AIST submission

SUPERANNUATION LEGISLATION AMENDMENT (FURTHER MYSUPER AND TRANSPARENCY MEASURES) BILL 2012

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

October 2012

Australian Institute of Superannuation Trustees

Background

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. This included the MySuper group.

We have subsequently made submissions and representations on every element, and at every stage, of Stronger Super (and MySuper) legislation, regulation and associated legislative instruments (e.g. APRA Prudential Standards) from the perspective of not-for-profit super funds.

AIST is strongly supportive of the Government's superannuation reform agenda, and is concerned to ensure that it is implemented in a practical, balanced and consistent way; fundamentally focused on delivering optimal retirement savings for all Australians. In part, AIST does this by testing legislative proposals for MySuper against the Government's core objectives of 'simplicity, transparency and comparability'.

AIST welcomes the opportunity to provide a submission on the Bill.

AIST

The Australian Institution 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's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

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Executive Summary

This submission identifies key issues that should be further considered by the Parliamentary Joint Committee on Corporations and Financial Services ('PJC") in the third tranche of MySuper legislation before it is tabled in Parliament.

Fees, costs and intra-fund advice

AIST proposes an amendment to section 29VA to allow funds to apply a fee cap on asset-based administration fees where this is in all members' best interest.

AIST recommends that the performance fee criteria become mandatory for all MySuper related investment management agreements by 1 July 2016.

Insurance

AIST recommends that "own occupation" insurance policies be permitted within superannuation.

Collection and disclosure of information

AIST proposes an amendment to require that government entities receiving superannuation information have an obligation to do so in a consistent manner, to the extent that consistency is desirable having regard to the purpose of the data collection.

AIST submits that the legislation prescribing the product dashboard (Section 1017BA) should be deleted from this tranche of the MySuper legislation pending further consultation with the superannuation industry, and be resubmitted in the fourth tranche of MySuper legislation in November 2012.

AIST submit there should be a safe harbour (as opposed to a defence) for a trustee that uses reasonable attempts to comply with collection and disclosure of information requirements

Transition to MySuper

AIST strongly supports the identification and transition of all Accrued Default Amounts as provided for in Schedule 6 of the Bill, and urges the PJC to resist calls to water down these provisions.

Eligible rollover funds

AIST submits that the Bill should be amended to provide an additional obligation on ERF trustees to locate and re-unite their members with their active superannuation, and contain an explicit prohibition on flipping to ERFs (that is, using transfers to an ERF as a means of extracting higher fees from a member without their knowledge or consent).

This list is not an exhaustive list of AIST's concerns but, having regard to the short time available for the Committee to consider this Bill, focuses on the matters that AIST submits are the most important and the most contentious, and where we believe that the perspective of the not-for profit sector can add the most value.

Additional areas of concern are identified in the attached submission that AIST made to the Treasury Exposure Draft of the Bill during the public consultation stage in May 2012. Most of the comments in the attached submission remain relevant.

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Chapter 1 Fees, costs and intrafund advice

Prohibition on a fee capping of asset-based administration fees

AIST proposes an amendment to section 29VA to allow funds to apply a fee cap on asset-based administration fees where this is in all members' best interest.

In the MySuper legislation, there is a prohibition on 'fee tiering'. The only permissible fees are asset-based, dollar-based fees, and a mixture of asset-based and dollar-based fees.

A fee capping arrangement is a limited fee tiering arrangement where the total fees paid by members are limited to a specific maximum.

There is a maximum cost incurred by members of funds for administrating their accounts, regardless of their balance. However, percentage-based fees do not recognise this and apply a limitless level of fees on members.

Members of a fund might, for example, be subject to a fee of 1%. This would mean that a member with an account balance of $10,000 would be subject to a fee of $100, whereas a member with $1 million would be subject to a fee of $10,000. It is obvious that the cost to administer an account for a member with a $1 million account balance is much less than this.

