

ISN SUBMISSION

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

**ISN SUBMISSION TO THE PJC
ON CORPORATIONS AND
FINANCIAL SERVICES**

3 October 2012



**Industry
Super
Network**

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| EXECUTIVE SUMMARY

ISN welcomes the opportunity to make a submission on the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012.

The Bill includes further detail on a number of key components necessary for a transparent and competitive MySuper regime and sets out a gradual transition of existing accrued default superannuation balances into commission free MySuper products.

Whilst supportive of most elements of the Bill there are some areas of detail either missing or not fully resolved which could undermine the competitive dynamics of MySuper and potentially lead to poor outcomes for members.

These shortcomings could be easily resolved through relatively simple amendments or deferral of some items to the fourth tranche of legislation to enable further industry consultation to resolve outstanding issues.

Key schedules and items of the Bill which warrant detailed consideration by the Committee include:

Schedule 1 – Fees and costs:

- 1. ‘Flipping’ - Item 35** (S 29VB(5)) adds an additional condition to the use of the employer sponsor administrative fee exemption (S 29VB). While this condition is welcome it is insufficient to prevent misuse of the exemption to hike administrative fees charged to members when they change jobs and remain in the same MySuper product. The existing drafting is inconsistent with amendment made to the MySuper Core Provisions Bill to prevent ‘flipping’ from one product to another and will undermine price competition for generic MySuper products. **It is recommended that these deficiencies be addressed by aligning use of the exemption with the stated policy rationale by limiting its use to specific administrative efficiencies realised with an employer sponsor (See 1.1.3 for the specific amendment) ;**
- 2. Intrafund Advice - Item 40** (S 99F) scopes the definition of intra fund advice and is generally appropriate. However the definition in s99F(1)(c)(ii) includes providing intra fund advice on a cash management facility. It is difficult to envisage circumstances where it would be appropriate for a trustee to collectively charge for financial product advice on cash management facility products which may not even be operated by the trustee. The inclusion of ‘cash management facilities’ seems inconsistent with the overarching policy settings determined for intra fund advice and in our view would in many situations not even fall within the sole purpose test. We strongly submit that **the reference to cash management facilities should be excluded as a product on which intra fund advice may be provided (see 1.2.4).**

Schedule 3 – Collection and disclosure of information:

- 3. Product dashboard – Item 8** (S 1017BA) specifies the scope of basic disclosures about the investment return target, risk, liquidity and fees of MySuper and Choice products. While these disclosures will serve a valuable purpose in the comparison of products we hold concerns that the drafting is deficient in parts and provides insufficient guidance for regulators to implement an effective disclosure regime. Early indications arising from APRA consultation on the measures which commenced 19 September suggest there is a serious risk of outcomes that could lead to members being misled about products and trustees being encouraged to make sub-optimal

investment decisions. Key concerns following detailed scrutiny of the provisions and initial APRA consultation are as follows:

- i. The investment return target (S 1017BA (2)(a)) does not require that the target is net of all fees (investment and administration) and as a consequence will overstate the level of returns to which a member would actually be entitled. This approach would also tend to overstate the number of times the investment target has been achieved for members (S 1017BA(2)(b)). Such a methodology, which APRA is currently consulting on (based on the drafting of the requirements for the product dashboard), is in conflict with MySuper trustee obligations in respect to returns which are inclusive of all fees and costs and taxes. At a minimum effective provisions would make it clear that the investment return target is net of all fees and taxes and aligns with what members would be entitled;
- ii. The risk measure (S 1017BA (2)(c)) is not clearly defined and APRA consultation suggests the measure is likely to replicate the flawed standard risk measure devised by FSC/ASFA. The measure which specifies the likelihood of a negative return (exclusive of some costs) provides no guidance as to the quantum of such a negative return and has been found in an academic study to be a poor risk measure for consumers to base decisions on.
- iii. The liquidity measure (S 1017BA (2)(d)) is not clearly defined and APRA consultation suggests development of a measure that extends far beyond what would traditionally be considered illiquid investments. Such a measure is likely to overstate the proportion of illiquid assets in a product and deter trustees from investing in long-term assets which attract an illiquidity premium. It is suggested that this requirement be omitted from the Bill and further consultation occur on an appropriate liquidity disclosure for consumers to be introduced in the forthcoming tranche 4 Stronger Super Bill;
- iv. A number of carve outs from the product dashboard (S 1017BA(4)) are inappropriate. For example pension products and fund of fund investment options delivered through a platform are exempt. Such an approach will give rise to regulatory imbalance by exempting a large number of retail superannuation investment options from product dashboard disclosure when consumers would benefit from their inclusion. For example the exclusions would enable products like real estate investment trusts (REITS) to avoid dashboard disclosure when during the GFC such products were frozen and members to this day are unable to make redemptions. Similarly it is not obvious why consumers of pension products should not benefit from product dashboard disclosure about the investment return target and risk.
- v. Finally it is evident that the product dashboard measures will deviate from those contained in the new short PDS regime. As a consequence consumers could receive contradictory information and be misled depending on which disclosure they rely on and trustees could be held accountable for decisions arising from conflicting information provided under the different regimes.
- vi. **In order to remedy these deficiencies in an efficient manner it is recommended that item 8 of Schedule 3 is omitted from the Bill and further consultation occur on appropriate investment return, risk, and liquidity disclosures with a legislative framework to be included in the forthcoming tranche 4 Stronger Super Bill (see 2.1);**

