

20 January 2012

Mr Shon Fletcher

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

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Dear Mr Fletcher

Colonial First State Submission – Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011

Thank you for the opportunity to provide a submission to the Parliamentary Joint Committee's inquiry into this Bill.

This submission is made by Colonial First State (CFS). CFS is one of Australia's largest wealth management organisations with over \$77 billion in funds under management and a retail market share of around 15%, across the Commonwealth Bank Group.¹ CFS offers investment, superannuation and retirement products. In addition, we have six financial advisory networks in Commonwealth Financial Planning, Financial Wisdom, Whittaker Macnaught, BW Financial Advice, Advice Essentials and Count Financial Group. Our flagship platform, FirstChoice, is the largest investment platform in the Australian market with \$48 billion in funds under management and includes our retail corporate superannuation product, FirstChoice Employer Superannuation. FirstChoice Employer Super has around \$4.7 billion in funds under administration and over 7,000 employer plans.

CFS supports the Government's Stronger Super reforms and is concerned to ensure the legislation to introduce MySuper is efficient and does not result in unintended consequences. CFS has contributed to a number of industry body submissions during the MySuper legislative consultation process, most notably through The Association of Superannuation Funds of Australia (ASFA) and the Financial Services Council (FSC). We support the submissions made on the proposed legislation by these industry associations. However, there is one issue in particular on which we wish to provide further comment. Our concern is that the proposed legislation requires employees to pay higher fees once they cease employment with their employer, even where they remain in the same plan. The legislation appears to mandate the practice of 'flipping' in these circumstances. The following submission recommends amendments to the legislation for the Committee to consider.

Should you have any questions regarding our submission, please contact me or Nicolette Rubinsztein (General Manager Strategy)

Yours sincerely,

Brian Bissaker
Chief Executive Officer

¹ Plan for Life, administrator view, June 2011



COLONIAL FIRST STATE SUBMISSION: SUPERANNUATION LEGISLATION AMENDMENT (MYSUPER CORE PROVISIONS) BILL 2011

The Cooper Review and ‘flipping’

The practice of flipping was one of the issues identified and addressed by the Review into the Superannuation System of Australia (the Cooper Review). In its final report the Cooper Review Panel (the Panel) described flipping as the practice of a member being automatically moved from one division of a fund to another on cessation by the member of the particular employment to which the original fund division related.² The personal division of the fund to which the employee/member is ‘flipped’ may have higher fees and / or may involve a decrease in insurance cover or increased premiums.

Fees in a corporate division of a fund may be lower than in the personal division. Employers can often negotiate discounted fees for its employees based on its scale (purchasing power). When a member’s employment ceases the member may no longer enjoy those benefits and can be flipped (otherwise referred to as ‘delinked’ from the employer plan).

The Panel clearly had some concerns with the practice of flipping and some of the issues associated with the practice, including disclosure. It is clear that the Panel assumed its Stronger Super recommendations (including MySuper) would solve many of the concerns about flipping. At recommendation 1.16 of the Final Report the Panel stated “*Members should only be able to be moved involuntarily out of a MySuper product if they are... (b) flipped from a MySuper product in a master trust to another MySuper product in another division of that trust.*” In describing this recommendation the Panel reiterated that it would be “a matter for the trustee whether a MySuper corporate master trust product engages in such flipping; the trustee could decide to retain the member and accumulated balance in the original MySuper corporate master fund product.” In its response to the Cooper Review’s Final Report the Government supported this recommendation.³

The Government’s final MySuper design

There was always a concern that the MySuper product would be sub-optimal if designed with a rigid one-size-fits-all approach. As a result of the Stronger Super consultation process in 2011, the Government made alterations to the MySuper framework to allow some flexibility into the definition of a MySuper product. Large employers (with over 500 employees) are now permitted to have their own tailored MySuper product. In other circumstances employers can negotiate their own (discounted) MySuper administration fee within a non-tailored MySuper product. These changes are welcome as they will allow employers some flexibility in designing an appropriate plan for their employees based on the particular demographics of the employee group or simply as a result of the pricing power of the employer.

These changes to the MySuper design required further consideration of how employee-members would be treated once they cease employment with the particular employer which has either created its own MySuper product or negotiated a discounted administration fee.

In drafting the *MySuper Core Provisions* legislation currently before the Parliament the Government has recognised the need to build flexibility into the framework for large employers to ensure trustees and employers have the ability to maintain employees on their existing fees and benefits once they cease employment with their employer. Specifically, section 29TB(1)(c) states that:

² SuperSystem Review para 6.3, page 24 part 2

³ Stronger Super – Government Response (16 December 2010) at page 20

“(c) under the governing rules of the fund, a person is not entitled to hold an interest of that class in the fund unless the person is:

- (i) An employee or a former employee of the large employer; or*
- (ii) An employee or a former employee of an associate of the large employer; or*
- (iii) A relative or dependant of an employee or a former employee mentioned in subparagraph (i) or (ii).”*

This is supported by the Explanatory Memorandum at paragraph 3.47 which makes it clear that a tailored MySuper product may be open to the categories of person mentioned in (i)-(iii) of section 29TB(1)(c).

