Chapter 2

Schedules 1 and 2 of the bill: provisions and views

2.1 This chapter considers the provisions of, and views on Schedules 1 and 2 of the Further MySuper Bill.

Schedule 1: fees, costs and intrafund advice

2.2 As chapter 1 of this report emphasised, the government's overarching policy objective in the MySuper reforms is to ensure that retirement savings are not being eroded through excessive fees. Schedule 1 of the Further MySuper Bill extends this objective to ensure that:

> ...members of MySuper products do not pay unnecessary fees, that a trustee does not enter into performance fee arrangements that are not in the member's best interests and limits certain fees to ensure they do not unfairly inhibit a member from making active choices.[1]

Conflicted remuneration

2.3 Proposed section 29SAC of the *Superannuation Industry (Supervision) Act 1993* ('the SIS Act') establishes new fee rules for superannuation funds that require registrable superannuation entities (RSEs) not to charge commissions for MySuper products. In effect, the trustee is prohibited from deducting any amount from a MySuper product that relates to making a commission payment to a financial adviser.[2]

2.4 Further, the RSE licensee must elect not to charge a member of the MySuper product a fee in relation to that product that relates to costs of the fund in paying an amount to another person, that the RSE knows—or reasonably ought to know—relates to conflicted remuneration paid by that other person to a financial services licensee.[3] The Explanatory Memorandum (EM) notes that RSEs will therefore be unable to pay premiums on insurance policies that have embedded commissions paid by an insurance company to a financial adviser in relation to insurance arrangements offered through the superannuation fund.

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1 The Hon. Bill Shorten MP, Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012, Second Reading Speech, *House of Representatives Hansard*, pp 12683–12684.

2 Explanatory Memorandum, p. 8.

3 Explanatory Memorandum, p. 11.

Performance-based fees

2.5 The intent of a performance-based fee is to encourage investment managers to secure returns that are greater than they otherwise would if paid an asset-based fee. The Cooper Review identified a range of concerns with the current structure of performance-based fees, indicating they may not always be in members' best interests.[4] The Review stated:

> Performance-based fees were, until recently, typically only charged by hedge funds or in the context of mandates relating to alternative assets. Quite quickly, they have become much more widespread. The Panel's view is that performance-based fees should be the exception, rather than the rule, for superannuation fund investments and has recommended that a performance-based fee standard be adopted for MySuper products.[5]

2.6 Proposed section 29VD of the SIS Act establishes new criteria for performance-based fees payable to an investment manager under a contract or arrangement to invest assets of a fund that are attributable to a MySuper product.

2.7 The bill sets out five criteria that must be contained in the terms of the arrangement the fund has with the investment manager if there is a performance-based fee. They are:

(a) if the investment manager is entitled to a fee in addition to the performance-based fee then this fee must be lower than it would be if there was no performance-based fee; [proposed subsection 29VD(3)]

(b) the period over which the performance-based fee is determined must be appropriate to the kinds of investment to which it relates; [proposed subsection 29VD(4)]

(c) the performance of the investment must be measured by comparison with the performance of investments of a similar kind; [proposed subsection 29VD(5)]

(d) a performance-based fee must be determined on an after-costs and, where possible, an after-tax basis; [proposed subsection 29VD(6)]

(e) the performance-based fee must be calculated in a way that includes disincentives for poor performance. [proposed subsection 29VD(7)][6]

2.8 The EM notes that a RSE licensee may still have an arrangement under which assets attributable to the MySuper product are invested subject to a performance-based

4 Explanatory Memorandum, p. 7.

5 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 13 http://www.supersystemreview.gov.au/ (accessed 24 September 2012).

6 Explanatory Memorandum, pp 12–13.

fee which does not meet the criteria, if it can demonstrate that the arrangement promotes the financial interests of the members of the fund.[7]

Intrafund advice

2.9 The bill places specific restrictions on the types of personal advice that superannuation trustees can charge across their membership as intrafund advice. Intrafund advice can be general in nature, not taking into account the particular circumstances of the client. Alternatively, it can be personal advice that does consider these circumstances. Currently, the only restriction on trustees passing these advice costs on to their membership is that it complies with the sole purpose test under section 62 of the SIS Act.

