriety

- As a matter of sound practice, APRA explains that the trustee's Fit and Proper policy would include adequate provisions to allow whistleblowing if a person believes that a responsible person, or the trustee, did not meet the criteria of that policy.
- As a matter of sound practice, the Fit and Proper policy would require that any provisions of the policy facilitating whistleblowing are adequately communicated to directors, responsible officers and other employees of the trustee and its related entities.
- APRA considers that all officers of an RSE licensee should possess appropriate skills, knowledge and qualifications to carry out their appointed roles in order to meet the fitness standard. Minimum requirements for all responsible officers of an RSE licensee would include:
 - an understanding of and ability to effectively implement the covenants outlined in section 52 of the SIS Act;
 - a working knowledge of the SIS legislation and other relevant prudential requirements, including accounting, auditing and operational processes;
 - basic investment knowledge;
 - basic knowledge of the elements and application of other RSE licensee and trust law; and
 - awareness of areas where additional technical, professional or expert advice should be sought.

ASFA submission

ASFA has indicated that it generally supports the changes incorporated within the draft guidance above, in particular:

- APRA being able to require trustees to hold an additional amount of liquid assets (cash and cash equivalents) when there are higher levels of operational risk;
- The utilisation by trustees of more advanced techniques than checklists in all but the simplest scenarios to identify and assess risk;
- The establishment of effective information systems to assist in risk mitigation; and
- The clarification of the minimum 'fitness' requirements applying to all individual responsible officers. However ASFA explains that trustees are still able to satisfy the broader fitness requirements at the collective board level (ie by having an investment specialist or specialists on the board).

Sources

Australian Prudential Regulation Authority, APRA releases further draft guidance for superannuation trustees, 14 August 2009.

http://www.apra.gov.au/media-releases/09_24.cfm

Association of Superannuation Funds of Australia, ASFA Action No.371, September 2009.



Ban on 'flipping'

Industry Super Network (ISN) has called on the Federal Government to immediately ban the phenomenon of "flipping", where workers are automatically transferred from a wholesale superannuation fund to a higher fee personal super fund when they leave their job.

The practice has been confirmed in media reports of an investigation into "flipping" by the regulator APRA.

According to these reports 100,000 Australians have been "flipped" without their 'express consent' in the last year.

Research from independent superannuation experts SuperRatings (commissioned by ISN) has shown that the increase in fees when workers are flipped can be as high as 60%.

The effect of flipping can be twofold:

- ↳ an increase in fees, commissions and premiums; and
- ↳ a decrease in insurance benefits for members.

Sources

Financial Standards, Ban flipping arrangements: ISN, 15 September 2009.

<http://www.financialstandard.com.au/news/view/26806/>

Switchers tend to be older males with high balances

A new research commissioned by the Australian Institute of Superannuation Trustees reveals that less than 6.5 per cent of superannuation fund members changed their investment strategy during a three year period to June 2009. The research indicates that most members have stayed in their default fund option.

The research involved six of the country's largest superannuation funds managing a total of \$74 billion in assets.

Key survey findings are as follows:

- ↳ switchers tend to be older males with high balances who make larger contributions;
- ↳ member age is a more important switching trigger than member balance but those with higher balances are more likely to switch;
- ↳ older members are more likely to react to failing markets; and younger members respond to rising markets. Through 2007, a largely positive market return period, the youngest age group did the most switching;
- ↳ the vast majority of superannuation fund members stay put in their superannuation fund, typically the balanced investment option. Over the 36 month period examined, less than 6.5 per cent of members made an investment change; and
- ↳ there is little use of member investment choice. Only a few members take advantage of investment option choice to structure their superannuation to their needs, age and profile.

Sources

Australian Institute of Superannuation Trustees, Member inertia highlights importance of Super Fund Default Design: AIST, 17 September 2009.

aonmastertrust.com.au

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