MySuper products are not only for disengaged members. They are also available for members who actively choose the default option of their superannuation fund and who want their trustee to make investment decisions on their behalf. These were key findings of the Super System Review (Cooper Part 2 2010, p. 9), are supported by the Government and the super industry consultation process, and are reflected in the legislation. Australians of all ages, life stages and account balances use the default option of their superannuation fund, both consciously and not.

Some funds (e.g. Equipsuper and CareSuper) recognise that there is a maximum cost incurred by members and use an administration fee cost limit.

Case study 1: CareSuper

CareSuper charges a variety of fees, with a dollar-based account-keeping fee of $1.50 per week, together with a percentage-based administration fee of 2%, subject to a maximum of $500 per annum, and an investment management fee of 0.81%.

Balance of member	**$1,000**	**$10,000**	**$100,000**	**$1,000,000**
Account keeping fee, p.a.	$78	$78	$78	$78
Administration fee, p.a.	$2	$20	$200	**$500**
Investment management fee, p.a.	$8	$81	$810	$8,100
Total fees (rounded to nearest dollar)	$88	$179	$1,088	**$8,678**

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If CareSuper were unable to apply an administration fee cost limit on their members' administration fee, their fees would look like this:

Balance of member	**$1,000**	**$10,000**	**$100,000**	**$1,000,000**
Account keeping fee, p.a.	$78	$78	$78	$78
Administration fee, p.a.	$2	$20	$200	**$2,000**
Investment management fee, p.a.	$8	$81	$810	$8,100
Total fees (rounded to nearest dollar)	$88	$179	$1,088	**$10,178**

In this example, a CareSuper member with a $1 million balance in a MySuper account with no cap would be paying $1,500 p.a. more than if they were allowed to maintain a cap.

The operation of any cap would need to be accompanied by a legislative rule to the effect that a cap only applies at a level above the reasonable cost of providing administration services for the member in question and does not result in any cross-subsidisation of high-account balance members by low-account balance members.

AIST submit that a cap on asset-based administration fees in MySuper be permitted through the following amendment in the Fee Rules in Division 5 of Tranche II (My Core Provisions Bill) - section 29VA Charging Rules. We submit that it is probably not necessary to amend Tranche III (Further My Super and Transparency Measures) Bill Part IIA- General Fee Rules.

We would propose to insert a new section 29VA (9) as follows:

> *"Section 29VA (9)*
>
> *For the purposes of this section, if the trustee or trustee of a regulated superannuation is permitted to charge a fee for all members of the fund who hold a MySuper product which is a percentage of so much of the member's account balance with the fund that relates to the MySuper Product, the trustee may cap the cost of the fee being a percentage of the member's account balance, providing that;*
>
> > *(a) the trustee attributes the costs of the fund between members who hold a MySuper Product fairly and reasonably; and*
> > *(b) the cap is necessary to enable the trustee to recover the reasonable costs of providing the services to members other than Investment Fees."*

This approach adopts the theme of the amendments that have been inserted into Tranche III (Further My Super and Transparency Measures) Bill Part IIA- General Fee Rules- the new section 99E of SIS which is a restatement of an existing principle.

"If there is more than one class of beneficial interest in a regulated superannuation fund, the trustee or trustee of a regulated superannuation fund must attribute the cost of the fund between the classes fairly and reasonably."

Section 29VA(9)(b) is qualified by exempting "investment fees" because these do not appear to have

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to be levied purely on a "cost recovery basis" as defined in section 29V.

Transition to performance fee criteria

AIST recommends that the performance fee criteria become mandatory for all MySuper related investment management agreements by 1 July 2016.

Many investment management agreements have an open-ended term, and so the limitation of these requirements to agreements executed after 1 July 2013 mean that there will be a long tail of arrangements that do not meet the criteria.

AIST does not support limiting the introduction of these criteria to arrangements entered into after 1 July 2013, without any further requirement for implementation.

