



Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011

**AIST submission to the Parliamentary Joint
Committee on Corporations and Financial
Services**

20 January 2012



Australian Institute of Superannuation Trustees

Background

The Government has announced its decisions on key design aspects of its Stronger Super reforms. A key component of these reforms is the creation of a new simple, cost-effective default superannuation product called MySuper.

The Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 (“the Bill”) is the first tranche of MySuper legislation and provides the legislative detail for the core provisions of MySuper. These include the changes to superannuation guarantee requirements, the application process for MySuper, the MySuper authorisation process, the characteristics of a MySuper product, permitted fees and charging rules associated within a MySuper product.

The core provisions will be supplemented by measures to be contained in subsequent tranches of legislation.

Treasury has sought comment on a draft “Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012” (“the draft second tranche Bill”) that may be the second tranche of legislation introduced to Parliament. The draft second tranche Bill introduces expanded duties for Registrable Superannuation Entity (RSE) licensees, including duties relating to MySuper products, and personal duties for directors or corporate trustees. It also provides the Australian Prudential Regulation Authority (APRA) with the power to make prudential standards.

The Explanatory Memorandum for the Bill and the draft Explanatory Memorandum for the draft second tranche Bill both identify the matters to be contained in the third and possibly other tranches of legislation.

AIST notes that the issues it identifies with the Bill may be addressed in the subsequent tranches of legislation. Conversely, matters that appear settled in the Bill may be disturbed in the subsequent tranches and require additional and possibly modified comment on the Bill. This is not an ideal way for either Parliament or bodies with an interest in the legislation to consider a highly important reform package.

It would have been preferable for key elements of MySuper (eg, trustee duties, protections for members transferred between funds when they change jobs, and the prohibition on commissions) to have been included in the first tranche.

AIST had representation on each group set up by the Government to consult on each element of the Stronger Super reforms, having previously made submissions and representations to the Superannuation System Review. AIST has also made submissions and representations to Treasury on both the first and second tranches of draft MySuper legislation.

AIST consents to all information contained in this submission being made available to the public.

AIST

The Australian Institute of Superannuation Trustees (AIST) is a national not-for-profit organisation whose members are superannuation fund trustee directors and officers of industry, public sector, and corporate superannuation funds who operate with a representative Trustee Board of Directors.

AIST advocates on behalf of its members, it undertakes research, develops policy and provides professional training, consulting services and supports trustee directors and staff to help meet the challenges of managing superannuation funds and advancing the interests of their fund members. AIST members manage \$450 billion of retirement savings for Australian workers.

AIST has drawn upon the vast superannuation knowledge and experience of its members to make this submission.

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Executive summary

AIST submits that the Exposure Draft and the Explanatory Memorandum are consistent with the Government's announcements of 21 September 2011 contained in the Stronger Super Information Pack (the "Information Pack"), but require clarification and extension in some areas.

We note that it is also necessary to have regard to the Government's Stronger Super announcement of December 2010 (the "December announcement"), the Stronger Super Outcomes of Consultation Process document (the "Costello Report") issued on 21 September 2011, the APRA September 2011 Discussion Paper "Prudential standards for superannuation", and the draft second tranche Bill to gain a full appreciation of the Government's policy position.

AIST makes the following key recommendations:

- The Bill should explicitly define that a MySuper product:
 - is a 'superannuation interest' as defined in the Superannuation Industry (Supervision) Act;
 - has the characteristics identified in proposed section 29TC of the Bill;
 - is not a separate product as defined in the Corporations Act;
 - is not defined as 'a class of beneficial interest'; and
 - requires the separate identification of assets but not the segregation of assets.
- A transfer from a MySuper product to an ERF must be in the financial best interests of the member, and not involve an increase in fees. Heightened ERF trustee duties and a requirement for ERFs to cross-match accounts need to be included in a subsequent tranche of legislation.
- Additional rules need to be prescribed in the Bill to protect members from being transferred to a substantially higher-priced product without their knowledge or consent.
 - AIST submits that this be done by limiting *all* transfers from MySuper products (other than member initiated) to ERFs that feature enhanced trustee obligations.
- MySuper authorisation documentation should be made available to RSE licensees from APRA no later than July 2012.
- APRA should be required to decide all applications for authorisation within the prescribed periods.
- The definition of a large employer able to make arrangements for a large employer-sponsor MySuper product should be further clarified.
- The nexus required by the Government between administrative efficiencies and administrative fee discounts should be made explicit in the legislation.

