Chapter 3

The tailoring exemption for large employers and the limits on tailoring within an organisation

3.1 This chapter looks at two issues relating to who can—and who should—offer what types of products under the proposed MySuper legislation:

- The first issue is the provision in the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 allowing large employers to tailor their MySuper products. Only employers with 500 or more members of a fund are considered 'large employers' and eligible to apply to the Australian Prudential Regulation Authority (APRA) for authorisation of a tailored MySuper product.[1]
- The second issue relates to some witnesses' concerns that in the context of large employers being able to offer tailored MySuper products, there is not provision to further tailor MySuper products to the diverse needs of an organisation's workforce.

The tailoring exemption for large employers—proposed section 29TB

3.2 The following discussion examines stakeholders' arguments relating to proposed section 29TB of the Core Provisions Bill 2011. The section allows for large employers to offer a tailored MySuper product 'where it is viable to offer a distinct product to suit the particular needs of the workplace. Proposed subsection 29TB(2) defines a 'large employer' as one in which there are 500 or more members of the fund who are employees of the employer or its associates.[2]

Submitters' views

3.3 Several submitters expressed concern with the 500 fund member threshold. Some witnesses advocated removing the threshold altogether. Their argument is that tailoring should be based on commercial viability of the MySuper product, not an arbitrarily prescribed limit. Others proposed keeping the 500 threshold but amending the basis for passing this number. The effect of these proposals is to enable more employers to use a tailored MySuper product.

The Corporate Superannuation Specialist Alliance (CSSA) argued that tailoring of MySuper funds should be allowed for all employers. It noted that in the current

---

1 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.14.

2 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.14.

superannuation environment, there is tailoring of superannuation plans at any level that is commercially viable. The CSSA argued that in terms of the proposed threshold, a 50 member fund of executives could conceivable have greater assets than a 500 member fund made up of blue collar workers. On this basis, the Alliance reasoned that if a threshold is to be imposed, it should be based on employers who contribute on behalf of greater than 50 members.[3] The Association of Financial Advisers also proposed a limit of 50 employees.[4]

3.4 The Australian Institute of Superannuation Trustees (AIST) argued that the proposed threshold is 'imprecise and complex'. It noted that superannuation guarantee payments made by individual employers can vary significantly and there is no industry-wide definition on what constitute regular contributions or temporary cessation of contributions. The AIST suggested that the solution could be:

> ...an arbitrary requirement, such as 500 members for whom an SG contribution has been received from the employer in the past 12 months, and who have not terminated their employment with the employer.[5]

3.5 Similarly, the Financial Services Council (FSC) told the committee that while it supports the 500 threshold, the measurement should be the number of employees rather than the number of fund members.[6] It drew the committee's attention to a discrepancy between the September 2011 Stronger Super information pack, which referred to flexibility for employers with more than 500 employees, and the provisions in the bill, which specifies a number of fund members.[7] The FSC recommended that the final wording of the legislation should state that the hurdle for a tailored plan will be based on employees for which superannuation guarantee contributions are payable. The FSC suggested amending proposed subsection 29TB(2) to define clearly not only an employee threshold but also the time at which this threshold should be met:[8]

> (2) An employer is a large employer in relation to a regulated superannuation fund:
>
> (a) where the employer is the only standard employer-sponsor in relation to the class of beneficial interest referred to in subsection (1), the employer has at least 500 employees at the time a beneficial interest in that class is first issued and at the end of each annual reporting period and where there is more than one standard employer in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that

3 Corporate Super Specialist Alliance, *Submission 2*, p. 4.

4 Association of Financial Advisers, *Submission 15*, p. 3.

5 Australian Institute of Superannuation Trustees, *Submission 9*, p. 11.

6 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, Proof *Committee Hansard*, 2 March 2012, p. 8.

7 Financial Services Council, *Submission 3*, p. 10.

8 This issue of the time at which the threshold must be met is neglected in section 29TB of the bill. It is discussed in paragraph 2.11 and in recommendation 2.1.

