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

Email: corporations.joint@aph.gov.au

Dear Dr Grant,

SUPERANNUATION LEGISLATION AMENDMENT (SERVICE PROVIDERS AND OTHER GOVERNANCE MEASURES) BILL 2012

Thank you for the opportunity to prove comment in relation to the *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012* ("Bill"). This Bill is, of course, the fourth tranche bill in the Stronger Super \ MySuper legislative package.

ASFA has some concerns about the Bill and with some of the Stronger Super \ MySuper provisions inserted into the relevant legislation through the first three tranches of amending legislation. In particular we consider that there are substantive issues with the undue restrictiveness of the administration fee provisions; the imposition of offences of strict, as opposed to fault, liability and the need for APRA to have an exemptions and modifications power with respect to the MySuper provisions.

We have broadened our submission on the basis that previously the Committee has noted that this is a package of bills. ASFA keenly want the legislation be workable and deliver to the members' best interests. The issues we have raised are material and warrant attention.

How to read this submission

Our three major concerns are raised in this covering letter.

We have raised a couple of matters with respect to the Bill at the beginning of Annexure A. Our concerns with the Stronger Super \ MySuper legislative package as a whole, most of which have been raised previously, constitute the rest of Annexure A.

In addition there are some drafting issues which we have identified in Annexure B and some matters with respect to the draft MySuper and Insurance regulations which are outlined in Annexure C.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

Major issues

1. Administration fees - prohibition on fee scales and \ or caps

While this provision was inserted by the first tranche bill (the "Core Provisions" bill), and was raised in our submission to the Committee with respect to that bill, we consider this of sufficient importance to raise it again here.

With respect to fees, MySuper members must all be charged the same flat fee or percentage **amount** or combination of the above.

Accordingly, where the trustee has adopted a percentage-based fee with respect to administration fees, in whole or in part, they are limited to charging each member the same percentage of their account balance. It is not readily apparent why a ban on capping asset fees is being imposed.

Trustees, in exercising their fiduciary duties, have often developed a reducing fee scale as they have considered that this is in the best interests of members and produces a more equitable result.

Administration costs are not directly proportional to the size of the account and, as such, trustees have developed administration fee scales. It does not cost 100 times as much to administer an account of $100,000 as it does an account of $1,000 and fee scales reflect this.

It is quite common for funds to either use administration fee scales and \ or capping the maximum amount of administration fee which is charged. This is done, for example, by charging: -

- a fixed percentage of assets on, say, the first $100,000 of the account balance;
- a lower percentage on, say, the next $100,000 of the account balance; and
- no fee with respect to the balance of the account.

This should be allowed to continue.

It is important to note in this context that all members are charged the same percentage by reference to the same scale, however, the actual percentage charged to each member will be a function of where their account balance falls along the scale.

Recommendation 1: -The provision which states that all members should be charged the same percentage **amount** should be replaced with a requirement that all MySuper members must be charged a fee in accordance with the same percentage **scale**.

2. Strict liability provisions

Considerable concern has been expressed that, given the nature of the obligations in the Bill, the imposition of strict liability offences is inappropriate.

We submit that the strict liability provisions should be amended to "at fault" provisions. This recognises the need for there to be an offence with respect to deliberate or systemic failures, however, it also reflects that liability will be a function of undesirable behaviour or conduct, as opposed to arising through inadvertent administrative or operational errors or omissions.

Failing that, consideration should be given to explicit reasonable steps \ safe harbour defences.

Recommendation 2: – That the strict liability provisions be replaced with fault provisions to the effect that "A person who intentionally or recklessly contravenes [relevant provision] is guilty of an offence punishable on conviction by a fine not exceeding [X] penalty units".

3. Need for exemptions and modification power

Part 29 of the *Superannuation Industry (Supervision) Act 1993* ("SIS" Act) empowers APRA to grant exemptions and make modifications to specified provisions of the SIS Act.

Given the diversity and complexity of superannuation funds, forcing trustees to adhere strictly to "one size fits all" legislation may, on occasions, cause a number of members to be detrimentally affected. One of the fundamental duties of a superannuation trustee is to act in the best interests of members and, as such, it is a sub-optimal outcome if complying with the legislation leads to outcomes where members are worse off (e.g. mandatory transfers of former employee members into a higher fee MySuper product).

In addition, strict compliance may cause a trustee to incur costs which are considerably in excess of those which would be necessitated by complying with slightly modified provisions, while still achieving substantially similar outcomes.

There are already precedents in the legislation where a trustee does not have to comply with particular provision if the trustee considers that it is not in the best interests of members to do so. One such example of this is the provision with respect to performance fees (section 29VD).

Accordingly, we consider it important that the exemptions and modification power be extended to Part 5C of the SIS Act to empower APRA to exempt classes of trustees, or individual trustees, from full compliance with a particular provisions or to modify how the law applies, subject to any conditions which APRA may impose. This would have the protection of being administered by APRA, while having the flexibility to accommodate specific circumstances.

Recommendation 3: – That the definition of "modifiable provision" in section 327 of the SIS Act be amended to include Part 5C and any other provisions which may be considered relevant.

