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23 January 2012

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

Subject: **SUPERANNUATION LEGISLATION AMENDMENT (MYSUPER CORE PROVISIONS) BILL 2011**

Dear Sir

We welcome the opportunity to comment on the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 (ie the first tranche of the MySuper legislation). We refer to this Bill as the MySuper Bill in this submission.

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 institutional clients worldwide. Mercer consultants help clients design and manage health, retirement and other benefits, and optimise human capital. The firm also provides customised administration, technology and total benefits outsourcing solutions including the Mercer Super Trust in Australia with over $15 billion of assets and 240,000 members. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.

Executive Summary

The Government's superannuation reform package is made up of four main components. These are:

- The introduction of MySuper
- The introduction of SuperStream
- The FoFA reforms (also being considered by the Committee)
- The enhancement of trustee governance requirements including the introduction of APRA prudential standards.

The current enquiry relates only to the MySuper element however we note the MySuper Bill 2011 only encompasses a part of the legislative package that will be necessary to cover MySuper. As can be seen on pages 7 to 9 of the Explanatory Memorandum (EM), there is a considerable number of items which need to be covered in subsequent tranches of legislation. We note the list in the EM does not appear to be exhaustive. Legislation covering the other components of the reform will also impact on MySuper.

The total package of legislation represents a significant shift in legislative requirements for superannuation and each of the four components will require significant work by trustees to ensure current practices and fund design are modified to comply with the new requirements.

We consider, in general, the changes are well intentioned and aim at providing a better and fairer superannuation system going forward. On this basis, we support the general thrust of the changes. Nevertheless we have a number of serious concerns, including concerns in relation to the MySuper Bill. We summarise these below.

We note an exposure draft of the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 has recently been released. Our comments below include some cross references to the provisions of this Bill which we have referred to as the Trustee Obligations Bill.

Timing

It is becoming increasingly clear the date of 1 October 2013 specified in the Bill as the date by which all default contributions must be made to a MySuper product is unlikely to be achievable. The October 2013 date leaves insufficient time for trustees to:

- analyse as yet unavailable legislative requirements
- design and implement the necessary modifications to fund designs
- amend trust deeds and other governing rules
- appropriately modify administration systems
- renegotiate insurance, administration, investment contracts etc
- lodge an application with APRA and receive the relevant approval to offer a MySuper product
- develop internal controls and processes and train staff, representatives and financial advisers to accurately represent the product features and benefits to consumers
- prepare and issue relevant communication material to members.

Not only will trustees need to implement MySuper arrangements at the same time as coping with the other three major areas of reform, there are still many significant details of the legislative requirements around MySuper which are not yet available. Until most details are available, it will be impossible for many funds to properly develop their MySuper products and non-MySuper (Choice) products.

Recommendation:

The 1 October 2013 deadline should be deferred. A period of eighteen months to two years from the time all of the relevant legislation is passed and APRA prudential standards are available should be allowed before contributions to MySuper products become mandatory for default members.

It should still remain permissible for funds to offer MySuper products from 1 July 2013 as this date may be achievable for some funds, particularly those with structures similar to MySuper at present. However the period of eighteen months to two years is necessary to enable other funds to continue to accept default contributions while they properly consider the requirements, design their MySuper product in a manner which minimises any potential adverse impact on existing members, renegotiate insurance, investment and administration contracts, amend trust deeds and rules, amend administration systems and obtain APRA authorisation.

Whilst we appreciate the Government is trying to get as much detail out as early as possible, the lack of detail on a number of issues is creating a serious dilemma for superannuation funds as they try and develop benefit designs to operate in the MySuper environment – both MySuper products and non-MySuper (Choice), in an extremely short time frame. Whilst the level of difficulty will vary depending on the type of fund and its current structure, it is critical that all details be made available as soon as possible.

The short time frame is expected to have adverse implications for trustees, employers and employees. This is likely to be particularly challenging for those funds that intend to have multiple MySuper products and multiple Choice products to redesign. Even the timeframe we have proposed above will be challenging for these funds.

We also emphasise the importance of maintaining member confidence in the superannuation system. A very tight implementation program, such as that included in the Bill, is much more likely to result in a loss of consumer confidence due to:

- potential (and possibly unforeseen problems) with the legislation noting it is not possible to properly consider the legislation until the whole package is available
- trustees being given insufficient time to develop products in a way which can possibly consider and implement strategies to minimise the impact of any adverse conditions, communicate to members and amend administration systems etc

Issues relating to fees

Over-emphasis on fees

One of the potential risks relating to MySuper is an over-emphasis on minimisation of fees to the potential detriment of the provision of value, including other services (such as financial advice, provision of retirement income products etc) and the encouragement of lower cost investment products which may provide lower long term investment returns.

> *Recommendation:*
>
> *Any comparison of MySuper products within league tables needs to compare like with like and clearly distinguish between funds with different investment models and different service provisions to members.*

Potential fee increases

Due to the fee rules in the MySuper Bill (largely applicable to MySuper) it appears some trustees may be required to increase fees in respect of the following groups of members:

- members who have a MySuper account and another account, either because of a particular choice or as a result of having two accounts during the transition to MySuper (potentially applying to millions of Australians during the transition period)
- defined benefit members with an additional accumulation account
- members with large account balances.