> employer and each other standard employer is 500 employees or can reasonably be expected to grow to 500 employees during the reporting period; or
>
> (b) where there is more than one standard employer-sponsor in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that employer and each other standard employer sponsor totals at least 500 employees at the time a beneficial interest in that class is first issued and at the end of each annual reporting period and where there is more than one standard employer in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that employer and each other standard employer is 500 employees or can reasonably be expected to grow to 500 employees during the reporting period;
>
> (c) A person is not counted as an employee for the purposes of subsection (2) if the person's salary or wages are not to be taken into account for the purpose of making a calculation under section 19 of the Superannuation (Guarantee) Administration Act 1992.[9]

3.6 Mercer argued in its submission that the large employer test proposed in the bill is 'too complex'. It explained that 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.[10] 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.

3.7 Mercer also drew the committee's attention to the government's September 2011 announcement, which noted that the test would be based on the number of employees. It recommended amending the 29TB threshold so that it is based on either the number of employees of the large employer and its associates or the number of members in the employer's plan.[11] Mr Partridge of Mercer told the committee: 'we could live with either of those definitions as long as it is something that is simple and easily measurable by the employer if it was number of employees of the fund if it was number of fund members.'[12]

3.8 The Association of Superannuation Funds of Australia (ASFA) argued that if a numerical measure is to be applied, it should be aligned with the prescribed class in regulation 3.01 of the *Superannuation Industry (Supervision) Regulations 1994*. This

---

9 Financial Services Council, *Submission 3*, p. 11; See also Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 2 March 2012, p. 4.

10 Mercer, *Submission 13*, p. 27.

11 Mercer, *Submission 13*, p. 28.

12 Mr Stephen Partridge, Product Leader, Outsourcing, *Proof Committee Hansard*, 2 March 2012, p. 40.

is the class of members which non public offer funds are allowed to have without having to become a public offer fund. It includes former employees, or relatives and dependants of employees and former employees.[13]

Support for the large employer exemption

3.9 Not all submitters proposed removing or substantively amending the large employer provision in proposed section 29TB. Colonial First State (CFS), for example, noted that the provision is 'welcome'.[14] It explained that the large employer exemption was originally not part of the MySuper proposals but was introduced during the consultation process in 2011 to allow some flexibility in designing an appropriate plan for employees.

3.10 In its submission to the inquiry, the Australian Chamber of Commerce and Industry (ACCI) also noted the historical context in support of the large employer exemption. It noted that the Stronger Super information pack released on 21 September 2011 accepted the principle of one MySuper product per registered superannuation entity (RSE). However, following consultation, the government decided to allow employers to negotiate an administration fee discounted from the standard fee and the option for large employers (those employing more than 500 employees) to have a company-specific tailored MySuper product. ACCI stated: 'these exceptions are supported and properly build on the current situation'.[15]

APRA's view on the large employer exemption in section 29TB

3.11 In evidence to the committee, APRA noted that '[w]henever you have a numerical test of any sort, there is always going to be an issue about what happens when you fall below it'.[16] It recognised that without the numerical threshold in proposed section 29TB of the Bill, APRA would have greater administrative flexibility.

3.12 APRA told the committee that in interpreting the 500 member threshold test, the onus must be on the trustee to satisfy APRA that they will stay above the limit or 'do something' once they fall below. It explained that APRA would require a more demanding plan from trustees with employee fund members around the threshold level.[17]

---

13 Association of Superannuation Funds of Australia, *Submission 12*, p. 5.

14 Colonial First State, *Submission 10*, p. 3.

15 Australian Chamber of Commerce and Industry, *Submission 6*, p. 15.

16 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 59.

17 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 59.