AIST makes these comments having regard to the Government's core MySuper objectives of "simplicity, transparency and comparability".

Characteristics of a MySuper product

Definition of MySuper

The Bill requires amendment to provide clarity as to the definition of ‘a class of beneficial interest’ and how it relates to the MySuper and Choice ‘products’, so that subsequent legislative tranches, regulations and regulatory requirements can be soundly based.

While the Explanatory Memorandum states (in paragraph 3.18) that a MySuper is not a separate financial product under the Corporations Act, this is not reflected in the Bill.

Paragraph 3.18 of the Explanatory Memorandum states (in part): *“The class of beneficial interest is simply the rights and obligations that attach to that part of the member’s interest in the superannuation fund. In most cases, the interest in the superannuation fund will be the relevant financial product.”*

However, the Bill does not provide a definition of this ‘interest’ that supports the statement in the Explanatory Memorandum. A definition within the Bill is critical if funds are to be given comfort and surety to approach the development of MySuper products.

The December announcement stated that *“MySuper is a new low cost and simple superannuation product that will replace existing default funds.”* Consistent with this, the Costello Report defined MySuper *“...as the default investment product of an appropriately licensed trustee”* and went on to clarify that, *“Accordingly, MySuper should be able to fit within an existing fund alongside existing products but the trustee must ensure that MySuper members are separately identifiable.”*

The Government response to the Costello report appears to accept the agreed recommendations, albeit with less detail provided. In a formulation that is used throughout the Bill, proposed paragraph 32C(2)(c) of the Superannuation Guarantee (Administration) Act 1992 states that *“a class of beneficial interest in the fund is a MySuper product within the meaning of the Superannuation Industry (Supervision) Act 1993; ...”* Conversely, *“A class of beneficial interest in a regulated superannuation fund is a choice product if it is not a MySuper product”* (proposed for s.10(1) Superannuation Industry (Supervision) Act 1993).

AIST has specific concerns about superannuation fund members who maintain an interest in both a MySuper product and a Choice product within a fund, namely:

- Will there be a requirement to maintain one or two separate Product Disclosure Statements, and combined or separate application forms?
- Will these members be sent one statement (with MySuper and Choice sections) or will separate statements be required?
- Will there be a requirement to send duplicated correspondence about their interests in the fund?
- Will they be charged separate administration fees for both their MySuper and Choice interests?

- We would expect that an administration fee amount that relates solely to MySuper would need to be disclosed as a separate item on a member statement and not melded with administration costs for a Choice option that have less regulation on those costs.
- If they switch completely out of their MySuper product and into a Choice option in the same fund (or vice versa) will they be required to pay an exit fee?

AIST understands from its involvement in the Stronger Super consultations and associated discussion with Treasury that funds will be able to manage these members in a manner similar to how they manage existing members with an interest in both the default investment option and an alternate (“choice”) investment option. That is, through combined communication, documentation and reporting.

This approach is also consistent with the key characteristics of MySuper: to be simple, standardised and cost-effective. The potential alternative (of separate requirements) would incur additional costs, and introduce complexity and confusion for members.

So, in summary, all of the context and supporting documentation (and especially the statement in paragraph 3.18 of the Explanatory Memorandum) makes it clear that a MySuper is not a separate financial product under the Corporations Act. All that is needed – critically – is for this to be reflected in the Bill.

AIST recommends that the definition of ‘MySuper product’ be changed to state that a MySuper product:

- is a ‘superannuation interest’ as defined in the Superannuation Industry (Supervision) Act;
- has the characteristics identified in proposed section 29TC of the Bill;
- is not a separate product as defined in the Corporations Act;
- is not defined as ‘a class of beneficial interest’; and
- requires the separate identification of assets but not the segregation of assets.

Enhanced trustee obligations

AIST is of the view that the separation of MySuper into core provisions and subsequent tranches of legislation is weakened by the exclusion of the definition of “*enhanced trustee obligations for MySuper products*” in this Bill (cf. paragraphs 29T(g) and 29U(c)). However, this concern may be significantly ameliorated by the provisions of the draft second tranche Bill.

Trustee duties in relation to a MySuper product are to be different from other superannuation products, and so are fundamental to the MySuper architecture. It will be difficult for trustees to plan for MySuper unless they know their specific and different obligations. This is compounded by the parallel intention to give APRA prudential standards-making power, and for the consequent standards to also cover trustee duties.