Schedule 6 – Moving Accrued Default Amounts:

4. **The transfer of existing default member balances to MySuper - Items 1-13** will require members' existing default superannuation savings be transferred within a reasonable period to commission free MySuper products. This will ensure existing superannuation savings held in retail default

products that pay commissions are not eroded indefinitely and members benefit from the consolidation of their savings. These provisions and the definition of accrued default balances contained in the Bill are strongly supported. In almost all circumstances individuals who have savings in a default superannuation product which may pay commissions will not have a relationship with a financial planner receiving the commissions and will not have obtained any financial advice. The flow of such commissions is in such circumstances unethical, and the lengthy transition period outlined in the Legislation (1 July 2017) is more than generous. If an individual under advice has elected to invest in a default superannuation fund as a matter of choice and wish to retain this arrangement the legislation will enable such members to 'opt out'. These arrangements are also appropriate and will act as a prompt to a member under advice to consider their arrangements. **It is recommended that that schedule 6 is supported without amendment. (See 3.1)**

Schedule 7 – Eligible rollover funds

5. The purpose of this schedule is to improve the regime of Eligible Rollover Funds (ERF's) and align director obligations with those of MySuper. The provisions contained in the schedule are supported but should be strengthened further. ERF's are intended to be a short term repository of lost members' savings. Unfortunately many ERF's represent very poor value and needlessly erode member savings. The enhanced director obligations are welcome but will not necessarily guarantee that ERF pricing is reasonable and appropriately reflects the lower costs which should be realised from maintaining an ERF (both administrative and investment costs should be significantly lower than a fund with active members and regular contributions). It is vital that the director obligations are rigorously enforced by APRA and ERF's are not utilised as an alternative avenue to 'flip' members from a discounted MySuper product and inferior ERF. This concern is relevant given no explicit member consent is required to transfer an interest from a MySuper product to an ERF. **Further it is recommended that the new ERF trustee duties are extended to a requirement to take such necessary and prudent steps to reconnect funds held with the beneficiaries of those amounts. It is suggested that this obligation should be clear in both the legislation and the Explanatory Memorandum. (See 4.0)**

1. Schedule 1 - Fees and costs (including intrafund advice)

Schedule 1 of the Bill includes further provisions necessary to regulate the charging of certain fees within the MySuper environment and provides rules for the charging of intrafund advice.

ISN is supportive of the provisions set out in the schedule with the exception of the scope of item 35 (administrative fee exemption for employer sponsors) and aspects of item 40 (intrafund advice).

1.1 The Administrative Fee Exemption

Item 35 of Schedule 1 includes a condition related to the use of S29VB (Administrative Fee Exemption for an Employer Sponsor). We support this condition but it is insufficient to guarantee that S29VB will not result in profoundly unfair outcomes for prospective MySuper members and used to undermine price transparency and price competition among MySuper products. As currently drafted the combined provisions will operate in a way which is inconsistent with the amended MySuper Core Provisions Bill 2012 and mandate a loophole which will subject members to fee increases when they change employment in much the same way as the retail practice of 'flipping' operates.

1.1.1 Background

A fundamental objective of MySuper is to provide for simple readily comparable default superannuation products for the eight in ten Australians who do not elect for choice of fund.

The fee charging rules are necessary to ensure fees between products are transparent and directly comparable to promote competition between products and maximise net returns to members. To this end Item 35 (S29VB(5)) must be considered alongside the fee rules set out in the MySuper Core provisions Bill.

The MySuper Core Provisions Bill 2012 seeks to meet this objective through the fee charging rules set out in S29V. These provisions set out the types of fees that are permitted (such as administrative fees, investment management fees, buy sell spreads, switching fees etc.) Further, S29VA specifies that the fees charged to members must be on a common basis and calculated the same way in respect to each member's interests¹.

The Government has however permitted an exemption from these rules in respect to administrative fees (the administrative fee exemption for single employer sponsors S 29VB). The stated purpose of this exemption is to allow product providers to pass on to members any savings in respect to the administration of their interests where an employer sponsor adopts particular administrative processes that results in cost savings².

We support this objective in principle however it is anticipated that such savings are likely to be small as SuperStream will standardise transaction arrangements between employers and funds. This likely outcome makes the drafting of the exemption especially concerning as there is no requirement that differential administrative pricing is linked in any way to administrative processes. As a consequence the provisions will allow product providers to vary administrative pricing irrespective of any actual administrative efficiencies

¹ Paragraph 6.4 of the MySuper Core Provisions Explanatory Memorandum states: "The fee charging rules will prohibit an RSE licensee from discriminating between members in relation to how they charge fees to members of a MySuper product. This does not mean that members will necessarily be charged the same fees in terms of dollars, but rather members must be charged fees on a consistent basis."

