Parliamentary Joint Committee on Corporations and Financial Services

Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

March 2012

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

Table of Contents

Abbreviations

ACCI	Australian Chamber of Commerce and Industry
AFA	Association of Financial Advisers
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
BT	BT Financial Group
CFA	Consumers' Federation of Australia
CFS	Colonial First State
CSSA	Corporate Superannuation Specialist Alliance
EM	Explanatory Memorandum
ERF	Eligible rollover fund
FPA	Financial Planning Association
FSC	Financial Services Council
ISN	Industry Super Network
RSE	Registrable Superannuation Entity
TPD	Total and permanent disability

Recommendations

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.

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.

Recommendation 3

5.40 The committee recommends that the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 be passed.

Chapter 1

Introduction

Referral of the Bills

1.1 On 3 November 2011, the House of Representatives referred the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 (the MySuper Core Provisions Bill) to the committee for inquiry and report. The committee initially resolved to report by 21 March 2012. The reporting date was subsequently brought forward to 13 March 2012. With changes to the membership of the committee and the appointment of a new Chair, the tabling date was extended to Monday 19 March 2012.

1.2 On 29 February 2012, the Senate referred the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (the Trustee Obligations and Prudential Standards Bill) to the committee for inquiry and report by 13 March 2012. As with the MySuper Core Provisions Bill, the tabling date was extended to Monday 19 March 2012.

Conduct of inquiry

1.3 The committee advertised the inquiry into the MySuper Core Provisions Bill in *The Australian* newspaper. Details of the inquiry, the MySuper Core Provisions Bill and associated documents were also made available on the committee's website. The committee received 18 submissions regarding the MySuper Core Provisions Bill, as listed in Appendix 1. A public hearing was held on 2 March 2012, at Parliament House, Canberra. A list of witnesses who gave evidence at the hearing is at Appendix 2, as is a list of answers to questions on notice.

1.4 The committee notes that the referral of the Trustee Obligations and Prudential Standards Bill allocated ten working days for the committee to conduct the inquiry and report. Consequently, the committee was unable to dedicate a hearing to this Bill. Witnesses at the hearing on 2 March were, however, invited to comment on the provisions in the Bill. Details of the inquiry into the Trustee Obligations and Prudential Standards Bill were placed on the committee's website. The committee received 11 submissions regarding the Trustee Obligations and Prudential Standards Bill, as listed in Appendix 1.

Committee view

1.5 The limited period of time given for the inquiry into the Trustee Obligations and Prudential Standards Bill necessarily restricted the evidence presented. Accordingly, comments in relation to the Trustee Obligations and Prudential Standards Bill focus on broad issues.

Acknowledgements

1.6 The committee thanks the organisations and individuals who made submissions to the inquiry, and those who gave evidence at the public hearing.

1.7 The committee particularly notes the response received from the Consumers' Federation of Australia (the CFA) to the committee's invitation to participate in the MySuper inquiry. Through advocating for the interests of consumers, the CFA has significantly contributed to the development of policies that promote the confident and informed participation of consumers within Australia's financial markets. The committee encourages the CFA to continue contributing to parliamentary inquiries, while drawing to the Government's attention the need to ensure that consumer advocacy and legal assistance agencies are appropriately resourced.

Notes on references

1.8 References to submissions are to individual submissions as received by the committee, not to a bound volume. References to the *Committee Hansard* are to the proof *Hansard* transcripts available on the parliamentary website. Please note that page numbers may vary between the proof and official *Hansard*.

Background

1.9 The MySuper Core Provisions Bill and the Trustee Obligations and Prudential Standards Bill are part of the Australian Government's Stronger Super reform package announced in December 2010. The reforms stem from the 2010 Super System Review, which assessed 'the governance, efficiency, structure and operation of Australia's superannuation system, including both compulsory and voluntary aspects'.[1] Commissioned by the government in May 2009[2], the review panel, lead by Mr Jeremy Cooper, was tasked with developing options to improve the regulation of the superannuation system, to promote the best interests of members and maximise retirement incomes for Australians while reducing business costs.[3] On 30 June 2010, the panel presented 177 recommendations intended to 'enhance Australia's world class

1 Australian Government, *Terms of reference – Super System Review*, http://www.supersystemreview.gov.au/content/terms_of_reference.aspx (accessed 27 February 2012).

2 Senator the Hon Nick Sherry, Former Minister for Superannuation and Corporate Law, 'Expert Panel and Terms of Reference for Review into the Governance, Efficiency and Structure and Operation of Australia's Superannuation System', Media release 066, 29 May 2009.

3 Australian Government, *Terms of reference – Super System Review*, http://www.supersystemreview.gov.au/content/terms_of_reference.aspx (accessed 27 February 2012).

retirement savings system'.[4] Of these, the government accepted, or supported in principle, 139.[5]

1.10 Broadly, the Stronger Super reforms can be divided into four categories:

- *Governance, integrity and other regulatory settings*: consideration of options to strengthen trustee obligations to manage assets prudentially and in the best interests of all members.[6]
- *Self-managed superannuation funds*: reforms to the sector to ensure that there is appropriate regulatory oversight, that fund investments are consistent with the purpose of superannuation and to curb fraudulent activity.[7]
- *SuperStream*: measures to enhance the 'back office' of superannuation.[8]
- *MySuper*: a reconfiguration of the current superannuation framework to replace existing default superannuation products with 'a new low cost and simple superannuation product'.[9]

MySuper reforms

1.11 The MySuper Core Provisions Bill would amend the Superannuation Guarantee (Administration) Act 1992 and the Superannuation Industry (Supervision) Act 1993 to introduce a new regulatory framework for default superannuation products. The existing framework derives from recommendations of the 1997 Financial System inquiry (the Wallis report), which concluded that 'choice should be maximised in superannuation'.[10] As summarised by the Australian Government over a decade after the report's release, the Wallis report 'argued that superannuation members could generally be treated as rational and informed investors able to make their own decisions about their superannuation'.[11] The Wallis report accordingly recommended:

> Superannuation fund members should have greater choice of fund. Employees should be provided with choice of fund, subject to any constraints necessary to address concerns about administrative costs and fund liquidity. Where superannuation benefits vest in a member, that

4 Jeremy Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages*, 30 June 2010, p. iii.

5 Australian Government, *Stronger Super – Government response*, 16 December 2010, p. 3.

6 Australian Government, *Stronger Super – Government response*, pp 13 – 14.

7 Australian Government, *Stronger Super – Government response*, p. 11.

8 Australian Government, *Stronger Super – Government response*, p. 8.

9 Australian Government, *Stronger Super – Government response*, p. 5.

10 Stan Wallis, *Financial System Inquiry Report*, March 1997, *Overview and recommendations*, p. 27.

11 Australian Government, *Stronger Super*, 2010, p. 3.

> member should have the right to transfer the amounts to any complying fund. Where a member chooses to exercise that right, payments should be transferred to the chosen fund as soon as practicable, subject to controls necessary to maintain orderly management for the benefit of all fund members.[12]

1.12 However, the assumptions underlying the Wallis report, and therefore Australia's current superannuation system, can be challenged by the findings of the Super System Review. The review cast doubt on the theory that superannuation members are 'fully informed' investors and capable of independently navigating the superannuation system. Contrary to the predictions of the Wallis report, the review panel concluded that there are low levels of financial literacy regarding the superannuation sector[13] and disengagement with superannuation investments by the majority of Australians.[14] The review further found that members who do not actively choose their superannuation product or seek superannuation-related services 'are not adequately protected and can find themselves paying for services that they do not need or request and, on some occasions, that they do not receive'.[15]

1.13 The review compartmentalised Australian superannuation members into three categories, namely, members that actively choose the funds in which to allocated their superannuation payments, members that do not choose but are referred to a default fund appointed under the terms of their employment contract, and members who self-manage, that is, who self-administer, their personal superannuation fund.[16] The review therefore concluded that 'a compulsory system needs to be able to cater for these different degrees of engagement'.[17]

1.14 To appropriately recognise the varying degrees of member engagement, the panel recommended that the architecture of the superannuation industry be re-cast, moving from an industry-orientated to a member-orientated perspective.[18] As Figure 1.1 depicts, the MySuper scheme is a core feature of a 'choice architecture' approach to superannuation regulation.

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12 Recommendation 88, Wallis, *Financial System Inquiry Report*, p. 31.

13 Cooper et al, *Super System Review: Final Report: Part one – Overview and recommendations*, p. 9.

14 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, p. 7.

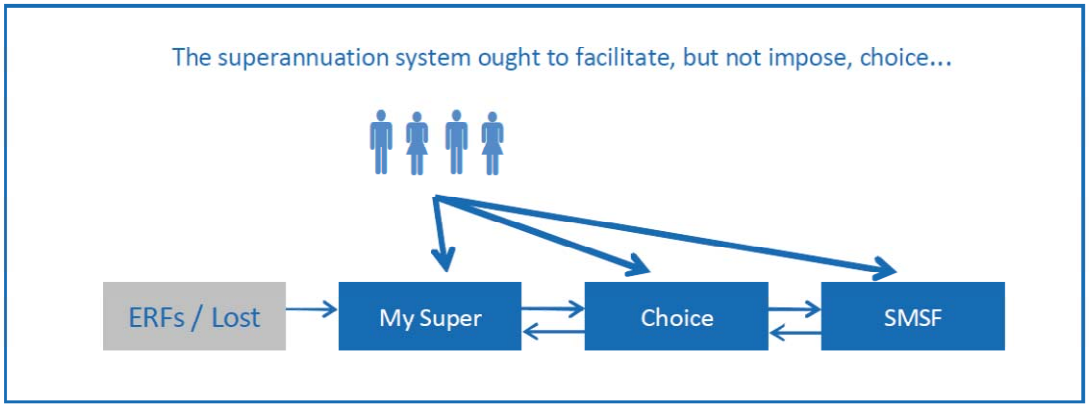
15 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, p. 5.

16 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one* p. 7.

17 Cooper et al, *Super System Review: Final Report: Part one – Overview and recommendations*, p. 9.

18 Cooper et al, *Super System Review: Final Report: Part one – Overview and recommendations*, p. 10.

Figure 1.1: 'Choice architecture' model[19]



1.15 As the review panel envisioned, the MySuper scheme would have the following key elements.[20]

- Members of MySuper funds 'would defer to the trustee generally in relation to all aspects of their superannuation'.
- Only MySuper products could be listed as the default fund for the purposes of awards and other industrial agreements. Employers would be restricted to nominating MySuper products as the default superannuation vehicle.
- All sectors of the superannuation industry could offer a MySuper product, providing certain pre-conditions are met. Pre-conditions would include:
  - MySuper trustees to be bound by 'high level, principles-based duties';
  - Trustees must obtain a licence from the Australian Prudential Regulation Authority (APRA) prior to offering MySuper products;
  - Trustees must develop and implement 'a single, diversified investment strategy for the MySuper product';
  - No direct or indirect cross–substitution of costs between MySuper products and choice products; and
  - Explicit fee schedules and discounts, which would not be subject to negotiation or rebates.

Governance, integrity and other regulatory settings—trustee duties

1.16 The review panel also recommended an overhaul of the trustee governance framework. The panel concluded that the framework is susceptible to areas of potentially significant weakness:

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19 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, p. 6.

20 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, pp 10 – 35.

> [t]rustee governance structures have not kept up with developments in the industry. There have also been difficulties for trustees and their trustee-directors in understanding what is expected of them and, as the industry consolidates, conflicts of interest and conflicts of duty arise regularly.[21]

1.17 Accordingly, the panel submitted that '[t]urning the governance spotlight on trustees' own operations is...critical to the long-term sustainability of the superannuation system'.[22] The panel therefore recommended changes to the structure of trustee boards,[23] that the trustee obligations currently found across various legislative instruments be consolidated in the Superannuation Industry (Supervision) Act,[24] and that these obligations 'demand a higher level of governance in respect of super fund members than the level required for shareholders in major listed companies'.[25]

1.18 In framing the recommendations, the panel noted the operation of the existing trustee duties under paragraph 52(2)(c) of the Superannuation Industry (Supervision) Act. Paragraph 52(2)(c) requires trustees to perform and exercise their powers and duties in the best interests of beneficiaries, that is, in the best interests of fund members. The panel agreed with concerns that there is 'considerable uncertainty' about the conduct expected of trustees under this best interest test, and therefore concluded that the Act:

> ...would benefit from a clearer articulation of what appears to be two important elements of that duty: the requirement that trustees place member interests ahead of the interests of all others, and the requirement that trustees should actively endeavour to achieve the best outcome for members and not to be content to accept merely an adequate, reasonable or peer-comparable outcome.[26]

1.19 The panel therefore recommended that trustee duties should include:

- to act solely for the benefit of members, including and in particular:

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21 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter two*, p. 43.

22 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter two*, p. 44.

23 Cooper et al, *Super System Review: Final Report: Part one – Overview and recommendations*, p. 12.

24 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter two*, p. 47.

25 Cooper et al, *Super System Review: Final Report: Part one – Overview and recommendations*, p. 12.

26 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter two*, p. 47.

  - to avoid putting themselves in a position where their interests conflict with members' interests;
  - to give priority to the duty to members when that duty conflicts with the trustee-director's duty to the trustee company, its shareholders or any other person;
  - to avoid putting themselves in a position where their duty to any other person (such as another super fund or a service provider) conflicts with their duty to members;
  - to avoid putting themselves in a position where their duty to any other person (other than members) conflicts with their duty to the trustee company;
  - not to obtain any unauthorised benefit from the position of trustee or trustee-director; and
  - not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;
- to act honestly;
- to exercise independent judgment;
- to exercise the degree of care, skill and diligence as an ordinary prudent person of business would exercise in dealing with the property of another for whom the person felt morally bound to provide; and
- to have specific regard to (among other matters) the likely long term consequences of any decision, including the impact of the decision on the community and the environment and on the entity's reputation for high standards of conduct.[27]

1.20 The review panel also recommended that in addition to these strengthened obligations, additional 'high-level, principles-based' duties would apply to trustees of MySuper products. Accordingly, the panel recommended that the Superannuation Industry (Supervision) Act be amended to require MySuper trustees to:

- formulate and give effect to a single, diversified investment strategy at an overall cost aimed at optimising fund members' financial best interests, as reflected in the net investment return over the long term; and

27 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter two*, Recommendation 2.1; p. 48.

- actively examine and conclude whether, on an annual basis, its MySuper product has sufficient scale on its own (with respect to both assets and number of members) to continue providing optimal benefits to members.[28]

1.21 As envisioned by the review panel, fulfilling the obligation regarding sufficient scale would require a trustee to 'demonstrate to APRA that the product had sufficient scale or, if a new entrant, there was a creditable path to building the necessary scale'. Furthermore, 'on an annual basis, a trustee would have to ask itself and determine whether it would continue to have sufficient scale...to deliver optimal benefits to members'.[29]

Government response

1.22 The government supported, or supported in principle, all bar four of the 28 recommendations relating to MySuper. Notably, the government did not support the recommendation to prevent cross-substitution of costs between MySuper and choice products. Rather, the government responded that 'trustees will be required to make a fair and reasonable allocation of costs between MySuper and other products'.[30] The Explanatory Memorandum to the MySuper Core Provisions Bill outlines the government's vision for the MySuper model:

> First, MySuper will lift the standards that apply to default superannuation funds. RSE (registrable superannuation entity) licensees will have a heightened obligation to act in the best financial interests of members that accept the default option. RSE licensees will also need to actively consider whether their MySuper product has access to sufficient scale to provide net returns that are in the best financial interests of members...Importantly, MySuper products will not allow commissions to be paid from the product.
>
> Second, MySuper will simplify and standardise the default superannuation product available to Australians...
>
> MySuper products will also have common characteristics meaning that they will be able to be compared based on a few key differences–cost, investment performance and the level of insurance coverage...[31]

1.23 Specifically, in response to the Super System Review the government announced that the MySuper scheme will incorporate the following features:

- a single investment strategy per MySuper product;

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28 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, Recommendation 1.6, p. 14.

29 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, p. 13.

30 Australian Government, *Stronger Super*, p. 17.

31 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraphs 1.9–1.11.