We note the Government indicated in its Information Pack issued in September 2011 that trustees will not be limited on the types of fees that can be charged in Choice products. However, there have been other indications that restrictions will be imposed. Trustees need to know the detail of any requirements so they can appropriately structure their products, including designs which may minimise adverse transition impacts. We consider that changes would be necessary to the exposure draft of the Trustee Obligations Bill as well as the MySuper Bill for this to be feasible. We note the MySuper Bill (presumably inadvertently) could be interpreted as severely restricting fees in relation to Choice products and the exposure draft of the Trustee Obligations Bill appears to prohibit some fee designs which might avoid the problems raised.

> *Recommendations:*
>
> - *The Government should clarify its intentions in relation to fees in Choice products so trustees can appropriately design their products*
> - *Any fee rules should be flexible enough to avoid what would potentially become mandated fee increases*

- *A specific exemption from MySuper fees in relation to a MySuper account held in addition to a member's defined benefits needs to be provided*
- *Amendments to the MySuper Bill are necessary to clarify the various MySuper fee restrictions do not apply in relation to Choice products.*

Insurance Issues

Potential reduction in insurance cover

Unless the requirements in the MySuper Bill are appropriately amended, it is likely the level of insurance will be reduced for many members from 1 October 2013, often without them realising. In other cases, insurance cover will be increased without members being aware of the extra cover and additional costs. These issues are particularly likely in corporate funds and corporate master trusts where different cover levels are generally provided for different employer groups and different classifications of employee within those groups.

Requirements for a standard level of insurance are likely to result in arrangements that are unsuitable for millions of Australians. For example, if a standard level of insurance cover is required, this may result in insufficient cover for white collar members but, on the other hand, result in excessive cover for many blue collar, casual and low paid employees and those not in the workforce. It is important more flexibility be allowed in relation to insurance including provisions allowing for differing levels of insurance for different employer groups as announced by the Government in September 2011.

For example, it appears it will be possible to charge different premium rates to blue and white collar workers and casuals in the same fund. However it is also important the legislative requirements acknowledge these classes of member may have different insurance needs relating to both the amount and type of cover. We note trustees will have to develop an insurance strategy that is relevant to its members but may find it is not possible to determine a strategy that satisfactorily covers all members.

Recommendation:

In addition to amendments to the exposure draft of the Trustee Obligations Bill, an exemption from the requirements of 29TC(1)(b)of the MySuper Bill is required in relation to the level of insured benefits:

- *to give trustees the flexibility to avoid significant changes in cover on transition to MySuper*
- *to enable trustees to develop insurance strategies which provide more appropriate cover for different types of members (for example, heavy blue collar, light blue collar and white collar)*

- *to enable insurance arrangements relevant to workplaces to be put in place in accordance with the Government's Information Pack*
- *to enable trustees to maintain previous commitments given to members.*

Potential anti-selection of insurance

The Bill requires all MySuper members be provided with the same options, benefits and facilities. This would appear to mean it will not be possible to offer insurance without health evidence to some members (eg employees) and not others (eg personal members who may not be employed). This is likely to lead to higher administrative costs and higher insurance premiums.

> *Recommendation:*
>
> *In addition to amendments to the exposure draft of the Trustee Obligations Bill, an exemption from the requirements of 29TC(1)(b)of the MySuper Bill is required in relation to the health evidence requirements for insured benefits.*

Potential reduction in financial literacy and knowledge about superannuation and retirement income

On the one hand the Future of Financial Advice (FOFA) reforms propose changes that are targeted at increasing the number of superannuation members who can access low cost financial advice. We understand a MySuper option can include the cost of financial advice as part of the overall superannuation management fee, or the advice can be paid for by the superannuation trustee (although the relevant details are not yet included in draft legislation).

On the other hand, the MySuper product structure means fees will need to be very competitive and if the fees are not competitive on a like with like basis, trustees will remove the cost of financial advice which could be seen as a "non-essential" benefit.

This will drive a reduction in members accessing affordable education and advice, and is contrary to the intent of both FOFA and Stronger Super. The following recommendation is consistent with our recommendation in the section on Fees.

> *Recommendation:*
>
> *Any comparison of MySuper products within league tables needs to compare like with like and clearly distinguish between funds with different investment models and different service provisions to members.*

A second issue is the requirement all members must be provided with the same options, benefits and facilities and the limitations this will impose in relation to employer based seminars.

Recommendation:

Greater flexibility in the provision of services to members of an employer group should be possible. The MySuper Bill already allows different administration fees to be applied to members of different employer groups in the same MySuper. It should therefore be possible for the employer based fee to reflect additional services (in particular seminars for members) that may not be provided to other member groups. This will require amendments to Section 29TC(1)(b) and to the exposure draft of the Trustee Obligations Bill.

Tailored MySuper arrangements

We support the MySuper Bill in relation to the allowing of tailored MySuper arrangements for large employer groups. However we have a number of concerns with the manner in which these arrangements must operate.

These relate to the need to apply for APRA approval, impractical requirements to terminate the membership of members in certain circumstances and the method of determining whether the employer is a large employer. Greater detail on these issues and the logic behind the following recommendations are included in the Appendix to this submission.