Yours sincerely

Pauline Vamos
Chief Executive Officer

ANNEXURE A

SUBSTANTIVE ISSUES

1. THE SUPERANNUATION LEGISLATION AMENDMENT (SERVICE PROVIDERS AND OTHER GOVERNANCE MEASURES) BILL 2012

1.1 SECTION 912A OF THE CORPS ACT

The bill proposes that RSE licensees that are also responsible entities for registered managed investment schemes must now comply with Corporations Act requirements to have available adequate resources and have adequate systems for managing their risks, except for those risks that relate solely to the operation of an RSE by these entities.

We are concerned that the section, through the use of the word "solely", may not recognise the extent to which resources can be used to address risk which relate to super and non super business. This may necessitate entities having to hold resources and have in place risk management systems which are differentiated for super and non-super purposes.

We do not support the outcome which may require funds to have duplicate resources or put frameworks in place to address the same risks and there is potential that the removal of the exemption in paragraphs 912A(1)(d) and 912A(1)(h) potentially could have this consequence.

Accordingly, we strongly recommend the drafting of the section should be refined to ensure that the same resources and \ or risk management mechanisms can be utilised to offset the same risk in different businesses and that additional resources \ mechanisms would be required only to the extent that the risks differ.

We note that the Explanatory Memorandum (EM) appears to be clearer on this point.

1.2 SECTION 58A OF THE SIS ACT

The legislation proposes to over-ride any provision in the governing rules of a registrable superannuation entity where a trustee "may or must" use a specified service provider, entity or product.

We are concerned that this section of the Bill overrides provisions prescribing that the RSE licensee "may" use a particular service provider, entity or product.

The use of the term "may" is currently a standard feature to overcome any risk in permitting the use of related parties. For example, a standard conflict of interest clause would permit that the trustee may deal with itself, contract with any person associated with the fund and transact or deal with a related party. If the term "may" is rendered void, this will raise considerable legal uncertainty as to whether a related party can continue to be utilised.

Accordingly, we strongly submit that the legislation should be clarified to only override governing rules where the provision stipulates that an RSE "must" use an entity or service.

2. ISSUES WITH THE STRONGER SUPER \ MYSUPER LEGISLATIVE PACKAGE GENERALLY

2.1 MYSUPER ADMINISTRATION FEES - EMPLOYERS PAYING FEES Paragraph 29TC(1)(e) of SIS

Recent advice from APRA to a particular fund has indicated that it is not permissible under the MySuper legislation to have employees in different categories of membership where, for example, some members pay all of their administration fee while for others the administration fee is paid by the employer.

On occasions this occurs because corporate sub-funds have transferred into a fund under the successor fund provisions, and the continuation of the employer paying some or all of the administration fees was part of the "equivalent rights" arrangement between the two trustees. These employers often have other employees, say for example because they are new members, who are in another category of membership where those members pay their own administration fees.

Frequently these categories are not large enough to establish a tailored MySuper offering (500 employees) so the Fund's generic MySuper offering will apply. Even if they were large enough, section 29TB would preclude a tailored product for a sub-set of employee members.

It is important to note that this is where there is a uniform administration fee scale for all members - there is no discounted employer fees, regardless of who it is who actually pays the fees. It is simply the source of the payment of these fees which can vary (member or employer).

The advice from APRA amends their prior advice that the employer paying the administration fee was permitted. APRA now considers that, under the terms of the legislation, that trustees must explicitly charge the fees to the member's account and explicitly receive an additional employer contribution into the member's account.

This two-step process would necessitate

- changes to administration systems and processes,
- amendments to the Trust Deed, and
- revisions to the member disclosure documentation (PDSs, websites, benefit statements etc

to achieve the same outcome at the end of the day.

Provided the administration fees are all determined on the same basis, it should be irrelevant who actually pays the fee - that is a function of the industrial relations \ employment agreement between the member and the employer and is not a feature of the benefit design of the fund.

In addition, this may act to deter funds from undertaking successor fund transfers and would appear to be counter to the Government's desire to see consolidation.

Accordingly, we submit that the legislation \ APRA's interpretation should only require that the fee in respect of all MySuper members be determined on the same basis and not address who actually pays the fee.

2.2 BENEFITS PAYABLE ONLY IF MEMBER SUFFERING PERMANENT INCAPACITY Section 68AA of SIS

2.2.1 "Own occupation" incapacity benefits should not be phased out in choice products

ASFA agrees that there is an argument that the higher "own occupation" premiums, and the less than full deductibility of premiums, is not appropriate in a MySuper product.

We believe, however, that own occupation insurance does have relevance in "choice" products. In particular, specialised employees may be highly educated, skilled or experienced.

For such employees the option of being able to access "own occupation" insurance in a choice product is a valid one and should remain. The amount of insurance paid into their superannuation fund, to be accessed upon retirement, would reflect the higher retirement income they would otherwise have had but for the disability.

Group life insurance within superannuation is often an affordable option for those members who need this kind cover. Compelling people to seek this cover on an individual basis outside superannuation will see a significant increase in costs \ premiums and a number of members unable to obtain replacement cover.