- funds may provide more than one brand of MySuper product, subject to APRA approval;
- trustees may use a lifecycle investment option as the single investment strategy for the MySuper product. (Lifecycle investment allows the trustee to automatically move members to other investment options based on the members' age, and to stream gains and losses between members based on members' age);
- subject to trustees being able to obtain opt-out cover at a reasonable cost, members may opt-out of life and total and permanent disability (TPD) insurance within 90 days of joining the fund. Members may increase or decrease their insurance cover; and
- trustees will not be required to hold a specific MySuper licence but will be required to apply to APRA for authorisation for each MySuper product offered.[32]

1.24 The government also announced that a standard set of available fees will apply across all MySuper products. It is proposed that the available fees for MySuper products will be limited to:

- administration fees, which may, at the trustee's discretion, be reduced for employers with over 500 employees;
- investment fees, including performance-based fees subject to limitations;
- buy and sell spreads limited to cost recovery;
- exit fees limited to cost recovery;
- switching fees limited to cost recovery; and
- fees for certain-member specific costs, such as account splitting pursuant to orders under the *Family Law Act 1975*.[33]

1.25 The government also agreed to strengthen trustee obligations, announcing that the MySuper reforms would include:

- new duties for trustees, including a specific duty to deliver value for money as measured by long-term net returns, and to actively consider whether the fund has sufficient scale; and
- a single diversified investment strategy, suitable for the vast majority of members who are in the default option.[34]

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32 The Treasury, *Stronger Super – 2. MySuper*, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm (accessed 28 February 2012).

33 The Treasury, *Stronger Super – 2. MySuper*, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm (accessed 28 February 2012).

1.26 While accepting the need to strengthen the obligations on trustees, the government's proposed framework for corporate governance differed from that proposed by the review panel. Specially, the government announced that the changes to trustee obligations will include:

- introducing a duty for trustees and directors to give priority to the interests of fund members when that duty conflicts with other duties;
- strengthening the requirements for individual directors in relation to managing conflicts of interest;
- increasing the standard of care, skill and diligence required of trustees and directors of corporate trustees to that of a prudent person of business;
- clarifying the duties applying to individual directors of corporate trustees to act honestly and to exercise independent judgment; and
- introducing a requirement for trustees to devise and implement an insurance strategy and impose a statutory duty on trustees to manage insurance with the sole aim of benefiting members.[35]

Support for the introduction of MySuper

1.27 As the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, stated the MySuper Core Provisions Bill is part of broader reforms intended to modernise the superannuation system to be responsive to member engagement and therefore reduce unnecessary superannuation fees:

> ...around 60 per cent of Australians do not make active choices in relation to their superannuation.
>
> And this government believes that Australians should not be charged for valet parking when they are catching the train...
>
> Having created an industry which flourishes on the back of compulsory savings mandated by legislation, it is fair that this industry, which benefits so much from the compulsory saving system in Australia, contributes to higher retirement savings through greater efficiency and lower fees.
>
> MySuper will provide a simple, cost-effective default product that all Australians can rely upon.[36]

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34 The Treasury, *Stronger Super – 5. Governance*, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm (accessed 4 March 2012).

35 The Treasury, *Stronger Super – 5. Governance*, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm (accessed 4 March 2012).

36 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 3 November 2011, pp 12683–12684.

1.28 Submitters were generally supportive of the introduction of simple, comparable and cost-effective default superannuation products, as envisioned by the MySuper reforms. The findings of the Super System Review regarding member disengagement were generally acknowledged in evidence before the committee.[37] The views of the Industry Super Network (ISN) were indicative of the support for the review's findings regarding members' active participation in their superannuation investments. The ISN argued that:

> ...committee members would be well served revisiting the Cooper review's key observation that superannuation, regrettably, does not operate like a competitive market where consumers make informed and active decisions to place their savings with the best performing funds... Without active engaged consumers there is little incentive for providers to strive to offer the best possible product delivering the best possible returns.[38]

1.29 Accordingly, the need to increase consumer protection through the introduction of cost-effective, simple default superannuation products was generally acknowledged. The Australian Chamber of Commerce and Industry (ACCI) argued that the reforms are required to give appropriate recognition to consumer behaviour:

> ACCI supports the MySuper goals of reducing account costs, making costs more transparent, improving the basis for inter-fund comparison, and providing improved member protection. ACCI recognises that many employees are not well positioned to be actively engaged in making investment decisions, and an appropriate superannuation system must recognise this.[39]

1.30 The Financial Services Council considered that the reforms will enhance transparency and consumer protection within Australia's superannuation sector:

> The MySuper captured particularly in the first bill puts, if you like, a safety net into the law—a set of parameters around what a default superannuation product should look like. For the first time, it effectively says that when you have a compulsory savings system in this country we believe there ought to be some protections or some provisions around where those compulsory moneys flow.[40]

1.31 Similarly, ISN strongly advocated regulatory reform, arguing that 'it is entirely appropriate to reassess the regulatory framework, particularly for

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37 See, for example, Australian Chamber of Commerce and Industry, *Submission 6*, pp 7–9; Mr Stephen Partridge, Product Leader, Outsourcing, Mercer (Australia) Pty Ltd, *Proof Committee Hansard*, 2 March 2012, pp 39–40.

38 Mr Matthew Linden, Chief Policy Advisor, Industry Super Network, *Proof Committee Hansard*, 2 March 2012, p. 9.

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

40 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 2 March 2012, p. 3.

superannuation providers who wish to offer default funds in workplaces where members do not exercise a choice of fund'.[41] The Financial Planning Association of Australia (FPA) recorded its agreement with the policy intent that is given effect to by the MySuper legislation and noted that 'the FPA supports the intention to have "comparable" characteristics based on cost, investment performance and the level of insurance coverage'.[42] Similarly, BT Financial Group also approved the consumer-orientated policy objectives underlying the MySuper scheme,[43] while Colonial First State (CFS) noted that the 'CFS supports the Government's Stronger Super reforms'.[44]

1.32 In contrast, the Association of Financial Advisors submitted that the proposed re-design of Australia's superannuation system may entail significant risk:

> Philosophically, the AFA disagrees with the government designing financial services products and intervening in such a substantial way in a market that is largely effective. History suggests that intervention of this type poses a significant consequences and suboptimal outcomes.[45]

1.33 The Corporate Super Specialist Alliance posited that an outcome of the MySuper reforms will be further disengagement by members.[46] However, Mercer anticipated that engagement will remain 'fairly similar' to levels under the current superannuation scheme:

> My gut feeling is it is probably going to be fairly similar. It is important to recognise that, if you look at the default funds at the moment, many members are in the default funds but there are many younger members with smaller balances. If you look at the latest APRA statistics that only came out a day or so ago there are significant assets outside the default funds and they are predominantly with older members with the bigger balances. So it is not surprising that what happens is that young members are disengaged, the balances are small, and as they reach 40—or 50, or whatever the magic age or balance is—they get engaged...I think you will inevitably get movement to choice at some point. Will that mean that the MySupers are similar to the defaults at the moment? My hunch is that they might be a bit more or a bit less but they are probably of about the same order.[47]

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41 Mr Linden, Industry Super Network, *Proof Committee Hansard*, 2 March 2012, p. 9.

42 Financial Planning Association of Australia, *Submission 16*, p. 1.

43 BT Financial Group, *Submission 11*, p. 1.

44 Colonial First State, *Submission 10*, p. 1.

45 Association of Financial Advisors Limited, *Submission 15*, p. 3.

46 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 19.

47 Dr David Knox, Senior Partner, Mercer (Australia) Pty Ltd, *Proof Committee Hansard*, 2 March 2012, p. 45.

Committee view

1.34 The committee considers that the introduction of a cost-effective, simple and comparable default superannuation scheme is compatible with the objective of promoting a market in which consumers can confidently invest. The evidence provided to this committee, and explored in the Super System Review, points to the need for reform. A system cannot be in the best interests of its members, or facilitate informed participation, if it does not effectively respond to members' engagement with that system.

1.35 The committee approves the proposed complete modernisation of Australia's superannuation system, and commends the principles underlying the MySuper scheme. However, evidence before the inquiry highlights areas of concern with the MySuper legislation. These matters are considered in subsequent chapters of this report.

1.36 The evidence before the committee highlights the alarmingly low levels of consumer financial literacy regarding Australia's superannuation system, notwithstanding the identified limitations to the number of engagements. The committee would welcome greater efforts to improve members' understanding of an investment that is of significant financial importance. The committee may raise this matter with the Australian Securities and Investments Commission (ASIC) as part of the committee's ongoing oversight of ASIC. The committee would also be interested in advice from the Financial Literacy Board regarding the Board's activities in this area.

Report structure

1.37 The report is divided into five substantive chapters:

- chapter two provides an overview of the MySuper Core Provisions Bill and the Trustee Obligations and Prudential Standards Bill;
- chapter 3 examines the exemption for large employers to tailor MySuper products in the Core Provisions Bill;
- chapter 4 considers new trustee obligations in the Trustee Obligations bill, including the 'financial interests' and 'scale' tests; and
- chapter 5 looks at how the Australian Prudential Regulation Authority would authorise default and tailored MySuper products.

Chapter 2

Overview of the proposed legislation

2.1 This chapter provides an overview of the MySuper Core Provisions Bill (paragraphs 2.2–2.23) and the Trustee Obligations and Prudential Standards Bill (paragraphs 2.24–2.35). It also canvasses concerns raised regarding the staggered introduction of the legislation necessary to transfer Australia's superannuation system to the choice architecture model (paragraphs 2.40–2.48).

Overview of the MySuper Core Provisions Bill

2.2 The MySuper Core Provisions Bill is intended to introduce the core framework for the new superannuation regulatory paradigm. As outlined in the Explanatory Memorandum (EM), the Bill would:

- define a MySuper product;
- set out the framework for trustees to obtain APRA approval to provide a MySuper product;
- limit a regulated superannuation fund to offering only one MySuper product except in certain circumstances;
- establish the standard set of available fees;
- determine the rules regarding contribution payments and account transfers for MySuper products; and
- underpin the MySuper framework with strict liability offences.[1]

Definition of 'MySuper product'

2.3 The Bill would define a 'MySuper product' as a class of beneficial interest in a regulated superannuation fund that a registrable superannuation entity (RSE) licensee is authorised by APRA to offer as a MySuper product.[2]

APRA authorisation to classify a product as a 'MySuper product'

2.4 This circuitous definition of 'MySuper product' would be clarified by the procedures for trustees to obtain APRA approval to offer a product as a MySuper product. The MySuper Core Provisions Bill would introduce a section 29T of the

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1 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, p. 3.

2 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Item 1, clause 6.

Superannuation Guarantee (Administration) Act, which would require APRA to provide authorisation if certain conditions are met. To meet the definition of 'MySuper product', funds must be registered, have five or more members and, unless certain exceptions are met, be the only MySuper product in the fund. In addition, APRA must be satisfied that the RSE licensee:

- is likely to comply with the fee charging rules in relation to MySuper products;
- is likely to comply with the enhanced trustee obligations;
- is not likely to represent a product as a MySuper product when they are not authorised to do so; and
- is not likely to place contributions of a member that does not have a chosen product into a product that is not a MySuper product.[3]

2.5 Accordingly, the definition of 'MySuper product' encompasses not only the characteristics of the product but also the 'likely' actions of the product provider. The Bill would provide APRA 60 days to assess an application from the date of its receipt or from the date APRA receives any additional information requested.[4] This timeframe may be extended a further 60 days.[5]

2.6 In addition, where an RSE licensee is seeking to offer a MySuper product before 1 July 2013, APRA will have 120 days to process applications made before 1 July 2013. The 120 day period may be extended by an additional 60 days. The EM states that:

> [t]his period will commence on 1 July 2012 if the application is made prior to that date...Any application received by APRA after 1 July 2013 will mean that APRA does not have the extended period to make a decision but also means that the RSE licensee will not have the transitional arrangements to continue to pay contributions to that product after 1 October 2013 until a decision is made by APRA.[6]

2.7 Once granted, APRA may revoke an authorisation to offer a product as a MySuper product if the regulator 'is no longer satisfied' that the fund or the trustee will

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3 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.31.

4 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 1, proposed section 29SB.

5 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 1, proposed section 29SB.

6 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 12; Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.29.

meet the conditions required under proposed section 29T.[7] The MySuper Core Provisions Bill would recognise potential links between the regulation of the financial services industry and the superannuation regulatory framework. APRA would be required to consult the Australian Securities and Investments Commission (ASIC) 'if it believes that the cancellation will affect the RSE licensee's ability to offer one or more financial products'. However, nothing in the Bill requires ASIC to approve the proposed cancellation prior to APRA cancelling the authority. Furthermore, failure to consult ASIC does not invalidate the cancellation of an authority to offer a product as a MySuper product.[8]

2.8 Consistent with the recommendations of the Super System Review,[9] the MySuper Core Provisions Bill would also create a second stream of superannuation products. All superannuation products not meeting the definition of 'MySuper product' would be classed as 'choice products',[10] and therefore would not be subject to the MySuper requirements. The EM notes that the MySuper Core Provisions Bill would not restrict trustees from charging fees that differ from the fees disclosed in the product disclosure statement.[11]

Characteristics of a MySuper product, including contributions and account transfers

2.9 The MySuper Core Provisions Bill would require MySuper products to have the following elements:

- a single, diversified investment strategy;
- equal access to options, benefits and facilities for all members;
- processes for amounts to be attributed to members in a way that does not stream gains or losses to only some members of the MySuper product, with an exemption for lifecycle investment strategies;
- no differences in the extent of fee subsidisation of employees of a certain employer if fee subsidisation is allowed by employers;
- no limits on the source or kinds of contributions made by or on behalf of members;

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7 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 4, proposed section 29U.

8 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 4, proposed section 29UA.

9 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter one*, pp 6 – 7.

10 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Item 1, clause 4.

11 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 5.12.

- no pension benefits paid from the assets of the MySuper product; and
- a prohibition on replacing a member's interest in that MySuper product without the member's consent, other than with an interest in another MySuper product in the fund, an interest in a MySuper product in another fund and the replacement is permitted by a law of the Commonwealth, or an interest in another fund if that transfer is otherwise permitted or required by a law of the Commonwealth.[12]

Limitations on the number of MySuper products within a superannuation fund

2.10 The MySuper Core Provisions Bill would provide an exception to the general rule that a fund may provide only one MySuper product.[13] Two or more MySuper products may be offered where:

- the RSE licensee is already authorised to offer a generic MySuper product in the fund, however the proposed MySuper product satisfies either the goodwill or large employer requirements; or
- the RSE licensee is seeking to apply for authorisation of a generic MySuper product and is already authorised to offer one or more MySuper products in the fund but each of those authorised products would satisfy either of the goodwill or large employer requirements.[14]

Tailored products for large employers

2.11 Proposed section 29TB of the Bill would allow trustees to provide tailored MySuper products for large employers. An employer with 500 or more members of a superannuation fund would fall within the definition of 'large employer'.[15] The EM clarifies the parameters of the definition of 'large employer':

> To qualify as a large employer, an employer or associate of that employer must contribute or would, apart from a temporary cessation of contributions, contribute to the fund for the benefit of at least 500 members who are either employees of that employer or employees of associates of that employer. For an employer that is not currently contributing to that fund, they may qualify if APRA expects that the employer and its associates will contribute for 500 members by the end of a time period specified by APRA. This excludes any employee of the employer or

12 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 3, section 29TC.

13 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 3, subsection 29T(1)(f).

14 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.33.

15 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, Schedule 1, item 9: Part 2C, Division 3, proposed subsection 29TB(2).

associate in respect of whom the employer or its associates does not make contributions on their behalf to the fund as well as employees that have a chosen fund different to the fund offering the tailored MySuper product.[16]

Permissible fees

2.12 Part 2C, Division 5 sets out the permissible fee structure for MySuper products. Consistent with the government's response to the Super System Review, proposed section 29V provides that trustees may charge administration fees, investments fees, buy-sell spread fees, switching fees, exit fees and activity fees.