Recommendation:

The Bill should be amended to:

- *remove the requirement for APRA approval of tailored MySupers (at least for cases where the 500 employee limit has been exceeded)*
- *enable employers and trustees to limit membership of a Tailored MySuper to a particular class or classes of employee*
- *limit those who can join the Tailored MySuper to employees, former employees and relatives. Once membership has been established, the member should be able, subject to the rules of the fund, to remain a member*
- *change the 500 employee test so it is based either on:*
  - *the number of employees of the large employer and its associates; or*
  - *the number of members in the employer's plan*

Retirement income benefits

It will not be possible to provide a retirement benefit in pension form from a MySuper product. This will not assist in the encouragement of pension benefits for future retirees.

We are also concerned the rules relating to fees may not enable a trustee to recoup part of the costs of establishing and developing a pension facility from MySuper members. This may provide significant discouragement to trustees establishing pension facilities.

Recommendations:

- *it should be possible for pensions to be provided through MySuper accounts (although different fee levels should be allowed), as a minimum, in the future*
- *further tranches of legislation should be drafted in a way which allows for the establishment and development costs of pension and other new products being recouped from fees from all members, at least where MySuper members may eventually use those services.*

Deferred tax assets and fund mergers

Currently, many funds are effectively unable to merge due to tax reasons. In particular they would permanently lose the benefit of considerable deferred tax assets following a merger. This would currently have a significant adverse impact on members.

Trustees who are considering winding up are therefore in a quandary. Should they wind-up or continue to operate and incur all the costs necessary to comply with the legislative reform program? Due to time constraints, and the current absence of appropriate rollover relief on fund mergers, trustees generally have no alternative but to proceed with the implementation of the changes required by the four elements of reform and incur considerable costs in doing so. These are costs which potentially could be saved if the fund were to merge with another fund.

Recommendation:

The Government should urgently announce the provision of rollover relief for merging superannuation funds including the terms of qualifying for such relief.

Modern Awards

Virtually all modern awards specify that default SG contributions must be made to one of a number of funds specified in that Award. This is anti-competitive and unfairly protects the relatively small number of funds that have been able to arrange for nomination in Awards.

Recommendation:

The Government should urgently announce that it will move to require Modern Awards to enable employers to make default contributions to any MySuper product.

We have provided more detail on the above issues in the appendix to this submission.

Mercer representatives would be keen to present to the Committee. Please contact John Ward if you have any queries on our submission or wish to arrange for us to present to the Committee.

Yours sincerely

David Anderson
Managing Director & Market Leader,
Australia/New Zealand

Appendix

APPENDIX

TIMING

Threat to long term confidence in the system

It is critical that the transition to MySuper does not threaten the confidence of fund members in the superannuation system. Clearly the intention is not to reduce confidence; however, there are various aspects of the MySuper policy which could lead to such a reduction in confidence, both in relation to individual funds and to the system as a whole. This is very important at a time where the industry has already suffered from a number of adverse events including:

- adverse investment performance due to the global financial crisis
- significant cutbacks in concessional contribution limits
- cutbacks in Government co-contributions

Some potential aspects which could undermine confidence include:

- fee increases (particularly as outlined in our comments on fees)
- loss of insurance cover or increases in premiums resulting from unwanted additional insurance (due to trustees having to standardise cover)
- transfers of current investments to a new MySuper option under the transition process
- removal or reduction in help-line services due to the design of the MySuper product
- poor or insufficient communication to members caused by a lack of time to prepare appropriate material
- employers having to change default fund providers because it was not clear that the current provider would have a MySuper product available in the required time
- delays in making benefit payments or complying with other member requests due to administration systems being unable to cope with the changes in the required time frame
- loss of particular insured benefits (such as cover for loss of limbs) – not covered in the MySuper Bill but it has been flagged that a number of very common insurance definitions will be banned

These threats to confidence are much more likely to arise with a system which implemented on a tight timetable rather than one where an appropriate transition timetable is in place. It is critical that the legislation is properly developed and considered and that trustees are given sufficient time to make all of the changes necessary, communicate to members and amend administration systems etc.

In particular, the legislation needs to be considered as a whole to determine whether it will operate effectively. It is not appropriate to develop it on a piece meal basis which will inevitably mean that unintended consequences will occur.

Implications for trustees

Trustees will not be able to finalise any MySuper arrangements until all details are known. It appears that this will not be until at least the second half of 2012, at the earliest.

Amendments to trust deeds and fund rules will then be necessary before these can be forwarded to APRA with an application for a MySuper product. These amendments will depend on as yet unknown requirements in future tranches of law and APRA standards and, in view of the breadth of changes, could take significant time to develop and finalise.

In addition, supplier arrangements for funds with insurers, software developers, investment managers and administrators, for example, are likely to need renegotiation.

At this stage it is unknown as to the level of detail that will be sought by APRA as part of the application process. For example, it is not known whether APRA will expect trustees to have developed appropriate policies based on the proposed prudential standards before submitting an application.

With much of this detail still unavailable, it is becoming increasingly clear that the date of 1 October 2013 specified in the Bill as the date by which all default contributions must be made to a MySuper product is unlikely to be achievable by many funds. We accept that some funds which already have a benefit design that is largely consistent with the MySuper requirements will have a greater chance of meeting this deadline. However, even these funds will, at the very least, have to complete detailed discussions with their suppliers.

Even if all of the legislation relating to each of the four major areas of reform had been finalised, it would be a tremendous effort for trustees to cope with all of these reforms at the same time. In reality, the legislation is far from finalised with significant further legislation still to be issued - even in draft form. In fact we expect that some parts of this Bill will need to be amended in subsequent tranches in order to satisfy Government policy and to avoid undesirable outcomes.