AIST recommended to Treasury that paragraph 29TC on the characteristics of a MySuper product be amended by the inclusion of these enhanced trustee obligations in terms consistent with the “*specific trustee duties*” listed in paragraph 1.15 of the Explanatory Memorandum. Key amongst these is the trustee obligation to optimise the “*best financial interests of members*”. Section 52(2) of the Superannuation Industry (Supervision) Act should also be consequentially amended to incorporate these enhanced trustee obligations.

This was addressed in the draft second tranche Bill; the details of which have been commented upon by AIST in its submission on the draft.

The absence of these enhanced duties from the first tranche resulted in a lack of clarity and delayed planning for the implementation of MySuper. This is particularly important given the now accelerated timetable for MySuper implementation announced in the Information Pack. However, this omission was relatively quickly addressed in the draft second tranche Bill. AIST has made recommendations in relation to the draft, but they go beyond the Bill currently before the Committee.

Identification of assets

As noted above, the Bill should require the separate identification of assets between MySuper and Choice products but not the segregation of assets. Superannuation funds routinely acquire assets that can be invested for members across all investment options. The allocation of these assets between investment options is a function of the asset allocation within each option and the level of funds invested by members in each option. This provides scale and flexibility advantages, while not in any way diminishing the ability to accurately identify the mix and value of assets in each option.

With regards to paragraph 4.6 of the Explanatory Memorandum, AIST proposes that certainty be provided around the fair and reasonable division of assets between each MySuper and Choice product by requiring certification as part of the annual audit.

Transfers to an Eligible Rollover Fund (ERF)

Paragraph 4.25 of the Explanatory Memorandum clarifies paragraph 29TC(1)(h) of the Bill to mean a member of a MySuper product could be transferred to an ERF, although ERFs cannot offer a MySuper product. This could occur without a member’s consent (express or otherwise), and could result in their transfer to a *higher priced* product.

Under the proposed authorisation requirements, APRA is unable to authorise an ERF to offer a MySuper product. Therefore, without further legislation, a trustee of an ERF will not be required to adhere to the higher standard of trustee requirements required of a trustee of a MySuper product, and will not have a specific requirement to be cost-effective.

Further legislation is likely to be forthcoming as the Explanatory Memorandum for both the Bill and the draft second tranche Bill state that “trustee duties for eligible rollover fund licensees that are similar to the specific trustee duties in relation to MySuper products” will be addressed in subsequent tranches of Stronger Super legislation. However, this does not mean that there will be a prohibition on transfers from a lower priced MySuper product to a higher priced ERF.

The legislation should also prescribe the same level of reporting and disclosure, and comparison of returns for ERFs. In this way, trustees would know that any ERF receiving transferred funds meet these minimum requirements, and thereby the trustee would meet its obligations to the members being transferred.

This would be consistent with the agreed recommendation of the Costello report that: *“It was noted that trustees of ERFs should be separately licensed but will have similar duties to trustees of MySuper products. In addition, it was suggested that ERF trustees cross-match accounts in the ERF sector to assist members to locate and consolidate their lost superannuation.”* However, the Government has not yet identified this as something that will be addressed in subsequent tranches of legislation.

Beyond a disclosure requirement, superannuation fund trustees are not constrained in their ability to transfer a member to an ERF (ie, any member can be transferred if this is disclosed to members as the possible criteria for ERF transfers). The provisions for transfers from a MySuper product should be tightened to prevent abuse of this mechanism.

The legislation should be amended to provide that a member of a MySuper product cannot be transferred to an ERF, unless the transfer is in the financial interests of the member. A financial interest test is contained in the draft second tranche Bill for the comparison of MySuper products, and AIST proposes that comparisons between MySuper products and ERFs be used to determine if a transfer fulfills the financial interests test.

In the alternate, and, at the very least, there should be a requirement that the fees and costs of the ERF are equal to or less than the cost of the MySuper product from which they were transferred.

Transfers from a large employer-sponsor MySuper product

The Explanatory Memorandum (paragraphs 3.50 and 4.25) provides for a member to be moved (without their consent) from a large employer-sponsor MySuper product to the generic or standard MySuper product in the same fund (or an ERF) if they no longer meet the membership requirements of the large employer-sponsor MySuper product. This may result in a member being moved from a lower priced fund to a higher priced fund.

