



# AIST submission

**INQUIRY INTO THE SUPERANNUATION LEGISLATION  
AMENDMENT (SERVICE PROVIDERS AND OTHER  
GOVERNANCE MEASURES) BILL 2012**

**PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL  
SERVICES**

**17 January 2013**



Australian Institute of Superannuation Trustees

## Background

AIST had representation on each group set up by the Government to consult on each element of the Stronger Super reforms, having previously made submissions and representations to the Superannuation System Review. This included the committee tasked with making recommendations on the design and implementation of MySuper.

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

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

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

## AIST

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

AIST advocates on behalf of its members, it undertakes research, develops policy and provides professional training, consulting services and supports trustee directors and staff to help meet the challenges of managing superannuation funds and advancing the interests of their fund members. AIST members manage \$500 billion of retirement savings for Australian workers.

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

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## Executive Summary

AIST commends the Government for making further and mostly necessary changes for the effective operation of the MySuper and superannuation governance legislation. These changes demonstrate that the Government has responded to changes raised in consultations, and is committed to efficiency, transparency, and comparability in the superannuation system.

This submission, however, is focused on identifying issues AIST believes should be further considered by the Parliamentary Joint Committee on Corporations and Financial Services ("PJC") in the fourth and final tranche of MySuper legislation; the *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012* ("the Bill").

In his second reading speech on 29 November 2012, the Minister stated that this Bill "*represents the final, the last tranche of legislation implementing the MySuper and governance elements of the government's Stronger Super reforms.*"

The Bill is supported, subject to the following proposed amendments:

- Existing service provider contracts which are not in members' best interests should not be permitted to apply in relation to members with an interest in a MySuper product (Chapter 1).
- Trustees should be required to inform members of their entitlement to reasons for decision upon a request in writing (Chapter 3).

However, it is appropriate that submissions on the Bill address not just the substantive provisions of the Bill, but also address all outstanding matters and those matters that require further amendment for MySuper to be truly finalised. In particular AIST proposes that:

- The Product Dashboard requirements should be amended to ensure that only useful and accurate information is displayed. The information must be able to help ordinary Australians assess their superannuation fund(s) and to compare it with others. This can be done by:
  - Showing the performance target net of all fees.
  - Comparing the target against actual performance, including of default products rebadged as MySuper products.
  - Developing better measures of liquidity and risk.
- The Bill should amend section 29VA to allow funds to apply a fee cap on asset-based administration fees where this is in all members' best interest.
- The Bill should introduce anti-avoidance measures for transition to MySuper so that members in a cash investment option exempted from transition cannot be flipped into a non-cash investment option without their actual consent.

AIST is involved in ongoing Government consultations with the superannuation industry that may result in changes to the views expressed in this submission.

## Chapter 1 - Service providers

AIST strongly supports the view that all service provider arrangements must be in the best interests of members. Accordingly, we support requiring a trustee to act in the best interests of members when entering into agreements with a service provider.

AIST notes that the amendments do not require the termination of existing contracts, but do require a determination of whether or not the arrangements are consistent with the obligation to act in the best interests of members.

Contracts covering MySuper members must meet the members' best interests test. While arrangements determined not to be in members' best interests may be able to continue until the end of the relevant contract, AIST submits that the legislation should be explicitly amended to prevent this adversely impacting on the financial interests members who have an interest in a MySuper product.

An existing and continuing contract not in a member's interest should not be permitted to apply in relation to members with an interest in a MySuper product. Under subsection 29VN(a) a trustee must promote the financial interests of members of a MySuper product.

It would be inconsistent with subsection 29VN(a) if an existing agreement arising from a requirement to contract with a specific service provider was permitted to continue operating if it is adverse to the financial interests of members of a MySuper product. Any other outcome would not be consistent with a fundamental tenet of the MySuper regime.

These provisions will mean that superannuation funds will not be able to have cosy arrangements with service providers that are not in the best interests of members. APRA's evidence has shown that related party provisions in the for-profit super sector have resulted in members paying nearly twice as much for administration services than members of not for profit funds.