2.13 As noted in the EM, the Core Provisions Bill would also require that, for MySuper products which include a lifecycle investment strategy, all members will be charged the same investment fee irrespective of their lifecycle stage.[17]

2.14 The Core Provisions Bill does not contain the complete framework for the standard set of permissible fees. As noted in the EM, further legislative tranches will introduce provisions to require exit fees, switching fees and buy-sell spreads to be charged on a cost recovery basis. The EM further notes that additional tranches will 'define those fees for financial advice that can be deducted from member accounts',[18] as well as the parameters for offering discounted administration fees.[19] The EM does not clarify why these measures could not be included with related measures in the Core Provisions Bill.

Commencement

2.15 The proposed amendments to the Superannuation Industry (Supervision) Act would commence on 1 January 2013, or an earlier date fixed by Proclamation. This would allow APRA to accept applications for authorisation to provide MySuper products from this date. The amendments to the Superannuation Guarantee (Administration) Act, which would require default payments to be made to MySuper products, would commence on 1 October 2013.[20]

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16 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.45.

17 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 6.12.

18 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 5.20.

19 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 6.19.

20 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, clause 2.

MySuper Core Provisions Bill - Strict liability offences

2.16 Two offences would underpin the core provisions of the MySuper framework. First, under proposed section 29W, it would be an offence for a person to offer a product as a MySuper product when not authorised to do so. Second, under proposed section 29WA, it would be an offence for a trustee to direct a member's contributions to a MySuper product if the member has elected to become a member of a choice product.

2.17 The offences would be strict liability offences. Section 6.1 of the *Criminal Code* explains that the effect of strict liability is to remove all fault elements for an offence. That is, it would be irrelevant whether the person intended to commit the offence, or knew, or was reckless as to whether, he or she was committing the offence.

2.18 Strict liability is purportedly required for the offence at proposed section 29W as the conduct prohibited may 'inadvertently cause' an employer to be in breach of requirements under the Superannuation Guarantee (Administration) Act.[21] The EM does not provide justification as to why strict liability for the offence at section 29WA is required to secure the efficacy of the MySuper scheme. It does, however, state that it 'is a reasonable expectation' that RSE licensees have appropriate administrative procedures in place to ensure each members' contributions are administered in accordance with the new superannuation framework.[22]

2.19 It is apparent that the offence at 29WA is incomplete. As stated in the EM, the scope and application of the offence will be clarified by subsequent draft legislation.[23] This approach appears to be contrary to Commonwealth criminal law best practice, as outlined in the Commonwealth Attorney-General's Department's *A guide to framing Commonwealth criminal offences, infringement notices and enforcement powers*. The guide advises that '[t]he scope of an offence should be clear on its face' and, further, that other provisions should not ordinarily extend the scope of the offence.[24]

2.20 Further evidence was obtained regarding the strict liability offences at the hearing on 2 March 2012. Treasury officials explained that strict liability:

> ...does not go to an element of intent by the person who is causing the breach. If objectively on the face that provision, you breach the elements of the provision, it does not matter whether you intended to or not... With

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21 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 3.59.

22 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 2.14.

23 Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011, paragraph 2.15.

24 Commonwealth Attorney-General's Department, *A guide to framing Commonwealth criminal offences, infringement notices and enforcement powers*, September 2011, p. 25.

> respect to this particular provision, I would suggest it is very unlikely that you would accidently represent yourself as offering a MySuper product when you are not authorised to. You have to apply to APRA to be authorised to offer MySuper, so the element of intent of deliberately breaching this provision is, I think, not as relevant.[25]

2.21 This explanation did not address the effect of proposed section 6.1 of the Criminal Code, whereby it would also be irrelevant whether the person knew, or was reckless as to whether, he or she was in breach of the MySuper licence requirements.

2.22 However, the imposition of strict liability under the offences at sections 29W and 29WA was considered by the Senate Standing Committee for the Scrutiny of Bills. The committee concluded that 'although the explanatory memorandum does not raise the point, it would be reasonable to expect the licensee to be in a position to guard against the possibility of a contravention.'[26]

Trustee Obligations and Prudential Standards Bill

2.23 The Trustee Obligations and Prudential Standards Bill contains measures in response to the recommendations of the Super System Review to strengthen trustee duties generally and to impose additional obligations on trustees of MySuper products.[27] The Bill would also allow for APRA to make prudential standards to govern Australia's prudential system.[28]

Trustee obligations

2.24 Section 52 of the Superannuation Industry (Supervision) Act outlines the obligations that apply to superannuation trustees. These obligations will be strengthened by new and expanded obligations. These obligations include that the superannuation trustee must:

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25 Mr Adam Hawkins, Policy Analyst, Financial Systems Division, Treasury, *Proof Committee Hansard*, 2 March 2012, p. 66.

26 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 14 of 2011*, 23 November 2011, p. 36.

27 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Schedule 1.

28 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Schedule 2.

- exercise the same degree of care, skill and diligence as a prudent superannuation trustee;[29]
- act fairly in dealing with classes of members and members within a class;
- give priority to the interest of members where a conflict exists;
- formulate, review and give effect to an insurance strategy for the benefit of the fund's members;
- formulate, review and give effect to a risk management strategy and manage financial resources to cover operational risk;
- in addition to the existing requirements regarding investment strategies—which relate to the fund as a whole—trustees must formulate investment strategies for each investment option and offer a range of options to allow adequate diversification. Trustees will also be obliged to have regard to valuation information, expected tax consequence and costs in their investment strategies.

2.25 Additional obligations will be introduced in respect of trustees that offer MySuper products. This reflects the unique nature of MySuper as a default product; as noted by the Minister in his second reading speech, members of MySuper products 'have effectively delegated all decisions for their superannuation to the trustee'.[30] Trustees of a registrable superannuation fund that includes a MySuper product will be required to:

- promote the financial interests of MySuper members (in particular returns after the deduction of fees, costs and taxes);
- assess on an annual basis whether the fund has sufficient assets and members to enable it to continue to promote the financial interests of MySuper members; and
- include in the investment strategy for the MySuper product, and update on an annual basis, the target investment return and level of risk for the product.

29 At present, paragraph 52(2)(b) of the Superannuation Industry (Supervision) Act refers to same degree of care, skill and diligence as an ordinary prudent person would exercise…'. The EM notes that this amendment brings the standard of care, skill and diligence 'into line with the existing State and Territory trustee legislation applying to professional trustees'. Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, paragraph 1.62.

30 The Hon Bill Shorten MP, Second Reading Speech, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, *House of Representatives Hansard*, 16 February 2012, p. 3.

2.26 The duties that will apply to directors of corporate trustees of superannuation funds in relation to a MySuper product and more generally are separately outlined.[31] These obligations are largely similar to those applying to superannuation trustees but focus on the directors as individuals. The EM also notes that APRA will provide specific guidance on some standards that are 'objective', noting for example that 'new directors will not be expected to have the level of skill and knowledge of an experienced director immediately'.[32]

2.27 The new trustee obligations will commence from 1 July 2013.[33] With some minor exceptions, the new obligations will not apply to self-managed superannuation funds.

2.28 Issues relating to the proposed trustee obligations are explored further in chapter 4.

Prudential standards

2.29 The operating standards in relation to superannuation are currently outlined in Part 3 of the Superannuation Industry (Supervision) Act, with additional standards prescribed in regulations.

2.30 The reliance on primary and subordinate legislation to form the system of standards that governs the superannuation industry differs from the frameworks which apply to other areas of the financial system. While APRA has the power to issue standards in relation to authorised deposit-taking institutions, life insurance companies and general insurance companies, it does not have a similar power that covers superannuation funds. The Stronger Super Review argued that APRA should be given a general standards-making power in relation to superannuation.[34] The Review observed:

> Standards can be made and varied more quickly than regulations which means that, if required, the law can be quickly adjusted to respond to developments in the industry. Further, complete topics could be addressed under a single standard whereas, at present, a topic may be found in several places in the SIS Regulations … the Panel believes that it is important that trustee duties not be sprinkled across several places but, rather, be readily available to trustee-directors in one place. This also means that a standard

31 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, proposed sections 29VO and 52A.

32 Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, paragraph 1.133.

33 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, clause 2.

34 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter ten*, p. 310.

has the capacity to leave less room for uncertainty than the promulgation of regulations on the same topic.[35]

2.31 Schedule 2 to the Trustee Obligations and Prudential Standards Bill will give APRA the power to issue prudential standards in relation superannuation prudential matters. These standards must be complied with by RSE licensees and 'connected entities'—the RSE licensees' subsidiaries and other entities prescribed in regulations.

2.32 APRA will be able to determine prudential standards on any matter that includes:

- protecting the interests of members;
- ensuring that the conduct of an RSE licensee or connected entity meets the reasonable expectation of members;
- keeping an RSE licensee or connected entity in a sound financial position;
- ensuring the conduct of an RSE licensee does not cause or promote instability;
- the appointment of auditors and actuaries and the conduct of audits and actuarial investigations.[36]

2.33 APRA will have the prudential-making power from the date of Royal Assent. The EM states that this will allow time for the standards to be developed and for industry to transition to them, generally by 1 July 2013—although some standards that relate to MySuper may apply from 1 January 2013.[37]

Committee view

2.34 The committee did not receive evidence on the standards-making power that the Trustee Obligations and Prudential Standards Bill proposes to give APRA. The power for APRA to make prudential standards will give it greater flexibility in performing its role as a prudential regulator and responding to developments in the superannuation industry, and the industry will benefit from the clearer and better-targeted rules that will result. The committee notes that the framework for the proposed powers appears similar to those that apply to the other industries prudentially-regulated by APRA, and the standards will still be subject to Parliamentary oversight through the disallowance process. Accordingly, the committee supports the prudential standards provisions and this report does not examine them further.

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35 Cooper et al, *Super System Review: Final Report*; *Part two – Recommendation packages, Chapter ten*, p. 310.

36 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, proposed subsection 34C(4).

37 Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, paragraph 1.145 and 2.43.

Commencement of the MySuper superannuation system

2.35 A number of submitters to the inquiry raised concerns with the commencement date of the compulsory contributions to default MySuper products. It was put to the committee that a date of 1 October 2013 for the commencement of MySuper products as the default superannuation vehicle is not feasible. Sunsuper noted that the changes may require 'lengthy computer system change lead times' and accordingly recommended Parliament promptly address the draft legislation.[38] Similarly, Mercer submitted that the timeframe for the transition to the new superannuation regime is 'extremely tight', positing that the legislation would not pass parliament until the Spring 2012 sittings.[39] Accordingly, Mercer recommended the 1 October 2013 start date be deferred until July 2014.[40] The Association of Superannuation Funds of Australia also proposed a 1 July 2014 commencement date, arguing that 'October 2013 does not give the industry or employers enough time to adjust to the changes'.[41]

2.36 In contrast, the Australian Institute of Superannuation Trustees (AIST) supported the proposed 1 October 2013 commencement date, submitting that the date allows sufficient time for industry to transition to the new superannuation framework:

> We support the timetable that is in place at the moment. We think it is in the nature of the superannuation industry, which is a large and sophisticated industry, to be able to cope with change. It is one of the criticisms that are often levelled at the creators of the superannuation system that change rolls about every year or two. As a consequence of that I think the industry is actually quite used to implementing quite significant changes on relatively short time lines, including in circumstances where the full details of the change are coming from a number of different directions.[42]

2.37 However, the AIST further commented that a prompt introduction of all legislative measures required to introduce the superannuation reforms is required to ensure a smooth transition to the new superannuation regulatory framework.[43]

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38 Sunsuper, *Submission 4*, p. 2.

39 Dr David Knox, Senior Partner, Mercer (Australia) Pty Ltd, *Proof Committee Hansard*, 2 March 2012, p. 37.

40 Dr Knox, Mercer (Australia) Pty Ltd, *Proof Committee Hansard*, 2 March 2012, p. 37.

41 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 2 March 2012, p. 30.

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

43 Mr Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 47.

Committee view

2.38 The committee acknowledges concerns with the timeframe to transition to the MySuper system. However, the committee notes that the reforms were formally announced in December 2010,[44] and have been the subject of extensive industry consultation that included the release of exposure draft legislation for public comment.[45] The committee concurs with the views of the AIST that the industry is well-placed to adapt to the new superannuation framework in time for a 1 October 2013 start date. However, the committee also notes the views of the AIST and other submitters that it is imperative that the legislation be confirmed and addressed by parliament as soon as possible. As will be considered, the introduction of the legislative measures in tranches undermines the timely consideration of the MySuper legislation.

Further tranches—additional legislation to introduce the MySuper system

2.39 As the Bill's title indicates, the MySuper Core Provisions Bill would establish the framework for the MySuper system. As noted in the EM, further legislative measures are required to establish the MySuper system.

2.40 With the introduction of the Trustee Obligations and Prudential Standards Bill, the following 17 measures are yet to be provided for the Parliament's consideration:

- further requirements in respect of insurance;
- allowing defined benefit funds and schemes to continue to be a default superannuation product;
- rules for the charging of financial advice deducted from member accounts and charging for intra fund advice;
- arrangements for the transition of member accounts from existing default superannuation products to MySuper products;
- trustee duties for eligible rollover fund licensees that will be similar to the specific trustee duties in relation to MySuper products;
- prohibition on deduction of commissions from MySuper member accounts;
- rules for the payment of performance based fees by RSE licensees to investment managers in relation to the assets of a MySuper product;
- limitation of certain fees to cost recovery;

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44 The Hon Bill Shorten MP, Minister for Financial Services and Superannuation, 'Government super reforms mean more money in retirement', Media release 024, 16 December 2010.

45 The Treasury, *Stronger Super – Consultation*, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=consultation.htm (accessed 5 March 2012).

- a rule for the fair and reasonable allocation of costs between each MySuper product and each choice product within a fund;
- additional governance measures (relating to selection of service providers, not preventing directors of trustees from voting other than in certain limited circumstances, increasing the time limits for which members can lodge complaints to the Superannuation Complaints Tribunal in relation to total and permanent disability (TPD) insurance claims, requiring trustees to provide members with reasons for decisions in respect to formal complaints and providing APRA with the administrative power to impose fines);
- ensuring APRA has the ability to determine prudential standards to facilitate the transition process;
- enhanced data collection and data publication powers for APRA;
- additional disclosure requirements in relation to MySuper and choice products;
- consequential amendments to deal with the nomination of superannuation funds in modern awards and enterprise agreements;
- consequential amendments to the *Corporations Act 2001* to ensure the necessary obligations of that Act apply to MySuper products;
- consequential amendments to move requirements for fitness and propriety, actuaries and auditors from the legislation to prudential standards; and
- amendments to the Corporations Act so that RSE licensees that are also responsible entities of managed investment schemes are no longer exempt from the Corporations Act requirements to have available adequate financial resources.[46]

Concerns with the staggered approach

2.41 Evidence before the committee is highly critical of this staggered approach to introducing the MySuper reforms.[47] The views expressed by the Financial Services Council are representative of the concerns raised:

> The FSC wishes to highlight the difficulty in commenting on and legislating significant reforms, such as MySuper, in multiple phases. Many questions arise in relation to the Bill, which may be answered in later tranches. Further, subsequent tranches may give rise to additional issues with this Bill. It is therefore very difficult to properly assess the full impact

46 Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, pp 4–5.