² Paragraph 6.15 of the MySuper Core Provisions Explanatory Memorandum states: "This will allow RSE licensee to pass on the lower costs from any administrative efficiency of dealing with an employer to the employees of that employer."

that are realised with an employer sponsor, effectively subverting the common charging rule framework in MySuper.

When announcing the policy framework for MySuper the Government stated there would be additional parameters associated with the administrative fee exemption. Tranche 3 includes one parameter which would require that the administrative fee charged to an employer sponsor member cannot be below the cost borne by the trustee (that is, the arrangement cannot be charged at less than cost)³. There is no upper limit on the administrative fee charged for other members.

1.1.2 Policy Risks:

We hold serious concerns the existing drafting could be open to misuse and allow multi-tiered administrative fee pricing among members in a single MySuper product which may be unrelated to the relative costs of administering the interests of these members. As a consequence there could be significant scope for cross-subsidisation and price discrimination between members. We are particularly concerned the exemption could be misused to arbitrarily increase the admin fee paid my members if they change jobs and leave an employer sponsor. This is often a particularly unfair outcome for members as their accounts typically become inactive anyway and their cost borne by the trustee to administer their account falls.

As other industry participants have identified the existing drafting would effectively make 'flipping' to a higher price point mandatory as a 'former employee' is not an eligible member for the purposes of the exemption. Trustees could not retain such members under a discount arrangement even if they wanted to.

In its current form the provisions will diminish price transparency and competition. The generic admin fee pricing will tend not be subject to price competition as product providers will typically only be competing for employer business on the basis of a price available through the exemption. However these discounts could be underpinned by the 'automatic' flipping of members to the second tier (higher) generic admin pricing. Members stand to be significantly disadvantaged by these arrangements.

Such arrangements would in our view also be in conflict with the new MySuper trustee duties to act in members financial interests (S29VN).

1.1.3 Remedy:

There are a number of possible remedies to limit or prevent poor outcomes arising from these provisions.

The simplest approach would be to make the use of S29VB subject to a sunset clause aligned to the full implementation of SuperStream. Once fully implemented there will be virtually no difference in the administrative arrangements used by employers and funds as they will be standardised thus removing the very rationale for the exemption.

If the Committee considers it would be desirable for some flexibility in administrative pricing to remain there are two basic steps which could be taken to address the existing problems arising from the drafting:

1. Align the use of the exemption with actual administrative efficiencies implemented with an employer sponsor;
2. Ensure members are adequately notified of any administrative fee increase if they leave an employer sponsor;

³ See proposed S 29VB (5)

Aligning the exemption with actual administrative efficiencies could be achieved by adding an additional provision to item 35 which would require a fee charged under the S29VB exemption to also be in accordance as follows:

- (6) *the difference in administrative fee charged in relation to employee members of an employer sponsor and non-employee members in the fund:*
- i) *cannot exceed the difference in the actual costs borne by the trustee for administering the two groups; or*
 - ii) *cannot be greater than the reduction in administrative costs realised by the trustee through different administrative processes implemented with the employer sponsor.*

This would also require a consequential change to item 34 so it reads as follows:

34 Paragraph 29VB(1)(d)

Repeal the paragraph, substitute:

(d) the fee is in accordance with subsection (2), (3) or (4); and 1

(e) the fee is in accordance with subsection (5) and (6).

Such provisions would not implement a price cap and trustees will be free to set administrative fees where they believe they need to be in the market. However the provisions do mean that differences in administrative fees among members in the same product will generally only be limited to the differences in cost in administering each group.

These requirements would ensure the exemption is aligned with the original policy intention (that administrative fees can vary in circumstances where administrative savings can be realised). Such arrangements would also ensure there is limited cross subsidisation between members, and any increase in costs that may be borne by a member who changes job may only reflect the loss of any administrative savings obtained with a specific employer.

Should administrative fees increase when an employee changes jobs then it should be considered a significant event and notice provisions triggered accordingly.

1.2 Intra fund advice

Superannuation is a compulsory investment for most working Australians. Superannuation assists retired Australians to live comfortably and with dignity in retirement whether they rely in part upon the old age pension or are self-funded retirees. Access to low cost advice to superannuation fund members assists them in maximising their benefits in superannuation and increasing their retirement savings. Facilitating the provision of intra fund advice services by super funds is critical to ensure that all Australians have access to basic advice on their superannuation.

Once the Stronger Super reform measures are passed, intra fund advice will be subject to dual regulation – the FoFA measures in the Corporations Act determining the extent to which advice can be properly scoped

and provided in a member's best interests and the MySuper provisions in the SIS Act determining the extent to which the advice can be collectively funded by the Trustee.