APRA research released in 2010 – *Australian superannuation outsourcing – fees, related parties and concentrated markets* (Liu and Arnold, 2010, available at <http://is.gd/X2PgmR>) - analysed the outsourcing arrangements of 115 super funds covering retail, industry, corporate and public-sector funds (the three latter categories comprising not-for-profit funds). It concluded that despite super trustees having a legal duty to act in the best interests of fund members, “*some retail funds using related-party administrators are paying significantly higher fees, effectively almost doubling the median member's cost load*” (Liu and Arnold, 2010, p. 29).

Subsequent research in 2012 also issued by APRA as a working paper – *Superannuation and insurance: Related parties and member cost* (Liu and Arnold, 2012, available at <http://is.gd/rwblff>) - shows that members of some retail funds where the fund is bound to use a related party insurer are paying roughly twice the average annual insurance premium of other funds, despite receiving only 20 per cent more in benefits (see Liu and Arnold, 2012, p.2).

This research supports the proposed legislation and AIST's recommendation to excise contracts not in members' best interest from applying in relation to members with an interest in a MySuper product.

## Chapter 2 – Infringement notices

It is noted that the infringement notice provisions in the bill relate only to provisions in the SIS Act, and AIST supports the giving to APRA the power to issue infringement notices as an alternative to criminal prosecution for selected SIS Act provisions.

These provisions are reasonable and practical, and give APRA additional flexibility in the administration of their responsibilities. This will also enable APRA to take more specific and targeted enforcement action, and so should reduce the incidence of non-compliant behaviour. From a super fund's perspective, it is also more efficient for infringement notices to be issued for minor and straightforward breaches of the SIS Act than the alternative of costly and time consuming court action.

## Chapter 3 – Reasons for decisions and Superannuation Complaints Tribunal time limits

The proposed amendment to section 101(1) of the SIS Act allowing complainants to request reasons for decisions is supported by AIST. We also support the requirement for the request for reasons to be in writing, and within a prescribed and limited period of time from the date that notification of the decision is received.

However, AIST submits that in addition to conferring the right to receive reasons for decisions, trustees should be required to inform beneficiaries of their entitlement to reasons upon a request in writing, within a certain time frame. The trustee should be required to inform beneficiaries in its communications about their entitlement to request reasons.

Super funds are subject to existing requirements to advise their members about their dispute settlement procedures, and to provide information about the Superannuation Complaints Tribunal ("SCT"). These requirements should be extended to advise members that they can request reasons for decisions. Knowledge of a right is crucial to people being able to access it.

AIST supports the amended time limits for lodging complaints to the SCT, an initiative that more closely aligns the time limits with those for the courts. AIST supports equal access to the SCT for complainants, as it offers complainants a more cost effective complaint mechanism with specialist expertise in the superannuation sector.

## Chapter 4 – Dual regulated entities

AIST supports the new obligations for trustees that also manage non-superannuation registered managed investment schemes.

There is a gap in the current regulatory regime. It is an anomaly that the non-superannuation businesses of RSE licensees are not required to ensure that adequate resources or risk management systems are maintained in respect of these businesses. AIST supports adequate and consistent consumer protection for all investors, not just for retail customers and superannuation members.

## Chapter 5 – Actions for breaches of directors’ duties

### Director liabilities - Defences

AIST is pleased to see that our submissions in relation to the legal defences contained in sections 55(5) and 55(6) of the SIS Act have been adopted. AIST supports the amendments contained in the Bill as tabled.

### Director liabilities – Actions for breaches of directors’ duties

Since making our submission in November 2012, we have had the advantage of reading the submissions made by the Law Council of Australia. We take this opportunity to endorse the Law Council’s recommendation to increase the threshold considerations for bringing an action for breaches of directors’ duties.

Sections 29VPA(5) and 55(4C) currently require that there be good faith on the part of the applicant and a “serious question to be tried” by the courts in considering whether to grant leave to bring an action.