Whilst we appreciate that the Government is trying to get as much detail out as early as possible, the lack of detail on a number of issues is creating a serious dilemma for superannuation funds as they try and develop benefit designs to operate in the MySuper environment – both MySuper products and non-MySuper (Choice).

Recommendation:

The 1 October 2013 deadline should be deferred. A period of eighteen months to two years from the time all of the relevant legislation is passed and APRA prudential standards are available should be allowed before contributions to MySuper products become mandatory for default members.

As indicated above, the MySuper Bill only includes some of the proposed provisions in relation to MySuper. Further, the Bill provides limited detail in relation to possible rules for non-MySuper sections of superannuation funds.

The major areas in which detail is required urgently include:

- insurance provisions
- transitioning of members to MySuper
- fees for Choice products including fees for members who may have a Choice and MySuper product in the same fund or who have a defined benefit and MySuper product in the same fund
- provisions covering charging (or not charging) for financial advice
- provisions for defined benefit funds
- APRA prudential standards

We note that trustees also need to take into account changes resulting from the other legislative reforms referred to above. For example, provisions in the exposure draft of the Trustee Obligations Bill include provisions which severely restrict decisions that a trustee might otherwise have made under the MySuper Bill. We note that based in the exposure draft, the Trustee Obligations Bill makes radical changes to long standing trust law, in particular relating to trustee covenants which will prohibit trustees from providing an unfair advantage to a member over other members. (These changes are far more radical than those which had been recommended and accepted by the Government following the Super System Review.) Difficulties will arise whenever a trustee’s strategy results in different fee levels, different insurance levels, different premium rates, different medical evidence requirements from one member to another as this will raise the issue of unfair advantage.

The fact that the legislation is being introduced in tranches also makes it difficult to comment efficiently and appropriately. Our comments are necessarily constrained due to the lack of detail on other aspects. Later tranches of legislation may impact on the comments we make on this first tranche. In any event we expect that some aspects of the MySuper Bill will need to be amended in order to make it consistent with Government announcements.

Implications for employers

Employers will need to ensure their current default fund offers a MySuper product by 1 October 2013. As we expect that approvals for many MySuper products will be running close to this deadline, employers will be under unnecessary pressure to make contingency plans in case their default fund does not obtain approval in time.

This will involve considering the relative merits of other funds which have already received approval (even though those funds may be more expensive or less appropriate for the employer's employees).

Alternatively, some employers may decide to hold off on making contributions from 1 October 2013, in the hope that their default fund obtains the relevant approval before the next contribution to satisfy SG requirements must be made (potentially January 2014).

The impact on employers reinforces the need for a deferral of the 1 October 2013 implementation date.

Implications for employees/members

Where an employer elects to change its default fund due to concerns that its current fund will not be available in time, members are likely to be subject to fees in both their existing and new funds for a period until consolidation can be arranged. This will reduce members' retirement benefits and generally require the active involvement of the member to arrange the consolidation of accounts.

Even if the existing fund can continue to be used, because of the short time frame available to trustees, it is likely that many members will be unnecessarily disadvantaged. These disadvantages will potentially include:

- reductions in insurance cover due to the lack of time for trustees to consider appropriate transitional provisions and negotiate these with insurers
- higher fees due to potentially being required to have multiple superannuation accounts in the same fund
- having their contributions invested in an inappropriate investment strategy taking into account their particular needs
- loss of investment earnings where employers have withheld contributions.

These potential adverse impacts reinforce the need for a deferral of the 1 October 2013 implementation date.

Transition issues

The MySuper Bill does not include provisions relating to the transition of members from current products to MySuper. These will be included in later tranches and APRA Prudential Standards.

Nevertheless, trustees need to know the requirements before they can make decisions about Plan design. This is necessary to ensure that members are not adversely impacted as part of the transition.

The lack of detail in relation to transitional provisions reinforces the need for a deferral of the 1 October 2013 implementation date.

Defined benefit issues

As drafted, the MySuper Bill does not provide an appropriate or adequate exemption for defined benefit arrangements, in particular where the defined benefit arrangement is the current default option for employees. However, we note that the Explanatory Memorandum indicates that legislation covering defined benefit arrangements will be included in a subsequent Bill.

Nevertheless, we are concerned with the comments included in paragraph 2.7 of the Explanatory Memorandum. This paragraph indicates that "superannuation guarantee contributions made in relation to an employee's interest in a defined benefit fund or scheme do not have to comply with the choice of fund requirements. This will not be changed". We consider that this comment is incorrect and that contributions made to many defined benefit arrangements are not currently exempt from Choice of Fund requirements. We have provided Treasury with a more detailed explanation of our concerns as part of our submission on the Exposure Draft of the MySuper Bill. We expect that more significant amendments than appear to be envisaged by Treasury will be required to effectively take defined benefit funds into account.

The lack of detail and the inconsistency between the content of the EM and current law is making it particularly difficult for trustees of defined benefit arrangements to plan for the MySuper regime.

The lack of detail in relation to defined benefit arrangements reinforces the need for a deferral of the 1 October 2013 implementation date.

FEE ISSUES

Over emphasis on fees

One of the potential risks relating to MySuper is the potential over-emphasis on minimisation of fees to the potential detriment of the provision of other services (such as financial advice, provision of retirement income products etc) and the adoption of lower cost investment products which may provide lower long term investment returns.