ISN is generally supportive of the proposed definition of intra fund advice contained in s99F. The definition provides a carefully worded boundary for the type of on- off, simple advice which should be able to be provided and funded by a super fund as a core service offering of the fund. Advice which falls outside this definition will have to be either approved as an activity fee deducted from the member's account (if the advice is consistent with the sole purpose test) or charged directly to the member/client.

1.2.1 ISN & AIST fund survey on provision of financial advice

- ISN and AIST conducted a brief survey of member funds to obtain a snapshot of provision of financial advice services to members in the financial year ending 30 June 2012. The results of this survey reveal that funds provide a very significant quantity of financial advice to members. The survey covers quantity of advice, broken down by general/personal advice, topics of advice provided, extent to which advice is outsourced or provided by the trustee or a subsidiary entity, and channels of delivery. A list of respondents to the survey is provided in Attachment 1.
- The funds which participated in the survey represent a significant part of the not-for-profit superannuation sector, totalling funds under management of \$193 billion and 8.7 million members.
- The responses provided by funds indicated that of the 15 funds which participated, 2 provided all their advice directly from the trustee office or through a wholly owned subsidiary, all provided general advice in-house, while 9 outsourced both general and personal advice to an external provider. One fund used a combination of in-house and outsourced providers for both general and personal advice provision.
- While the bulk of member advice needs are still dealt with by general advice (around 80% of advice delivered was general advice) there is an increasing and significant quantity of personal advice provided by respondent funds: see Table 1. Key topics of personal advice provided by funds in the survey included all the main intra fund advice topics. However, member investment choice remains the most sought after advice at around 35% of advice requests. Basic retirement advice, including transition to retirement advice also represents a significant proportion of advice delivered: see Table 2. While currently it is not possible to currently segment the advice which would fall into the definition of intra fund advice, we believe that it is reasonable to assume that nearly all of the TTR, contributions, insurance and investment advice is provided in a manner which will fall into the intra fund advice definition, once legislated (therefore around 80% of personal advice currently provided by surveyed funds).