Paragraph 4.26 recognises that this might not be a desirable policy outcome, where it is stated (in part):

“... the Government will give further consideration as to whether additional rules are needed to protect members from being transferred to a substantially higher-priced product without their knowledge or consent. This may include standardised disclosure requirements in situations where a member would be placed in a higher-fee product as a result of changing their employment.”

The nature of these additional rules were alluded to in the Minister’s second reading speech introducing the Bill to Parliament:

“Provisions contained in the bill will generally allow for the transfer of a member interest from a MySuper product to another product under certain circumstances. Of particular concern is where

members are transferred between funds when they change jobs. Additional safeguards, including enhanced member disclosure or approval, will be included in subsequent legislation."

Notwithstanding these intimations of future but unspecified safeguards, the operation of the Bill as it stands can result in members from being transferred to a substantially higher-priced product without their knowledge or consent.

Paragraph 29TB of the Bill states that only employees of one specified employer may hold an interest in a large employer-sponsor MySuper product. The legislation does not provide a prohibition against flipping, and some instances actually require it. For example, paragraph 3.46 of the Explanatory Memorandum requires the terminating employee of an employer using a tailored MySuper to be transferred to another MySuper product within the same fund or to an ERF. There is no current or proposed price protection for a member being transferred to an ERF.

Such a move will result in financial disadvantage for the member, and provide an incentive for financial product providers to direct members from lower cost to higher cost products. In the absence of amendments to the Bill or subsequent legislation to prohibit the practice, the Act arising from this Bill will provide legislative support for the practice of "flipping" individuals into more expensive products.

AIST proposes an alternative that incorporates the Government's proposed actions on account consolidation and the reduction in unnecessary account proliferation:

- Employees leaving employment with the specified employer who have not elected to transfer to another superannuation fund may maintain their membership in the large employer-sponsor MySuper product, but may not receive contributions from other employers into the account, nor tag the account for exclusion from account consolidation.
- These accounts to be included in automatic account consolidation processes when they meet the consolidation criteria of 2 years inactivity.
- In the event that the account consolidation process does not result in the account being transferred in to the members active superannuation account, the fund may transfer the account to an ERF.
- The ERF trustees (with heightened trustee obligations) will include the account in their processes to assist members to locate and consolidate their unclaimed and inactive superannuation.

This solution protects members against flipping, limits the cost of maintaining accounts for former employees, and ultimately transfers the account to a superannuation entity specifically charged with managing unclaimed superannuation.

AIST submit that a transfer of this type should have a clear price limitation on it so that if a member is transferred without their consent to either another MySuper (within or without the fund), then the administration fee should be no more than 25bps in total higher than the MySuper option that they were transferred from. Transfers to an ERF should be at the same price or less.

Also, we note that contribution based insurance offerings will not be adequate for retained/non-active members as they will not meet the opt-out requirements for insurance due to automatic cessation rules. This infers that all MySuper products will need to offer account based insurance entitlements.

MySuper authorisation

Timetable

APRA will be able to receive applications for standard or generic MySuper authorisations from RSE licensees from 1 January 2013, or earlier if so approved. It has up to 180 days to decide an application to authorise a MySuper product (60 days to review plus 60 days available to request further information plus 60 days further extension available if required).

For applications made *before* 1 July 2013 for a large employer MySuper product, APRA will also have 180 days *from* 1 July 2013 to decide the application (120 days to review + 60 days extension available). Although the draft legislation states that funds will only be able receive default contributions in their MySuper product from 1 October 2013, the key date where a fund makes a MySuper application for a large employer MySuper prior to 1 July 2013 will be 27 December 2013. Within this time frame, funds will be able to accept default contributions into their existing default fund while their MySuper application is being decided.

Effectively, this means funds (other than in relation to large employer MySuper products) will have to make an application for MySuper authorisation within the six month window between January and June 2013.

Funds are likely to want to apply as early as possible in this period and ideally prior to 1 April 2013, so that they can advise employers of their MySuper status, and ensure that they will be MySuper compliant if APRA require the full 180 days, as well as for other marketing purposes.

Employers will require information on the MySuper status of their existing default fund as soon as possible, so that they can make alternate arrangements for the payment of default SG contributions (for which they are legally liable) in the event that their existing fund is refused authorisation or is late in making an application. Also, the Productivity Commission and Fair Work Australia reviews also add uncertainty as to the MySuper products available.