2.10 Intrafund advice that is simple and non-ongoing personal advice relating to the member's interest in the fund is able to be collectively charged across the fund's membership.[8] This includes advice about moving between investment options within the fund, such as from an accumulation option to a pension option. It also allows collective charging for advice about a related pension fund for the member and the fund, a related insurance product for the member and the fund, or a cash management facility.[9] Costs for an ongoing advice relationship must be charged directly to the member.[10]

2.11 Treasury explained the bill's provision on intrafund advice as follows:

> ...non-ongoing advice relating to a member's interest in a fund is able to be provided by the fund, whether it be internally or externally by an adviser, and collectively charged across the membership. But any more complex advice—which is likely to be more costly—cannot be collectively charged and must be charged to the individual member.[11]

2.12 The bill would impose specific restrictions to the types of personal advice that superannuation trustees can charge collectively across their membership. Proposed subsection 99F(1) of the SIS Act specifies the conditions under which trustees will *not* be able to charge across the membership of the fund. These are in cases where:

- the person to whom the advice is given has not acquired a beneficial interest in the fund, and the advice relates to whether the person should acquire such an interest;

7 Explanatory Memorandum, p. 14.

8 Explanatory Memorandum, p. 14.

9 Explanatory Memorandum, p. 16.

10 Explanatory Memorandum, p. 15.

11 Mr Jonathan Rollings, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 45.

- the advice relates to a financial product other than a beneficial interest in the fund, a related pension fund, a related insurance product or a cash management facility;
- the advice relates to whether the member should consolidate their superannuation holdings in two or more superannuation entities into one; or
- the advice is ongoing personal advice, insofar as there is a reasonable expectation that the trustee will periodically review the advice, provide further personal advice, monitor the implementation of recommendations or other prescribed circumstances apply.[12]

2.13 The EM notes that while the Australian Securities and Investments Commission (ASIC) is the responsible regulator for intrafund advice, APRA may also cancel an RSE licensee's authorisation to offer a MySuper product if, on the advice of ASIC, the licensee has not complied with section 99F.[13]

General fee rules

2.14 The bill contains various general fee rules relating to administration fees, investment fees, insurance fees, activity fees, entry fees and buy-sell spreads, switching fees and exit fees. The rules will apply to fees charged by regulated superannuation funds and approved deposit funds: they will not apply to self managed superannuation funds (SMSFs) and pooled superannuation trusts.[14]

2.15 The MySuper Core Provisions Bill establishes conditions to be met for a fund to be able to offer a different administration fee in respect of employees of a particular employer. Proposed section 29VB of the SIS Act in the Further MySuper bill would establish an additional condition:

> (5) The total amount of the administration fee charged in relation to the employee members is at least equal to an amount that reasonably relates to costs that:
>
> > (a) are incurred by the trustee, or the trustees, of the fund in the administration and operation of the fund in relation to those members; and
> >
> > (b) are not otherwise charged as an investment fee, a buy-sell spread, a switching fee, an exit fee, an activity fee, an advice fee or an insurance fee.

2.16 The EM notes that the aim of this provision is to ensure that any discounted administration fees reflect actual administrative efficiencies, and also prevent cross subsidisation of administration fees across different members of a fund. The fee

12 Explanatory Memorandum, p. 15.

13 Explanatory Memorandum, p. 15.

14 Proposed subsection 99A of the SIS Act

charged to members that are employees must at least equal the costs in the administration and operation of the fund in relation to the members that are employees of the employer. However, the fee may be paid fully or partly by the employer. Costs incurred by the trustee in the administration and operation of the fund that are charged as part of an investment fee, a buy-sell spread, a switching fee, an exit fee or an activity fee are excluded from this additional condition.[15]

2.17 Proposed subsection 29VC of the SIS Act states that an insurance fee in relation to a MySuper product must be an amount that is not more than it would be if it were charged on a cost recovery basis. The EM explains that:

> ...this will ensure that a trustee cannot charge above cost fees outside of the two main headline fees of a MySuper product—the investment fee and administration fee—and the advice fee which may be charged where the member seeks financial advice. These two main headline fees will be a key point of comparison between MySuper products, and therefore, by only allowing certain fees to be charged greater than cost recovery, this comparability will place downward pressure on the total fees that are charged to members in MySuper products.[16]

2.18 The bill also states that an activity fee in MySuper will be limited to being charged at an amount that is not more than it would be if it were charged on a cost recovery basis.