> *Recommendation: Any comparison of MySuper products within league tables needs to compare like with like and clearly distinguish between funds with different investment models and different service provisions to members.*

Potential fee increases

Many of our concerns in relation to fees relate to issues around members who have non-MySuper accounts.

Whilst the Government has indicated in its Information Pack issued in September 2011, that no restrictions will be placed on Choice fees, we note that Treasury have indicated that subsequent tranches of legislation will include:

- A rule for the fair and reasonable allocation of costs between each MySuper product and each Choice product within a fund (EM to Exposure Draft Trustee Obligations Bill)
- Cost recovery rules for some fees (it is unclear whether this relates to MySuper only)

In addition, provisions in the exposure draft of the Trustee Obligations Bill that prohibit a trustee from providing an “unfair advantage” to some members over others. (Note that we consider that these provisions represent a significant departure from existing laws relating to trustees and go far beyond the recommendations from the Super System Review)

Further, Section 29VA of the MySuper Bill is poorly worded and could, in some areas, be interpreted as applying to Choice products.

Fee capping for large account balances

Many funds currently cap administration fees or charge a lower administration fee in respect of account balances in excess of a specified level. This will not be possible in a MySuper product. At this point it is not clear whether a fee cap (or similar) will be allowed in Choice products. If not, then the ban on such fees is likely to have an adverse impact on **all** members of the fund. (We note that whilst draft legislation covering fees for Choice products has not yet been issued, the trustee covenants included in the exposure draft of the Trustee Obligations Bill could be interpreted in a manner which would not allow such capping.)

If a fee cap is not applied, then it is likely that members with a high account balance will be charged fees which are considerably greater than the actual costs of administering their account and considerably higher than current fees. If a cap can be applied in a Choice product, then we would expect that the member would transfer to that Choice category rather than being in the MySuper category. This would generally allow a satisfactory outcome. However, if capping is not allowed in Choice products, then we expect that a high proportion of members with large account balances will have little option but to set up a Self Managed Superannuation Fund in order to minimise costs. (These costs may be more than the member is currently paying and in any event, the person would be taking on additional responsibilities as trustee of the SMSF – responsibilities that the person may not want or be equipped to handle.)

At the same time, the current fund will suffer a loss of scale with the withdrawal of large accounts. This may have an adverse impact on the fees charged to remaining members.

This is potentially a “lose-lose” scenario.

Fees for members during transition

From 1 October 2013, some members may have a new MySuper “account” established for them which will accept any contributions from that date. However, it may be necessary for this account to be separate from the member’s existing account (for example, the investment strategy may be different). The Bill requires a standard fee for MySuper “accounts”. Depending on the fee rules to be covered in subsequent tranches, it may be necessary to charge a separate fee for each “account” which represents an increase in fees until the member’s accounts are consolidated either at the member’s election or by some form of automatic transition covered in future tranches.

Fees for members who have a Choice and a MySuper account

Even after the transition period, some members may elect to have a Choice “account” in addition to a MySuper “account”.

Currently, members can invest in more than one investment option and are generally charged a single dollar based fee covering both options (in addition to potential asset based fees). For example a fee of $1 a week might be charged. Having a MySuper account and a Choice option is very similar to having more than one investment option. However, the MySuper Bill requires that the dollar based fees charged for a MySuper option must be the same as for other members of the MySuper product who have the same employer. Thus if the trustee determines that the dollar based fees under MySuper will also be $1 a week, then it would be necessary to charge a zero fee for this member in respect of their Choice option to avoid an increase in fees.

However this would appear to conflict with the provisions included in the exposure draft of the Trustee Obligations Bill as members of the Choice option who also have a MySuper option would be charged less in the Choice option than other members of that option who do not have a MySuper option.

Fees for members who have a defined benefit and a MySuper account

A similar issue arises in respect of defined benefit members. Many defined benefit members also have additional accumulation accounts. Currently, it would be unusual for any dollar based fee to be applied to this additional accumulation account. Any dollar based fee would be deemed to be part of the defined benefit section of the fund and effectively paid for by the employer. We expect that many such accounts will, either initially or subsequently become MySuper accounts and consequently, under the provisions of this Bill, there would appear to be a requirement for the fund to charge this dollar based fee to defined benefit members. This will result in an increase in fees for these members. We further note that it would not be possible for the employer to subsidise these fees as the Bill bans employer subsidies except where the same subsidy is applied to all employees of that employer in the fund. (In most cases, employers no longer provide defined benefits for new employees however have agreed to continue providing defined benefits for those who joined the employer at a time such benefits were available.)

Employer subsidies

Section 29TC of the MySuper Bill prohibits an employer subsidising fees in a way which favours some members compared to other employees who are members. There are numerous reasons why employers have agreed to subsidise fees for some (but not necessarily all) members in the past. These include:

- commitments following a fund merger where the employer has guaranteed transferring members that the fees in the new fund will not exceed those in the previous fund
- commitments given to employees at a particular date following a decision by the employer to change its practice of fee subsidisation for new employees
- existing fund rules where fees are not charged to former defined benefit members whose defined benefit has been crystallised (eg on reaching age 65), or following death

Such subsidies will no longer be allowed under the requirements of the MySuper Bill. Whilst potentially this would result in an increase in fees paid by such members, it will presumably be possible for the employer to make additional contributions for such members to effectively replicate the current fee subsidy. Whilst this might achieve the same result, it will involve additional costs including the costs of explaining the change to members and amending systems etc.