Accordingly, we strongly recommend that consideration be given to allowing choice products, but not MySuper products, to offer "own occupation" insurance.

If considered necessary this could be accompanied with requirements as to disclosure, to ensure members appreciate the difference between "own occupation" and "any occupation" insurance.

2.2.2 Possible alternative – amendment of conditions of release to allow "own occupation"

One possible alternative to resolve the above issue is to give consideration to amending the conditions of release such that amounts paid in the event that a member is disabled, such that they are unable to continue in their own occupation, are able to be released.

The SIS conditions of release could be amended such that an "own occupation" definition of total and permanent disability is included as a condition of release. This would result in superannuation benefits being paid to claimants at an earlier time and may result in less reliance on disability benefits, reflecting a net transference of the risk from the public sector to the private sector.

3. FEES AND COSTS LIMITATIONS INAPPROPRIATELY EXTENDED TO CHOICE PRODUCTS

Applying the fee and cost provisions apply to choice products as well as to MySuper is radically different to the policy as originally announced. This effectively stifles innovation and effectively reduces the scope for differentiation between MySuper and choice products.

The underlying policy rationale of MySuper was to create a relatively simple, low cost product for members who were defaulted in a fund and\or who were happy to choose to have all of their money invested in the default option, while allowing choice products for more engaged members who wanted investment choice or other options not available in MySuper.

The imposition of obligations and restrictions with respect to the fees charged in choice products has the effect of significantly limiting the ability of trustees to be able to continue to provide what are, effectively, choice products - which a member has chosen to be a member of - on their existing basis. Further, there are considerable legal and practical issues with respect to the application of the fee \ cost provisions to off-market \ closed or legacy products.

Choice members are - by definition - engaged and have made the decision to acquire or move to a choice product for the features which it offers. One such feature of a choice product may well include the provision of personal advice, the cost of which is included in the fees. Such a choice should be one which it is open to the member to make.

It is our view that fee restrictions, particularly around advice, should only be with respect to MySuper products

Accordingly, we recommend that: -

- **the obligations with respect to fees charged be confined to MySuper only; and**
- **that the obligations for both MySuper does not commence until 1 July 2014 or, at the earliest, the date at which it will become mandatory to make default SG contributions to MySuper (currently 1 January 2014).**

4. COLLECTION AND DISCLOSURE OF INFORMATION

ASFA is supportive of the principle of full, transparent disclosure of information to superannuation fund members.

Having said that, we do have some specific concerns with respect to some aspects of the Stronger Super \ MySuper provisions, as follows.

4.1 Product dashboard
Section 1017BA of Corps Act

4.1.1 Updating of information – 14 days after the end of each quarter
Paragraph 1017BA(1)(c)

The requirement is to update information about the average amount of fees and other costs, expressed as a percentage of the assets of the fund, within 14 days after the end of each quarter.

Funds are reliant on third parties, such as custodians and investment managers, to provide information with respect to the value of the assets of the fund. While some assets are valued daily, or even intra-day, others are valued less frequently.

Accordingly, 14 days is too short a time in which to obtain valuation of assets, determine fees and cost, perform and verify calculations, subject to due diligence review and then update and publish the dashboard. We submit that a significantly longer period is required.

It should be noted in this context that the obligation to publish portfolio holdings, without calculations, is 90 days after period end.

This should be changed to 30 days.

4.1.2 Updating of information – 14 days after change to information
Paragraph 1017BA(1)(d)

The requirement is to update information (other than the average amount of fees and other costs) within 14 days after any change to the information.

It is unclear as to what this means, especially with respect to such matters as the level of investment risk, which may fluctuate daily.

Accordingly, there needs to be a definition or principle with respect to how often updating is required with respect to each element.

Furthermore, we submit that the concepts of: -

- **the trustee "becoming aware of the change; and**
- **materiality**

should be introduced in order to make these provisions workable.

4.1.3 Investment Return Target
Paragraphs 1017BA(2)(a)

We note that the Corps Act does not define the basis upon which the targets are to be determined.

We submit that the Act should be amended to include a regulation - making power with respect to this and that the regulations specify that the investment return targets be net of both investment and administration fees.

Given the range of effects which administration fees can have upon member accounts, and that the use of averages can be misleading, we submit that the investment return target be determined by reference an opening account balance of a prescribed value.

4.1.4 Number of times target has been achieved
Paragraphs 1017BA(2)(b)

There are two issues with respect to this obligation: -

- it is not meaningful, and may even be misleading, as
    - it is effectively a measure of volatility and not of the quantum of returns. In particular, there is no disclosure as to the amount by which the target was achieved or missed, which may lead to significantly misleading outcomes;
    - different funds may be disclosing over different periods, which may make comparisons difficult; and
- it will be commencing from a "standing start", making the data for the first few periods virtually meaningless.

Accordingly, we submit that: -

- **in lieu of the number of times the target was achieved, the return for each of the last ten, five , three and one years be disclosed; and**
- **historical returns for MySuper products be disclosed on the following basis: -**
    - **for funds which are "re-badging" - the returns for the investment option being re-badged; and**
    - **for other funds - on a basis approved by APRA as part of the MySuper application process.**

4.1.5 Level of investment risk
Paragraphs 1017BA(2)(c) and 1017BA(3)(c)

It is unclear as to how this is to be defined and measured. There are a number of measures of investment risk, such as downside deviation; risk of capital loss; cash-flow risk; diversification risk; liquidity risk; valuation risk; tax risk; expense risk etc.