2.19 Proposed subsection 99B(1) of the SIS Act prohibits the charging of entry fees. An entry fee is defined as a fee that relates, directly or indirectly, to the issuing of a beneficial interest in the superannuation entity to a person who is not already a member of the entity.

2.20 Proposed subsection 99C(1) of the SIS Act states that buy-sell spreads, switching fees and exit fees will only be able to be charged as an amount that is not more than it would be if it were charged on a cost recovery basis.

2.21 Proposed section 99D of the SIS Act states that the costs of providing personal financial advice to employers cannot be included in any fee charged to any member of a superannuation fund.

2.22 The cost of financial product advice provided to a member will be able to be charged to that member as an advice fee. Proposed subsection 29V(8) of the bill states that an advice fee:

> (a) relates directly to costs incurred by the trustee, or the trustees, of a superannuation entity because of the provision of financial product advice to a member by:

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15 Explanatory Memorandum, p. 31.

16 Explanatory Memorandum, p. 18.

(i) a trustee of the entity; or

(ii) another person acting as an employee of, or under an arrangement with, a trustee or trustees of the entity; and

(b) those costs are not otherwise charged as an administration fee, an investment fee, a switching fee, an exit fee, an activity fee or an insurance fee.

Submitters' views on Schedule 1

2.23 The following section presents submitters' and witnesses' views on the following aspects of Schedule 1 of the Further MySuper bill:

- intrafund advice;
- grandfathering arrangements realting to proposed subsection 29SAC;
- performance-based fees;
- the administration fee exemption;
- the cost of financial product advice;
- the definition of a 'switching fee' and 'investment fee'; and
- the impact on superannuation business models.

Views on intrafund advice

2.24 The Association of Financial Advisers (AFA) expressed concern that the bill's provisions on intrafund advice will not serve the best interests of clients. In evidence to the committee, the Chief Executive Officer of the AFA, Mr Richard Klipin, argued that:

> ...the payment for personal advice out of an administration fee is a less-than-transparent mechanism and also serves to detrimentally impact the perceived value of any advice that people get. Anything you get for free you do not properly value, and if you can get it for what appears to be free from your superannuation fund then why would you go to a financial advisor and pay for it? This is about protecting advisers from what we believe is an artificial distortion in the marketplace.[17]

2.25 He added:

> Our strong concern is that the legislation is inconsistent, and seems to allow for advice on a pension fund and insurance, which is, in general, complex advice and not simple advice. Advice on pension funds is retirement advice, and retirement advice is complex advice. It should not be allowed to be considered an advice that can be covered by an administration fee. The situation is pretty much the same for insurance advice, as this requires a very good understanding of clients' personal circumstances, relevance,

17 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisors, *Proof Committee Hansard*, 5 October 2012, p. 21.

> amount of cover, type of cover and making sure that the level of cover they have meets their needs and objectives. This goes in many ways to the heart of the FOFA changes around best interest and keeping the client's needs front and centre.[18]

2.26 The AFA's general position is that advice that is provided without any adequate investigation of the client's personal circumstances 'poses a very serious risk'. It feared that the MySuper legislation will encourage superfunds to see all advice as simplistic, which 'may ultimately be very disadvantageous to clients'.[19]

2.27 In contrast, other organisations were strongly supportive of the bill's provision on intrafund advice. The Australian Institute of Superannuation Trustees (AIST), for example, supported what it called the 'dual regulation' of intrafund advice through both the Future of Financial Advice provisions and the provisions in proposed section 99F of the SIS Act. However, AIST did note that trustees should not be able to provide intrafund advice on products that are not be operated by the trust. It also stated that while the 'one-off' test for intrafund advice is appropriate, this should not preclude the fund from subsequently inviting the member to review his or her advice.[20]

2.28 Further. Treasury was asked whether, under the intrafund advice provisions in the bill, a contract would need to be terminated between a financial adviser and a superannuation fund for advice by the adviser to a particular class of employees. It responded:

> There is no requirement for provision of that type of service to be ceased. What the bill does do is that it requires that only advice of a particular type—these are the intrafund advice provisions—can be collectively charged. If a trustee decides that they want to provide some general advice, whether through an external adviser or through their own internal advisers, they can do so and collectively charge, as long as it is that one-off, modular, transactional type of advice.
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> ... If the adviser is remunerated by the trustee, that is not the issue that is addressed by the bill. What is addressed by the bill is how members are charged. To the extent that they are not receiving that advice, or to the extent that it is general advice and the trustee wants to provide it or it is personal advice of the limited type defined in the bill, that can continue and it can continue to be collectively charged. However, if it is not of that type then the member will actually have to request it and decide to pay themselves for that particular type of advice. So, if that type of advice is currently being provided, you are right in that it cannot continue to be

18 Mr Richard Klipin, *Proof Committee Hansard*, 5 October 2012, p. 21.

19 Mr Richard Klipin, *Proof Committee Hansard*, 5 October 2012, p. 21.

20 Australian Institute of Superannuation Trustees, *Submission 19*, p. 6.

> provided by that adviser without the member choosing to receive that type of advice.[21]

Grandfathering arrangements

2.29 In its submission to this inquiry, the Law Council of Australia (LCA) expressed concern about proposed subsection 29SAC(1) of the SIS Act. This subsection sets out the conditions a trustee must satisfy in order to make an election as part of its MySuper authorisation application.

2.30 The LCA noted that a trustee making an election will undertake not to charge MySuper members a fee relating to costs incurred by the trustee in paying conflicted remuneration to a financial services licensee. It described the election process as 'inappropriate' and considered that the provision will 'detrimentally affect trustees where they have continuing obligations to pay conflicted remuneration under grandfathered arrangements'.[22]

2.31 In verbal evidence to the committee, Ms Michelle Levy of the LCA foresaw problems with the generous grandfathering provisions contained in the Future of Financial Advice (FOFA) legislation, relative to the MySuper legislation. She told the committee:

> We are concerned by the mismatch here between the very generous grandfathering that is provided under FOFA and the Stronger Super regime. You may well end up with a situation where a trustee has an ongoing obligation to pay what would, but for the grandfathering provisions, be conflicted remuneration—they will have that contractual obligation, but they will have lost their source of funds to pay that amount.[23]

2.32 She added:

> I could be receiving a commission because I have put somebody in a managed fund or in a superannuation fund, and that commission will continue to flow from the managed fund or platform but not from the superannuation fund, if they have been moved to a MySuper product.[24]

2.33 The issue of grandfathering is revisited in chapter 4 of this report in relation to the transfer of 'accrued default amounts' to a MySuper product by 1 July 2017.

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21 Mr Adam Hawkins, Analyst, Financial Systems Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 44.

22 Law Council of Australia, *Submission 10*, p. 3.

23 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 16.

24 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 16.

Performance-based fees

2.34 In terms of performance based fees, the LCA argued that the bill's provisions are drafted in 'simplistic and aspirational terms', which 'are likely to be problematic and ambiguous in several respects'.[25] In particular, it cited the bill's reference to conducting an 'after-tax calculation'[26] where possible and added: 'That is a very high standard—many things are possible but not necessarily practical or in the interests of members'.[27]

2.35 The LCA's position is that RSE licensees should be encouraged to calculate performance-based fees outside the legislation. It suggested that if a performance-based fee provision remained:

> RSE licensees might instead be required to use their reasonable endeavours to estimate performance after making adjustments on account of Australian taxes to the extent considered reasonable and practicable, on the basis of such assumptions which the RSE licensee considers to be reasonable in all of the circumstances. Otherwise, RSE licensees may be driven away from utilising performance-based fees altogether.[28]

Views on the administration fee exemption

2.36 The Industry Super Network (ISN) expressed concern that while the stated aim of proposed subsection 29VB(5) of the SIS Act is to align administrative efficiencies with administration fees, the provision potentially enables trustees to set differential fees for members irrespective of whether savings had been made. Mr Matthew Linden of the ISN told the committee there is no guarantee that:

> ...section 29VB could not be misused by product providers to set differential administrative fees within the same MySuper product in a way to avoid price competition and to treat members of a single employer unfairly when they change jobs by hiking administrative fees without consent. Indeed, under the existing drafting this outcome would be mandatory.
>
> There have been amendments made to the core provisions bill to prevent these outcomes, commonly known in the industry as flipping, in respect to the transfer of interest from one product to another. However, the treatment of members in the same product when the administrative fee exemption applies creates a loophole that needs to be addressed.[29]

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25 Law Council of Australia, *Submission 10*, p. 4.

26 Proposed subsection 29VD(6) of the SIS Act

27 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 16.

28 Law Council of Australia, *Submission 10*, p. 4.

29 Mr Matthew Linden, Industry Super Network, *Proof Committee Hansard*, 5 October 2012, p. 40.

2.37 ISN proposed in its submission that the simplest approach would be to make the use of S29VB subject to a sunset clause, which would be aligned to the full implementation of SuperStream. When SuperStream is fully implemented, it argued that there will be 'virtually no difference' in the administrative arrangements used by employers and funds. Accordingly, there would be no rationale for the exemption. ISN suggested that no ensure there could be some flexibility in administrative pricing, the bill could be amended to:

- align the use of the exemption with actual administrative efficiencies implemented with an employer sponsor; and
- ensure members are adequately notified of any administrative fee increase if they leave an employer sponsor.[30]

Views on the cost of financial product advice

2.38 The LCA also drew the committee's attention to proposed subsection 99F(1)(c)(ii) of the SIS Act which would protect the general membership from the cost of advice given to a particular member, where that advice relates to a 'financial product that is not a beneficial interest in the fund'. It expressed concern that this provision would be 'very difficult' to administer in cases where a fund offers members a limited range of investment options, some of which may be financial products in their own right.[31] In these cases, the trustee would need to track which advice relates to which investment option. Accordingly, the LCA recommended that:

> ...this provision should apply only where the fund is in the nature of a “super wrap” (where all or the great majority of the available investment options are financial products in their own right).
>
> Many investment options within a superannuation fund are generally not regarded as financial products in their own right. As such, the legislation would not prevent a trustee from charging the general membership for the costs of advice provided to members to assist them in choosing between investment options offered within the fund.
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> However, in other cases, investment options may constitute a financial product. This is commonly the case where a trustee offers ethical investment options and chooses to do so by offering investment in an ethical fund that is itself a financial product.[32]

2.39 The LCA also noted some difficulty with proposed section 99F(1)(c)(iv), referring to the reasonable expectations of the 'subject member' as to whether the adviser will periodically review the advice, provide further personal advice or monitor

30 Industry Super Network, *Submission 20*, pp 6–7.

31 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 16.

32 Law Council of Australia, *Submission 10*, p. 6.

the implementation of the recommendations in the advice. The Law Council argued that:

> ...the trustee should not be required to form a view about a member's reasonable expectations in order to determine whether the cost of that advice can be borne by the general membership. The Committee suggests a more principled approach such as: where personal advice relates to a specific member's interest in the fund, the cost of the advice must be borne by the specific member except in the following instances. The legislation could then list the matters that would generally fall within the concept of 'intra fund advice'.[33]

Views on the definition of a 'switching fee' and 'investment fee'

2.40 The LCA argued that the bill's proposed definition of a 'switching fee' overlaps with the concept of buy/sell spreads and only captures switches between classes of beneficial interest. The definition thereby fails to capture fees which may be charged for switching between investment options within the same class. The LCA proposed amending the definition to refer to costs—other than transaction costs recovered through a buy/sell spread—related to a change in the investment of a member's interest in a superannuation entity.[34]

2.41 The LCA also commented on the bill's definition of an 'investment fee' in proposed subsection 29V(3) of the SIS Act. It argued if this provision is passed:

> ...it will no longer be possible for trustees to recover costs incurred by the trustee (that are not otherwise charged by way of another fee). This is because, under the new definition, investment fees must relate to the investment of the fund's assets (whereas previously the investment fee was an inclusive amount). This may mean that there is no longer a permitted fee that can include costs incurred in respect of MySuper members that would fall within a trustee's general right of reimbursement under trust law.[35]

