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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

3 October, 2012

Subject: Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012

Dear Sir/Madam

Thank you for the opportunity to comment on this Bill. Our major concerns are set out in the following sections, based on the Schedule in the Bill to which they relate. We have referred to the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 as the MySuper Core Provisions Bill.

Executive Summary

Our major concern is the timing of the requirements. Despite the amendments in the House of Representatives to the MySuper Core Provisions Bill which provide a three month deferral of some aspects of the Stronger Super package, the period for superannuation funds to fully implement the considerable changes required remains too short.

We consider a further six month deferral to 30 June 2014 of the requirement for RSE licensees to allocate contributions for existing fund members would enable a much smoother transition and minimise the potential problems which could otherwise result in members having multiple accounts with multiple fees and multiple insurance premiums. This deferral is also likely to result in a much quicker transfer of existing default investment accounts (accrued default amounts) to MySuper. It will allow RSE licensees to communicate to members more effectively and make all necessary changes for each member in one step rather than two or more, making it easier for members to understand.

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Our recommendations include:

Schedule 1: Fees

The Bill to be amended to clarify the fee rules where a member has a MySuper interest in addition to another interest in the fund.

Schedule 2: Insurance

- Section 29TC(1)(b) to be amended to clarify that insurance can be provided as intended (i.e. to allow different levels of cover for employees of different employer groups and for different groups of employees within an employer group).

- Current common definitions of disability (including own occupation, loss of limbs, home duties, daily living activity and cognitive loss style) should continue to be allowed. Further, the definition of permanent incapacity (as used for SIS condition of release purposes) should be updated to reflect superannuation membership trends and incorporate the loss of limbs, home duties, daily living activity and cognitive loss style definitions.

- The legislation could be simplified for employers by:
  - removing the insurance requirements from the SG legislation; and
  - incorporating similar requirements as a minimum standard for funds offering a MySuper.

Schedule 3: Collection and disclosure of information

Our main concerns relate to the volume of information to be disclosed and whether the value of providing such information is worth the cost involved.

- Rather than entrenching the disclosure requirements in the legislation, the final requirements should be determined between the industry and ASIC.

- Consideration should be given to limiting the asset details provided on a fund's website so a more manageable list of assets can be provided. For example, the details should be restricted to, say, the 100 investments of greatest value or those products/investments exceeding x% of the total value of the fund's assets.

- Greater consideration needs to be given to the extent of the information to be collected by APRA and APRA should justify the value of collecting such extensive data compared to the cost of collecting it.

Schedule 5: Defined benefits

The ability to use a fund which does not have a MySuper as a default fund for defined benefit employees should be incorporated in Section 32C of the SG legislation rather than Section 19(2C).

Schedule 6: Accrued default amounts

- RSE licensees should be able to continue allocating contributions to an existing investment option for existing members (as at 1 January 2014) until 30 June 2014. Contributions for new members should be allocated to a MySuper product unless the member has directed otherwise. This would provide licensees with a more appropriate period to enable a smoother transition to MySuper including the transfer of accrued default amounts to MySuper at the same time future contributions are allocated to MySuper.

- The definition of accrued default amounts should be amended to exclude all accounts for members who have part of their account in a Choice investment option because such members could be assumed to have already chosen to have part of their account in the current default strategy.

- The 30 day requirement to transfer accrued default amounts to MySuper is inappropriate in certain cases:
  - Where a defined benefit is crystallised, particularly in relation to death benefits
  - Death benefits for accumulation members

- Further amendments are necessary to avoid barriers to fund mergers and other successor fund transfers (eg where an employer changes its default fund). Such amendments should enable RSE licensees to:
  - transfer a member between MySuper products (subject to appropriate successor fund "equivalent rights" provisions)
  - transfer a member's non-MySuper interests to another fund under the successor fund provisions by deeming that investment and contribution instructions provided to the first trustee carry across to the new trustee.

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Our more detailed comments are set out in the following pages.

If you have any queries on our submission, please contact me on 03 9623 5552 or by email at john.ward@mercer.com.

Yours sincerely

John Ward
Manager, Research and Information

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APPENDIX 1: COMMENTS ON FURTHER MYSUPER BILL

We have commented on the following Schedules of the Bill.

Schedule 1: Fees
Schedule 2: Insurance
Schedule 3: Collection and Disclosure of information
Schedule 5: Defined Benefit members
Schedule 6: Transition to MySuper

SCHEDULE 1: FEES

The Bill needs to be considered in conjunction with the fee provisions in the MySuper Core Provisions Bill.