This ensures members are not required to be compulsorily ‘flipped’ to the higher MySuper product fee and different insurance premium rates in all cases. This provision is important because it permits trustees such as CFS to continue offering the same product fees and features to former employees of an employer plan under its retained benefits facility. [An explanation of the advantages of the retained benefits facility are explained at Appendix A]

There are clear benefits here which are open to employees of large employers, including once they cease employment with that employer. Unfortunately the legislation does not afford the same options to other employers and their employees, including those whose employer has negotiated a discounted MySuper administration fee for their workforce. Under section 29VB of the *MySuper Core Provisions Bill* an employer can negotiate a discounted administration fee for their employees. This recognises that there may be administrative efficiencies in dealing with employers that warrant a lower administration fee. Importantly, the discount can be applied to an employer irrespective of their size.

Impacts of the legislation for employees of non-tailored MySuper products

The ability to offer a discounted administration fee to some employers in MySuper will be an important way to ensure that employers who do not wish to have their own MySuper product can still negotiate a competitive deal on fees for their employees. Unlike the provisions which permit tailored MySuper products to be offered to the employees of large employers, however, section 29VB does not allow former employees to enjoy the discounted administration fees they may have benefited from prior to ceasing employment.

The effect of this section is to mandate the practice of ‘flipping’ for these employee-members once they cease employment. The discounted administration fee as negotiated between the employer and trustee can no longer be charged to the former employee, meaning the trustee must apply the standard (higher) MySuper administration fee. Trustees generally administer each employer’s benefits as a discrete ‘plan’. The effect of section 29VB as currently drafted complicates the ability of a trustee to continue to administer a former employee’s benefits within the same plan. It is unclear why the proposed legislation is drafted in this way and inconsistent with section 29TB(1)(c). We are concerned that members will be negatively impacted by this construction of the law. In the absence of the ability to ‘retain’ former employees under their existing fee and benefit structure, the impact of flipping members to a higher fee, and potentially higher insurance rates, should not be underestimated. See our analysis in Appendix A.

Recommendation

To optimise the MySuper legislation and ensure it achieves consistent policy outcomes, we recommend that the legislation make it possible for former employees to continue to benefit from a discounted administration fee which their former employer may have negotiated on their behalf. One way to implement this recommendation would be to make minor amendments to section 29VA(8) and section 29VB as per the recommendation below.

Recommendation - former employees should be able to continue to benefit from a lower administration fee which their employer negotiated on their behalf. To effect this recommendation sections 29VA(8) and 29VB could be amended in the following way [**in bold**]:

29VA(8) Administration fee exemption for employees [**and former employees**] of an employee-sponsor

(8) The fee is an administration fee charged in accordance with the administration fee exemption for employees [**and former employees**] of an employer-sponsor (see section 29VB).

29VB Administration fee exemption for employees [**and former employees**] of an employer-sponsor

(1) An administration fee charged to members of a regulated superannuation fund who hold a MySuper product is charged in accordance with the administration fee exemption for employees [**and former employees**] of an employer-sponsor if:

- (a) the fee is charged in relation to all members of the fund who hold the MySuper product; and
- (b) an employer-sponsor contributes to the fund or would, apart from a temporary cessation of contributions, contribute to the fund for the benefit of one or more members of the fund (the employee members) who hold the MySuper product and who are:
 - (i) employees of the employer-sponsor, or an associate of the employer-sponsor; or
 - (ii) the relatives or dependants of those employees; and
- (c) the trustee, or the trustees, of the fund have entered into an arrangement with the employer-sponsor that secures lower administration fees for the employee members [**and for members who are former employees of the employer sponsor (the former employee members)**]; and...

The committee could also consider similar amendments to subsections 29VB(2)-(4) to ensure the words "employees" in each sub-heading becomes "employees and former employees" and the words "employee members" in each subsection becomes "employee members and former employee members".

APPENDIX A

About: FirstChoice Employer Super retained benefits

This innovative facility allows members to remain in their employer plan and keep their benefits when they leave their employer.

FirstChoice Employer Super employer plans receive rebates, tailored pricing and insurance rates based on a range of factors including plan size and claims experience. A larger plan may qualify for greater rebates, leading to a reduction in member costs.

However, employers frequently experience workforce turnover. And it's often those members with higher super balances, meaning plans can end up reducing in size rather than increasing, putting their plan pricing levels at risk. With access to retained benefits (RB), generally all members and employers benefit with lower fees and consistent benefits.