3.13 Under further questioning, APRA recognised that as the bill is written, it would not have the discretion to allow the number of members in a tailored MySuper fund to fall below 500. It told the committee that in its opinion, trustees should not be seeking authorisation under proposed section 29TB with a bare 500 fund members.[18]

Treasury's view on falling below the threshold

3.14 Treasury was asked for its view on whether APRA could revoke a MySuper product where an organisation offering the product falls below the 500 fund member threshold. Treasury responded:

> That is a possible outcome but we have made provisions in this bill that allow for APRA to extend where they have cancelled authority of a particular MySuper product. They can for all intents and purposes extend the authorisation as if the cancellation had never happened. That is in provision 29UB. In the circumstance where APRA felt that an employer had short notice then they have the flexibility to make the cancellation but ensure that employers are not in breach of their SG requirements.[19]

Committee view

3.15 The committee is concerned that the proposed threshold test enabling large employers to tailor a MySuper product may have adverse and unintended consequences. A trustee might reasonably apply for and seek authorisation from APRA with the number of fund members in excess of the 500 threshold, but, for unforseen reasons, these numbers may in time fall below the threshold. Consequently, as the bill is written, it appears that APRA would eventually have to cancel the authority to offer the tailored MySuper product which would cause considerable disruption to both the employer and fund members. Even if the product retained marginally more members than the 500 threshold, it seems an unnecessary burden for APRA to monitor these levels and seek urgent plans from the trustee.

3.16 The committee is doubtful that proposed section 29UB, by itself, offers an adequate resolution to this problem. A far better approach is to amend section 29TB to insert timeframes upon which the threshold must be met. Such an arrangement was well set out in the FSC's submission (paragraph 3.5, above). The effect would not be lower the threshold, as some proposals would have, but to ensure that the intent of proposed section 29TB can be upheld in practice. It would also be less onerous on APRA. Instead of constantly monitoring fund member numbers against the threshold, APRA would only be required to check at specified points in time.

---

18 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 60.

19 Mr Adam Hawkins, Policy Analyst, Financial System Division, Treasury, *Proof Committee Hansard*, p. 67.

Recommendation 1

3.17 The committee recommends that proposed section 29TB of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 be redrafted to clarify that the large employer requirement of 500 or more members of the fund needs to be satisfied upon authorisation of the MySuper product and at the end of each annual reporting period.

3.18 The committee believes that in addition to proposed section 29UB, the Core Provisions Bill should insert a clause which provides a trustee whose fund member numbers have fallen below the threshold upon APRA's annual check, a grace period of up to six months. During this time, APRA should monitor the trustee's progress in ensuring the threshold is met. Where the threshold has not been met after the six month period, APRA should exercise its judgment under proposed sections 29U and 29UB.

Recommendation 2

3.19 The committee recommends that a clause be inserted into proposed subsection 29U(2) of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 allowing APRA to grant a grace period of up to six months for large employers whose member fund numbers have fallen below the 500 member threshold as part of the annual check. In exercising this judgment, APRA should be satisfied that the employer is likely to comply with the threshold in the near future.

3.20 The committee does not believe the fund member threshold requirement should be amended. This is a clear and simple measure on which to base proposed section 29TB. Conversely, a measure based on employees would require simple rules covering the counting of casuals, seasonal workers and part-time employees. The committee does not think this is feasible. Moreover, the committee believes a measure based on the number of employees is likely to fluctuate, particularly in workforces with a large number of casual or seasonal workers.

'Flipping'

3.21 Another issue raised in relation to the provisions in proposed section 29TB of the Core Provisions Bill was the issue of 'flipping'. Flipping refers to a member being automatically moved from one division of a superannuation fund to another on cessation by the member of the particular employment to which the original fund division related without their authority into a higher price fee product.[20]

3.22 The AIST told the committee that 'flipping exists extensively within the industry at the moment'. It is concerned that members who leave a large employer and move to work with another large employer may be transferred from a MySuper product with a discount fee to a MySuper product with no discount fee. It added: for those people who are disengaged with their super, 'they might not become aware of that'.[21]

3.23 The AIST criticised the Bill's allowance of flipping, noting that it does not provide a prohibition and in some instances, may actually require it. The AIST highlighted paragraph 3.50 of the Explanatory Memorandum which requires the terminating employee of an employer using a tailored MySuper to be transferred to another MySuper product within the same fund or to an eligible rollover fund (ERF). It even claimed that in the absence of amendments to the Bill or subsequent legislation to prohibit the practice of flipping, the Act arising from this Bill will provide legislative support for the practice of "flipping" individuals into more expensive products.'[22]