47 See, for example, the Association of Superannuation Funds of Australia, *Submission 12*, p. 2; Association of Financial Advisors, *Submission 15*, p. 3

> of the Bill without the benefit of the related tranches of legislation, regulations and prudential standards.[48]

2.42 Reflecting these concerns, AIST submitted that additional elements fundamental to the operation of the MySuper scheme could appropriately have been included in the MySuper Core Provisions Bill:

> AIST notes that the issues it identifies with the Bill may be addressed in the subsequent tranches of legislation. Conversely, matters that appear settled in the Bill may be disturbed in the subsequent tranches and require additional and possibly modified comment on the Bill. This is not an ideal way for either Parliament or bodies with an interest in the legislation to consider a highly important reform package.
>
> It would have been preferable for key elements of MySuper (eg, trustee duties, protections for members transferred between funds when they change jobs, and the prohibition on commissions) to have been included in the first tranche.[49]

2.43 The Corporate Super Association questioned whether a tranche approach will deliver the new superannuation framework effectively:

> We do acknowledge that the scale of the legislative task that has been undertaken is considerable, but we are not happy with piecemeal introduction of legislation that is intended to work as a package. If the operation of the part that has been introduced depends on the subsequent introduction of a later tranche, it is undesirable. Later tranches may not be passed if parliament does not sit as anticipated or the timetable is delayed; hence, the legislation may remain incomplete and either ineffective or hard to enforce. And piecemeal introduction does not give the public or parliament a full and complete understanding of the legislation which is being considered.[50]

2.44 It was evident that the introduction of the MySuper scheme in tranches has resulted in Bills that are not self-contained. It was put to the committee that matters contained in one Bill cannot be evaluated on the basis of the provisions in that Bill alone. Rather, understanding one concept requires reference to all tranches of the MySuper legislation. This includes the regulation of intra-fund advice.

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48 Financial Services Council, *Submission 3*, p. 3.

49 Australian Institute of Superannuation Trustees, *Submission 9*, p. 1.

50 Mrs Elizabeth Goddard, Research Officer, Corporate Super Association, *Proof Committee Hansard*, 2 March 2012, p. 26.

Intra-fund advice

2.45 Several submitters brought the matter of intra-find advice to the committee's attention.[51] Strong views were expressed regarding the regulation of intra-fund advice, and it was noted with concern that the form of the regulation is currently unclear as later tranches of MySuper legislation will affect the parameters in which intra-fund advice may be provided.[52] Treasury confirmed that the approach to regulating intra-fund advice is a matter that has yet to be settled. Treasury officers advised that '[w]e have not got to the detailed drafting yet', with one adviser stating 'I do not have any more detail than was outlined in the press release of 8 December.'[53]

Committee view

2.46 The committee acknowledges stakeholder concerns about a staggered approach to introducing legislative measures to comprehensively modernise Australia's superannuation system. The committee appreciates the details provided in the Explanatory Memoranda to the Bills regarding the measures required to wholly implement the MySuper system.

2.47 The committee agrees with stakeholders' views that introducing the measures in various legislative tranches diminishes stakeholders', and the Parliament's, capacity to comprehensively review the measures proposed. The introduction of the MySuper legislation in numerous tranches in effect asks Parliament to pass a segment of an overall policy scheme, in reliance on statements by the Executive on the final form of the scheme. It is also of concern to the committee that measures in tranches yet to be introduced, and apparently still under development, will affect the measures in the two Bills that are the subject of a parliamentary inquiry. However, given the extensive nature of the policy changes announced, and the need for lengthy consultation with industry (which they themselves have requested and been given), these significant reforms require a practical response. While the approach taken may not be best practice, it is the most practical.

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51 See, for example, Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 2 March 2012, p. 32; Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Committee Hansard*, 2 March 2012, p. 18.

52 See, for example, Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 2 March 2012, p. 4; Mr Matthew Linden, Chief Policy Adviser, Industry Super Network, *Committee Hansard*, 2 March 2012, p. 14.

53 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Proof Committee Hansard*, 2 March 2012, p. 63.

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

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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

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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]

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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.

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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

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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.

Chapter 4

Trustees obligations: the financial interests of beneficiaries, the 'scale test' and investment strategy

4.1 This chapter examines the provisions in proposed section 29VN of the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012. They impose additional obligations on the trustees of MySuper products to help improve trustee decisions regarding these products. These provisions require trustees to promote the financial interests of beneficiaries, assess the appropriate scale of the funds (in terms of both members and assets), and execute an appropriate investment strategy on behalf of these members.

4.2 Proposed section 29VN would establish the following additional obligations on trustees of a superannuation fund that includes a MySuper product. Trustees must:

(a) promote the financial interests of the beneficiaries of the fund who hold the MySuper product, in particular returns to those beneficiaries (after the deduction of fees, costs and taxes);

(b) determine on an annual basis whether the beneficiaries of the fund who hold the MySuper product are disadvantaged, in comparison to the beneficiaries of other funds who hold a MySuper product within those other funds. This disadvantage should be assessed on the basis of whether:

(i) the number of beneficiaries of the fund who hold the MySuper product is insufficient; or

(ii) the number of beneficiaries of the fund is insufficient; or

(iii) the assets of the fund that are attributed to the MySuper product are, or are to be, pooled with other assets of the fund or assets of another entity or other entities—because that pool of assets is insufficient; or

(iv) the assets of the fund that are attributed to the MySuper product are insufficient;

(c) include in the investment strategy for the MySuper product the details of the trustee's determination on matters relating to (b) above;

(d) include in the investment strategy for the MySuper product (with an annual update) the investment return target over a period of 10 years for

> the assets of the fund that are attributed to the MySuper product and the level of risk appropriate to the investment of those assets.[1]

4.3 These provisions were referred to in this inquiry as 'the scale test'. Proposed section 29VO of the Bill states that each director of a corporate trustee must exercise 'a reasonable degree of care and diligence for the purposes of ensuring that the corporate trustee carries out the obligations referred to in section 29VN'. Proposed subsection 29VP(1) states that a person must not contravene section 29VN or 29VO.

4.4 There is important detail contained in the Explanatory Memorandum (EM) to the Trustee Obligations Bill on proposed section 29VN. The committee commends the government on the quality of the EM in this regard.

The financial interests— proposed paragraph 29VN(a)

4.5 In relation to paragraph 29VN(a), the EM to the Trustee Obligations Bill notes that 'a trustee must promote the financial interests of members of a MySuper product', the most significant component of which are the returns to those beneficiaries.[2] Significantly, the EM adds:

> While this will lift the standard required of trustees, it is not a requirement that trustees generate certain level of returns. Sustained low returns may indicate a failure to promote the financial interests of beneficiaries, but low returns, on their own, will not necessarily involve a breach of this obligation. The obligation does not imply that members of a MySuper product should be given preference over other members of the fund, for example, by the trustee in allocating investment returns, or in any other way.[3]

4.6 The EM also notes that the obligation to promote the financial interests of beneficiaries:

> ...necessarily includes consideration of the level of investment risk appropriate for these members, recognising that different groups of members may have a different risk tolerance and there is a trade-off between investment return and investment risk.
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> To be clear, this requirement does not prevent trustees from offering advice, insurance or services to members that do not directly improve returns to those beneficiaries (after the deduction of fees, costs and taxes). However,

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1 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, proposed subsection 29VN. The wording has been paraphrased: it is not the exact wording of the bill.

2 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Explanatory Memorandum, p. 13.

3 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Explanatory Memorandum, p. 13.

> the trustee must consider whether the benefits of offering the advice or service is appropriate having regard to the impact on members' returns. For example, financial advice (including intra-fund advice) to members on contributions may not directly promote returns to beneficiaries (after the deduction of fees, costs and taxes), however, offering this financial advice may be in the financial interests of members.[4]

Annual determination of scale— proposed paragraph 29VN(b)

4.7 In relation to subparagraph 29VN(b)(i), the EM states that a relevant consideration for trustees is whether the number of beneficiaries is sufficient to ensure those costs for each beneficiary are not so high as to place the financial interests of the beneficiaries of the MySuper product at a disadvantage compared to beneficiaries of other RSEs holding a MySuper product.[5]

4.8 In terms of investment scale, the EM outlines that a trustee's determination must consider the sufficiency of assets that are relevant to the investment for the MySuper product, which includes the effect of scale on costs and investment opportunities. In considering whether the MySuper product does have adequate assets, a MySuper trustee can have regard to the extent to which the MySuper assets are pooled with other assets of the fund.[6]

4.9 In terms of those cases where there is a judgment by the trustee that the number of members or assets of the MySuper product is insufficient, the EM advises that:

> It will be incumbent upon a trustee that determines that assets or members are insufficient to take appropriate action to rectify the insufficiency so they continue to meet their general obligation to promote the financial interests of beneficiaries. APRA will provide prudential guidance on processes trustees could adopt to form a determination and relevant considerations for trustees in rectifying insufficient scale.[7]

Targeted investment return & level of risk for MySuper product—proposed paragraph 29VN(d)

4.10 In relation to proposed paragraph 29VN(d), the EM notes that 'in determining the risk appetite for the investment of its MySuper assets, a trustee may consider the

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4 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Explanatory Memorandum, p. 14.

5 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, Explanatory Memorandum, p. 14.

6 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, *Explanatory Memorandum*, p. 14, paragraph 1.26.

7 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, *Explanatory Memorandum*, p. 14, paragraph 1.27.

age of members as well as other relevant factors'. It identifies the trustee's obligation as managing the trade-off between the investment return target and the level of risk for a MySuper product. The trustee will have to 'clearly articulate and justify the investment return target and level of risk they have adopted for the MySuper product'.[8]

Submitters' views on the scale test

4.11 Several submitters expressed concern with the scale test in proposed paragraph 29VN(b) of the Trustee Obligations Bill. Their basic argument was that scale—the number of members and the size of assets—are not the only metrics and should not be main metrics to assess whether a fund is failing to promote the best interests of its members.

4.12 The Association of Superannuation Funds of Australia (ASFA), for example, told the committee that size of portfolio and number of members are only two determinants of the reason why a MySuper product trustee may underperform. Ms Pauline Vamos, Chief Executive Officer of ASFA, told the committee:

> ...there are other factors as well. In our view, fund trustees, as part of their best interest duties, have to look each year at whether or not they are able to provide services in the best interests of their members. So our initial view is very much that the...whole scale test may produce the wrong results.[9]

4.13 The AIST told the committee that while it does not necessarily propose abolishing the Bill's scale test, it would not be disappointed if the test was omitted. It told the committee that the 'number of members... has no relationship whatsoever to the ability of the fund to perform'. It argued that any test other than the financial interests test for members runs the risk of 'clouding or distorting' this key focus.[10] Moreover, it added that that net returns are not necessarily correlated with questions of size.[11]

4.14 The Financial Services Council argued that while it is 'comfortable with the idea that the trustee should consider scale...a scale test should not be in law'. It added:

> Not only is it a barrier to entry but the test, as suggested in the current drafting, is very subjective, very open. We are not sure how one would be required to perform the scale test. I am not sure what sort of data you would

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8 Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, *Explanatory Memorandum*, p. 14, paragraphs 1.30 and 1.31.

9 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 2 March 2012, p. 32.

10 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, pp 51–52.

11 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 52.

> be asked to use. Presumably, it is a comparative test. So I am not sure how you test scale.[12]

4.15 The Corporate Super Association had similar reservations about how the scale test would work in practice. Mrs Elizabeth Goddard, the Association's Research Officer, suggested that:

> It is very difficult to know how a trustee will form a view and it is very difficult to determine whether APRA will agree with their view. So there is subjectivity in the requirement on the trustee and we submit that there will be a degree of opinion from APRA as to whether the trustee's judgment is appropriate. So we think the scale test is going to be a difficult one.[13]

4.16 Dr David Knox, Senior Partner at Mercer, told the committee:

> [T]he scale tests are problematic and may not end up with the best outcomes. They are very prescriptive and they do not necessarily deliver what may be in the members' best interests.[14]
>
> ...
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> Whilst I can understand where Jeremy Cooper was coming from in wanting larger funds...I think with the current direction of scale the scale test is not needed if trustees have that responsibility to act in the member's best interest...The problem with the prescriptive scale test as it is at the moment is that it cannot possible consider every situation.[15]

4.17 Dr Knox also indicated the difficulty of comparing MySuper products' offerings in terms of meeting the requirements under proposed paragraph 29VN(b). He told the committee:

> [W]e are now going to be comparing MySuper products. Some MySuper products will be offering better member education, intra-fund advice, a large range of services, whereas other MySuper products may not choose to do those. Our issue here is that we need to compare like with like.[16]

4.18 Dr Knox did note that APRA has been working on the investment risk metric which, while 'not perfect', is at least a measure that seeks to establish the risk or volatility within a particular investment.[17]

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12 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 2 March 2012, p. 5.

13 Mrs Elizabeth Goddard, Research Officer, Corporate Super Association, *Proof Committee Hansard*, 2 March 2012, p. 30.

14 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 38.

15 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 42.

16 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 40. See Mercer, *Submission 13*, p. 23.

17 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 41.

4.19 The Industry Super Network's (ISN) commented that 'there are undoubtedly benefits which flow from scale'. It told the committee:

> We published research previously...on analysis of APRA fund level data and it shows among industry funds there is in fact a strong relationship between the size of the fund—that is, member assets—and net returns; however, for retail funds, that is not the case. In retail funds, the larger the fund is, in fact, it could be argued that the returns actually fall. That is an unusual circumstance. There may well be scale benefits for those particular funds but it appears as if it is not making its way through to members.[18]
>
> ...
>
> There is not an automatic correlation to the scale with providing a financial interest to members. But there is a sufficient link between scale and returns to members for that to be appropriately considered. It is a proper duty that a fund consider whether it has sufficient scale to operate in the financial interests of its members. How it does that is going to be a problematic exercise because, no doubt, a smaller fund may be of sufficient scale to perform well.[19]

The AIST's recommendation on the scale test

4.20 The AIST drew the committee's attention to its 13 January 2012 submission to the Treasury on the exposure draft of the Trustee Obligations Bill. This submission, also attached to its submission to this inquiry, made four key recommendations relating to the scale test in proposed section 29VN of the Bill.

- The first is that the legislation should require the annual determination of scale as an integrated exercise forming part of a super funds risk management process. In other words, proposed paragraphs 29VN(b) and 29VN(c) of the bill should be merged.
- Second, the legislation should clarify the conduct that would be in contravention of scale requirements.
- Third, the financial interests comparison of MySuper products should be 'totally or overwhelmingly' based on net returns to members together with a standardised risk measure. The AIST argued that while the range of member services offered by superannuation funds (such as access to financial advice, insurance and online services) are important ancillary services, they do not directly improve net returns, and should not form part of a member's financial interests.[20]

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18 Mr Matthew Linden, Chief Policy Advisor, Industry Super Fund Network, *Proof Committee Hansard*, 2 March 2012, p. 14.

19 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 2 March 2012, p. 15.

20 Australian Institute of Superannuation Trustees, *Submission 9*, supplementary, p. 6.

- Fourthly, a breach of proposed sections 29VN or 29VO should not result in cause of action for loss or damage by fund members or beneficiaries.[21] (Proposed subsection 29VP(3) of the Trustee Obligations Bill states that a person who suffers loss or damage as a result of the conduct of another person in contravention of section 29VN 'may recover loss or damage by action against that other person or against any person involved in the contravention.)

4.21 In terms of the last point, Mercer seems to share the AIST's apprehension. Dr Knox told the committee that trustees' obligations are to act in the best interests of all members. However, in acting in the best interests of all members, an individual member may be disadvantaged. Mercer expressed concern that because of the way in which proposed subsection 29VP(3) of the Bill is currently worded, the disadvantaged member could take action against the trustee.[22]

Treasury's view on the scale test

4.22 In evidence to the committee, Treasury defended the scale test in the Bill. It noted that the purpose of the test was to indicate that where there are some small funds that are not performing well, scale may be one of the reasons why they are not. A Treasury officer told the committee:

> I was a little surprised that some people felt the provisions were prescriptive. In fact, the intent here is that the provisions are quite principle based, in a sense. What is being required here is simply for trustees to ask themselves the question: is the scale of my fund disadvantaging my ability to promote the best interests of my members? That is simply the requirement—to ask that question and answer that question. You could imagine that, for a very large number of funds that clearly have sufficient scale, it would be pretty easy for them to answer that scale is not a factor for them. There would be another large number of funds that are performing quite well and it is quite clear that scale is not a problem. There is no element of this test that is concluding that bigger is necessarily better. It clearly gives room for small, well-performing funds to conclude that being small is not impacting on their ability to deliver good outcomes for their members.[23]

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21 Australian Institute of Superannuation Trustees, *Submission 9*, supplementary, p. 3.