Given that there is only one Standard Risk Measure across this industry – the ASFA \ FSC risk measure which identifies the risk of a negative return in any 20 year period – there is a considerable risk that the information could be reported on an inconsistent basis. This will produce misleading results if used to compare information across products, unless regulations prescribe the basis upon which various risk measures are to be determined.

We submit that consideration needs to be given to the definition of this measure.

4.1.6 Statement about liquidity
New paragraphs 1017BA(2)(d) and 1017BA(3)(d)

As it is not clear what is being measured and for what purpose, we submit that, in the short-term at least, the requirement for a statement of liquidity in the product dashboard be reconsidered and that it be left to the prudential standards. In particular, the effect of contribution flows being made into the product \ option, as well as the underlying investment made by the fund, need to be taken into consideration, as for some funds incoming contributions will be considerable for some time to come and will serve to ensure that a product \ option is essentially liquid.

We submit that implementation of this provision be deferred until such time as it is determined how liquidity is to be measured.

4.1.6 Average amount of fees and other costs in relation to the product
Paragraphs 1017BA(2)(e) and 1017BA(3)(e)

It is unclear why fees and costs are being added together, as fees are levied against members to recoup costs incurred by the trustee in administering and operating the product. If fees and costs are added together this will result in significant double counting.

There is also a question as to how to treat cost recovery which is embedded in the unit price, as opposed to specific fees which are charged. Trying to combine the two gives a meaningless figure that only works for the account balance used in the calculation.

As the definition of fee appears to be restricted to fees charged by the trustee and appears to include exit fees and switching fees as well as administration and investment fees, this would serve to inflate the average fees for funds in which: -

- there are more exits or switching; and \ or
- the fees for the provision of financial advice are included in the administration fee, as opposed to being an activity fee, as the latter is excluded from the definition of fee in section 1017BA.

Given the range of effects which fees have upon member accounts, and that the use of averages, especially fund averages, can be misleading, we submit that the effect of fees is best disclosed in the form of a worked example with respect to an opening account balance of a prescribed value.

4.1.7 Exclusions from obligation
Paragraph 1017BA(4)(c)

"Single asset" will need to be defined.

4.2 Requirement to publish portfolio holdings
Section 1017BB of Corps Act

4.2.1 General Comments about approach adopted in legislation

4.2.1.1 Self-regulation

There is a strong argument that – as opposed to imposing prescriptive statutory obligations – the industry should be allowed to self-regulate, utilising a combination of industry standards and market forces to produce a result which is appropriate and reflects stakeholder interests.

Discussion with ASIC had been based on self-regulation, with industry bodies providing guiding principles and there would be a long lead time to implement.

4.2.1.2 Difficulties for trustees in obtaining and publishing information

We note that creation of new regulation-making powers to enable regulations to be made which may provide that investment in a financial product or other property is not a material investment and therefore, in prescribed circumstances, information relating to the investment is not required to be made publically available.

Notwithstanding this, there would be major difficulties on obtaining this information, especially with respect to managed investment schemes and fund of fund managers, where holdings are bundled and commercially sensitive such that not even the custodian is aware of them. It is not apparent whether many custodians would be able to provide this type of reporting.

Further difficulties are created for trustees who invest through a PST and unit trust into an underlying unrelated fund. This will result in a very long chain of reporting and at each level the responsible entity or trustee at that level will have to work out the proportion applicable to the investor the next level up the chain. This will represent an inordinate amount of work and cost for little appreciable benefit, especially with respect to MySuper members who are not participating in investment choice.

4.2.1.3 Costs

The cost of publishing all of the required information would appear to be prohibitive, especially when compared to any potential value it may provide for members.

We query the policy objectives, beyond increased transparency. Realistically, it is most unlikely to be used to inform consumer decision making.

The amount of information required to meet the obligation to publish portfolio holdings is extreme and of little value to the member.

Accordingly, the compliance costs of this obligation as currently framed are likely to far outweigh any benefit to fund members, who ultimately will be bearing the brunt of the costs. As such, this obligation should be subject to a proper cost \ benefit analysis as part of the regulatory impact statement.

4.2.1.3 Possible alternative approaches

4.2.1.4.1 Alternative approach 1 - impose obligation directly into investment managers

An alternative to trustees being forced to police investment manager disclosure would be for portfolio managers, managed investment schemes and find of funds to be required to make full disclosure. Superannuation funds could then publish links to the investment managers' web-sites to enable the complete portfolio holdings to be available. This approach would provide transparency while avoiding the need for onerous contracts, monitoring and systems changes for superannuation funds.

Discussions with ASIC to date have centred on disclosure by trustees at the first legal level with investment managers to disclose further on their own websites.

4.2.1.4.2 Alternative approach 2 – scaled back obligation

This obligation should be scaled back to something more meaningful to the member and cost effective, such as more analytical summaries on the funds characteristics and risk profiles. This could include information about such matters as the location (country and sub-sector) of different groups of assets but may stop short of dollar values \ percentages of each asset.