These provisions are reasonably clear where a member only has a MySuper interest in the fund (although various details are still to be prescribed in regulations).

However, there is still a lack of clarity over the fees which can be charged to a member who has both a MySuper interest and a Choice interest.

The problem arises in relation to the weekly fee where a member has both a MySuper and a Choice interest. The following two examples illustrate the issue:

Example 1: Fund A

Fund A is considering administration fees for its MySuper option equal to $1.50 a week plus a percentage of the MySuper account balance.

Fund A also offers a Choice investment option and is considering administration fees of $2 a week plus a percentage of the Choice account balance.

Section 29VA introduced by the MySuper Core Provisions Bill indicates a MySuper member cannot be charged more than the standard weekly MySuper fee of $1.50.

It appears that this would not allow funds to recoup additional costs resulting from the member having two investment options through the weekly fee. If so this would also result in the member paying a lower weekly fee than would have been payable if the member only held a Choice interest.

The Bill is also silent on how this fee would need to be allocated between the MySuper and Choice options e.g. is the $1.50 a week required to be deducted from the member's MySuper account or is it open to the fund to deduct it from any account?

Example 2: Fund B

Fund B will also offer a MySuper and a Choice option, and is considering applying a standard weekly fee of $1.50 irrespective of how many interests the member has. For example a member will be charged a weekly fee of $1.50 irrespective of the member having only a MySuper or Choice interest or a combination of MySuper and Choice interests.

Whilst Fund B's fees appear to satisfy the requirements in the Bills, it is not clear how this fee would need to be allocated between a member's MySuper and Choice interests.

Recommendation

The Bill needs to be amended to clarify the fee rules where a member has a MySuper interest in addition to another interest in the fund.

SCHEDULE 2: INSURANCE

The Bill sets out insurance requirements for MySuper members. We have a number of concerns with these provisions.

a) Conflict with MySuper Core Provisions Bill

The Bill does not specify the level of insurance to be provided – this will be left to the RSE Licensee to determine.

The EM to the Further MySuper Bill indicates the level of insurance may vary between and within employer groups. We support this approach as it gives trustees the discretion to provide different levels of insurance depending on what is in the members' best interests. This is sensible as it enables trustees to distinguish between highly paid executives and lower paid and casual workers.

However, we are concerned this is not consistent with Section 29TC(1)(b) of the SIS Act to be introduced by the MySuper Core Provisions Bill. This section sets the following condition for a MySuper product:

> "all members who hold a beneficial interest of that class in the fund are entitled to access the same options, benefits and facilities"

It is difficult to understand how such a requirement can be met where different insurance levels are provided to members of different ages, employer groupings and groupings within employer. Paragraph 2.18 of the EM clearly indicates different benefits can be provided "notwithstanding the requirement of paragraph 29TC(1)(b) of the MySuper Core Provisions Bill". Yet it provides no indication as to how RSE licensees can effectively ignore those provisions.

> ***Recommendation***
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> ***Section 29TC(1)(b) needs to be amended so that it is clear insurance can be provided as intended.***

b) Removal of insurance for various types of insurance that may not be released when an insurance payment is made for them, because the circumstances do not meet a condition of release

Our concerns particularly relate to the following issues as not being in the best interest of members:

- The provision of benefits in respect of loss of limbs or eyes where it is unlikely that there would be any reduction in premium if such provisions were removed. Trustees would effectively be required to tell members that the Government has forced the trustee to remove existing (and long-standing) entitlements even though there is no change in insurance premium.

- The provision of benefits in respect of a member's inability to perform daily living activities or home duties. If these cover types are banned, then it is likely that either no premium reduction will apply or the insurer will refuse to offer insurance for some groups of members at all (eg casuals and those not in the workforce). Again, trustees would effectively be required to tell members that the Government has forced the trustee to remove existing entitlements even though there is no change in insurance premium or that no disability cover can be provided at all.

  Home duties, daily living and cognitive loss definitions have become increasingly popular in recent years and have been an important development in the insurance area to reflect the changing nature of superannuation membership. Such definitions have been specifically designed for members who have no connection with a work place (including women caring for children, and the unemployed), casual employees and those working only a small number of hours a week. Conversely, the definition of permanent incapacity in the SIS legislation (intended to be applied for future insurance requirements) has failed to keep pace with these trends. It is a definition that is really applicable only to a person in the workforce.