3.24 The AIST's recommended solution is to incorporate the government's proposed actions on account consolidation and the reduction in unnecessary account proliferation. It proposed that employees leaving employment with a large employer who have not elected to transfer to another superannuation fund may maintain their membership in the large employer-sponsor MySuper product. However, they will not receive contributions from other employers into the account. Where the account consolidation process does not result in the account being transferred in to the

---

20 Cooper et al, Super System Review: Final Report; Part one—overview and recommendations, p. 112. In evidence to the committee, Mr Matthew Linden, Chief Policy Adviser of the ISN gave a more malicious definition:

> This is where a provider will offer a superficially low-cost product, often at a loss, with the intention of recouping the loss and additional profits when an employee leaves the employer and is transferred to another, substantially higher-priced, product—in this context, a higher-priced MySuper product.

Proof Committee Hansard, 2 March 2012, p. 10.

21 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 47.

22 Australian Institute of Superannuation Trustees, *Submission 9*, p. 8; Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 47.

member's active superannuation account, the fund may transfer the account to an eligible rollover fund (ERF).[23]

Committee view

3.25 The committee acknowledges the AIST's concerns relating to the potential of flipping under the Core Provisions Bill. It also notes the government's response to the Super System Review that it will 'define the circumstances where a member can be involuntarily moved out of a MySuper product, and will consult with relevant stakeholders on implementation details, including to address the practice of 'flipping' members to higher fee default products upon cessation of employment with a particular employer'.[24] The committee believes it is important that the government carefully examine the AIST's concerns that proposed section 29B of the Core Provisions Bill leaves loopholes for flipping to occur.

Tailoring MySuper products within the workforce of a large employer

3.26 The committee also received evidence that within large organisations, it is important to have the flexibility to offer tailored products to differt parts of a diverse workforce. Several witnesses made the point that in terms of a tailored large employer MySuper product, one size will not fit all.

3.27 Mercer, notably, expressed concern that it does not appear that tailored MySuper products can restrict membership to 'particular classes of person'. It gave the example of an insurance strategy that may be appropriate for the employer's salaried or professional workforce, but might not be appropriate for other employees. Mercer raised the prospect that if trustees are required to set strategies that are appropriate for all groups of employees, 'it may end up with an "average" strategy that is sub-optimal for all members'.[25]

3.28 In evidence to the committee, senior partner at Mercer Dr David Knox gave the example of casual employees who are offered 'death only' cover because insurers are not willing to offer disability cover. He added:

> ...what happens with MySuper? You might actually have a reduction in the cover offered to the white-collar workers because the disability cover is not available to another group in the workforce. At the moment you say, 'Here's one group in the workforce and here's another group and we'll offer them death only, disability cover and income protection because of their different categories or types of work.' If they are all bundled into the single MySuper

23 Australian Institute of Superannuation Trustees, *Submission 9*, p. 8;

24 Australian Government, *Stronger Super*, p. 20, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf (accessed 5 March 2012).

25 Mercer, *Submission 13*, p. 5.

> because they all work for the same employer, there may well be loss of insurance.[26]

3.29 Mercer highlighted the government's September 2011 announcement that it is important there is more flexibility to allow different levels of insurance for different employer groups. Consistent with this statement, it recommended an exemption to the 'same option, benefits and facilities' requirement of proposed paragraph 29TC(1)(b) of the Core Provisions Bill to enable different levels of insurance benefits.[27]

Committee view

3.30 The committee acknowledges the concerns of some organisations that the MySuper product cannot be tailored to different parts of an organisation's workforce. However, it believes that the Bill as currently drafted is consistent with the key policy objectives underpinning the MySuper reforms: 'a simple, cost-effective default product...limited to a common set of features to make it easier for members, employers and other stakeholders to compare performance across MySuper products'.[28] These features will encourage competition among MySuper product providers to lower fees.

26 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 40.

27 Mercer, *Submission 13*, pp 5–6.

28 The Hon. Bill Shorten, MP, Assistant Treasurer, Second Reading Speech, *House of Representatives Hansard*, 3 November 2011, p. 12,683.