4.2.1.4.3 Alternative approach 3 – formalise materiality

An alternative to the current proposal is that the "look-through" is limited to assets \ investments which make up 5% or more of the option's assets (or possibly a lower figure, but no less than 1%).

4.2.1.5 Timing

Given the magnitude of the changes required, and the other projects which are being implemented at this time (such as SuperStream and FOFA), a number of providers have expressed concern about meeting the 31 December 2013 deadline.

We submit that this should be moved to 31 December 2014.

4.2.1.6 Confidentiality

The legislation needs to recognise investments which are subject to a duty of confidentiality on the part of the trustee \ provider and accordingly are not able to be disclosed. This should extend to new investments as well as existing ones.

4.2.2 <u>Specific comments re the legislation</u>

4.2.2.1 Information sufficient to identify each financial products in which assets invested
Sub-section 1017BB(1)

It is unclear here as to what is meant by “financial product”. The explanatory memorandum says the intention is to organise by each MySuper and choice product but it is arguable that the correct interpretation of this provision in the Bill is that the obligation is to publish information relating to each financial product *in which the **fund** is invested*.

Data collection organised by investment products – MySuper and choice - as proposed in the explanatory memorandum will be complex and costly for many funds and \ or custodians, especially where look through to underlying managed investment schemes, derivatives etc. is required.

4.2.2.2 Obligation to provide information relating to investment of assets
Section 1017BC

There is an obligation on investment managers to provide the data to the trustee if they enter unto an arrangement on or after the date of Royal Assent. Where there is an ongoing appointment of an investment manager which pre-dates Royal Assent the trustee will have to rely on the co-operation of the investment manager to obtain the data.

If the trustee inadvertently publishes inaccurate or incomplete date it will be committing an offence punishable with a penalty of 100 penalty units or imprisonment for 2 years or both.

In the absence of co-operation by the investment manager the trustee will be forced to rely on the defence. This is totally inappropriate.

Where the trustee is unable to compel a commitment from the investment manager it should not have to demonstrate that it took reasonable steps to ensure that the information would not be misleading or deceptive.

Further, as the obligation to provide information only applies to new contracts entered into from the day of Royal Assent, this could result in a long period where the information published is incomplete because trustees are unable to obtain some of the information, further impacting on the usefulness of the information.

These are further reasons why the Corporations Act should be amended to impose a direct obligation upon investment managers to disclose such information.

4.2.2.3 Strict liability offence – trustees’ obligation to publish information
Paragraphs 1021NB

Concern has been expressed that imposing strict liability offences with respect to these obligations is totally inappropriate. This is especially the case as there is a limit to the extent to which the board can exercise governance oversight, particularly with respect to third parties, and having regard to the somewhat limited nature of any potential harm which may be considered to arise.

It is also considered that the level of penalties also appears to be far too onerous, particularly as it is an offence irrespective of whether the information is known to be defective. Given the current approach, trustees are being forced to rely on their investment managers and custodians – they are not in a position to verify that the information is correct.

If the strict liability provisions are not removed they should be modified to allow trustees to reasonably rely on the information provided to them and exceptions from timing rules created conflicted where the data cannot be sourced in the time specified.

4.2.2.4 Strict liability offence – third parties obligation to provide information Paragraphs 1021NC

It is unclear as to how the offence provisions in relation to failure to notify will work in the case of overseas investment managers who are outside jurisdiction – presumably they would be unenforceable.

4.3 Reporting Standards
Quarterly reports about superannuation
Section 348A

It has been questioned why an undue focus has been placed on short-term returns through the mechanism of publishing quarterly MySuper returns. There is considerable tension here between adopting the long-term view appropriate to superannuation and the publication of date quarterly, which only serves to encourage short-term thinking.

Concern was also expressed about the size and scope of the proposed new quarterly returns of information to APRA, including the need for the data to be audited, and the direct and indirect costs which would incurred in producing this data.

5. DEFINED BENEFIT MEMBERS

There may be an issue with respect to defined benefit members whose benefit has crystallised. If the trustee is compelled to move the accrued default amounts of former defined benefit members into another product, especially if this is in another fund, this may cause the member to lose any rights they may have had to recommence the accrual of their defined benefit should they be re-employed by a participating employer.

Accordingly, we suggest that the definition of defined benefit member include former defined benefit members whose benefit has been crystallised.

There is an additional issue with respect to tailored, large employer MySuper products. The 500 employee measure for large employers excludes defined benefit members from the head count, however, it is conceivable that, for example, an employer \ trustee may want to offer a tailored employer product for 500 or more employees where the benefit design would be comprised of hybrid defined benefits. In addition, hybrid funds may have a closed defined benefit division and a growing, but still less than 500, accumulation division. We query the policy rationale which would preclude the employer \ trustee from being able to provide as a large employer sub-plan in the above circumstances.

6. TIMING OF OBLIGATION TO PAY DEFAULT CONTRIBUTIONS INTO MYSUPER Section 29WA of SIS

ASFA supports the commencement date of 1 July 2013.