- The provision of benefits on an own occupation definition which can become an integral part of member's retirement planning (even though it may not always be immediately available). The fact that this insurance results in an amount secured for the member is a significant financial benefit for such members. In any case, members who have reached their preservation age will generally be able to access the benefit immediately.

- The difficulties trustees will face in removing accrued entitlements in such cases and how they will be able to simultaneously comply with SIS Regulation 13.16

  Recommendation

  Such definitions should continue to be allowed. Further, the definition of permanent incapacity (as used for SIS condition of release purposes) should be updated to reflect superannuation membership trends and incorporate the loss of limbs, home duties, daily living activity and cognitive loss style definitions.

c) Legislative duplication of insurance requirements

The Bill, together with the MySuper Core Provisions Bill requires an employer, when selecting a default fund for its employees, to choose a fund which

- offers a MySuper; and
- satisfies the minimum insurance rules in relation to death set out in the SG regulations

Some funds offering a MySuper may not satisfy the SG Choice of Fund requirements. The Bill imposes a requirement on RSE licensees to provide insurance (on death and permanent incapacity) to MySuper members however there is no requirement for a fund offering a MySuper to provide the level of death cover required by the SG regulations.

This adds an additional (and unnecessary) layer of complexity for employers choosing a default fund. Many employers already find the superannuation requirements very difficult to follow. It is unreasonable they should be required to understand the intricacies of the various pieces of legislation and not only check their default fund offers a MySuper but also provides the relevant insurance.

Recommendation:

The legislation could be simplified for employers by:

- ***removing the insurance requirements from the SG legislation; and***
- ***incorporating similar requirements as a minimum standard for funds offering a MySuper.***

SCHEDULE 3: COLLECTION AND DISCLOSURE OF INFORMATION

The Bill sets out requirements for:

- Making product dashboards publicly available on a fund's web-site
- Regular updating of the dashboards
- Making details and the value of each financial product or other property held by the fund publicly available on the fund's web-site and updating this twice a year
- Making details of the remuneration of each executive officer of the RSE licensee (each trustee where the trustee is a group of individual trustees) publicly available on the fund's web-site.

In addition, the requirements to provide data to APRA are being expanded.

We are concerned with the significant costs that may be incurred in relation to the disclosure of information and that insufficient consultation has occurred on this important issue.

This is particularly the case in relation to the disclosure of investment information including the look through arrangements and the timing of such disclosure and the potential impracticality and cost of the requirements around disclosure of potentially thousands of security holdings.

Clearly there is a conflict between the benefits of making such information available and the costs of providing the information. Any such disclosure requirements need to be practical and provide value that is related to the cost.

Recommendation

Rather than entrenching these requirements in the legislation, we recommend that the requirements in the legislation be kept to a very general level with final requirements to be determined between the industry and ASIC.

The provision of data on each financial product and other fund investments will, in most cases, represent a huge amount of data. The size of the data to be provided will make it difficult for members to easily analyse those investments.

Recommendation:

Consideration should be given to limiting the asset details provided so that a more manageable list of assets can be provided. For example, the details should be restricted to, say, the 100 investments of greatest value or those products/investments exceeding x% of the total value of the fund's assets.

We are also concerned with the volume of data APRA intends to collect. We consider the costs, in many cases, will outweigh the benefits to be gained. We will be responding to APRA's discussion paper in due course.

Recommendation:

Greater consideration needs to be given to the extent of the information to be collected by APRA and APRA should justify the value of collecting such extensive data compared to the cost of collecting it.

SCHEDULE 5: Defined benefit members

The Bill generally provides reasonable provisions in relation to defined benefit members.

We have one concern, however, which relates to the amendments to the SG default fund requirements in the SG legislation.

We understand the intention is to enable employers to adopt a defined benefit fund as a default fund (for employees entitled to defined benefits) even though the fund does not offer a MySuper. We strongly agree with the logic of this intention.

However, it appears this is achieved by imposing a zero penalty on the employer in such circumstances (Section 19(2C)) rather than specifically allowing such a default fund in Section 32C.

In our view, this leads to questions as to whether employers need to complete a Superannuation Guarantee Statement in such cases as there will have been a breach of Section 32C. This may also result in the employer incurring an administration fee penalty.