AIST concurs with the Law Council’s position that this does not address consideration of the particular merits of the case before it and accordingly we too submit that the applicant should be required to demonstrate “sufficient likelihood of success”, or “reasonable prospects of success” to be granted leave to proceed.

In addition to an amendment to the Explanatory Memorandum, AIST submits that this amendment should be added to the considerations listed in sections 29VPA(5) and 55(4C) of the legislation.

## Chapter 6 – Other measures and consequential amendments

AIST supports the various consequential and other matters in the Bill. In particular, AIST identifies the following matters as being appropriate and necessary for the proper operation of the MySuper system in accordance with the Government’s policy intentions:

- Prohibition on different administration fees for members of a tailored large employer MySuper product (Schedule 1, item 42, paragraph 29VB(1)(aa)).
- Application of switching advice requirements to all switches from a MySuper product (Schedule 1, items 7 & 8, subsection 947D(1)(b)).
- Transfer of a deceased member’s interest in a MySuper product without their consent (Schedule 1, item 39, paragraph 29TC(1)(g)).

## Other matters requiring consideration

### Product dashboard

As a consequence of a measure in the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012* (the third tranche of MySuper legislation), superannuation funds

will be required to publish a product dashboard for each of the fund's MySuper and choice products on a part of their website that is accessible to the public at all times (section 1017BA).

The product dashboard will contain information on the investment return target and the number of times the target has been achieved, level of investment risk, a statement about the liquidity of the product and a measure of the average amount of fees and other costs in relation to the product.

Notwithstanding the passage of this legislation, there remain issues with the product dashboard requirements. The PJC should consider these issues and recommend changes to the product dashboard requirements to resolve the various issues that have been identified by the superannuation industry and Government.

When the PJC held an inquiry into the third tranche of MySuper legislation, the Committee recommended further deliberation in relation to the product dashboard.

In tabling the majority report to Parliament, the Chair of the PJC, Ms O'Neill stated:

*"There seem to be various issues of a technical nature that need to be resolved if the dashboard is to work effectively. It is now up to the Australian Prudential Regulation Authority, APRA, in consultation with stakeholders, to develop a system that enables participants to view and compare the key performance information of MySuper and choice products."*[Hansard, p.11,792]

During the Consideration in Detail of the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 by the House of Representatives on 28 November 2012, the Minister for Superannuation concluded in a similar vein by saying:

*"Finally, there has been further consultation with the industry about the product dashboard and its practical operation. Issues have been identified around its coverage and ensuring the dashboard fully captures all relevant fees and net returns experienced by members and around ensuring that risk and liquidity requirements are workable and relevant to members. Consultation with the industry is continuing, also having regard to APRA's consultation on its reporting standards, and it is likely that further tranches of legislation will need to clarify the product dashboard requirements with respect to these areas. The government will also consult on the need for anti-avoidance provisions."* [Hansard, p.13, 782]

These issues have been the subject of discussion with the Government. A meeting is scheduled to be held between superannuation industry associations (including AIST) and the Government and regulators on 21 January 2013, and any outcome that has a bearing on the PJC inquiry will be reported at the hearing scheduled for 22 January.

Details of these issues are provided in the following paragraphs.

### **Performance return target**

The Bill does not require performance return targets to be shown net of administration fees. The Bill requires that product dashboard show "the investment return target for the product" (subsections 1017BA(2)a) and (3)a)), that is, that they be shown net of investment fees. AIST



submits that they should specify that the target is net of both investment and administration fees. Such an amendment would be consistent with the requirement of section 29VN that trustees promote the financial interests of members by promoting optimal net returns.

The exclusion of administration fees would:

- not align with members' experience of the performance of their accounts
- encourage fee manipulation by "redefining" investment-related fees as administration fees

AIST does not accept the argument of some commentators that a target net of administration fees would be complicated and difficult to calculate and administer. Simple, consumer-friendly comparability can be provided by requiring that the dashboard show the target at the same account balance and with the same standard assumptions for all MySuper products. In terms of showing historical returns against the target, this may require the recalculation of returns using the standardised methodology, but this would be a finite and limited exercise.