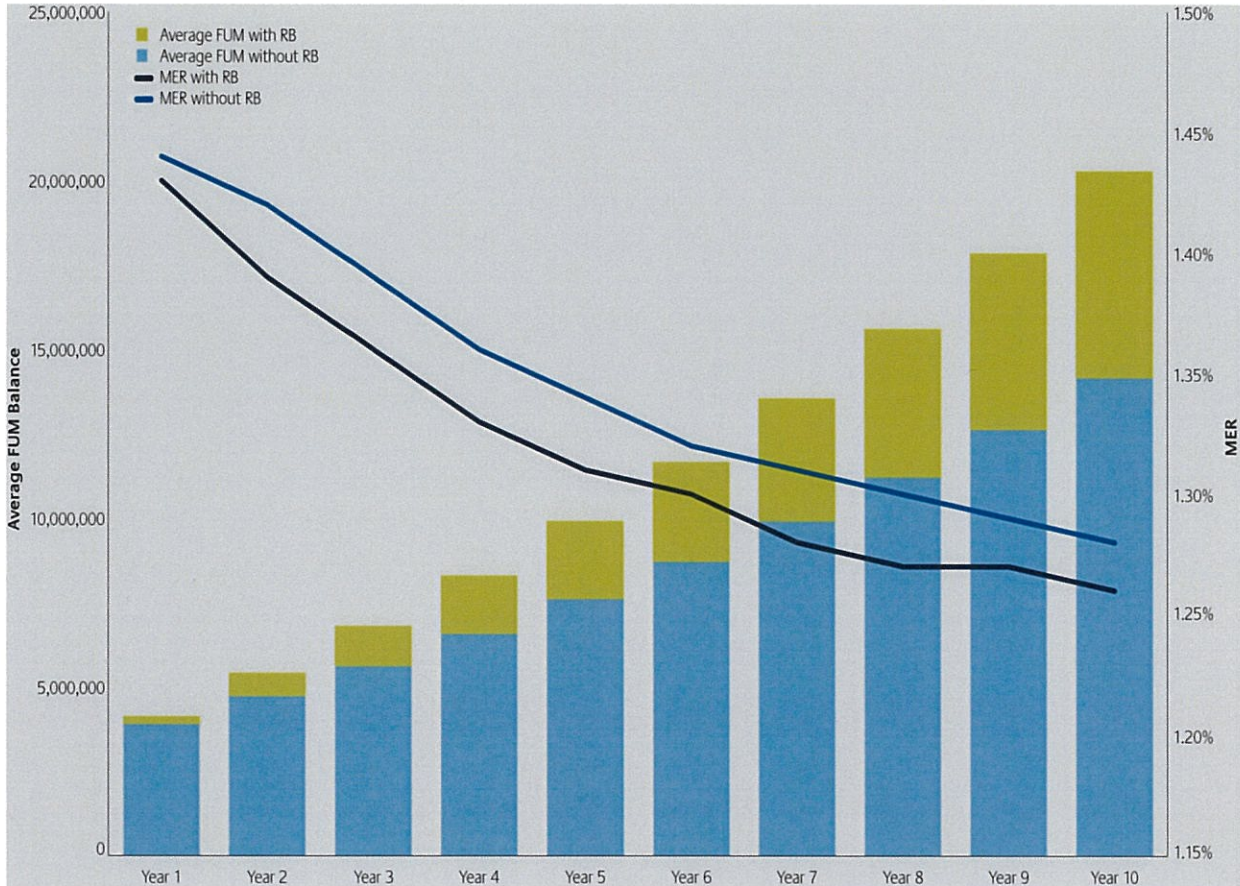
The key benefits of CFS' retained benefits facility for members and employers include:

- The continuation of discounted fees for members;
- The continuation of group insurance rates, meaning premiums remain competitive
- The employer plan continues to benefit from the retained member funds under managements – as the employer plan gets larger members receive greater discounts automatically by entering new pricing tiers;
- No transaction costs – because members stay within the same plan, there are no costs associated with transferring assets;
- Seamless transition/portability for members. Even though the member is transferred to the retained benefits category, they maintain their existing membership number, online login etc.; and
- Employers also benefit by providing a better member experience and outcome through a more compelling superannuation offer for employees.

Please see the chart on the next page which demonstrates how an employer plan can potentially grow over time as a result of retained benefits.

Growth as a result of retained benefits

After 10 years this less than \$5m fund has the potential to be worth over \$20m, over four times its original size. Through the retention of the original balances, gaining future SG contributions and market growth, the plan size alters significantly, leading to greater automatic pricing discounts. In this example we see an automatic reduction of two basis points due to retained benefit members.



Assumptions: funds invested in FirstChoice Moderate, investment returns 5%, average salary \$65,000, staff turnover 15%, retained benefit retention rate 70%, new member take up rate 70%