AIST proposes that performance fee requirements should be phased in for existing contracts over three years to ensure implementation of these measures within a reasonable and finite period, whilst minimising disruption to investment markets and any disadvantage to members resulting from a required transition from one manager to another to meet criteria. This could be done by requiring the regular (generally annual) review of investment managers to include the phase-out of non-compliant performance fees over the transition period.

Intrafund advice

AIST notes and supports the dual regulation of intrafund advice in the FoFA measures and the provisions in this Bill, including the definition in section 99F of the Bill. This support is subject only to one caveat: Trustees should not be able to provide intrafund advice on products that are not be operated by the trust, such as providing advice under subsection99F(1)(c)(ii).

Also, while AIST supports the "one-off" test for intrafund advice, this criteria should not preclude the fund subsequently inviting the member to review their advice, providing reports in relation to the implementation of the advice, or receiving other, "one-off intrafund advice from the fund on different matters.

Chapter 2 Insurance

Concern about prohibition on "own occupation" disability insurance in superannuation

AIST recommends that "own occupation" insurance policies be permitted within superannuation.

"Own occupation" insurance is to be prohibited by the proposed legislation to the extent that it is inconsistent with conditions of release. While this is not a position supported by AIST, tax rulings on deductibility and strong governmental resistance to altering conditions of release have made the maintenance of own occupation arrangements increasingly difficult.

Notwithstanding this, AIST continues to argue that insurance on this basis provides a real benefit to members, and that conditions of release should be amended to allow the release of benefits to members paid out under own occupation policies.

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In the event that the Government persists with this prohibition, AIST recommends that existing policies providing own occupation cover be allowed to continue for as long as a super funds obtains insurance cover from their existing insurer providing this cover.

Chapter 3 Collection and disclosure of information

Ensuring government entities receiving superannuation information have an obligation to do so in a consistent manner

AIST proposes an amendment to require that government entities receiving superannuation information have an obligation to do so in a consistent manner, to the extent that consistency is desirable having regard to the purpose of the data collection.

Super funds are required to fulfill numerous reporting and disclosure requirements to various government agencies:

- Other than tax payments, ATO reporting obligations are largely *member-level* requirements around various (but not necessarily connected) legislative responsibilities.
- APRA reporting obligations are largely *fund-level* requirements and focused on prudential regulation.
- Other than Trustee Company reporting, ASIC reporting and disclosure obligations are largely *product-level* requirements.

The implementation of the Stronger Super reform package is changing the relationship between agencies, and their respective data collections obligations:

- The ATO is collecting increased information from super funds (e.g. account balances) through enhanced member contribution reporting requirements that will be used in an enhanced SuperSeeker service. This data will include information on all super accounts, not just information in respect of members who have received a contribution.
- The ATO will also have a central role in the operation of account consolidation measures.
- APRA's new reporting standards for superannuation will greatly increase super fund reporting at a product-level.
- ASIC will receive super fund information from APRA and be responsible for oversight of product dashboards and portfolio holding disclosure.

In addition, AASB's ED233 Superannuation Entities will prescribe new financial reporting requirements for super funds that should be aligned with other reporting arrangements, especially reporting to APRA.

These changes require closer co-operation between agencies in the delivery of Government policy objectives. In addition to the fulfillment of each agency's statutory responsibility applicable to their agency, there should be an overall requirement to have regard to the government's overall policy objectives, including the delivery of specific requirement by other agencies.

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AIST submits that the extent of the current changes being implemented provide a rare opportunity to bring data collection and reporting arrangements into alignment in a way that benefits the Government, its agencies and the super industry.

AIST propose that the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 be amended to require that government entities receiving superannuation information have an obligation to do so in a consistent manner, to the extent that consistency is desirable having regard to the purpose of the data collection.

This approach is consistent with the requirement of proposed subsection 29QC(1) where there is a requirement for consistency in how information is calculated.

These issues are particularly relevant to the following matters:

- Definition of asset classes
- Allocation of assets into asset classes
- Definition of fees and costs
- Allocation of fees and costs into different categories
- Methodology for reporting investment performance
- Member demographic information

This proposal is made to support consumer-friendly comparability and disclosure of superannuation information, and to promote efficiency in the operation of the superannuation system.