Additionally, the dashboard should show or provide ready access elsewhere on the superannuation fund's website to worked examples showing both the performance return target and performance against that target expressed as amounts in dollars. It is widely accepted that many people do not understand the calculation or significance of percentages, and that the implications of worked dollars examples using standardised assumptions are more easily understood.

This is in line with the mandated requirement to disclose investment and administration fees in superannuation fund Product Disclosure Statements. Dollar disclosure is required by section 1013D(d) and (e) of the Corporations Act, with the requirements detailed in ASIC Regulatory Guide 182 Dollar Disclosure. It is noted that these disclosure of dollar amounts for this purpose does not include disclosure that is given as a percentage, or a range of amounts.

### **Performance against return target**

Subsection 1017BA(2)(b) only requires performance to be shown against the return target for the period the MySuper product has been in existence or 10 years, whichever is the shortest. AIST submits that this is not in the interests of comparability or of consumers.

A historic comparison should be required wherever possible. This should include circumstances where the MySuper product is a rebadging of a previously existing default investment option, and the trustee has transitioned that option to become a MySuper product by using the provisions paragraph 4 of APRA Prudential Standard SPS410. In these circumstances, at transition the MySuper product will have the same investment strategy, and investment and admin fees as the previous default option.

Such a comparison both aids the consumer in better understanding their superannuation, and in comparing it with other MySuper products. It should also be structured so as to avoid a poorly performing superannuation fund being able to rebadge without the requirement to disclose prior performance.



AIST also submits that comparison of performance against the target should use the average net investment return over a long-term period rather than the number of times in the past ten years that the superannuation fund has achieved its target.

A dashboard showing the number of times a target has been achieved does not provide a comparison.

### **Liquidity**

The product dashboard requirements include a requirement to include a statement about the liquidity (sections 1017BA(2)(d) and (3)(d)). The provision requires disclosure to be of a member's investments in a MySuper product.

AIST strongly supports the legislative intent that the liquidity measure should be a meaningful tool for consumers and superannuation fund members.

From the perspective of a member, a liquidity measure must accurately convey any limitations on the capacity to redeem or move their superannuation benefit. A member (whether they are consciously aware of this or not) would expect this measure to be relevant to both good times and bad.

However, for such a measure to meet this requirement, it must be related not only to the liquidity of underlying assets, but also to super fund cash flows and cash requirements, and member movements in and out of a fund.

This is difficult information to disclose in a single, simple and useful measure. On the one hand, it would be unusual for a superannuation fund to be unable to meet a member's request to redeem or move their superannuation benefit in normal market circumstances. On the other hand, it is possible for liquidity to be an issue in certain stress scenarios.

Such a measure does not currently exist, and AIST submits that would be better not to include a liquidity measure at this stage rather than include a measure that is not useful for consumers, and may possibly be misleading. AIST encourage ASIC and APRA to develop a useful, consumer-friendly measure of liquidity and to consult with the industry about this.

In the meantime, liquidity is best managed by appropriate regulation of liquidity rather than by a possibly unhelpful measure in a product dashboard. Recent Government initiatives will improve liquidity management.

APRA Prudential Standard SPS530 on Investment Governance require trustee to formulate a liquidity management plan. Paragraph 29 of that prudential standard states:

- 29. An RSE licensee must have a liquidity management plan, approved by the Board, for each RSE within its business operations that, at a minimum:*
- (a) covers each investment option in the RSE;*
  - (b) outlines the procedures determined by the RSE licensee for measuring and managing liquidity on an ongoing basis;*

- (c) includes consideration of how the liquidity of investment options in an RSE can be managed in a range of stress scenarios;*
- (d) identifies the circumstances the RSE licensee considers to be a significantly adverse liquidity outcome that requires action (liquidity event); and*
- (e) outlines what action the RSE licensee will take when a liquidity event occurs.*

AIST submits that the regulation of liquidity pursuant to this requirement will provide comfort to the PJC to support this recommendation.