Recommendation

The ability to use a fund which does not have a MySuper as a default fund for defined benefit employees should be incorporated in Section 32C of the SG legislation rather than Section 19(2C).

SCHEDULE 6: Transfer of Accrued Default Amounts

The transitional provisions in this section require trustees to transfer any accrued default amounts to a MySuper account no later than 1 July 2017.

More general provisions require the transfer of accrued default amounts to a MySuper within 30 days (90 days if the transfer is to a MySuper in another fund).

Whilst these provisions are generally reasonable, we have several specific concerns which are outlined below.

a) Duplication of accounts

The requirement to allocate all contributions to a MySuper from 1 January 2014 is likely to result in many members having more than one "account" during the transition phase.

Subject to appropriate clarification of our concerns on fees in Schedule 1, we expect that this will generally not result in multiple fees. However, in many cases it may result in a duplication of insurance with the member paying premiums for the new insurance in the MySuper product whilst continuing to pay premiums for existing cover.

Once the member's existing account is transferred to their new MySuper account, we expect the multiple insurance cover arrangements will generally cease.

This provision of multiple levels of cover will generally not be in members' best interests, but the short time frame between the finalisation of this legislation (and any required clarification of what it means) and 1 January 2014 may not be sufficient for trustees, particularly in complex arrangements, to implement the MySuper requirements in the most effective and efficient manner.

Recommendation

RSE licensees should able to continue allocating contributions to an existing investment option for existing members (as at 1 January 2014) until 30 June 2014. Contributions for new members should be allocated to a MySuper product unless the member has directed otherwise.

This would provide licensees with a more appropriate period to enable a smoother transition to MySuper including the transfer of accrued default amounts to MySuper at the same time future contributions are allocated to MySuper. This would include communication with members, providing any required three month notice of transfer and avoiding the provision of multiple levels of cover during the transition period.

We note such an extension would also provide an encouragement for trustees to transfer accrued default amounts by 1 July 2014 rather than by the current proposed deadline of 1 July 2017. This would generally be to the benefit of members and RSE licensees.

b) Definition of "accrued default amounts"

The definition of accrued default amounts includes amounts for members who have clearly made an investment choice in relation to their account with that choice being to invest in the default option. We consider that requiring trustees to transfer such accounts may not be in the interests of such members. However, we acknowledge that it would be difficult, in many cases, for trustees to determine which members have made such a decision.

One relatively simple approach would be to conclude that where a member has made an investment choice that includes investing part of their account in a Choice option and part in the default option, that member has made a choice in relation to choosing the default option.

> **Recommendation**
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> ***The definition of accrued default amounts should be amended to exclude all accounts for members who have part of their account in a Choice investment option.***

c) Defined benefit members

It is unlikely new accrued default amounts will arise in an accumulation fund after 1 July 2017. However, this is not the case in a defined benefit fund. When a defined benefit member leaves the employment of the sponsoring employer, the defined benefit is generally crystallised. At this point it becomes an accumulation benefit and would, under the provisions of the Bill, be considered to be an accrued default amount (unless/until alternative investment instructions are provided by the member). (This has been confirmed by APRA in the frequently asked questions section on their website.)

Retirement benefits (and often other benefits) for defined benefit members are generally protected from the variations in investment markets during their period of employment with the sponsoring employer. Once a defined benefit member leaves that employment, the defined benefit is often crystallised and most defined benefit funds ensure this crystallised benefit is invested in a conservative investment strategy (or cash) until the member instructs the trustee on how it should deal with that benefit. Such approaches have been developed over many years to protect the crystallised defined benefit from downside investment risk.

In the short term, the Bill (and APRA's draft Prudential Standard on Transition) enables trustees to continue this protection of benefits for former defined benefit members until 1 July 2017. Even though the crystallised benefits will become accrued default amounts they do not have to be transferred until 1 July 2017. This will generally enable trustees to contact the former defined benefit members and for the member to decide the most appropriate investment option (including the MySuper option) or whether transfer to another fund or pension product is more appropriate in their circumstances. (Based on APRA's draft Prudential Standard, the member would be given three months notice of any transfer to the fund's MySuper option.)

However, where defined benefits are crystallised closer to (and after) 1 July 2017, it will generally be impossible to give members any reasonable period of notice in which to decide where their crystallised benefit is to be invested. In any event it will be impossible to comply with the 30 day requirement in the Bill as well as the 90 day notice requirement in APRA's draft Prudential Standard.