General versus Personal Advice, 15 funds

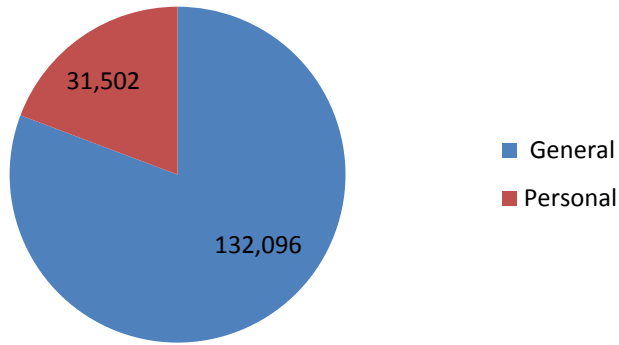


Table 1: Provision of general & personal advice

Advice Topic Breakdown by Percentage

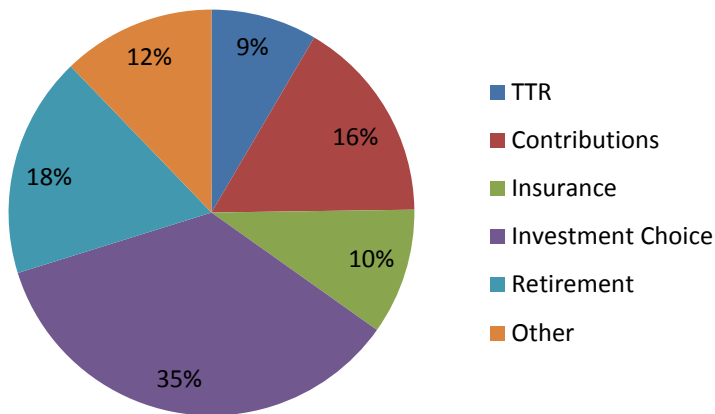


Table 2: Personal advice delivered by topic

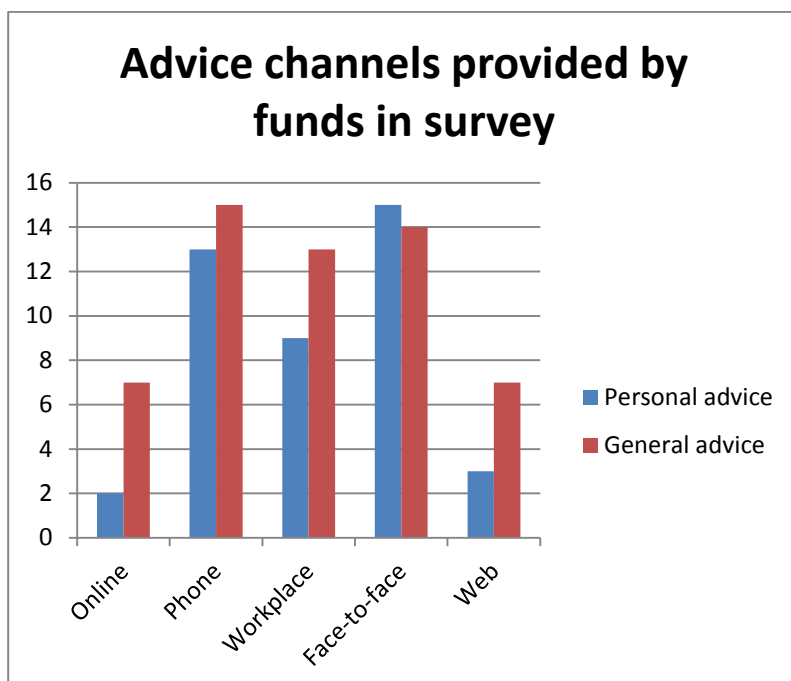


Table 3: Delivery channels of general and personal advice by number of funds

1.2.2 General advice vs personal advice

ISN is supportive of the proposed definition which only restricts a trustee's capacity to fund *personal* advice services. We agree that a trustee should be unrestricted in regards to provision of general advice (except by overarching trustee obligations) as general advice applies to a very broad spectrum of trustee activities including publication of regulated documents such as annual reports and product disclosure statements, website and internet publications, member education materials, seminars and services and call centre operations. It would be very difficult to attempt to regulate intra fund advice provided as general advice and not have unintended impacts on other general advice channels.

1.2.3 Excluded advice

ISN supports the exclusion of provision of intra fund advice to those who are not members of the fund. We note that the drafting of s99F(1)(c)(i) specifically excludes provision of intra fund advice to subject members who do not yet have a beneficial interest in the fund where the advice relates to whether the member should acquire such an interest. ISN supports this exclusion – it is not appropriate for members of a fund to be funding this type of advice.

ISN also strongly supports the exclusion of consolidation advice contained in s99F(1)(c)(iii).

1.2.4 Other product limitations

ISN supports that intra fund advice should be available on a related pension fund and a related insurance product.

ISN's member funds provide significant amounts of basic retirement and TTR advice to their members as intra fund advice, because their members will often have very straightforward circumstances even at retirement. For many, the only key assets needing to be considered as their super and their residential

home. It is critical for such members to be able to access simple advice that will enable them to maximise what super they have.

As many trustees do not operate their accumulation and pension products as one fund, it is appropriate that intra fund advice can be available to assist a member with the transition into the income drawdown phase.

However, we note that the definition in s99F(1)(c)(ii) includes providing intra fund advice on a cash management facility. We do not think that it is appropriate for a trustee to collectively charge for financial product advice on cash management facility products which may not even be operated by the trustee. The inclusion of 'cash management facilities' seems inconsistent with the overarching policy settings determined for intra fund advice and in our view would in many situations not even fall within the sole purpose test. **We strongly submit that the reference to cash management facilities should be excluded as a product on which intra fund advice may be provided.**

We note that the way in which this definition is drafted leaves a trustee without restriction in relation to the provision of strategic advice which fits within the sole purpose test. We believe this is an appropriate policy setting, as intra fund advice should include strategic advice that enables a member to better utilise the product in which their superannuation is invested.

The definition also does not restrict a provider from taking into account assets or products outside the fund in terms of their fact find and enquiry – provided that the resulting advice does not relate to the external products or assets. ISN and its member funds consider that this aspect of the definition is very important to ensure that the quality of intra fund advice is not compromised. A provider must be able to undertake inquiry about a member's financial circumstances to the extent necessitated by the subject matter but the resultant advice must be limited to the member's interest in the fund. For example, a member might seek advice in relation to making additional contributions to the fund. An adviser must explore their other financial commitments, any super contributions made to the fund or any other fund, in addition to mortgage or other debts if they are to satisfy the best interests test, even if the advice only relates to whether they should make additional contributions to the fund.

1.2.5 Ongoing advice limitation

Section 99F(1)(c)(iv) limits intra fund advice by excluding advice which the subject member reasonably expects will be ongoing in nature. ISN supports that intra fund advice should be limited to one off pieces of advice which do not require ongoing review or monitoring. However, we believe that it would be beneficial for the EM to include some clarification of the application of this aspect of the definition. In particular, we believe that if a member initiates the provision of further advice, this should not be caught by s99F(1)(c)(iv). In addition, we submit that the EM should make clear that a fund will not breach this aspect of the definition by:

- encouraging a member to seek review of their advice or contacting them to invite them to have their advice reviewed (indeed, ASIC's consultation on their proposed approach to administering the BID requires advisers to provide a date or circumstances when the advice should be reviewed (see CP182, p.57, draft of RG175 paragraph A111);
- sending system generated statements or progress reports to members, which tracks the extent to which the member has successfully implemented the advice (but does not provide further personal advice).
- providing further one off advice on other topics, as initiated by the member (subject to policy to ensure equity in delivery of these services)

- providing assistance to members to implement the initial piece of advice, as many will experience difficulty in implementing advice. Many of our members who are less engaged or literate will require assistance in implementing advice that they receive and fund advisers see this as integral to their best interests obligation.