We were pleased to see the amendment of the first tranche bill to extend the date from 1 October 2013 to 1 January 2014 by which employers making "default" contributions, in compliance with the Superannuation Guarantee ("SG") legislation, will pay those contributions to a fund with a MySuper offering.

Having said that, ASFA strongly believes that the employer's compliance date must be extended to 1 July 2014.

The Super System Review envisioned that implementation would involve **at least a two-year** transition period **from passage of legislation** to establish the new regime.

Compliance with these reforms will necessitate considerable changes being made to a mature and complex superannuation system. The Future of Financial Advice (FOFA), SuperStream and APRA reporting reforms also have a significant impact on a number of superannuation funds.

Trustees need certainty with respect to the implementation of a MySuper offering.

We are unlikely to see final legislation until the second quarter of 2013. There will be little time remaining to implement the required changes. This is during a time when trustees also have to implement considerable changes in order to comply with FOFA, SuperStream and data reporting.

Implementation of the legislative requirements will involve considerable and extensive alterations to IT systems; processes and procedures and fund documentation. Change management of this magnitude and with a high degree of interrelatedness is not only expensive but, more importantly, carries a significant risk of lost or corrupted data or functionality, which can result in inaccurate or incomplete member records.

The most effective means by which such a risk is mitigated is by utilising robust project management methodologies, but this takes time and resources. Rushing to meet deadlines materially increases the risks to a project and will increase costs, which are ultimately borne by the members.

It should be noted that the Regulation Impact Statement with respect to the MySuper bill stated as follows (emphasis added): -

- "[t]he requirement that employers have to make default contributions to funds offering a MySuper product from **1 July 2014**" (Page 15);
- "It is expected most trustees will offer a MySuper product so they are able to accept default contributions from **1 July 2014**" (Page 17);
- " ... some MySuper products may not be licensed until close to **1 July 2014**" (Page 20)

To the extent that the time-frame is contracted, costs are driven up and the quality of outcome is potentially compromised. This is exacerbated by the fact that the entire industry is implementing the same reforms, with a finite pool of resources, and is constrained to the same (shortened) timetable of needing to have MySuper in place for 1 January 2014, as opposed to 1 July 2014.

Should a fund, for whatever reason, not be in a position to have a MySuper offering in place by 1 January 2014 all employers who have nominated that fund as a default fund will be forced to go through the process of nominating another fund, advising their employees of this and then making default contributions to that other fund. This possibly may be for a limited time only. This will have the effect of having to create a new account for all of the affected employees in the second fund to accept default contributions while their account balances remain in the first fund, thus subjecting these employees to multiple fees.

We submit that – in order to mitigate the risks outline above – the six months from 1 July 2013 to 1 January 2014 is not an appropriate transitional period. Funds should certainly be able to offer a MySuper product from 1 July 2013, however, the mandatory period from which default contributions must be made to a MySuper offering should not commence until 1 July 2014.

7. CHANGES TO FINANCIAL DATA REPORTING
Section 13(4A) and 13(4B) of the Financial Sector (Collection of Data) Act 2001

The requirements with respect to related entities reporting result produce two outcomes: -

- they considerably increase compliance costs for vertically integrated structures; and
- they make vertically integrated structures appear more expensive relative to disaggregated structures.

As this has considerable competition and equity considerations, we ask that these provisions be reconsidered and potentially removed.

8. FUND NOTIFICATION OF CONTRIBUTIONS TO MEMBERS
Section 1017CA of the Corporations Act

This measure requires superannuation funds, with respect to active accounts, to: -

- either
  - quarterly, by electronic means, notify members that they have either “received” or “not received” contributions during the quarter, and
  - maintain a web-based portal for members to consult; or
- issue six monthly notices which show contributions made

We submit that this obligation: -

- **should commence from 1 July 2014;**
- **quarterly statement should be able to be hard copy mailed statements if this suits the fund ; and**
- **six monthly statements should be able to be electronic (if this is what member has elected to receive.**

ANNEXURE B

SUGGESTED AMENDMENTS TO DRAFTING

1. Amendments with respect to section 20B of SIS Act – Accrued default amounts

1.1 Discretion

Paragraphs 6.22 and 6.33 of the revised EM to the 3rd tranche bill state as follows (emphasis added): -

> *"6.32 To facilitate the transition to MySuper products, RSE licensees will have discretion to move amounts in an investment option in which the member's assets would be invested if no direction were given* ***to a MySuper product, even if the amount is not an accrued default amount****.*
>
> *6.33 This is achieved by making void any governing rules that would prevent an RSE licensee from moving these amounts to a MySuper product and ensuring that moving these amounts will not give rise to a liability to a member.* ***This discretion will permit funds to convert their existing default investment option to a MySuper product*** *because the proposed definition of accrued default amounts would not capture all amounts invested in the default investment option".*

Despite what the EM state, section 29XB and sub-section 55C(1) do not give the trustees a discretion.

Section 29XB purports to ensure that a trustee will not be liable for certain transfers but is expressed in terms of not being liable for an action taken under sub-section 55C(1). Sub-Section 55C(1) merely voids any provision in the governing rules which purport to prevent a trustee from attributing an amount to MySuper.