It is appropriate that the legislation provide appropriate guidance to ensure there is complete transparency – which is aided by consistency – on superannuation financial products.

Standardised methodology for disclosure of fund information

AIST submits that the legislation prescribing the product dashboard (Section 1017BA) should be deleted from this tranche of the MySuper legislation pending further consultation with the superannuation industry

Overall, AIST supports an increased disclosure regime with greater and specific requirements. However, such disclosure must meet members' best interests requirements.

The proposed Standard Risk Measure that will be incorporated into disclosure requirements and the product dashboard is deficient and should not be set in concrete by the Bill and associated measures.

The proposed FSC/ASFA measure uses volatility as a proxy for risk, does not measure other forms of risk, and does not measure severity of market risk. As a consequence, the measure can be misleading and inappropriate for members who are in a mandatory long term investment environment. These limitations are recognised by the proposers of this measure.

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AIST's concerns about the Standard Risk Measure are of longstanding, have been discussed with Government and APRA, and have been the subject of extensive media commentary. The attached letter to the Deputy Chair of APRA following a recent discussion with him outlines further particulars of AIST's concerns. At the time of writing AIST has not received a written response to this correspondence.

Time constraints currently limit the capacity to include any other risk measure into the metrics displayed on the product dashboard. In addition, it is imperative that the product dashboard is transparent and meaningful to consumers and applies consistently across super product offerings.

Section 1017BA should be deleted from Tranche III and re-submitted to Parliament as part of the fourth tranche of MySuper legislation scheduled for late November 2012. At that time, the legislation and explanatory memorandum should resolve the product dashboard issues identified below and clearly identify a process and a timetable (of not more than 18 months from 1 July 2013) for implementing a more fit-for-purpose risk measure.

This will mean that reconsideration of these matters both in the Bill and in the context of APRA's discussion paper on reporting arrangements for superannuation funds will be able to proceed in parallel.

AIST submits that the product dashboard should proceed in Tranche IV on the following basis:

- Removal of the Standard Risk Measure pending further consultation with industry.
- Confirmation that the statement of liquidity be a general disclosure requirement for trustees, so as to create certainty regarding what is a strict liability disclosure obligation, with subsections 1017BA(2)(d) and s1017BA(3)(d) not to be subject to additional requirements by APRA.
- The carve-out provisions from the product dashboard (S1017BA(4)) should not allow the exclusion of fund-of-fund investment options and mortgage and property trusts.
- The amount of fees disclosed in S1017BA(2)(e) and (3)(e) should be consistent with MySuper requirements, that is, that this figure include administration fees and as well as investment management fees. The current requirements, and APRA guidance, can be manipulated.

Providing a safe harbour for trustee using reasonable efforts to comply with collection and disclosure of information

AIST submits there should be a safe harbour (as opposed to a defence) for a trustee that uses reasonable attempts to comply with:

1. product dashboard requirements dashboard requirements;
2. portfolio holdings disclosure; and
3. provision of information to APRA, ATO and the Bureau of Statistics (ASIC), and who, in good faith, has relied on information provided by service providers and others in the disclosure process.

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Under the Bill, non-compliance is a strict liability offence with a defence available if the trustee took reasonable steps to ensure that the information was not misleading or deceptive etc (refer for example s1021NA(7) and other similar provisions).

AIST recommend that the Bill should provide (similar to the safe harbour in section 1043F of the *Corporations Act*) that a trustee does not contravene a provision imposing a requirement if the trustee has:

> (a) relied in good faith on information provided by another person; and
> (b) taken reasonable steps to comply with the [… requirements …].

Chapter 6 Transition to MySuper

Transition of Accrued Default Amounts (in order to ensure an orderly transition of all such accounts)

AIST strongly supports the identification and transition of all Accrued Default Amounts as provided for in Schedule 6 of the Bill, and urges the PJC to resist calls to water down these provisions.