It is therefore unclear as to why fee subsidisation will not be allowed.

In order to address the above concerns relating to fees we make the following recommendations:

- *The Government should clarify its intentions in relation to fees in Choice products so that trustees can appropriately design their products*
- *Any fee rules that impact on non-MySuper products should be flexible enough to avoid what would potentially become mandated fee increases*
- *A specific exemption from MySuper fees in relation to a MySuper account held in addition to a member's defined benefits needs to be provided*
- *Amendments to the MySuper Bill are necessary to clarify that the various MySuper fee restrictions do not apply in relation to Choice products*

INSURANCE ISSUES

Potential reduction in insurance cover

Proposed section 29TC(1)(b) of the MySuper Bill requires that all members of a particular MySuper have access to the same options, benefits and facilities.

This implies that the same level of cover must be provided, at the same premium, for all members. The EM however indicates that later tranches of legislation will clarify that access to insurance cover may differ for members as a result of their age, medical status, occupation or other factors.

In other words, it will be necessary for amendments to be made to the provisions of the MySuper Bill to enable funds to provide different levels of cover at different ages, charge different premiums based on age or occupation and also take into account the member's medical status.

Further, the EM does not refer to the comments in the Government's Stronger Super Information Pack issued in September 2011 that, within a MySuper product, it will be possible for the standard insurance cover to be replaced by a default insurance strategy tailored to meet the specific requirements of the employees of a particular employer.

Whilst we understand that subsequent tranches of legislation will allow some ability to vary the standard insurance for different employer groups, it remains unclear as to the extent of such variability.

The funds particularly concerned with the lack of detail available in this area are corporate funds and corporate master trusts.

Many corporate funds have tailored their insurance to reflect the differing needs of different sections of their workforce. Higher cover is traditionally provided to white collar employees with lower cover provided to blue collar and casual employees and those not in the workforce. (If higher cover was provided to these workers, the cost of premiums would potentially have a significant adverse impact on retirement savings.) Any required standardisation of cover for all members would result in a significant number of members losing insurance cover (whilst other member may face an increase in premiums due to an increase in cover). Whilst no doubt trustees will make members aware of such changes, we expect that many members will not realise that their insurance cover has changed and/or will not take the relevant steps necessary to voluntarily reinstate or opt-out of the increased cover. For those who wish to reinstate cover, any such reinstatement may potentially be subject to health evidence.

Corporate master trusts face an even more difficult dilemma as they would normally provide different levels of cover for different employer groups whilst at the same time providing different levels of cover to different levels of employee within each employer group.

In many cases, existing arrangements have been put in place based on the insurance provided in a predecessor fund. This continued provision of pre-existing insurance arrangements has generally been one of the aspects considered important when members transferred as part of a successor fund arrangement. To remove such cover without member consent will potentially breach commitments given to members on transfer.

We also note a potential conflict with the Trustee Obligations Bill which would prevent a trustee providing an unfair advantage to a member over other members. We are concerned that providing different levels of cover to different members (for whatever reason), may be seen to be unfair. (We have objected strongly to these provisions in our submission to Treasury on the exposure draft of the Trustee Obligations Bill.)

Recommendation:

In addition to amendments to the exposure draft of the Trustee Obligations Bill, an exemption from the requirements of 29TC(1)(b)of the MySuper Bill is required in relation to the level of insured benefits:

- *to give trustees the flexibility to avoid significant changes in cover on transition to MySuper*
- *to enable trustees to develop insurance strategies which provide more appropriate cover for different levels of employee/member*
- *to enable insurance arrangements relevant to workplaces to be put in place in accordance with the Government's Information Pack*
- *to enable trustees to maintain previous commitments given to members*

Potential anti-selection of insurance

The Bill requires that all MySuper members be provided with the same options, benefits and facilities. This would appear to mean that it will not be possible to offer insurance without health evidence to some members and not others. Currently, insurance up to an automatic acceptance limit is generally provided automatically to members of employer groups provided the employee joins the fund when first eligible to do so. However, other members are required to provide some level of medical evidence (at least a personal health statement). If this status quo is not maintained there is a risk that either:

- members of employer groups will also be required to provide medical information (resulting in a considerable increase in administrative and underwriting costs)
- if all members are able to obtain insurance without health evidence, then individual members, even if they were terminally ill, could join a number of funds, obtaining insurance cover in each. This could lead to an increase in claim rates and eventually premium rate rises for all members.

Recommendation:

In addition to amendments to the exposure draft of the Trustee Obligations Bill, an exemption from the requirements of 29TC(1)(b) of the MySuper Bill is required in relation to the health evidence requirements for insured benefits.

POTENTIAL REDUCTION IN FINANCIAL LITERACY AND KNOWLEDGE ABOUT SUPERANNUATION AND RETIREMENT INCOME

On the one hand the Future of Financial Advice (FOFA) reforms propose changes that are targeted at increasing the number of superannuation members who can access low cost financial advice. We understand that a MySuper option can include the cost of financial advice as part of the overall superannuation management fee, or that the advice can be paid for by the superannuation trustee.

On the other hand, the MySuper product structure means that fees will need to be very competitive and if the fees are not competitive on a like with like basis, trustees will remove the cost of financial advice which could be seen as a “non-essential” benefit.