Despite what the EM says, section 29XB and sub-section 55C(1) do not give a trustee a discretion to attribute or transfer an amount which is not an accrued default amount.

We strongly submit that section 20B be amended to give trustees such a discretion.

1.2 Cash

Legally "cash" is considered to be currency or cheques. Most "cash" investments are held in cash management trusts or managed funds.

Accordingly, consideration may need to be given to amending section 20B to reflect this.

2. Amendments with respect to paragraph 29WA(1)(c) of SIS Act

2.1 Election as to product \ direction as to option

The tranche 1 bill introduced section 29WA which required that, where no election is made that contributions are to be paid into a choice product, contributions must be paid into a MySuper product.

The third tranche bill amended paragraph 29WA(1)(c) such that it now refers to a direction in writing that the contributions are to be invested in one or more investment options.

Rather than referring to either choice product or investment option, ASFA submits that paragraph 29WA(1)(c) should refer to both choice of product and choice of investment.

Furthermore, as: -

- some funds accept verbal directions
- some funds will either never have received the direction in writing (e.g. from a previous fund under a success or fund transfer) or will not have retained them

trustees generally rely on the records in their administration system. Given the risk trustee are exposed to should an investment direction not be observed, there are considerable "checks and balances" in place within operational processes to ensure that members' investment directions are implemented, which are rigorously audited, and of course the members themselves will monitor this.

Given this, the reference to "direction in writing" should be removed.

2.2 Interaction with the Superannuation Guarantee legislation

There is a potential issue with respect to how section 29WA of SIS will interact with sub-section 32C(6) of the *Superannuation Guarantee (Administration) Act 1992* (SGAA).

Sub-section 32C(6) has been amended by the third tranche bill to include two more transitional industrial instruments into the list of instruments set out in that section. Sub-section 32C(6) automatically deems contributions made in accordance with the listed industrial instruments to have been made in compliance with "choice of fund" requirements. The list of instruments in sub-section 32C(6) includes an "enterprise agreement" made under the Fair Work Act 2009.

Section 29WA, however, requires a trustee to make contributions into a MySuper product, where the member has not given a written election to the trustee that the contribution (or part contribution) is to be paid into a specified choice product or products.

There is a fundamental question of how sub-section 32C(6) of the SGAA is intended to interact with section 29WA. Specifically, it is unclear whether a contribution made in accordance with sub-section 32C(6), where there has been no election by the member, would be subject to section 29WA.

On the face of the legislation it appears as though the interaction of the two sections will be such that: -

- an employer will be able to satisfy choice of fund by making contributions in accordance with the transitional instruments and sub-section 32C(6); but
- a trustee will be forced to divert those contributions to a MySuper product as there is no "written election" by the member.

The EM for the third tranche bill, at paragraph 4.38, makes it clear that it is intended that contributions made in accordance with these instruments will remain compliant and as such contributions will not have to be made to a MySuper product.

The transitional provisions state that s29WA does not apply to contributions made in accordance with an enterprise agreement approved before 1 January 2014 but does not mention any of the other types of instruments in sub-section 32C(6). We recognise the importance of the 1 January 2014 date given the new requirements for superannuation clauses in enterprise agreements approved by Fair Work Australia after that date.

This existence of the above transitional provision calls into question why it was considered necessary to provide for pre-1 Jan 2014 enterprise agreements, but not other transitional instruments, with respect to the proposed operation of s29WA.

We submit that there should be transitional provisions for the other transitional instruments listed in sub-section 32C(6) of the SGAA.

2.3 Options which are not considered to be a default option under the accrued default amount definition in section 20B

Under section 20B various investment options, such as cash, or an option which was a default in the past but is no longer one, are not considered to be investment options which given arise to accrued default amounts.

Section 29WA needs to be amended to reflect that the trustee may continue to allocate contributions to these options, notwithstanding the absence of a direction by the member. This could be achieved by “deeming” such contributions to have been the subject of a direction by the member.

3. Amendments with respect to MySuper and self insurance

Section 68AA of SIS

S68AA of the SIS Act states that a trustee must provide death and incapacity benefits “by taking out insurance”.

The draft MySuper and insurance regulations released by Treasury in November propose to provide those funds which currently self insure until 2016 to transition out of self-insurance.

ASFAS strongly endorses the proposed grandfathering of self insurance arrangements, however, the section 68AA of the SIS Act needs to be amended to reflect that the obligations in that section are subject to any regulations which may be made.

SUGGESTED CHANGES TO DRAFT REGULATIONS

Notification of attribution \ transfer of accrued default amounts

A number of fund have raised concerns with the provisions of the draft MySuper and Insurance regulations released by Treasury in November which are with respect to notifying members of the attribution \ transfer of accrued default amounts.

There are three main aspects to this – timing, content and form of notification. There is also as drafting issue.