Superannuation is a highly regulated system, with the treatment of the many layers of complexity requiring special attention at the time of transition. Unfortunately, it is all too easy for the management of these details to obscure and even distort the implementation and operation of sound Government policy.

The transition of Accrued Default Amounts to MySuper is an example where concerns about the implementation process should not be allowed to diminish or undermine the fundamental purpose of MySuper.

MySuper is a value-for-money investment product that will be the destination for default superannuation contributions for which trustees will have enhanced obligations. As the explanatory memorandum explains, members with a MySuper interest will have arrived in the product either consciously or unconsciously. In any event, trustees – quite rightly – have a higher obligation for members who *allow* the trustees of their fund to manage the investments of their compulsory superannuation.

This is now widely accepted. However, the treatment of superannuation contributions that have been placed in the default investment options of funds prior to the advent of MySuper remains the subject of disagreement within the industry. AIST submits this is because segments of the industry want to continue to extract revenue that would be prohibited under MySuper rules from often unsuspecting members. This could be in the form of high fees or commissions.

In its initial response to the Stronger Super Review, the government announced that Accrued Default Amounts would be transitioned to MySuper by 1 July 2015. However, after the Stronger Super consultations, the government amended its position to allow Accrued Default to be held outside of the MySuper rules for up to 1 July 2017. This extension was opposed by AIST as it meant that often unsuspecting members would be paying for services that they may not be aware of or use for up to four years from the start of MySuper; much longer than was needed in any necessary

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transition period.

AIST understands that the loss of revenue to financial institutions from the transition to MySuper is likely to be significant. For example, in its *2012 half year results report* to analysts on 16 August 2012 "*AMP expects margin compression on investment-related revenue to AUM of 3.5% - 4.5% pa (excluding SMSF) over MySuper implementation period to 2017 – compression more likely at higher end of range post 2014*"

It is not surprising that a rearguard action to carve out some superannuation interests from these rules has continued. However, the PJC should assess whether arguments for the delayed or limited transition are driven by commercial fears about revenue loss (dressed up as administrative or policy concerns) or if they have any substantive merit.

AIST opposes any suggestion that the requirement to transfer Accrued Default Amounts should be limited to benefits associated with an employer-sponsor .

We have three main reasons for coming to this view: one policy-related, one practical and one related to the opportunity for abuse.

1. A limitation of this sort would allow commissions to be paid on the benefits (including after the end of the MySuper transition date of 1 July 2017). This is inconsistent with the policy intention of MySuper, and of Stronger Super more generally, to remove commissions from superannuation.
2. It is not uncommon for benefits to be rolled-over between super funds. When this occurs, it is generally the case that the receiving fund does not have any record about whether or not any of the benefit was associated with an employer sponsor.
3. In order to generate commissions from the above loophole, commission-based financial planners are likely to apply a re-contribution strategy to client's super accounts, to churn benefits out of an account into another account, converting the benefit from a taxable component to a non-taxable component.

Below are further observations that support the underlying problems and policy distortions that would arise with limiting the requirement to transfer Accrued Default Amounts to benefits identified with an employer-sponsor.

On the mandated Rollover Benefit Statement (RBS) there is provision for including the "tax free" and "taxable" components. However, it does not require the disclosure of the value of each contribution type. Hence, if a benefit has been rolled over into another superannuation fund (or through re-contribution) the new fund will not be able to isolate which portion of the benefit constitutes SG (and/or salary sacrifice contributions), let alone earnings on these concessional contributions. For instance, pre-83 components in relation to the "crystallised segment" (or pre 1 July 2007 benefit) are included in the "tax free" component, but could consist entirely of superannuation guarantee (SG) contributions.

Contribution amounts and types are provided to the new fund, but only for the year to date period since last review. The only other source (for values for different contribution types) would be the ATO, given that funds report contribution types and values every year in the Member Contribution

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Statement (MCS). However, by implementing a re-contribution strategy (which may be in the members best interest, but not necessarily in the broader interests of the superannuation system), any identification as to the source of the benefit is completely removed making it possible to re-classify the benefit as "choice" even if the source could be SG and earnings only. This will encourage financial planners to apply this strategy if it means that the accrued default amounts are excluded from transferring into another MySuper account.