This will drive a reduction in members accessing affordable education and advice, and is contrary to the intent of both FOFA and Stronger Super. The following recommendation is consistent with our recommendation in the section on Fees. It should apply to APRA, tender managers and others preparing comparative tables.

> *Recommendation:*
>
> *Any comparison of MySuper products within league tables needs to compare like with like and clearly distinguish between funds with different investment models and different service provisions to members.*

A second issue is the requirement that all members must be provided with the same options, benefits and facilities. As indicated in the Explanatory Memorandum, it will not be possible to provide employer based seminars in a multi-employer fund without making them available to all members of the MySuper.

Currently such seminars are often partly subsidised by the employer in that the employer provides the venue in which the seminar is held. This may be on their business premises and it may be inappropriate for members who are not employees of the relevant employer to access those premises.

We note that the EM advises

- that it would be possible for trustees to provide the content of seminars to other members by enabling other members to have access to the seminar material on the fund's web-site. However, the exposure draft of the Trustee Obligations Bill would appear to negate this statement as it could be argued that those members who were able to attend the seminar were provided with an unfair advantage over other members
- that it would be possible for the employer to fully pay the costs of running a seminar and this would not be considered to be part of the MySuper. We expect many employers would not be prepared to pay such costs

The provision of employer based seminars has become common place and it would be a retrograde step for these to be discouraged with members becoming less informed, due to the restrictions imposed.

Recommendation:

Greater flexibility in the provision of services to members of an employer group should be possible. The MySuper Bill already allows different administration fees to be applied to members of different employer groups in the same MySuper. It should therefore be possible for the employer based fee to reflect additional services (in particular seminars for members) that may not be provided to other member groups. This will require amendments to Section 29TC(1)(b) and to the exposure draft of the Trustee Obligations Bill.

A further difficulty facing trustees trying to design a MySuper product is the current lack of detail around the rules for the charging of financial advice deducted from member accounts and charging for intra-fund advice. Again these will be covered in later tranches of legislation.

TAILORED MYSUPER

We support the Bill in relation to the allowing of tailored MySuper arrangements for large employer groups. However we have the following concerns with the manner in which these arrangements must operate.

Applications to offer a Tailored MySuper

We do not consider that it should be necessary for separate approval be sought from APRA in relation to Tailored MySupers.

In order to offer a Tailored MySuper, the trustee must already have convinced APRA that it is competent to operate a MySuper product. It therefore seems unnecessary that trustees have to obtain separate approval to operate a tailored MySuper, particularly where the proposed arrangement already has the requisite number of employee members to qualify. The requirements will add to inefficiency, make transition to MySuper more difficult and create further inefficiencies and time delays in relation to future fund mergers.

> *Recommendation:*
>
> *The requirement for APRA approval of tailored MySupers should be removed (at least for cases where the 500 employee limit has been exceeded).*

Limitations to membership

Whilst it appears that trustees of MySuper products can generally restrict membership to particular classes of person, this does not appear to be the case for tailored MySuper products where all employees of the large employer must be able to join that product.

We are concerned with this requirement as it removes the ability of employers and trustees to design a MySuper product that is tailored for a particular sub-group of employees. For example, an investment strategy or an insurance strategy may be appropriate for the employer's salaried or professional workforce but might not be appropriate for other employees. If trustees are required to set strategies that are appropriate for all groups of employees, then it may end up with an "average" strategy that is sub-optimal for all members.

> *Recommendation:*
>
> *The requirements for tailored MySuper products should be amended to enable employers and trustees to limit membership to a particular class or classes of employee.*

Membership of a tailored MySuper

Section 29TB(c) of the MySuper Bill would enable the following persons to be members of a Tailored MySuper:

(i) an employee or a former employee of the large employer
(ii) an employee or a former employee of an associate of the large employer
(iii) a relative or dependant of an employee or a former employee mentioned in subparagraph (i) or (ii)

The fund's governing rules must not allow other persons to hold an interest in that MySuper.

The way in which the Bill is drafted means that it would not be possible for a member of a Tailored MySuper product to remain a member if:

- the member was a member by virtue of being an employee of an associate of the large employer and the member's employer ceases to be an associate of the large employer
- the member was a member by virtue of being the spouse of an employee and the member became divorced (unless the member was considered to be a dependant of the employee)
- the member was a member by virtue of being the adopted child of an employee member's spouse and the child's parents divorce
- the member was a member by virtue of being a dependant of the member but that dependency had now ceased

Thus, there are likely to be many occasions where a member must be transferred out of the Tailored MySuper, generally to the detriment of that member as it would be expected that higher fees would apply in alternative arrangements.

This problem is exacerbated by the wording which would effectively require the transfer immediately or before the employer ceases to be an associate, the divorce occurs etc.

This is not only unreasonable but highly impractical. Clearly trustees will not be in a position to find out that a member has been divorced and arrange for an immediate transfer. Where an associate employer has been sold, it is also likely that some time would be necessary in which alternative arrangements could be put in place and members' benefits transferred. At the very least, trustees will be in breach of their own fund rules if they allow membership to continue in the above and other similar circumstances.

Recommendation:

The Bill should be reworded to limit those who can join the Tailored MySuper to employees, former employees and relatives. Once membership has been established, the member should be able, subject to the rules of the fund, to remain a member.

This recommended approach is also much more consistent with existing requirements in the SIS legislation relating to members of non-public offer funds.