ISN also notes and supports that this aspect of the definition -the prohibition of ongoing advice- will operate to effectively prohibit certain topics of advice. Any advice which necessitates constant monitoring or ongoing review (for instance if the advice recommends a tailored investment strategy, using other than trustee directed and supervised options), then it is difficult to see how a provider would satisfy the best interests test in providing such advice as one off advice, as it necessarily should require an adviser to provide ongoing monitoring/rebalancing of the investments.

1.2.6 Switching from MySuper to Choice product

We understand that an adviser's obligations when switching a member from a MySuper product into a Choice product are proposed to be in T4. Given the restrictions on investment strategies able to be offered by a MySuper product, this will include any personal financial advice which recommends the member move from the default investment option. In all situations, s961B will need to be satisfied and where a conflict of interest arises in the recommendation of a choice product/investment option s961J will also need to be satisfied.

ISN strongly supports setting a high level of obligation when members are recommended to shift out of the MySuper product, although this may be able to be achieved without further legislative provisions. At the very least however, clear guidance which establishes expected conduct when switching members would be needed to ensure a high level of consumer protection.

1.2.7 Need for guidance on s99F

The Draft Explanatory Memorandum notes that guidance is expected to be provided by ASIC in relation to the administration of intra fund advice. ISN submits that further guidance will be required in relation to the definition of intra fund advice in s99F and on intra fund advice in general.

1.2.8 Requirement for trustee policy to ensure intra fund advice equitably delivered to members

The EM notes that trustees will be expected to have in place internal policies to ensure that the provision of intra fund advice services are not excessively used by any particular member to the detriment of other members and to manage the costs of providing those services. ISN supports this expectation in the EM.

2. Schedule 3 - Collection and disclosure of information

ISN is generally supportive of the enhanced data collection and disclosure requirements. The requirement for a product dashboard and regular publication of information on MySuper and Choice product returns and fees will be integral to assessing the suitability of products and assessing their performance.

It is vital however that the measures adopted are transparent, meaningful to members, and consistent with other disclosure requirements. We have significant concerns about the practical application of item 8 in Schedule 3 (Product Dashboard).

2.1 Product dashboard

Item 8 of Schedule 3 outlines the requirements for trustees in respect to a product dashboard for consumers. Whilst the policy intent of the provisions is supported the drafting is deficient in parts and provides insufficient guidance to the relevant regulator (APRA).

Concerns about the effect of the drafting have been heightened since the release of the APRA consultation on the new data standards and likely dashboard requirements on September 19.

Whilst the drafting of the provisions has been designed to 'not rule anything out' it places inappropriate emphasis on APRA's interpretation and implementation of the provisions. Concerns about poor outcomes from this process are heightened by longstanding disagreement in the industry about how superannuation performance and risk should be measured. For example such debates normally focus on whether all relevant costs pertinent to a member should be included in the calculation of investment returns. Such decisions are critical since the exclusion of certain costs have the effect of overstating the return to which a member could actually be entitled.

2.1.1 Investment return target

The product dashboard is to include an investment return target and historical performance for a MySuper product S 1017BA (2)(a)(b) and Choice investment option S 1017BA (3)(a)(b).

The provisions do not specify how such an investment return should be calculated, however it is evident the drafting gives rise to an anomaly where Choice options will not need to include the impact of administrative fees charged as part of the product but outside the investment option (see 2.1.4 for further discussion).

APRA's draft data collection consultation⁴ suggests it will collect data for multiple levels of returns, including gross returns, returns net of investment management costs and returns net of all costs.

The emphasis appears to be on the middle performance number which would mean administration and advice fees are not deducted.

A number of reasons are cited for this emphasis, including that the MySuper product dashboard has an investment returns expectation which is set at this level.

ISN strongly believes the emphasised returns should reflect the member's actual entitlement, net of all fees and taxes. Any other performance figure will misrepresent all members' experience and this error will be compounded in any projections or historical calculations over multiple periods using such a returns figure.

It is recommended that the investment return measures in the product dashboard are explicitly defined so they reflect a member's entitlement – that is net of all fees and taxes.

⁴ <http://www.apra.gov.au/Super/Pages/Reporting-Standards-for-Superannuation-September-2012.aspx>

2.1.2 Risk Measure

Amendments to the Corporations Act 2001 via the insertion of a new section 1017BA which requires Trustees to publish on the product dashboard the level of investment risk that applies to MySuper ((2)(c)) and Choice ((3)(c)) products.

The Bill provides no detail regarding the process by which a fund must quantify and articulate a level of investment risk.

Whilst supportive of the requirement to provide a measure of risk in the product dashboard, ISN is concerned that there is no industry agreement regarding a standardised risk measure. ISN has argued that the only measure proposed to date is deficient. ISN does not believe that any risk measure based on volatility is a useful guide to long-term investors.

In June 2010 APRA wrote to its regulated funds stating that it believed it would be good practice for funds to adopt a standardised risk classification process.