22 Dr David Knox, Senior Partner, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 38.

23 Mr Jonathon Rollings, Principal Advisor, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 2 March 2012, p. 65.

Committee view

4.23 The committee believes that witnesses' concern with the scale test in proposed paragraph 29VN(b) of the Trustee Obligations Bill is misplaced. The test is not intended to be absolute: importantly, paragraph 29VN(a) provides trustees with an obligation to promote the financial interests of beneficiaries of the fund. As Treasury has explained, the reference in proposed paragraph 29VN(b) to the number of members and size of assets of the fund is simply to indicate that one of the reasons that a small fund may not be performing is that it may not have sufficient scale. It is not, as some have argued, to claim that all small funds underperform because of their size or even to suggest there is strong correlation between these factors.

4.24 The committee notes the concerns of Mercer and the AIST relating to possible actions against a trustee where it is alleged that proposed sections 29VN or 29VO have been breached. However, it does draw attention to the defences in proposed subsections 55(5) and 55(6) of the Bill. These subsections state that it is a defence if the defendant establishes that they have complied with the covenants in sections 52 to 53 and prescribed under section 54A, and the obligations referred to in section 29VN and 29VO that are relevant to the circumstances.

Chapter 5

The proposed authorisation process of the Australian Prudential Regulatory Authority

5.1 The Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 sets out the authority and the obligations of the Australian Prudential Regulatory Authority (APRA) in relation to deciding whether to authorise a registrable superannuation entity (RSE) to offer a MySuper product.

5.2 The overriding purpose of APRA's authorisation process is to ensure that a class of beneficial interest in a regulated superannuation fund is not offered as a MySuper product unless it offers a simple product that shares common characteristics.[1] As chapter 1 emphasised, this is the core objective of the MySuper reforms and has widespread stakeholder support.

5.3 Proposed section 29T of the Core Provisions Bill states that APRA must authorise an RSE to offer a class of beneficial interest in a regulated superannuation fund as a MySuper product. Proposed section 29T attaches several requirements that must be met for APRA to grant this authorisation. These are:

- compliance with proposed section 29S which outlines the minimum information required and other administrative requirements applicants must satisfy for their application to be considered by APRA;
- the applicant providing APRA with all the further information requested;
- that the fund is registered under Part 2B of the Superannuation Industry (Supervision) Act;
- that the fund has 5 or more members or that APRA is satisfied that the fund will have 5 or more members within a specified period;
- that the licensee is not already authorised to offer a MySuper product or, where it is, that further provisions are satisfied[2] in relation to either the class of beneficial interest in the fund to which the application relates or the class of beneficial interest that the RSE licensee is already authorised to offer as a MySuper product;
- that APRA is satisfied that proposed section 29TC (relating to the characteristics of a MySuper product) is satisfied in relation to that class of beneficial interest;

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1 Superannuation Legislation Amendment (MySuperCore Provisions) Bill 2011, Section 29R, p. 5.

2 Namely, proposed section 29TA (product in another fund in which there is already material goodwill) or proposed section 29TB (MySuper products for large employers).

- that APRA is satisfied the RSE licensee—where it is a body corporate or a group of individual trustees—is likely to comply with the enhanced trustee obligations and fee rules for MySuper products[3]; and
- that APRA is satisfied the RSE licensee is not likely to offer a MySuper product when not authorised to do so or contravene the requirement that unless a member has elected for contributions to be paid into a specified choice product or more than one specified choice product, contributions will be paid into a MySuper product.[4]

Transitional arrangements and the authorisation timetable

5.4 Chapter 2 noted that the proposed amendments to the Superannuation Industry (Supervision) Act would commence on 1 January 2013, or on an earlier date fixed by Proclamation. This would allow APRA to receive applications for standard MySuper authorisations from RSE licensees from this date.

5.5 Potentially, APRA has up to 180 days from the date it receives the application to decide whether to authorise a MySuper product: 60 days to review, a further 60 days available to request further information and a further 60 days if required.

5.6 Part 2 of the Core Provisions Bill notes that if APRA authorises an RSE licensee before 1 July 2013 to offer a MySuper product, that authority takes effect on 1 July 2013. For applications made before 1 July 2013, therefore, APRA will potentially have 180 days from that date to make a decision on an authorisation.

5.7 The amendments to the Superannuation Guarantee (Administration) Act, which would require default payments to be made to MySuper products, would commence on 1 October 2013.

5.8 Proposed Section 29SB of the bill gives APRA 60 days after receipt within which to make a decision on an application. Proposed subsection 29SB (2) states that APRA may extend the period for deciding an application 'by up to 60 days' if APRA informs the RSE licensee of the extension in writing and within the period in which it would otherwise be required to decide the application.[5]

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3 The trustee obligation requirements contained in s29VN of the Superannuation legislation Amendment (Trustee Obligation and Prudential Standards) Bill 2012. See chapter 2.

4 Superannuation Legislation Amendment (MySuperCore Provisions) Bill 2011, proposed section 29T.

5 Superannuation Legislation Amendment (MySuperCore Provisions) Bill 2011, proposed section 29SB.

Submitters' concerns with the proposed authorisation processes

5.9 Several submitters and witnesses expressed their concern with various aspects of the authorisation process as proposed in the bill. The following section examines these concerns, firstly in relation to the general process to obtain MySuper authorisation and secondly in the context of the authorisation process for tailored plans. It also notes APRA's views and responses to these issues.

The process to obtain a MySuper authorisation

5.10 In its submission to the inquiry, the Industry Super Network (ISN) argued that it is anticipated that most RSE's will seek early approval from APRA, applying soon after 1 January 2013 to accept contributions as at 1 July 2013. It noted that given the time lag between an application by an RSE and a determination by APRA:

> ...the sooner APRA provides pro-forma forms and guidance regarding the application process as outlined in section 29S, the more orderly the transition to MySuper will be. To avoid any confusion and uncertainty, information on the MySuper transition process should be made available as soon as is possible.[6]

5.11 The Australian Institute of Superannuation Trustees' (AIST) reached a similar conclusion. It reasoned that:

> ...the key date where a fund makes a MySuper application for a large employer MySuper prior to 1 July 2013 will be 27 December 2013. Within this time frame, funds will be able to accept default contributions into their existing default fund while their MySuper application is being decided. Effectively, this means funds (other than in relation to large employer MySuper products) will have to make an application for MySuper authorisation within the six month window between January and June 2013.
>
> Funds are likely to want to apply as early as possible in this period and ideally prior to 1 April 2013, so that they can advise employers of their MySuper status, and ensure that they will be MySuper compliant if APRA require the full 180 days, as well as for other marketing purposes.[7]

5.12 The AIST told the committee that while the possible six month timeframe is 'satisfactory', there should be an 'absolute legislative requirement' on APRA to process all applications within that timeframe. Mr Haynes noted that the consequences of not getting MySuper authorisation for a fund are 'dire', given the fund would not be able to accept SG contributions after 1 October 2013, and would therefore not be able to operate.[8]

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6 Industry Super Network, *Submission 7*, p. 1.

7 Australian Institute of Superannuation Trustees, *Submission 9*, p. 10.

8 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, pp. 49, 51.

5.13 The AIST recommended that given a fund's investigations and application process 'could reasonably take 3 months or more to complete', information about application requirements, forms and processes should be available from 1 July 2012.[9] As Mr Haynes told the committee:

> ...we would strongly urge... parliament to expedite the carriage of all elements of the stronger super legislation through parliament so that there can be some greater clarity so that, in the second half of this year, funds are in a position to be able to do everything that is needed to get their application into APRA for their MySuper product from 1 January.[10]

5.14 The AIST also recommended that where APRA does not make a decision within the required period, it should be required to give reasons.[11]

5.15 Mercer was unclear as to what APRA will request from trustees as part of the authorisation process:

> 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.[12]

APRA's views on the process to obtain MySuper authorisation

5.16 The committee did not receive a written submission from APRA. Its evidence to the committee is limited to that given by its officers at the public hearing on 2 March 2012. At the hearing, APRA told the committee that it would be seeking to make public its draft application authorisation forms and standards in May–June 2012, with a view to finalising these before the end of 2012. It noted that it has already started 'dialogue with trustees about the sorts of things we expect to see'.[13]

5.17 In response to comments from the ISN (above) relating to its expectation that most RSE's will seek early approval, APRA told the committee that:

> [T]he biggest danger is that there might be some trustees who are laggards in the process, who come in quite late in the piece...In terms of the queuing process, we are not going to date, stamp and number each one when it

9 Australian Institute of Superannuation Trustees, *Submission 9*, p. 10.

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

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

12 Mercer, *Submission 13*, p. 12.

13 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 54.

> comes in...But we have 260 front-line supervisors. Out of them probably 120 or 130 will have some involvement in this process.[14]
>
> If we got 100 different applications on one day they would be likely to go to 50 different supervisors... [T]he queuing issue might be less of a problem than what people were suggesting...[W]e are encouraging draft applications in the second half of 2012. That is, again, to try and facilitate the process.[15]

5.18 APRA told the committee that the MySuper authorisation process represents the first time that the Authority has had to authorise a product rather than an organisation.[16] It acknowledged that the focus on the features of a product, rather than a trustee's characteristics and behaviour, would require a change in mindset.

5.19 In this context, APRA anticipated that the task of processing applications for a MySuper product will have a heuristic element. It will examine the types of compliance issues and challenges that arise and plan with these in mind for future rounds. As APRA explained: '[G]etting those early ones [applications] in, or having collegiate discussions about the ones that do come in on 1 January and 1 February, is going to help'.[17]

5.20 In response to the comments from Mercer (above), APRA also noted that it is unlikely there will be demands for many different MySuper products from the same trustee.[18] APRA told the committee that it not intending to 'batch' applications to allow particular competitors to have authorisation clearance at the same time.

5.21 APRA told the committee that it will be 'very pragmatic' in processing the second and third round of applications from the same trustees. It will examine the primary default MySuper product in the first instance and subsequent employer-sponsor applications in the context of the trustee's knowledge and experience with the default product. That said, APRA did recognise that some of the employer-sponsor MySuper applications could have 'quite strange' insurance arrangements making APRA's 'entry-control' important.[19]

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14 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p.55.

15 Dr Katrina Ellis, Senior Manager, Policy Development, Policy, Research and Statistics Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 55.

16 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 54.

17 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 55.

18 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 54.

19 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 54.

The process to obtain a tailored large employer MySuper plan

5.22 Five organisations—BT, Mercer, the Corporate Superannuation Specialist Alliance (CSSA), the Association of Superannuation Funds of Australia (ASFA) and the Financial Services Council (FSC)—all argued that the authorisation process in the Core Provisions Bill for tailored MySuper products for large employers is unnecessary.

5.23 BT Financial Group argued that APRA should only be responsible for licensing the ability of the trustee to offer MySuper products, 'which would be a natural extension of its current role in licensing trustees'. BT viewed the prudential regulator's involvement in commercial arrangements entered into by superannuation funds with employers as 'costly, time consuming and inefficient for the industry'.[20]

5.24 BT recommended amending the Core Provisions Bill so that APRA is only required to licence the ability of an RSE to offer MySuper products. Superannuation funds offering tailored MySuper products should only have an annual reporting obligation to APRA. This information could be used by APRA to ensure the tailoring of MySuper products is consistent with legislation.[21]

5.25 The CSSA told the committee:

> Tailored MySuper funds should not require individual approval from APRA, as a blanket approval could be provided RSE licenses. This would reduce the time taken for approval and reduce administration, and therefore costs.[22]
>
> At the end of the day, the main difference between a tailored MySuper and the standard MySuper, to use a better term, is that the investment strategy can be chosen differently. There is no other difference between the two of them. If, as FSC requested, you go for a MySuper approval and you get it and do not have to come back with each tailored fund, it sort of takes away the need to have any number or any restriction around it, in my opinion. Investment strategy is the only difference, at the end of the day.[23]

20 BT Financial Group, *Submission 11*, p. 2.

21 BT Financial Group, *Submission 11*, p. 3.

22 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 19.

23 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 20.

5.26 The Association of Superannuation Funds of Australia (ASFA) put a similar argument:

> To compel the trustee to make a series of separate applications to APRA would prove an extremely inefficient process, consuming considerable resources and creating significant delays for little or no benefit. As a prudential regulator APRA has the power to assess large employer offerings as part of their regular reviews of funds.[24]

5.27 Mercer also argued that it does not consider necessary the separate approval for tailored large employer MySuper plans. It saw as 'very strange' an arrangement where a trustee would have to apply for 50 tailored sub-plans where most of the content would be 'identical' for all of them.[25] Further, it argued that:

> ...in order to offer a tailored MySuper product, 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.[26]

5.28 Mercer argued that the bill should be amended to remove the requirement for APRA approval of tailored MySuper products 'at least for cases where the 500 employee limit has been exceeded'.[27]

5.29 The Financial Services Council (FSC) proposed an alternative authorisation process for tailored plans. It recommended that rather than APRA actively authorising each tailored plan proposal, trustees should simply have to report:

> MySuper tailored plans must be reported to APRA on an annual basis – APRA can disallow a tailored plan where the tailored plan is not compliant with the licence conditions within 30 days. At which time, tailored plan closure arrangements commence.[28]

5.30 The FSC explained that a system of reporting tailored plans will deliver transparency and competitive pressures, whereas the proposed system of applying for tailored plans will lead to duplication and inefficiency.[29]

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

25 Mr Stephen Partridge, Product Leader, Outsourcing, Mercer, *Proof Committee Hansard*, 2 March 2012, p. 43.

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

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

28 Financial Services Council, *Submission 3*, p. 6.

29 Financial Services Council, *Submission 3*, p. 9.

AIST's view on tailored MySuper authorisations

5.31 In contrast to the arguments put by BT, ASFA, Mercer, the CSSA and the FSC, AIST told the committee that it is important for APRA to test the ability of the applicant to meet all of the MySuper criteria on each product that is offered. This up-front process will avoid unintended consequences where an applicant is retrospectively found not to have met the MySuper product requirements.[30] It added that this vetting process is particularly important when 'dealing with MySuper subsets... that will often be smaller and have different offerings even if they are within a similar template'.[31]

5.32 AIST did raise the logistical issue of 'queuing', with APRA having to process a backlog of applications. However, it told the committee: 'we are a pretty adaptive industry'[32]—'[T]he industry responds well to a tight timetable.'[33] In terms of APRA, AIST commented:

> ...this is not the first time that they have dealt with major structural change. They did so in relation to RSE licensing a number of years ago. It is, I think, the case that this probably involves less procedural administrative work on the part of APRA than did the move to RSE licensing. I think this is probably more analogies to moves of funds to public offer status.[34]

5.33 Notwithstanding its confidence in the industry and the regulator, AIST did comment that it would be interested in APRA's approach to processing the tailored MySuper plans. The President of AIST, Mr Gerard Noonan queried whether APRA would process the early application of a smaller fund with little more than 500 members before the later application of an AMP-type organisation with thousands of members.[35]

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30 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, pp 48, 51.

31 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 48.

32 Mr Gerard Noonan, President, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 48.

33 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 48.

34 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 49.

35 Mr Gerard Noonan, President, Australian Institute of Superannuation Trustees, Proof Committee Hansard, 2 March 2012, p. 49.

APRA's views on the authorisation process for tailored plans

5.34 The FSC proposal was put to APRA for its comment. It responded that the Authority is generally in favour of entry control as it allows for an evaluation and a 'pre-test' of issues. While APRA does have significant supervisory responsibilities, its 'definite preference is for an entry control'.[36] It recognised the work involved in this authorisation process would be considerable.

5.35 APRA did not accept that its responsibility to authorise an employer-sponsored tailored plan could lead to it 'second-guessing' a tender process. It told the committee that it could potentially disrupt a tender process. However, APRA emphasised that the types of issues that are likely to relate to an employer-sponsored tailored plan are idiosyncratic in nature: the main issues relating in the RSE licensee and the default MySuper product have already been cleared through separate processes.[37]

Committee view

5.36 The committee notes that the successful implementation of the MySuper reforms hinges on APRA's ability to deliver within the set timeframes. APRA's record as a prudential regulator is very strong. It is consultative, highly skilled and responsive. It is important that APRA releases its draft authorisation forms, establishes the authorisation process and provides industry guidance on trustee obligations and prudential standards as quickly as possible. It is also important that APRA is well resourced by government to carry out its new responsibilities.