The limitation being floated has other serious policy problems. The limitation could result in a member unnecessarily maintaining two accounts (MySuper and "choice" account), with two sets of administration fees and possibly two insurance benefits. This is inconsistent with Stronger Super promoting the consolidation of unnecessary duplicate accounts and stopping future account proliferation.

This is a problem that is likely to exist with the extended transition period to 1 July 2017. It should not be exacerbated by any further limitation upon transitions to MySuper.

Also, the proposed approach is inconsistent with MySuper policy intent. With introduction of Stronger Super, non-concessional contributions will also be subject to MySuper rules (e.g. no commissions) if any money – even $1 - is invested in a MySuper product. There is no policy justification for permanently ring-fencing some accrued benefits from these rules, especially in circumstances where the Government has legislated a very long transition period (ie, to 1 July 2017) for Accrued Default Amounts.

Chapter 7 Eligible rollover funds

Additional obligations on trustees of ERFs

AIST submits that the Bill should be amended to provide an additional obligation on ERF trustees to locate and re-unite their members with their active superannuation, and contain an explicit prohibition on flipping to ERFs (that is, using transfers to an ERF as a means of extracting higher fees from a member without their knowledge or consent).

The explanatory memorandum to the Bill notes that "ERF's play a specialised role in the superannuation system as a temporary repository for the interests of members who have lost connection with their superannuation accounts" (paragraph 7.42)

The Super System Review found that ERFs have not achieved the intended objectives (see Final Report, Part 2, page 293). Accordingly, the Review recommended (recommendation 10.15) that "ERFs should be subject to very similar duties as apply to MySuper trustees (*bearing in mind the different functions and characteristics of ERFs*)" [AIST's italics].

These different functions and characteristics are to ensure that ERFs:

- operate so that they are a temporary repository (as opposed to a permanent destination) for small, lost and inactive superannuation interests; and
- provide a connection to ERF members who have lost connection with their superannuation accounts.

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Although this is a view that is a common thread through the Super System Review, the Stronger Super consultations, and indeed the explanatory memorandum itself, the Bill does not fully ensure that ERFs will be able to undertake these specialized roles.

AIST supports the additional trustee obligation proposed for section 242K. However, the obligation is limited, and may be fulfilled by optimising net returns. There is no specific requirement in the Bill for ERFs to undertake the roles that reflect the functions and characteristics of ERFs that are different form the obligations of trustees offering MySuper products.

This should be remedied by the following amendment to the Bill:

Re-number existing section 242K as subsection 242K(1), and insert the following as subsection 242K(2):

> "*The reference in subsection (1) to promote the financial interests of the beneficiaries of the fund also includes a requirement for the trustee of an eligible rollover fund to have specific processes to:*
> *(a) locate valid address for beneficiaries of the fund where a valid address is not held by the fund; and*
> *(b) to formulate, review regularly and give effect to a strategy for the rollover of beneficiaries interest in the fund into other complying funds in which each beneficiary has an interest.*"

An amendment to the MySuper legislation in the winter session of Parliament resulted in the legislation now requiring a super fund to obtain the consent of a member to the transfer of their MySuper account to another class in the super fund.

AIST submits that this consumer protection be extended to transfers from MySuper accounts to ERFs with a caveat that transfers can be without consent where a member is not locatable.

Existing superannuation legislation and regulation provide rules governing the steps to be taken by super funds to determine if they are locatable.

In the Corporations Act 2001, insert the following immediately after subsection 1017(1A)(g)

> *"(h) a beneficial interest of that class in the fund cannot be replaced with a beneficial interest in an eligible rollover fund, unless the person who holds the interest:*
>
> *(i) consents in writing to that replacement no more than 30 days before it occurs; or*
> *(ii) is not locatable;*
>
> *and*

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