## **Risk**

The product dashboard requirements also include a requirement to include information about the level of investment risk that applies to the product (1017BA(2)(c) and 1017BA(3)(c)).

AIST still has serious concerns about the labelling, form, and potential uses of the risk measure. We recognise that there is a clear need for consistent descriptions of risk, and that no single measure of risk will be perfect. Nonetheless, it is apparent that the measure can be improved on, and that legislative support for looking at risk from a longer-term perspective will assist consumers, regulators and the superannuation industry.

AIST is concerned that a risk measure is being implemented that captures annual downside volatility, expressed over a 20 year period rather than investment risk per se. This may be misleading to consumers and not in members' best interests.

Annual volatility may not be the best general risk measure for superannuation – a retirement savings vehicle with a legislated long-term investment horizon. The use of a downside volatility measure without full explanation and without the use of other risk measures would be expected to encourage more consumers to reduce volatility, and therefore reduce long-term expected returns.

A number of superannuation funds are considering a range of alternatives, including risk in relation to a range of potential retirement balances over 5, 10, 20 or 40 years. AIST continue to encourage ASIC and APRA to develop a useful, consumer-friendly measure of risk and to consult with the industry about this. This process would be assisted by the legislation having a similar long-term focus.

AIST recommends that subsections 1017BA(2)(c) and 1017BA(3)(c) be amended to read by the addition of the word long term so that the subsections read as follows: *"the level of long-term investment risk that applies to the product."*

## **Carve-outs from product dashboard requirements**

AIST recommends that it be made clear that pre-mixed investment options offered by superannuation funds should not be exempt from dashboard requirements. There is a lack of clarity around the existing definition which is causing confusion and uncertainty.

This will require an amendment to subsection 1017BA(4) and (5). AIST supports the amendment proposed by ISN in their submission as follows:

- Delete subsection 1017BA (4)(b).
- Amend subsection 1017BA (4)(c) to read:  
*(c) The assets of the fund that are invested under the options are invested directly in listed securities.*
- Subsection 1017BA (5) should be amended to include:
- **Listed Securities**, has the same meaning as in the Superannuation Industry (Supervision) Act 1993

## Prohibition on fee capping of asset-based administration fees

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

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

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

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

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

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

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

AIST proposes to insert a new section 29VA (9) as follows:

*“(9) For the purposes of this section, if the trustee or trustee of a regulated superannuation is permitted to charge a fee for all members of the fund who hold a MySuper product which is a percentage of so much of the member's account balance with the fund that relates to the MySuper Product, the trustee may cap the cost of the fee being a percentage of the member's account balance, providing that;*

*(a) the trustee attributes the costs of the fund between members who hold a*

*MySuper Product fairly and reasonably; and  
(b) the cap is necessary to enable the trustee to recover the reasonable costs of  
providing the services to members other than Investment Fees."*

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

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

Section 29VA(9)(b) is qualified by exempting "investment fees" because these do not appear to have to be levied purely on a "cost recovery basis" as defined in section 29V.

### Anti-avoidance measures for transition to MySuper

Default members whose benefit is invested in cash are exempted from transition to MySuper (subsection 20B(3)(3)(c)(iv)). This exemption was inserted following extensive superannuation industry consultation and agreement in November 2012.

The exemption should not apply if the product design can result in a member being subsequently transferred to another investment strategy without their actual consent being given immediately prior to the transfer.

The Government has agreed to consult on the need for such anti-avoidance measures for transition to MySuper. During consideration by the House of Representatives of the third tranche of the MySuper legislation, the Minister for Superannuation concluded in a similar vein by saying: *"The government will also consult on the need for anti-avoidance provisions"*.

This AIST recommendation will prevent products being designed to initially place members in a cash option, and then transferred to a non-cash investment option if they have not made an investment choice within a specified period (eg, 12 months). A member's investment option will remain in cash until the member either acts to choose an investment option other than cash or the member consents in writing to a proposal by their superannuation fund that their investment option be changes to a non-cash option.