5.37 The committee believes that entry-point control through an authorisation process is an appropriate system through which to introduce both standard and tailored MySuper products. It agrees with the AIST that an authorisation process is far preferable to a situation where, under a reporting system, a MySuper product that is already in use is subsequently cancelled by APRA. Nonetheless, the committee believes that as APRA becomes more proficient with processing MySuper products, and as both APRA and the industry become more aware of the types of products that will not gain authorisation, there may be a case to shift from an authorisation to a notification scheme.

36 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, pp 53–54.

37 Mr Keith Chapman, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Proof Committee Hansard*, 2 March 2012, p. 58.

Concluding comments

5.38 This report has canvassed the various concerns of submitters with the detail of two complex Bills. While the committee's timeframe to examine the provisions of these Bills has—by necessity—been truncated, the inquiry has raised a number of issues for the Government and the Parliament to give careful consideration. The committee particularly draws attention to the recommendations in chapter 3 of this report.

5.39 That said, the committee believes that this inquiry's focus on the detail and potential weaknesses of the legislation does tend to distract from the overriding support for the MySuper reforms. The committee believes that the Bills meet the government's overarching objectives of providing simplicity, transparency and comparability of MySuper products. As Mercer told the committee: 'overall, the whole approach is a step forward for better protection for those members who do not make their own choices'.[38]

Recommendation 3

5.40 The committee recommends that the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 be passed.

Chair
Ms Deborah O'Neill MP

38 Mr Stephen Partridge, *Proof Committee Hansard*, 2 March 2012, p. 42.

Coalition Members and Senators Dissenting Report

Coalition Members and Senators agree that the default superannuation industry needs reform to enhance competition, transparency and comparability in the system.

We recognise that the regulatory environment in the compulsory savings regime is critical in achieving the policy goal, which is to maximise Australia's retirement savings through publicly mandated, privately managed superannuation.

The two MySuper Bills before this Committee will change the way in which the private sector is allowed to operate in this market.

In the Coalition's view, these Bills will not increase competition but they will contribute to better transparency and comparability.

The genesis of these Bills was the Super System (Cooper) Review of 2009-10.

Since endorsing the MySuper recommendations in August 2010, the Government has approached delivery of the reform in a very piecemeal manner.

There are two Bills before this Committee now and there is another MySuper Bill (the third) which is yet to be exposed for consultation.

In addition, competition matters will be examined by the Productivity Commission, which is presently undertaking a review into default superannuation under modern awards.

The final incarnation of MySuper in these Bills is vastly different from where the government started.

The government's original approach would have resulted in a highly rigid "one size fits all" default superannuation market, which would have been unable to accommodate different demographic profiles in Australian workplaces.

The Coalition welcomes the moves away from a rigid "one size fits all" approach as it had the potential to disadvantage many Australians.

Despite our in-principle support for the policy, the Coalition has considerable reservations about the proposed regulatory design features of both Bills.

We believe these reservations are significant enough to oppose passage of the legislation. Principally these are around the authorisation process, the licensing regime, a proposed "scale test" and the lack of clarity surrounding the provision of intra fund advice.

Further, the Coalition does not support the proposition that the Parliament should consider voting on these Bills without the outcome of the Productivity Commission inquiry and any legislative changes resulting from this inquiry.

Competition in the default superannuation market

The Coalition has long argued in favour of genuine choice and competition in the default superannuation market.

Only with genuine competition in an efficient and transparent default superannuation market will fund returns and retirement savings for Australians in default super funds be maximised.

Current arrangements where default funds under modern awards are selected by Fair Work Australia are not transparent, not competitive and inappropriately favour union dominated industry super funds.

The continuation of those current closed shop anti-competitive arrangements for the selection of default superannuation funds is a national disgrace.

In the lead-up to the last election the government was shamed into promising a Productivity Commission inquiry to address the anticompetitive aspects of its decision to hand to Fair Work Australia the power to approve default funds. Having recognised the deep flaws in the current process before the last election it was disappointing that the government has been so slow to act on that commitment.

It took the government more than eighteen months to commission this inquiry which we are now told will take the best part of this year.

It is clear that the Minister for Workplace Relations and Superannuation has been intent on protecting the best interests of his friends in the union movement for as long as possible.

It is the view of Coalition members of the Committee that this has been at the expense of working families across Australia who have been missing out on the benefits of genuine choice and competition for far too long

We have welcomed the fact that the government has finally asked the Productivity Commission to recommend a more open, transparent and competitive process for the selection of default funds under modern awards.

However we consider that even before the Productivity Commission has reported, the Parliament should amend this legislation to force the government to ensure Australians in default superannuation can benefit from enhanced competition in that market.

Specifically, we point to recommendation 1.2 of the Cooper Review in relation to MySuper and modern awards which said: "*The SG Act should be amended so only a MySuper product is eligible to be a 'default' fund nominated by an employer*."

In recommending, universal eligibility of default funds for industrial purposes, recommendation 1.3 stated:*" ...all MySuper products are able to be nominated, for 'default fund' purposes in awards approved by Fair Work Australia."*

Coalition members of the Committee are of the view that in creating this new default superannuation product, all MySuper funds should be allowed to be an eligible default fund for any workplace and be able to compete freely. To not allow MySuper funds to compete on a level playing field fails to address the existing competition issues in the default super industry and undermines the MySuper reforms.

Under the proposed reforms every product must be assessed by APRA as meeting a minimum set of standards or requirements before it is registered as a MySuper product. This process will ensure that all MySuper products offer appropriate levels of consumer protection and are therefore suitable to be utilised as default superannuation funds.

Once compliance with this set of criteria is established and a MySuper product is registered the Coalition members of the Committee are of the strong view that there is no need for any other process to further determine which eligible and suitable default funds should be included into individual awards.

To embark on such a separate process would create duplication and additional costs for no additional consumer benefit or protection.

Once assessed as meeting the relevant standards and being eligible to be used as a default superannuation product, every MySuper fund should be able to freely compete in the marketplace and to offer itself as a default fund with no further barrier or restriction.

Coalition members of the Committee are concerned that instead of acting in the public interest, the government's continued delays in implementing reforms to ensure genuine competition in the default superannuation market are driven by its desire to protect the vested interests of union dominated industry super funds.

We consider it imperative that action to address the current highly undesirable lack of competition in the default super market should be taken now in conjunction with any other changes to default super rather than be delayed further.

Recommendation 1:
That the legislation be amended to allow any authorised MySuper product to become a default fund under any industrial arrangement.

General concerns on Authorisation requirements

A number of submitters to the Committee expressed concerns about the impact of APRA authorisation requirements.

The Industry Super Network (ISN) argued that given the time lag between an application by an RSE and a determination by APRA:

> ...the sooner APRA provides pro-forma forms and guidance regarding the application process as outlined in section 29S, the more orderly the transition to MySuper will be. To avoid any confusion and uncertainty, information on the MySuper transition process should be made available as soon as is possible.[1]

The Australian Institute of Superannuation Trustees' (AIST) noted:

> ...the key date where a fund makes a MySuper application for a large employer MySuper prior to 1 July 2013 will be 27 December 2013. Within this time frame, funds will be able to accept default contributions into their existing default fund while their MySuper application is being decided. Effectively, this means funds (other than in relation to large employer MySuper products) will have to make an application for MySuper authorisation within the six month window between January and June 2013.
>
> Funds are likely to want to apply as early as possible in this period and ideally prior to 1 April 2013, so that they can advise employers of their MySuper status, and ensure that they will be MySuper compliant if APRA require the full 180 days, as well as for other marketing purposes.[2]

The AIST explained that:

> ...we think that there should be an absolute requirement on APRA to process all applications within that time frame because the consequences of not getting MySuper authorisation from a fund is dire. It is not like not getting a public offer licence. You will not be able to accept superannuation guarantee contributions after 1 October, which effectively means for a live fund that you will not be able to operate in the marketplace.
>
> ...if employers are proceeding quite happily to make contributions to a particular fund and then on 1 October they can no longer make SG contributions to the fund how do they actually fulfil their obligations under the SG requirements?[3]

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1 Industry Super Network, *Submission 7*, p. 1.

2 Australian Institute of Superannuation Trustees, *Submission 9*, p. 10.

3 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 49.

The AIST told the committee:

> we would strongly urge...the parliament to expedite the carriage of all elements of the Stronger Super legislation through Parliament so that there can be some greater clarity so that in the second half of this year, funds are in the position that they can do everything that is needed to get their application into APRA for their MySuper product.[4]

The AIST also recommended that where APRA does not make a decision within the required period, it should be required to give reasons.[5]

Mercer was unclear as to what APRA will request from trustees as part of the authorization process:

> 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.[6]

APRA told the committee that it would be seeking to make public its draft application authorisation forms and standards in May–June 2012, with a view to finalising these before the end of 2012. It noted that it has already started 'dialogue with trustees about the sorts of things we expect to see'.

APRA told the committee that:

> The biggest danger is that there might be some trustees who are laggards in the process and come in quite late in the piece...In terms of the queuing process, we aren't going to date, stamp and number each form when it comes in...But we have 260 frontline supervisors and probably 120 or 130 will have some involvement in this process.
>
> If we got 100 different applications on one day, they are likely to go to 50 different supervisors...The queuing issue might be less of a problem than what people were suggesting...We're encouraging draft applications in the second half of 2012 and that's again to facilitate the process.[7]

APRA explained to the committee that this legislation gives APRA the job of approving specific products (as opposed to product providers) for the first time in its history:

> ...this is the first time in any of our legislation that we have a product authorisation role. Equally, this is the first time that our legislation is actually a prescribed product, because we do not have prescribed bank accounts or insurance policies and so on. So from that perspective it is new.

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

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

6 Mercer, *Submission 13*, p. 6.

7 Keith Chapman, APRA, *Proof Committee Hansard*, 2 March 2012, p. 55.

> I do not think the process needs to be different; I think the level of detail and the level of analysis that we undertake need to be different. That is what we have been looking to try to do.
>
> We will have challenges to get people out of the mindset of, 'I'm looking at everything this trustee does and how they operate,' to, 'I'm looking at this product.' That is why we are talking about a MySuper authorisation form and authorisation process as opposed to an RSE MySuper offerer authorisation process. While it is different, I see that it is much more of a check on the product's specific characteristics rather than on trustee behaviour. Having said that, we have been public in some of our seminars, which I referred to earlier, with comments that we will obviously be looking more askance at the trustees who apply to offer MySuper products where we have a long history of fringe behaviour, for want of better terminology. There is an official word but I cannot remember what it is. We have said that, but those numbers are not huge. It is not 50 per cent of the population but it is probably somewhere around five per cent to 10 per cent. That does not mean that it is trustees where we have a legitimate disagreement. We have had legitimate disagreements with many people over time. But it is the ones where it might just be taking an awfully long time to get rectification that we thought was fundamental.

The Coalition members consider that it is imperative given the complexity of the task ahead that APRA provide appropriate guidance to the industry about the standards and forms required for the authorisation process at least 12 months prior to the commencement of the MySuper legislation.

Recommendation 2:

That APRA provides full details of the standards and forms required for the authorisation process at least 12 months prior to the commencement of the MySuper legislation.

The process to obtain a tailored large employer MySuper plan

A provision in the Core Provisions Bill requires prior authorisation of each tailored large MySuper employer plan rather than simply providing a reporting mechanism.

Five organisations—BT, Mercer, the Corporate Superannuation Specialist Alliance (CSSA), the Association of Superannuation Funds of Australia (ASFA) and the Financial Services Council (FSC)—all argued that the Bill's authorisation process for tailored MySuper products for large employers is unnecessary.

BT Financial Group argued:

> According to the legislation APRA may take up to 180 days to approve a tailored MySuper offering. We believe the requirement for APRA approval will result in:
>
> Significant delays to how quickly members can benefit from the new arrangement, by delaying how quickly the members can transition to the new fund.

> Uncertainty for employers who have commercially negotiated a beneficial arrangement for their employees. Employers must wait for approval from APRA and then take further action if not approved.
>
> Reduced competition within the superannuation industry as employers become less likely to negotiate a tailored arrangement or conduct a competitive tender due to the considerable length of time it would take.
>
> BTFG believes that the proposed level of APRA involvement in commercial arrangements entered into by superannuation funds with employers is unnecessary and inefficient. APRA's role should be to monitor compliance with MySuper legislation through annual reporting and ongoing supervisory activities, as envisaged in the Stronger Super Information Pack.[2]

BT recommended that:

> ...the Bill be amended so that APRA is only required to licence the ability of an RSE to offer MySuper products.
>
> Superannuation funds that enter into a commercial relationship with an employer and in doing so create a tailored MySuper product, would then only have an annual reporting obligation to APRA. The information collected could be used by APRA, along with its other prudential activities, to monitor the tailoring of MySuper products and ensure that they are consistent with legislation.

The CSSA told the committee:

> Tailored MySuper funds should not require individual approval from APRA, as a blanket approval could be provided RSE licenses. This would reduce the time taken for approval and reduce administration, and therefore costs.[8]
>
> At the end of the day, the main difference between a tailored MySuper and the standard MySuper, to use a better term, is that the investment strategy can be chosen differently. There is no other difference between the two of them. If, as FSC requested, you go for a MySuper approval and you get it and do not have to come back with each tailored fund, it sort of takes away the need to have any number or any restriction around it, in my opinion. Investment strategy is the only difference, at the end of the day.[9]

The Association of Superannuation Funds of Australia (ASFA) put a similar argument:

> To compel the trustee to make a series of separate applications to APRA would prove an extremely inefficient process, consuming considerable resources and creating significant delays for little or no benefit. As a

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8 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 19.

9 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 20.

> prudential regulator APRA has the power to assess large employer offerings as part of their regular reviews of funds.[10]

Mercer argued the case for not requiring a tailored MySuper product authorisation process as follows:

> The fund that Mercer runs is a good example. We mentioned earlier the master trust with 260 corporate subplans. We have something like 50 employers, or more than that, that have more than 500 employees. They might want to look at having a tailored MySuper vehicle. It seems very strange to us that the trustee of the fund—there is one trustee running the whole fund for all of the subplans—would potentially have to make 50 separate applications to APRA. Most of the content of the applications would be identical. There will be variations with fees and some minor variations with insurance and possibly investments, but we are talking about the same trustees having met the trustee obligations in similar ways. We think it would be better to have a single application per trustee and some sort of provision for APRA to review and disallowed—:
>
> ...in order to offer a tailored MySuper product, 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.[11]

Mercer argued in its submission:

> 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).[12]

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

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

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

The Financial Services Council (FSC) proposed an alternative authorisation process for tailored plans:

> MySuper tailored plans must be reported to APRA on an annual basis – APRA can disallow a tailored plan where the tailored plan is not compliant with the licence conditions within 30 days. At which time, tailored plan closure arrangements commence.[13]

The FSC proposal of a reporting system for tailored large employer MySuper products was put to APRA for its comment. It responded:

> From our perspective, we are generally in favour of entry control because it does give us the ability to evaluate the application that is coming in and we can do a pretest of those issues. Having said that, all our normal supervision work is like an exit control because once we have somebody in we then continually supervise them and, over the years, we learn more about what they are doing.[14]

> From our perspective we see the introduction of MySuper as a major change. There are different specific responsibilities for trustees, different legislative obligations and we would have a definite preference for an entry control. Having said that, when you tease it through the AIST representatives, who have just finished, there is a lot of work involved in that process, and we are conscious of that. We will work within the timeframe to do as thorough job as we can on entry so that there will still be some degree of post-entry review and potential exiting of trustees who we do not believe are doing the right thing. We worked for a long time to get the trustee licensing back in 2005-06 because we saw that as a significant means of increasing the standard of the trustee directors and trustees within the industry. We see this one the same way. [15]

Coalition members of the Committee agree with those submitters who have stated that this process would be cumbersome, time consuming, unnecessary and costly.

We endorse the FSC recommendation of converting this cumbersome process with an annual reporting process that would still allow APRA to disallow a non-complying fund. We believe that such a process would address the public policy concern that the existence and number of employer plans are unclear to APRA. It would require reporting without undermining the efficiency, competitiveness and commerciality of tender processes.