500 member test* - *29TB(2)

In order to qualify as a large employer, the fund must have at least 500 members who are either employees of the employer or its associates. Only employees for whom the employer is contributing would count towards meeting this requirement.

We consider that the methodology for determining the number of members who count towards the 500 member test is too complex. It is important that a simple test be developed. For example, it should be possible for either the trustee or the employer to readily determine the relevant number of members or employees.

If the test is to be determined by the trustee, then the test should be based on the number of members in the employer arrangement (irrespective of whether they are currently an employee or whether the employer might be contributing for them). If the test is to be determined by the employer, it needs to be a simple test based on the number of employees.

Whilst the proposed test might sound simple, in practice it may be very difficult for a trustee to determine for which members the employer is contributing, particularly in relation to casual and seasonal workers. Contributions may not be received for several months even though the member is still an employee and the employer will contribute when it next needs to make a contribution to satisfy its Superannuation Guarantee requirements.

Further, if the trustee is to determine whether the test is satisfied, we consider that it would be more appropriate if the test were to be based on all members of the relevant employer arrangement (including MySuper and Choice members). Whilst this would include former employees who have remained in the employer plan, it would not however include any members which have been transferred to the fund's standard MySuper product.

We note that the Government's announcement in September 2011 indicated that the test would be based on employees (rather than the number of members for whom the employer is contributing). This may also be an appropriate test provided that there were simple rules covering the counting of casuals, seasonal workers and part-time employees. We assume that it would be necessary for the employer to advise the trustee of the number of employees on a regular basis.

Recommendation:

The 500 test should be amended to be based either on:

- *the number of employees of the large employer and its associate; or*
- *the number of members in the employer's plan.*

RETIREMENT INCOME BENEFITS

It will not be possible to provide a retirement benefit in pension form from a MySuper product. This includes both post-retirement and transition to retirement pensions. This is hopefully only a short-term provision which will be modified after the Government has had more time to consider any necessary rules to be placed around such pensions. In the meantime, it will be necessary for a member who wants a pension to switch to a Choice option before taking up a pension. This will not assist in the encouragement of pension benefits for future retirees.

It will also create particular difficulties for a fund which only offers a MySuper product. It will have to establish a Choice section if it wishes to provide pensions.

However, more importantly, it would be inappropriate if trustees were only able to recoup the costs of establishing and developing a pension facility in their fund from Choice members. This may provide significant discouragement to trustees establishing pension facilities. As any pension will effectively be available to both Choice and MySuper members and it should therefore be appropriate to allow for establishment and development costs to be recouped from all members.

Recommendations:

- *it should be possible for pensions to be provided through MySuper accounts (although different fee levels should be allowed), as a minimum, in the future*
- *further tranches of legislation should be drafted in a way which allows for the establishment and development costs of pension products and other new products being recouped from fees from all members, at least where MySuper members may eventually use those services*

MERCER

DEFERRED TAX ASSETS AND FUND MERGERS

Over the last 10 – 15 years, many superannuation funds have been wound-up, generally by a "merger" with another fund. The additional requirements that will need to be satisfied will potentially result in a number of remaining funds determining that it is not appropriate to continue. However a merger with another fund is effectively not possible at the current time because the fund is carrying significant deferred tax assets including the value of realised and unrealised capital losses. These deferred tax assets would be lost if the fund were to be wound up now. This would not be in the interests of fund members.

Trustees who are considering winding up are therefore in a quandary. Whilst the Government has indicated that there may be some roll-over relief offered for funds which do not have the scale to provide a MySuper product, there appears to be no firm commitment and, in any event, any requirements on such roll-over relief have not been announced. We would expect that few trustees would be prepared to merge in the current environment until they can be satisfied that roll-over relief will be available (or investment markets recover to the extent that the deferred tax assets can be effectively utilised). In many cases, a loss of 3% of assets or more could result from a merger in which no rollover relief is available.

In the meantime, trustees have no alternative but to proceed with the implementation of the changes required by the four elements of reform and incur considerable costs in doing so. In other words, the current lack of roll-over relief is not only severely hindering the rationalisation of superannuation funds, it is already resulting in trustees of funds which are keen to merge incurring significant costs in coping with the various areas of superannuation reform.

> *Recommendation:*
>
> *The Government should urgently announce the provision of rollover relief for merging superannuation funds including the terms of qualifying for such relief.*

MODERN AWARDS

Virtually all modern awards specify that default SG contributions must be made to one of a number of funds specified in that Award. This is anti-competitive and unfairly protects the relatively small number of funds that have been able to arrange for nomination in Awards.

Whilst the Government has announced that only funds which have a MySuper option will be able to be nominated in future, the Modern Award arrangements will remain anti-competitive.

Once nominated in an Award, there appears to be no system in place to monitor the continued appropriateness of such funds or their performance. As such, the Modern Award system does not provide any real safeguard that nominated funds remain appropriate.

On the other hand, all MySuper products will need to satisfy numerous legislative requirements and will be subject to ongoing monitoring. This in itself will provide appropriate protection for employees and hence it should be possible for an employer to make SG contributions to **any** MySuper product.

We note that the Government has indicated that it will refer this issue to the Productivity Commission. We understand that this has not yet occurred. This is a critical issue, particularly for funds that are not listed under Modern Awards. If there is no possibility of becoming nominated, why should they bother to establish a MySuper product?

Recommendation:

The Government should urgently announce that it will move to require Modern Awards to enable employers to make default contributions to any MySuper product.