- In August 2011 the Financial Services Council (FSC) and the Association of Superannuation Funds of Australia (ASFA) released a Standardised Risk Measure Guidance Paper for Trustees.⁵
- APRA has continued industry discussions on the desirability of establishing a standardised risk measure to form part of the APRA reporting standards flowing from the Stronger Super reforms and has recently released a proposed standard risk measure which is consistent with the methodology used by the FSC/ASFA proposal.

ISN has concerns that any articulation of risk should not be misleading to the consumer. Proposals to date have methodological flaws, use labels that are not commonly found in the market place and are not based on returns net of all fees and taxes.

The proposed standard risk measure has not been consumer tested, although an academic study by researchers at University of Technology Sydney has found the standard risk measure led participants to make inappropriate decisions about risk⁶.

- This study strongly supports ISN's concerns that proposals for the articulation of risk proposed to date are inadequate and potentially misleading.
- The study vindicates a concern expressed by large sections of the superannuation industry that the proposed measures send the wrong message to super fund members by measuring short term investment volatility, rather than the risk in regards to members' goals.

It is suggested that a better approach would be to take into account members' different ages and needs, rather than a one-size-fits-all approach to measuring risk and to describe such measures as volatility rather than risk measures.

Given the lack of industry understanding and agreement on investment risk measures and the likelihood of existing proposals misleading and confusing consumers there is further work required to establish a standard that provides a benefit to consumers.

This contentious issue should be resolved prior to the introduction of a requirement to report risk; particularly so as this obligation has strict liability attached to it.

⁵ See http://www.superannuation.asn.au/ArticleDocuments/116/FSC-ASFA_StandardRiskMeasures_July2011.pdf.aspx

⁶ University of Technology Sydney. Submission to Productivity Commission Inquiry into Default Superannuation Funds in Modern Awards p2. http://pc.gov.au/__data/assets/pdf_file/0010/116299/sub022-default-super.pdf

2.1.3 Liquidity

The requirement for a 'statement' about liquidity in the product dashboard MySuper S 1017BA(2)(d) and Choice products S 1017BA(3)(d) is general in nature however the APRA consultation suggests development of a specific metric linked to strict liability that will be misleading and unworkable.

- Our concern is that APRA will require that this 'statement' become an 'estimate' of the percentage of assets that can be redeemed in 30 days without changing the value of the assets.
- This approach is problematic as it will result in some fund assets not conventionally being considered illiquid as being so. For example thinly traded small cap equities, and even very large equity shareholdings in significant companies may be considered illiquid because of the price effects if sold over 30 days;
- Further, such a definition does not capture cash flows available to the fund to meet member redemptions;
- Such a measure if adopted is likely to understate the working liquidity of a fund and discourage members and trustees from investing in illiquid assets where an illiquidity premium is available.
- A determination of future market impact in selling some investments cannot reasonably be the basis of determining whether a trustee has breached or complied with disclosure requirements.
- Further, APRA's proposal would require updating more often than every quarter because investment in most options is dynamic. For example, this estimated percentage based on APRA's definition might change every day in a \$25billion MySuper option - it won't change merely every quarter. The compliance burden (and the impossibility of effective compliance) outweighs the proposed regulatory benefits in this proposal. We suggest a statement of liquidity be an annual requirement.

The statement of liquidity should be a general disclosure requirement for trustees and be a statement only, so as to create certainty regarding what is a strict liability disclosure obligation. Consequently It is suggested that s1017BA(2)(d) and s1017BA(3)(d) remain as shown, WITHOUT further overlay of requirements by APRA.

2.1.4 Fees

The amount of fees disclosed in S1017BA(2)(e) and (3)(e) should be consistent with MySuper trustee obligations, that is, that this figure include administration fees and as well as investment management fees.

As noted in 2.1.1 the current requirements, and APRA guidance, allow for significant gaming which can mislead consumers about the level of fees linked to a product and their impact on the investment returns to which they are entitled.

The deficiencies in industry practice and APRA's consultation are compounded by the drafting of S 1017BA (3) and (5):

- Specifically the definition of 'fee' in subsection (5) does not exclude administration fees, but as the product dashboard for Choice subsection (3) only applies to investment options, administration fees that are charged by the fund outside of those options will be excluded.
- They should be counted back in and disclosed; otherwise the lack of transparency will hamper effective member decision-making.

2.1.5 Exclusions:

S 1017BA (4) specifies superannuation products which should be excluded from the dashboard disclosure requirements.

The carve-out for platform products be reviewed and amended. S1017BA(4) should not have application to exclude fund of fund investment options and mortgage and property trusts from the product dashboard as it does presently.

- These types of investments significantly affected the retirement savings of many older Australians during the GFC when they became frozen. Even today, there are still sixty such products which remain frozen, causing retirees to refer to Centrelink for benefits where they would previously have funded their own retirement. They should not be immune from disclosure simply because they are placed behind a single investment option.
- We suggest that this carve-out instead have application to investment options which have a component allowing members direct choice of shares. For example, if an investment option provides access to the ASX Top 300.