1. Timing

1.1 ADA Notification 90 days prior to attribution \ transfer

Paragraph 6.27 of the Revised EM to the 3rd tranche bill stated as follows (emphasis added): -

> *"6.27 The RSE licensee must also elect to comply with requirements to be prescribed in regulations to provide a notice to a member when their accrued default amount is moved to a MySuper product or is moved to another fund. It is expected that the regulations will provide that a notice must be given 90 days in advance of an accrued default amount being moved where it will result in a change to the fees, insurance or investment strategy of the member's interest.* ***However, in some cases, there may be only immaterial changes to members' rights as a result of the RSE licensee being authorised to offer a MySuper product****, for example, if an existing default investment option is simply able to be converted into a MySuper product.* ***In this case, it is expected that a notice will be able to be given after the change has occurred.*** *It is also expected that the Corporations Regulations will amended to ensure that an RSE licensee is not required to provide a notice under section 1017B of the Corporations Act where amounts are moved under this election to avoid duplication. ASIC will be responsible for enforcing the regulations prescribing that notices must be given to members".*

In the draft regulations released in November there is a proposed new regulation 9.46 which states as follows: -

> *"(1) For subsection 29SAA (3) of the Act, the RSE licensee must, in writing, notify a member mentioned in paragraph 29SAA(3 (a) or 29SAA(3)(b) of the Act of an intended attribution or transfer of the member's accrued default amount at least 90 days before the attribution or transfer".*

For funds which are "re-badging" we strongly advocate a return to the policy position as reflected in the revised EM. It appears as though Government may be considering this issue and we await a favourable outcome.

1.2 Query whether a trustee can notify members in advance of being granted MySuper authorisation \ MySuper product commencing

It appears as though ASIC has advised at least one fund as follows: -

> "*Under the the current wording of proposed paragraphs 9.46(2)(b) and 9.46(4)(b) of the Superannuation Industry (Supervision) Regulations 1994, it might be difficult for an RSE licensee to validly provide a transition disclosure notice to members before a MySuper product exists, or prior to the RSE licensee receiving an authorisation from APRA to offer a MySuper product".*

If this is the case it will have a significant impact on trustee's ability to schedule notifications.

2. Content – need to tailor notification

The proposed disclosure under draft regulation 9.46 is in lieu of a Corps Act Significant Event Notice ("SEN").

SENs were conceived as being "generic" notices sent to member with respect to a decision of the trustee (such as to wind-up the fund and transfer the members to another fund as part of a successor fund transfer, or to increase fees payable by members) over which the member has no control. The intention of a SEN is to disclose to a member what will occur if the member does not take some action (such as instructing the trustee to roll-over their benefit to another fund) i.e. the "default" position for the member. They are generally at a fund, or class of member, level, not at the level of an individual member (e.g. winding up the fund or a change in fees which will be charged to all, or a sub-set, of members).

Draft regulation 9.46 appears to necessitate individual tailoring of notifications, as follows: -

2.1 Amount which will be transferred

The regulation 9.46 notice requires that the notification must specify "the amount that will be attributed or transferred". This would appear to necessitate an individual, tailored notice being sent to each member.

It should be noted that: -

- actual dollar amount to be attributed or transferred will be unknown ninety days prior to the attribution \ transfer, as it will fluctuate due to investment earnings, contributions, investment switches and roll-overs \ withdrawals. As such any figure disclosed is not especially meaningful; and
- this will have a significant impact on costs, with little discernible benefit.

We submit that the requirement should be amended such that that affected members are advised that the amount in "investment option X" or "product Y" or "fund Z", as at the effective date, will be attributed or transferred to MySuper. This is sufficient to inform the member about what will occur, while allowing providers to notify members via a letter, or something similar, which does not have to be tailored with member specific information.

2.2 Details of any change to a fee or charge to be disclosed to the member in dollars

Similarly, draft new paragraph 9.46(4)(e) and sub-regulation 9.46(5) require details of any change to a fee or charge, on transfer of an accrued default amount, to be disclosed to the member in dollars.

Fees for MySuper products, however, are permitted by the fee rules to be in the form of a percentage (or a dollar amount plus a percentage).

It should be noted that: -

- requiring disclosure in dollars will mean funds will need to create, develop and implement a program in order to be able to calculate the dollar impact with respect to each member, based on an estimated account balance 90 days' before;
- this will add considerably to the cost of the notice.

We submit that it should be sufficient for the trustee to disclose the basis upon which fees will be charged in the MySuper product.

2.3 Any change to the member's insured benefits

It is similarly essential that "any change to the member's insured benefits" (paragraph 9.46(4)(f)) should be permitted to be described in general terms and not require programming of the MySuper product's insured benefits into the transferring fund's administration system in order to produce the accrued default amount notice.

3. Form - "In writing"

One other area of the draft regulation which has been subject to debate is the term "in writing" utilised in proposed new sub-regulation 9.46(7). There is concern that the use of the term "in writing" specifically excludes electronic notification and therefore means that the notification must be paper based. If this is the case it will increase costs considerably.

4. Drafting issue

Proposed new paragraphs 9.46(2)(d) and 9.46(4)(h) require an accrued default amount notice to include "any other information that the member needs to understand the attribution or transfer". The draft explanatory memorandum explains this as "any other information the RSE licensee considers the member needs …", but the reference to the RSE licensee's consideration is missing from the regulation and needs to be inserted.

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