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13 Financial Services Council, *Submission 3*, p. 6.

14 APRA, Proof Committee Hansard, 2 March 2012, p.

15 APRA, Proof Committee Hansard, 2 March 2012, p.

Further, the Coalition does not believe this is the proper role for the prudential regulator, which should be focused on risk and governance, not on commercial matters which affect neither factor.

Recommendation 3:

That the requirement for MySuper trustees to apply to APRA when issuing a tailored employer plan be replaced with an annual reporting obligation.

The large employer threshold

There was significant concern expressed to the Committee about the benchmark above which large employers can tailor funds for their employees. The provisions of the Bill allow for such tailoring where an employer contributes to a fund on behalf of 500 or more members.

The Corporate Super Specialist Alliance (CSSA) argued that tailoring of MySuper funds should be allowed for all employers:

> The proposed legislation allows for plans of large employers and their associates to be tailored if they contribute on behalf of 500 or more members. We believe this is inconsistent with the current superannuation environment which allows tailoring of superannuation plans at any level that is commercially viable, and we question why 500 members was chosen as a benchmark for a large employer. A 50 member fund of executives could conceivably have greater assets than a 500 member fund made up of blue collar workers, with a lot less administration required, so why should members of that fund be prohibited from negotiating a distinct product to suit the particular needs of their workplace? Different workplaces will have very different requirements.[16]

The Association of Financial Advisers also proposed a limit of 50 employees:

> Further to our point above about prescriptive detail, the AFA does not support the requirement that tailored plans can only be offered for employers with 500 employees. This seriously limits the number of eligible employers and would mean that many employees missed out on the potential benefits of a tailored plan. If the government feels the need to be prescriptive in this area, a number of 50 employees would be more appropriate.[17]

The Australian Institute of Superannuation Trustees (AIST) argued for:

> ...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.[18]

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16 CSSA, Submission 2, p. 4.

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

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

The Financial Services Council (FSC) proposed amending subsection 29TB(2):

> *(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 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.*[19]

Mercer told the committee:

> Our main concerns about that area are the complexity of the test in the way it is written into the bill. We think it should be replaced with a much simpler test. Various submissions have suggested it should be based on the number of employees of the employer, or it should be based on the number of members in the employer's fund if we are talking about a corporate master trust, for example. 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.[20]

Mercer 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.[21]

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19 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.

20 Mercer, *Proof Committee Hansard*, 2 March 2012, p. 40.

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

The Association of Superannuation Funds of Australia (ASFA) argued in its submission that:

> If a numerical measure of 500 is to be employed we suggest that the measure be aligned with the prescribed class in regulation 3.01 of the Superannuation Industry (Supervision) Regulations 1994 ("SIS regs"), which is the class of members, other than standard employer members, which non public offer funds are allowed to have without having to become public offer. This includes former employees, or relatives and dependants (generally spouses) of employees and former employees, of the employer - and its associates.
>
> Further, with respect to the requirement that "any" employee may become a member - there may be instances where, owing to the industrial relations circumstances of the employer, it may not be possible for this to be the case.
>
> Finally, it is unclear whether the trustee must make a separate application with respect to each large employer MySuper offering or can simply make one application with respect to being able to offer one or more large employer MySuper offerings. If it is the former then it is unclear as to why this should be the case, given that the only additional criteria are relatively narrow and capable of being determined "objectively" as a question of fact.[22]

In evidence to the committee, APRA indicated that it did not understand the implications of the 500 fund member threshold in proposed subsection 29TB:

> What about the issue that there are some provisions here that appear to give you very little discretion? I am thinking particularly of the 500 employee test or, as drafted presently, the 500 members of the fund test. It is the case, isn't it, that if the number of members drops below that then you essentially have to press the button to say that this fund has to cease operating?
>
> Mr Chapman: We will obviously treat that with some discretion. If it is down to 499 today—
>
> Mr FLETCHER: I just want to understand that because, unless I am misreading the bill, I am not quite sure on what basis you would have that discretion.
>
> Mr Chapman: I have been corrected by my expert, Dr Ellis. I have unfortunately said the wrong thing. One of the ways we want to address that is that when we get the trustees applying for those sorts of funds—which is in the draft application we are working on at the moment—we want to come up with a contingency plan for if employee numbers drop. We have said publicly that we do not think the trustees should be coming to us with a 29T(b) request for 500 employees. We think it needs to be more than that. The trustee has to be reasonably satisfied—and again we have those words 'reasonably satisfied'—that the 500 are going to be there. There is a little bit of a scale argument as well—

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

> Mr FLETCHER: Can I just make sure I understand that? What you are saying to me, in practical terms, if I am understanding correctly, is that there is no discretion for you as drafted if it falls below 500 members and therefore the only means to mitigate against the risk of a fund having to come to a screaming halt with all the attendant inconvenience for members, employers and so on is that the employer and the trustees must make sure that there is in fact substantially more than 500 members? Is that a fair assessment?
>
> Mr Chapman: Yes.
>
> Mr FLETCHER: That tends to make a bit of a nonsense of the 500 member test to start with, doesn't it?
>
> Mr Chapman: I am not going to comment on your conclusion there. Whenever you have any numerical test of any sort, there is always going to be an issue about what happens when you fall below it.
>
> Mr FLETCHER: Can I put the question to you another way. Would it give APRA additional administrative flexibility if the provision were amended so it did not refer to a hard test of 500 members?
>
> Mr Chapman: Clearly the answer to that is yes. It would give us an additional measure of flexibility. I know I have harped on this quite a bit this afternoon, but the test we would have would still be the same. Whether we are triggering that test at 550 or 450, it does not really matter. It still comes down to the fact that the onus has to be put back on the trustee to satisfy us that either they are going to stay above whatever the limit or they have a plan to do something once they fall below the limit. So even if there were flexibility in the legislation that said, 'If they fall below 500, APRA has discretion on whether to close the fund or not,' we would be unlikely to keep the fund open as it went from 500 to 400 to 300 to 200 to 100. We would still be putting the onus back on the trustee to have a contingency plan in place as they get down towards 500, which is what we propose at the moment. At the moment we are proposing with the legislation as it is now that any trustee who comes to us with a MySuper product between 500 and, say, 1,000 (a) has to make an assessment that they believe they are going to be over that and (b) has a plan which obviously would ramp up in terms of intensity and detail as you get closer to the bottom about what they will do when those numbers drop. The strict answer to your question is that clearly having that would give us more administrative flexibility, but the process we would go through would still be very similar. It is just that it would be returned from a hard number to some 'reasonable' number in APRA's view, which might be 450 or whatever.[23]

The Coalition members accept the strong submissions made by so many participants in the superannuation industry that the threshold in its current form is complex, unworkable and may have a number of unintended consequences.

23 *Proof Committee Hansard*, 2 March 2012, p. 59.

We therefore recommend a simple and effective test that the threshold be amended to define a large employer as any employer that has 500 or more employees at the relevant time.

Recommendation 4:

That the large employer threshold be amended to define a large employer as any employer that has 500 or more employees at the relevant time.

The 'scale test'

The Committee also received evidence about strong concerns relating to the proposed scale test contained in the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.

The Financial Services Council expressed its concerns at the hearing as follows:

> Mr Bragg: We are comfortable with the idea that the trustee should consider scale. You recall that, during the review, the chairman of the review was very keen to canvass the issue of the Canadian Pension Fund coming to Australia and trying to buy Transurban and I think he mused at the time that it would be good if Australian pension funds or super funds could do the same thing. That is fair enough. Our view is that a scale test should not be in law. Not only is it a barrier to entry but the test, as suggested in the current drafting, is very subjective, very open. We are not sure how one would be required to perform the scale test. I am not sure what sort of data you would be asked to use. Presumably, it is a comparative test. So I am not sure how you test scale. Another issue about scale is that the ACCC has made it very clear that, in certain parts of the wealth industry, mergers are not permitted. So even if you find you do not have enough scale, I am not sure whether you would be able to get anymore scale.
>
> Senator CORMANN: Obviously, the way the scale test has currently been drafted into the legislation there is obviously the implication in there that biggest is best. Is the evidence in the marketplace that biggest is necessarily best when it comes to fees or performance?
>
> Mr Bragg: It can be.
>
> Senator CORMANN: Is it always the case?
>
> Mr Bragg: No. There are some very well-performing smaller industry and retail funds. There are some very inexpensive, from a fee perspective, large corporate retail and industry super funds. I think it is a mixed bag.
>
> Senator CORMANN: Scale should be a consideration, but should it be a test that drives decision making towards effectively aiming for bigger scale, no matter what?
>
> Mr Bragg: Not in isolation to member value.[24]

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[24] Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 2 March 2012, p. 5.

The Industry Super Network agreed that such a test would be problematic in practice and accepted that there was no automatic correlation between scale and fund returns to members:

> Senator CORMANN: There are a lot of smaller funds that argue they are cheaper and better performing than most of the other larger funds. The data seems to support that proposition. Looking at the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill, how would trustees make judgments when they have to apply the scale test the way it is currently proposed in the legislation? It is going to be rather subjective isn't it? Who is going to ultimately make a judgment as to whether they have properly discharged their duty to apply the scale test?
>
> Mr Watts: We agree that is problematic. There is not an automatic correlation to the scale with providing a financial interest to members. But there is a sufficient link between scale and returns to members for that to be appropriately considered. It is a proper duty that a fund consider whether it has sufficient scale to operate in the financial interests of its members. How it does that is going to be a problematic exercise because, no doubt, a smaller fund may be of sufficient scale to perform well.
>
> Senator CORMANN: How can a trustee satisfy themselves that they have discharged a duty? How are regulators ultimately going to make a judgment on whether or not they have?
>
> Mr Watts: Ultimately I think it is going to be on the returns they are providing to their beneficiaries.
>
> Senator CORMANN: Does it create a significant level of uncertainty though in making judgments? You are nodding.
>
> Mr Watts: Absolutely, there will be a level of uncertainty. In our opening statement we raised it as an issue that would require some guidance as to how trustees are going to meet that duty.[25]

The Corporate Super Association expressed its concerns about the subjectivity of the proposed test and the potential for ongoing disputation between APRA and various funds over the interpretation of the test:

> Senator CORMANN: Do you have any views about the scale test?
>
> Mrs Goddard: Yes. It is very difficult to know how a trustee will form a view and it is very difficult to determine whether APRA will agree with their view. So there is subjectivity in the requirement on the trustee and we submit that there will be a degree of opinion from APRA as to whether the trustee's judgment is appropriate. So we think the scale test is going to be a difficult one.[26]

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25 Mr Richard Watts, External Relations Manager & Legal Counsel, Industry Super Network, *Committee Hansard*, 2 March 2012, pp 14–15.

26 Mrs Elizabeth Goddard, Research Officer, Corporate Super Association, *Committee Hansard*, 2 March 2012, p. 29.

The Association of Superannuation Funds of Australia described the wording of the test as problematic, expressed concerns that the test may produce 'wrong results' and strongly argued that the scale test should be removed from the legislation:

> Ms Vamos: We believe the current wording of the scale test is problematic. On speaking to Treasury, we believe that guidance will be provided by APRA. In terms of being able to provide for fund members, size of portfolio and number of members are certainly two factors, but there are other factors as well. In our view, fund trustees, as part of their best interest duties, have to look each year at whether or not they are able to provide services in the best interests of their members. So our initial view is very much that the—and certainly part of the consultation process—whole scale test may produce the wrong results.
>
> Senator CORMANN: So what you are implying is that, as the current scale test definition goes, biggest is necessarily best and that is wrong. Is that what you are saying?
>
> Ms Vamos: That there were many examples where big is not necessarily better. Fund trustees and superannuation funds must be accountable on their long-term performance. They must be accountable on what they provide to members in terms of retirement outcomes. We want to ensure that this is the focus of any trustee obligations and any regulation around the superannuation industry.
>
> Senator CORMANN: You said that the way the current scale test is defined is problematic. How would it need to be changed or improved? Or do you think we should do away with the scale test all together?
>
> Ms Vamos: I think there are other ways to get the outcome that the scale test is trying to achieve. I think it could be removed. The discussion between the industry and the regulator in terms of how you measure the long-term performance of a superannuation fund in relation to the retirement outcomes they are providing their members is where the discussion should be had. The measures should be part of that. It is part of the contemplation of the governance requirements.
>
> Senator CORMANN: Sure. We would agree with all of that. There is no case, really, to introduce the scale test into the trustee obligations, is there?
>
> Ms Vamos: We think there is the case to introduce performance testing, but we are uncertain as to whether the scale test will get the right outcomes in the end.
>
> Senator CORMANN: Beyond what is already in place now and beyond what is proposed, how would you improve duties around performance testing?
>
> Ms Vamos: It is not so much how to improve duties. When you are measuring the long-term performance of a superannuation fund there are a number of measures that need to be looked at. A lot of those measures could even be what a number of analysts look at in listed organisations as well. What those factors should be and what those measures should be are currently being determined. The minimum is what is the net return to members, sustainability of a fund in the long-term, being able to continue to

> provide services, efficiency of services, quality of communication, ability to provide choice, ability to provide post-retirement, and whole-of-life investing. They are all factors that need to be taken into account.
>
> Senator CORMANN: Sure. Would your recommendation to us be that it would be preferable not to proceed with the scale test as is proposed in the legislation?
>
> Ms Vamos: Our preference would be to see the scale test removed, yes.[27]

Mercer also stated at the Committee hearings that in its opinion the scale test was problematic and should be removed from the legislation:

> Dr Knox: … There are two areas in the second bill that we would want to address—and, again, some of them were raised this morning. We think the scale tests are problematic and may not end up with the best outcomes. They are very prescriptive and they do not necessarily deliver what may be in the members' best interests.[28]
>
> Senator CORMANN: Did I hear you say that the current scale test is problematic?
>
> Dr Knox: Problematic.
>
> Senator CORMANN: Do you think the scale test should be removed?
>
> Dr Knox: Whilst I can understand where Jeremy Cooper was coming from in wanting larger funds and so forth, I think with the current direction of scale the scale test is not needed if the trustees have that responsibility to act in the member's best interest.
>
> Senator CORMANN: I think that that is a very good point. In a general sense the trustees have to make judgements on a whole series of things, so the question really is: why would the legislation seek to prescribe something that is quite vague really but seems to have this implication that bigger is best? Is that a fair suggestion?
>
> Dr Knox: Yes, that is fair. There is evidence around the world from studies that, certainly on the admin side, as funds get bigger, generally admin fees come down. As you get more funds you get economies of scale for administration. As funds get bigger you get slightly different investment opportunities. I think the problem with the prescriptive scale test as it is at the moment is that it cannot possibly consider every situation. There will be some small funds operating in a niche market that do a very good job. If you follow the logic that the scale tests suggest—as you have suggested: bigger is best—then we would not have credit unions; we would only have the big four banks. I am not sure that that logic holds. I think we do need that tension.
>
> It is somewhat interesting that in Australia we have some very big funds—we also have the self-managed super fund sector, which is at the other

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27 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 2 March 2012, pp 32–33.

28 Dr David Knox, Senior Partner, Mercer, *Committee Hansard*, 2 March 2012, p. 38.

> end—but I think there is an opportunity, as long as that fund is operating well, is
>
> well-governed and is delivering good outcomes to members, where bigger is not always best and particular niche fund may well do well.
>
> Senator CORMANN: To go back to my original question, then, it would be better to leave these sorts of judgments to trustees on the basis of having to act in the best interests of members, rather than to introduce a scale test.
>
> Dr Knox: Because the scale test is prescriptive and cannot possibly cover in legislation—
>
> Senator CORMANN: I am just trying to get you to say whether you think it would be better if we remove the scale test.
>
> Dr Knox: Let's get rid of the scale test.
>
> Senator CORMANN: Thank you. That is what I was looking for.
>
> Mr Partridge: In the end, the marketplace will weed out those funds that are not going to survive because they do not have the scale necessary in some form or other.[29]

The Australian Institute of Superannuation Trustees also called for the removal of the scale test and made the point that it did not believe there was any direct correlation between fund size and fund performance:

> Mr Haynes: It is not necessarily our preference, but we would not shed any tears over the removal of the scale test. In an earlier iteration of the legislation, there were two separate scale tests—one for investments and one for number of members. Clearly, the number of members, to our mind, has no relationship whatsoever to the ability of a fund to perform.