The provisions of the Bill result in a potentially greater problem (and risk) in relation to death benefits. Where a defined benefit member dies and the benefit is crystallised, it may still take some time for the trustee to determine the relevant beneficiary. This may mean the death benefit will have to be transferred to a MySuper and hence become subject to the fluctuations in value under that option. In the case of death, there may be no-one who could instruct the trustee to invest the death benefit in, say a cash option rather than transferring it to MySuper.

Recommendation:

The 30 day requirement to transfer accrued default amounts to MySuper is inappropriate in certain cases:

- ***Where a defined benefit is crystallised, the trustee should be required to instigate the transfer process within 30 days of becoming aware of the crystallisation. Instigation should involve providing the member with three months notice of a proposed transfer to a MySuper with the member having the ability to direct the trustee not to transfer the benefit. If no direction is received, the transfer should occur within 30 days of the expiry of the three month notice period***
- ***In the case of death, any defined benefit death benefit should be allowed to be retained in a cash or conservative investment option. (This could be achieved by amending the definition of accrued default amounts to exclude such death benefit amounts.)***

d) Death benefits for accumulation members

APRA have recently added a Frequently Asked Question to their website relating to the treatment of the insured component of a death benefit. The answer indicates as the insurance proceeds is not a contribution, it would not need to be allocated to a MySuper product and could be invested in, say, a cash option.

However, the answer does not indicate why this amount would not be considered to be an accrued default amount which would, post 1 July 2017, need to be transferred to a MySuper with its associated investment risks within 30 days. It is unclear who would be able to advise the trustee to retain the benefit in cash as the member is deceased and the beneficiaries generally not yet clarified. There is the potential for death benefits to be adversely impacted by negative investment returns on the insured component of their benefit during the period the trustee is determining the appropriate beneficiaries.

Recommendation:

Clarification is needed as to whether the insurance component of a death benefit is to be treated as an accrued default amount. If it is, the 30 day requirement is inappropriate.

e) Successor fund transfers post introduction of MySuper

The requirements in this section appear to create confusion and a barrier to the rationalisation of superannuation funds.

For example, consider a merger of Fund A with Fund B. Erica is a member of Fund A and has chosen a cash investment option (not Fund A's MySuper option).

Under normal circumstances, the merger would be arranged on a successor fund basis with Erica's account being transferred to a similar (ie cash) investment option in Fund B. Future contributions would also be allocated to the cash option in Fund B to ensure Fund B replicates Erica's instructions to the Trustee of Fund A as far as possible.

However, under the Bill it will appear this will no longer be possible because, unless Erica has given written investment instructions to the trustee of Fund B:

- Schedule 6 of the Bill appears to treat Erica's existing balance as an accrued default amount after the transfer has occurred and the trustee of Fund B would be required to transfer it to its MySuper option within 30 days.
- Section 29WA of the SIS Act (to be inserted by the MySuper Core Provisions Bill) will require the trustee of Fund B to allocate future contributions to the MySuper option.

This will result in a situation where the member's wishes are clearly being overridden by the MySuper legislation. Even though Erica will be able to advise the trustee of Fund B to keep the transfer value in the cash option and to allocate contributions to the cash option, the above requirements may make it difficult for the trustees of funds A and B to agree the transfer satisfies the successor fund requirements.

We also note the amendments which were adopted just prior to the passage of the MySuper Core Provisions Bill in the House of Representatives also appear to create a barrier to successor fund transfers and the merger of superannuation funds by banning the transfer of members from one MySuper to another without the member's consent.

(Whilst we understand this restriction was intended to stop transfers between MySuper products which would result in an increase in fees, it appears to have a much broader impact and could stop transfers to a MySuper which provides equivalent or more favourable conditions.)

Recommendation:

Further amendments are necessary to avoid confusion and possible barriers to fund mergers and other successor fund transfers (eg where an employer changes its default fund). Such amendments should enable RSE licensees to:

- ***transfer a member between MySuper products (subject to appropriate successor fund "equivalent rights" provisions)***
- ***transfer a member's non-MySuper interests to another fund under the successor fund provisions by deeming that investment and contribution instructions provided to the first trustee carry across to the new trustee***

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APPENDIX

Who is Mercer?

Mercer is a leading global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have $55 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust, the Mercer Super Trust, has approximately 260 participating employers, 240,000 members and more than $15 billion in assets under management.