The exclusion is also extended to pension products S 1017BA (4)(b). It is suggested that consumers of these products would benefit from the same / or similar product dashboard disclosure requirements that will apply during the accumulation phase. Clear information about the investment strategy, risk, fees, and performance are just as relevant during the retirement phase and differences will significantly influence the adequacy of a product in retirement.

2.1.6 Remedy of product dashboard

Given the imprecision of the legislative requirements and risk that the existing drafting could result in substandard outcomes it is recommended that item 8 be omitted from the Bill and detailed consultation occur on the key elements with revised drafting incorporated into the tranche 4 Bill.

2.1.7 Strict liability penalties

Items 12 to 22 of Schedule 3 deal with liability and penalties. The penalties attached to the new reporting requirements are of concern. The application of strict liability to an offence is not in itself problematic, provided the defences available are reasonable. ISN is of the view that the appropriate balance has not been achieved.

The application of significant penalties for the failure to publish or to publish correctly is problematic when the specific requirements are yet to be finalised. These concerns are heightened as the penalties will apply during a period of significant product change.

Guidance on when information becomes out of date is required for trustees to be fully aware of their obligations. There should be industry consultation on this matter.

In the circumstances it is suggested that it would be more appropriate to provide a 12 month period where trustees, whilst being required to abide by the new reporting requirements, would not be subject to any

claims for penalty, unless it was ASIC’s view that the trustee’s actions were deliberate or reckless or there were multiple breaches.

3. Schedule 6 – Moving Accrued Default Amounts

The transfer of existing default member balances to MySuper - Items 1-13 will require members’ existing default superannuation savings be transferred within a reasonable period to commission free MySuper products.

This will ensure existing superannuation savings held in retail default products that pay commissions are not eroded indefinitely and members benefit from the consolidation of their savings. These provisions and the definition of accrued default balances contained in the Bill are strongly supported and will ensure individuals who are paying commissions on default superannuation balances but have never seen a financial planner will have their savings protected into the future.

3.1 Estimate of retail super fund members paying commissions but not receiving advice

In July 2011 Roy Morgan Research released their “Retirement Planning Report”, following a survey of 1,597 Australians who have superannuation. The research was conducted in March 2011.

- Among those who identified themselves as retail fund members, the following table indicates their level of contact with a financial planner:

		As % all Retail Fund members
Frequency of communication with financial planner	Monthly or more often	4.9%
	Yearly	23.0%
	Every Few Years	7.5%
	Less Frequently	4.9%
	Only Communicated Once	7.6%
	Never communicated	52.0%

Base: Aust Pop'n aged 14+ with superannuation and identify as a member of a Retail super fund March 2011 (RMR special request data)

By comparing these survey responses with Official APRA data on retail super fund segments and market share it is possible to determine that almost 2.2 million retail super fund members are paying commissions to a financial planner whom they have never met (summarised below):

		Member accounts	Estimated Members
Frequency of contact with financial planner	Instances where advice fees or commissions are deducted for ongoing advice which is received once or more a year (ongoing)	2,679,748	1,172,390
	Instances where advice fees or commissions are deducted for ongoing advice but where advice has been provided only once or irregularly (defined as every few years or less frequently than every few years)	1,916,732	838,570
	Instances where advice fees or commissions are deducted for ongoing advice but where there has never been communication with a financial planner	4,979,520	2,178,540

The flow of such commissions is in such circumstances unethical, and the lengthy transition period outlined in the Legislation (1 July 2017) is more than generous.

If an individual under advice has elected to invest in a default superannuation fund as a matter of choice and wish to retain this arrangement the legislation will enable such members to 'opt out'. These arrangements are also appropriate and will act as a prompt to a member under advice to consider their arrangements.

The trustee protection from liability when transferring accrued sums is necessary and welcomed.

ISN believes further guidance is required concerning the requirements for material change notification, particularly as it relates to any changes to insurance coverage.

It is recommended that that schedule 6 is supported without amendment.

4. Schedule 7 - Eligible Rollover Funds

The purpose of this schedule is to improve the regime of Eligible Rollover Funds (ERF's) and align director obligations with those of MySuper.

The provisions contained in the schedule are supported but should be strengthened further.

ERF's are intended to be a short term repository of lost members' savings. Unfortunately many ERF's represent very poor value and needlessly erode member savings. The enhanced director obligations are welcome but will not necessarily guarantee that ERF pricing is reasonable and appropriately reflects the lower costs which should be realised from maintaining an ERF (both administrative and investment costs should be significantly lower than a fund with active members and regular contributions).

It is vital that the director obligations are rigorously enforced by APRA and ERF's are not utilised as an alternative avenue to 'flip' members from a discounted MySuper product and inferior ERF. This concern is relevant given no explicit member consent is require to transfer an interest from a MySuper product to an ERF.

It is recommended that the new ERF trustee duties are extended to a requirement to take such necessary and prudent steps to reconnect funds held with the beneficiaries of those amounts. It is suggested that this obligation should be clear in both the legislation and the Explanatory Memorandum.