A fund's investigations and application process could reasonably take 3 months or more to complete. In order to make an application within this period, funds will require advance information about application requirements, forms and processes. We submit that this should be available from APRA from 1 July 2012. This would give funds 6 months to prepare their applications, amend their trust deeds and constitutions, and so make best use of their and APRA's limited resources.

APRA will provide MySuper authorisations if a fund can, amongst other things, satisfy it that it will comply with the enhanced trustee obligations.

However, these extra obligations are going to be contained in a later tranche of legislation that will not be introduced before the autumn session of Parliament 2012. The first round of Treasury consultation on the draft second tranche Bill was completed on 13 January 2012. This compounds the tightness of the schedule.

Refusal to grant authorisation

The Bill should be amended to clarify that APRA is required to make a decision on an application for MySuper authorisation within the required period. Paragraphs 29SB(3) and 29SB(4) of the Bill appear to be inconsistent. Paragraph 29SB(3) requires APRA to decide on authorisation applications within a defined period, whereas paragraph 29SB(4) deems APRA to have refused an application where it has not made a decision within a defined period.

The part of the Explanatory Memorandum addressing the time period for deciding applications (paragraphs 3.26 to 3.30) references only the requirements on APRA to decide under paragraph 29SB(4). At the very least, the proposed legislation should be amended to require APRA to provide reasons where it does not make a decision on MySuper authorisation within the required period.

Scale

Scale requirements are included in the draft second tranche Bill, however, the details of these requirements are not clear. This may put some funds in an invidious position of preparing to make a MySuper application not knowing if they will be able to meet the scale requirements or not.

This will be less of a concern if the key test is net returns to members, but if other elements form part of the scale test, funds and their members could be disadvantaged. We submit that the key test should be net returns to members with no objective asset or member number requirements.

Large employer MySuper products

The definition for a large employer-sponsor MySuper product specified in s. 29TB(2) is imprecise and complex.

Even more than the normal variation of an employer's staffing levels, the numbers of SG payments made by individual employers can vary significantly, and there is no industry-wide definition on what constitutes regular contributions or temporary cessation of contributions.

This could be addressed by an arbitrary requirement, such as 500 members for whom an SG contribution has been received from the employer in the past 12 months, and who have not terminated their employment with the employer.

While the draft legislation addresses the circumstances that may result in cancellation of MySuper authorisation, it does not sufficiently address the subsequent consequences of cancellation.

Fees

Administration fee discount

The discounted administration fee arrangement in 6.15 of the Explanatory Memorandum is explained as “... allow[ing a] RSE licensee to pass on the lower costs from any administrative efficiency of dealing with an employer to the employees of that employer.”

However, draft s.29VB(1) does not require a link between administrative efficiency and the lower fee. Rather, it allows in subsection (c) a discounted fee if “...the trustee, or the trustees, of the fund have entered into an arrangement with the employer-sponsor that secures lower administration fees for the employee members...”

This nexus is also identified in the Information Pack where it states (at p.4): “This recognises that there may be administrative efficiencies in dealing with some employers that warrant a lower administration fee.”

In AIST’s view, the draft legislation should be amended to explicitly require a link between discounted administration fees and commensurate administrative efficiency. This would properly fulfil the Government’s policy objective, and protect MySuper products against inappropriate within-MySuper cross-subsidisation.

Paragraph 29VB(1)(c) should be amended to read:

“(c) the trustee, or the trustees, of the fund have entered into an arrangement with an employer sponsor that provides demonstrable administrative efficiencies for the fund and the cost savings of the efficiencies are passed on as lower administration fees for the employee members; and”

The Explanatory Memorandum should be amended in turn to identify that use of ecommerce between the employer and fund is an example of an arrangement that provides administrative efficiencies to a fund.

Administration fee discounts should be verified on the basis of representing an appropriate variation from the generic MySuper administration fees and involving no cross-subsidisation; be included in the regular compliance audit of the fund; disclosed on the fund website and other publications; and be reported to APRA.

It would not be a satisfactory arrangement to allow administration fee discounting by way of pre-set schedules based on the number of an employer’s employees. It cannot be necessarily assumed that there is a correlation between employer size and administration efficiency.

We note that there may be comparative efficiencies in administering inactive accounts compared to employer sponsored accounts but this is not reflected in any of the policy developments here – all the more reason for funds operating a MySuper to demonstrate how they achieve the efficiencies in the employer space.