Coalition members of the Committee find that the submissions made by the industry about the scale test are compelling and do not consider that it is an appropriate test to apply to default superannuation arrangements.

Although there can often be benefits that accrue to consumers from investing in large pooled investments, a scale test for super funds would have a number of negative consequences including the following:

- It introduces a barrier to entry in the marketplace and therefore lessens competition;
- It is a wide, subjective test with no guidance of how to undertake it;
- How would scale measured in relation to net returns of members and what would happen where a large fund has a poor return but a small fund produces a good return? It assumes that big is best and that is not always the case;
- No official data is to be provided to make the comparison; and

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29 Dr David Knox, Senior Partner, Mercer, *Committee Hansard*, 2 March 2012, pp 42–43.

- In many cases, mergers are not possible due to taxation matters, Australian Competition and Consumer Commission resolutions etc.

The Coalition understands the aspiration that big funds are good for Australia and that there can be significant benefits in achieving greater benefits from scale. However, we do not agree with legislatively imposing a duty upon trustees to have regard to the inherently vague and imprecise notion of 'scale'. We don't believe that the scale test would be workable in the context of a properly functioning default superannuation system.

Recommendation 5:

That the 'scale test' be removed from the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.*

Intra Fund Advice

Intra fund advice is the provision of financial advice by superannuation funds to their members.

Currently, the term 'intra fund advice' and the advice provided by various superannuation funds ranges widely from very general advice, product specific advice, advice on retirement options or even more specific or individualised 'holistic' financial advice.

Today intra fund advice only exists by an ASIC Class Order exemption.

The Committee received evidence from a number of participants expressing strong concerns about how intra fund advice would interact with the MySuper legislation, particularly given that it is only briefly referred to in the explanatory memorandum of the Bill currently before the Committee.

These concerns included a risk that such intra fund advice would lack transparency, lead to some super fund members cross-subsidising others through the fees they pay and the risk of secret commissions.

The Financial Services Council was concerned about the risk that the legislation would allow for a cross subsidy from some members of a superannuation fund to other members who choose to access such intra fund advice:

> Mr Bragg: We would be uncomfortable if in the third tranche of this legislation, which is going to define the parameters of intrafund advice, which can be cross-subsidised amongst the membership of a fund, it includes the capacity for a fund to issue complex personal financial advice and then cross subsidise that amongst the membership. Our view would be that the existing parameters, as we discussed with the Chairman, should be maintained but not expanded.[30]

[30] Mr Andrew Bragg, FSC, *Proof Committee Hansard*, 2 March 2012, p. 2.

The Corporate Superannuation Specialist Alliance expressed its concerns to the Committee:

> We feel strongly that intrafund advice should be restricted to general advice. It should not include personal advice. Personal advice should not be cross-subsidised by members of funds and should be paid for individually. It is not practically possible to provide advice on complex matters such as transition to retirement without understanding the client's financial position. It is therefore necessary to follow the correct advice process of knowing your client. Allowing personal advice to be provided under the guise of intrafund advice will result in a reduction of consumer protection. This seems to completely contradict the desired outcomes of FoFA. We would recommend that where intrafund advice is provided, an explicit fee is charged rather than hiding the fee within the administration fee. This will make sure fund members are aware of what they are paying for and are therefore entitled to receive intrafund advice. If this fee is explicit and is negotiable it could be used to remunerate advice providers for the provision of general advice and education. Paragraph 4.12 of the MySuper explanatory memorandum further limits educational opportunities, as it suggests education must be made available to every member of a MySuper fund and cannot be, for example, workplace specific. This suggests that employees of any number of different employers must all be invited to each educational seminar regardless of their location in Australian and regardless of the fact that they may be industry competitors. This will make the provision of education in the workplace basically impossible. It will only serve to reduce education and therefore financial literacy. We suggest this is removed as it seems illogical.[31]

It added:

> The only way that we would be rewarded for adding services into the workplace would be through this intrafund fee, of which you are going to have no control over its value or level. We are hitting a MySuper world that sounds as though it is going to compete on cost. As soon as you start competing on cost, it is very tempting to cut back on various fees and minimise the advice-service component. That then means that we may not be renumerated sufficiently to be able to deliver the services that we do today—and we are not going to run them at a loss; we would be forced to withdraw the services. I cannot see how that is going to benefit when we are the one group out there that are being proactive rather than reactive in providing services to the workplace.[32]
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> ...
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> Frankly, we believe in transparency. We think that the intrafund fee is effectively going back to the 1980s where fees were all bundled together

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31 Mr Gareth Hall, CSSA, Proof Committee Hansard, 2 March 2012, p. 18.

32 Mr Douglas Latto, CSSA, *Proof Committee Hansard*, 2 March 2012, p. 23.

> and it was a secret commission. We do not understand why that is being proposed.[33]

The Association of Superannuation Funds of Australia (ASFA) told the committee that intra fund advice should be limited:

> Senator CORMANN: What is your view on intrafund advice? Do you think there should be any limitations placed on what intrafund advice can be provided?
>
> Ms Vamos: Our view is that intrafund advice should be limited. It is at the very low end of the scale of personal advice. It is, if you like, an extension of general advice. Our position is very much that it should be principles based. We do not support a broad, nine-category approach as currently is being supported. Our view is that, as it does come out of administration fees, it should be a service that a member of a superannuation fund would believe they would be entitled to because they have that money in the fund. So if they have a question about their interest in the fund, the account balance of their fund, and simple scenarios that can be answered through the process of calculations and calculators, then we believe it should be part of the intrafund offering.
>
> Senator CORMANN: So you are in favour of the proposition that the cost of providing intrafund advice is bundled into the overall administration fee—that is, it is not transparent—and that it can be charged across the whole membership, irrespective of whether individual members access advice?
>
> Ms Vamos: Our view is that all fees should be transparent. The administration—
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> Senator CORMANN: So you are not in favour of bundling it into the admin fee?
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> Ms Vamos: No, we are definitely in favour of it being part of the administration fee. We would support the disclosure of, if you like, where the administration fee pie is, in terms of funds. We have done a lot of work in this area with Rice Warner. As to the operational costs and the operational fees charged, only a small amount of that overall fee actually applies to call centres and intrafund advice. We do support the transparency where administration fees are applied, as well as where investment fees are applied.
>
> Senator CORMANN: When people put evidence to us which says that intrafund advice, the way it is proposed, is completely opposite and counter the spirit by FoFA, that it is distorted, conflicted, with hidden fees and hidden payments, with no capacity to opt out, do you not agree with that characterisation?

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33 Mr Gareth Hall, CSSA, Proof Committee Hansard, 2 March 2012, p. 23.

> Ms Vamos: We do not agree. We believe that, when you look at the definitions of 'personal advice' and 'general advice', the definition of 'personal advice' is so broad that it captures the type of simple scenario advice that a member of a superannuation fund believes they are entitled to because they are a member of that fund.
>
> Senator CORMANN: But why should any member of a fund pay for the personal advice of other members of the fund that they do not access themselves?
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> Ms Vamos: The same argument can be applied in terms of website access, general advice access, call centre access. The majority advice provided by superannuation funds is general advice and factual information. Indeed, as members—
>
> Senator CORMANN: I am not talking about the general advice. I am talking about the personal advice.
>
> Ms Vamos: Again, when you look at the concept of intrafund advice, and you look at general advice, we think the better view is that infrafund advice is general advice that has been extended. Our view is that you have to limit personal advice and frame it more in terms of holistic financial planning. But intrafund advice is very much about interest in the fund. Really, it is definitions of advice that have raised this issue.[34]

Mercer supported the notion that some personal advice should be permitted in intra fund advice but highlighted that it was a real challenge to draw the line at how much advice should be permitted:

> Senator CORMANN: What is your view about intra-fund advice? Should there be limitations on it, or do you think that personal advice should be freely provided under the guise of intra-fund advice?
>
> Dr Knox: I think our view is that we should be able to go beyond general advice, but some personal advice is very personal and takes a lot of effort, and that should be paid for by the individual. The question is: where on the continuum between general advice and personal advice do you draw the line?
>
> Senator CORMANN: But why would it be appropriate for the collective membership to pay for any individual personal advice at all? The objectives of FoFA are transparency around fees and removing conflicts. If you look at what we have been told, here you have hidden fees, a lack of transparency around fees and potential conflicts and you are charging the whole membership irrespective of whether members take advantage of the advice. They would seem to be in conflict with each other.
>
> Dr Knox: There are currently, I think, four elements of intra-fund advice that are permitted to be offered by super funds, with examples such as insurance and investment choices and learning about different types of contributions. Our concern is that, if you make every question, apart from general knowledge, if you like, or general information, subject to a fee,

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34 ASFA, *Proof Committee Hansard*, 2 March 2012, p. 32.

> many members actually will not ask the question. They will ring up the call centre and ask, 'Do you think I should make salary sacrifice or after-tax contributions,' and the operator at the other end will say, 'That's going to cost you $50 to $100,' to which the member will say, 'I won't pay.' We have a level of intra-fund advice at the moment and we would not reduce it.[35]

Treasury appeared to be uncertain about the way that intra-fund advice will be treated under the MySuper reforms. The following exchange reflects both uncertainty and confusion:

> Mr FLETCHER: Do you envisage that, under the intra-fund advice provisions, it will be possible to offer personal advice as opposed to general advice and have that considered to be intra-fund advice?
>
> Ms Vroombout: Minister Shorten put out a press release on 8 December which outlined the broad parameters of the definition of intra-fund advice. Yes, that contemplated that it would be both general and personal advice.
>
> Mr FLETCHER: What kind of personal advice? How detailed might it be? Does Treasury have a view on that?
>
> Ms Vroombout: We have not got to the detailed drafting yet. The press release indicates that it would have to be advice that was consistent with the sole-purpose test in the superannuant industry (supervision) legislation. Then it notes that, notwithstanding that the advice met that test, there would be certain sorts of advice that wouldbe excluded from the definition of intra-fund advice. More complex sorts of advice would be excluded from the definition. I do not have any more detail than was outlined in the press release of 8 December.
>
> Mr FLETCHER: Does that mean we can think of three classes of advice: general, personal not so complex and personal more complex—or personal below a complexity threshold and personal above a complexity threshold, where personal below a complexity threshold will be permitted as intra-fund advice?
>
> Ms Vroombout: That is correct.
>
> Mr FLETCHER: Are you able to enlighten us as to what the complexity threshold will be?
>
> Ms Vroombout: All I can say is that the press release of 8 December outlined, I think it was, four things that would be regarded as sufficiently complex not to form part of intra-fund advice.
>
> Mr FLETCHER: On the issue of the allocation of the cost of intra-fund advice, it is the case that, essentially, a member who chooses not to take intra-fund advice is cross-subsidising those who do.

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35 Dr David Knox, Proof Committee Hansard, 2 March 2012, p.

> Ms Vroombout: The nature of intra-fund advice and, I guess, the purpose of its definition is that it is the sort of advice that can be collectively charged to the membership.[36]

Coalition members of the Committee consider that if intra fund advice is to continue to be provided in the future it should be provided under the same legislative and regulatory framework as all other financial advice.

Despite intra fund advice clearly being a type of financial advice there is no definition or scope of such advice provided in either the MySuper legislation or the government's Future of Financial Advice (FOFA) legislation.

There is no limitation placed on what may constitute intra fund advice and there are no provisions determining who should pay for such advice in any of the proposed legislation.

Coalition members of the Committee consider that the complete lack of consideration, definition or restriction of intra fund advice within both the MySuper and the FOFA legislation is a serious omission on the part of the government that exposes consumers to severe risks.

This is particularly the case because intra fund advice would not be subject to the best interests duty being introduced by the FOFA legislation and because many industry super funds currently fund such intra fund advice by levying fees for this advice on all fund members. This would not be permitted if FOFA applied, as FOFA essentially bans the provision of advice in circumstances where the cost of providing the advice is not met by a direct and transparent payment from the recipient of the advice. The policy rationale is that in these circumstances the provider of advice will be receiving its economic return from sources other than payment from the recipient (for example, an undisclosed commission from a product provider) and hence the provider of the advice will be motivated by factors which are not known to the recipient. Unfortunately, that principle appears to have been overlooked by the government when it comes to intra fund advice. It is hard to see any clear policy rationale for applying the principle in one context but ignoring it in another.

Given the reliance of many industry super funds on the provision of intra fund advice for marketing advantage and the attraction of new members, we are concerned that the government has avoided defining and limiting the scope of intra fund advice because it has bowed to the interests of the union-dominated industry super funds.

Coalition Committee members strongly recommend that intra fund advice should be defined in both the MySuper and the FOFA legislation, that there be express limitations included in the legislation to ensure that such advice is general in nature only (similar to the provisions relating to basic banking products) and that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty and be paid for by the person accessing this advice without any cross-subsidy from other fund members.

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36 Treasury, Proof Committee Hansard, 2 March 2012, pp. 62–63.

Recommendation 6

That the MySuper legislation be amended to:

1. **Provide a comprehensive definition of the term 'intra fund advice';**
2. **Ensure that 'intra fund advice' is general in nature only;**
3. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty contained in the proposed FOFA legislation;**
4. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be paid for by the person accessing this advice without any cross-subsidy from other fund members; and**
5. **Repeal the existing ASIC Class Order exemption as it would be superfluous once intra-advice is properly defined in legislation.**

Senator Sue Boyce **Senator Mathias Cormann**

Paul Fletcher MP **Tony Smith MP**

Appendix 1

Submissions

Submissions to Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011

1 Consumers' Federation of Australia
2 Corporate Superannuation Specialist Alliance
3 Financial Services Council
4 Sunsuper
5 Fiduciarys Friend Pty Ltd
6 Australian Chamber of Commerce and Industry
7 Industry Super Network
8 Confidential
9 Australian Institute of Superannuation Trustees
10 Colonial First State
11 BT Financial Group
12 The Association of Superannuation Funds of Australia Limited
13 Mercer
14 Bendigo Wealth
15 Association of Financial Advisers Ltd
16 Financial Planning Association
17 Corporate Super Association
18 Dimensional

Answers to questions on notice

1 Corporate Super Specialist Alliance: Fee levels for members. Received 7 March 2012.

Submissions to Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

1 Australian Institute of Superannuation Trustees

2 Professional Financial Solutions

3 Association of Superannuation Funds of Australia

4 Confidential

5 Mercer

6 Financial Services Council

7 AustralianSuper

8 Confidential

9 AMP Financial Services

10 Law Council of Australia

11 Corporate Super Association

Appendix 2

Public Hearing

Friday 2 March 2012

Witnesses

Financial Services Council

Mr Andrew Bragg, Senior policy Manager

Industry Super Network

Mr Matthew Linden, Chief Policy Adviser

Mr Richard Watts, External Relations Manager and Legal Counsel

Corporate Superannuation Specialist Alliance

Mr Douglass Latto, President

Mr Gareth Hall, Treasurer

Corporate Super Association

Mrs Elizabeth Goddard, Research Officer

Association of Superannuation Funds of Australia

Ms Pauline Vamos, Chief Executive Officer

Ms Fiona Galbraith, Senior Policy Officer

Mercer (Australia) Pty Ltd

Dr David Knox, Senior Partner

Mr Stephen Partridge, Product Leader, Outsourcing

Australian Institute of Superannuation Trustees

Mr Gerard Noonan, President

Mr David Haynes, Project Director

Australian Prudential Regulation Authority

Mr Keith Chapman, Executive General Manager, Diversified Institutions Division

Dr Katrina Ellis, Senior Manager, Policy Development, Policy, Research and Statistics Division

Treasury

Ms Melissa Bray, Policy Analyst, Financial System Division

Mr Adam Hawkins, Policy Analyst, Financial System Division

Jonathan Rollings, Principal Advisor, Financial Services Division

Ms Sue Vroombout, General Manager, Retail Investor Division