2.42 It gave the example of a trustee incurring legal costs to defend a claim for a total and permanent disability (TPD) benefit by an individual MySuper member which had been refused by the insurer. It noted that these costs would ordinarily be able to be indemnified out of the fund, but added:

> [I]t is difficult to categorise such costs as related to the administration and operation of the fund or to the investment of the fund assets. Further, those costs would not appear to fall within the definition of an 'activity fee' under proposed section 29V(7), because an activity fee is defined as a fee that relates to the costs incurred by the trustee that are directly related to an

33 Law Council of Australia, *Submission 10*, p. 7.

34 Law Council of Australia, *Submission 10*, p. 4.

35 Law Council of Australia, *Submission 10*, p. 4.

> activity engaged in at the request or with the consent of a member or that relates to a member and is required by law.[36]

2.43 On this basis, the LCA argued that either the administration fee or the investment fee should be an inclusive fee rather than a restrictive fee. It argued that if this is not the case, choice members may subsidise the costs incurred in respect of MySuper members that do not fall within one of the permitted fees.[37] As Ms Levy told the committee:

> It is not clear from the drafting whether or not the fee rules are intended to provide for the entire universe of amounts that can be deducted or applied to assets attributed to MySuper members. If that is the case, then the concern is that in the drafting of the fee, the definitions themselves are too narrow to allow a trustee to be indemnified for the full range of expenses and costs that it would ordinarily incur.[38]

Impact of superannuation business models

2.44 The committee also received evidence that the MySuper provisions will have a detrimental impact on the services that corporate superannuation firms provide. Mr Douglas Latto of the Corporate Super Specialist Alliance (CSSA) made the point that under the proposed arrangements, the CSSA cannot charge a collective fee for its services under MySuper. He told the committee that in terms of the information service that the CSSA provides:

> ...we have an agreement with employers as to how that should be charged and there are signed agreements, and we deliver on those services. Those services are then charged back collectively to the fund on a fee basis which is transparent to the members and of which the members are informed. We cannot have that collective fee anymore. That collective fee is not one of the fees that are allowed under MySuper. We also have income coming, if you like, on our existing clients, and all that is going to be swept up and will disappear when it transitions to MySuper as well. So not only the income going forward but all our existing income disappears, and the only way we can now be paid for our services is if the employer pays directly. I can assure you, given the fact that super is going from nine to 12 per cent, that employers are not necessarily in the mood for putting their hands in their pockets at this point in time.[39]

2.45 The committee believes these fears are exaggerated. It understands that corporate super advisers will be able to negotiate an intra-fund fee for advice given at

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36 Law Council of Australia, *Submission 10*, p. 4.

37 Law Council of Australia, *Submission 10*, p. 4.

38 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 20.

39 Mr Douglas Latto, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 13.

workplace level if members join a 'choice fund' as opposed to a MySuper product. Given this, it is up to the corporate super advisers to negotiate with the retail super funds to convince the trustees responsible for setting intra-fund fees to allow these fees to be negotiable at workplace level for 'choice' fund members.

Committee view on Schedule 1

2.46 The committee strongly supports the provisions in Schedule 1 of the bill. This schedule establishes the government's commitment to MySuper as a commission-free superannuation product placing the onus to RSEs to ensure that their MySuper products do not charge any fee that relates to commission payments.

2.47 In terms of intrafund advice, the committee believes it is appropriate that superannuation funds continue to be able to provide a member with simple, non-ongoing personal advice relating to the member's interest in the fund. More complex advice of an ongoing nature should be paid for by the member or members receiving the benefit. To this end, the committee believes that the provisions in Schedule 1 of the bill are clear and well drafted.

2.48 The committee also supports the drafting in Schedule 1 on performance-based fees. Following Cooper, it is appropriate to apply new criteria to these fees while allowing trustees some leeway if they can demonstrate that the arrangement promotes the financial interests of MySuper members.

2.49 The committee believes that the outstanding issues of stakeholder concern relating to Schedule 1 of the bill have been considered closely by government. That said, the committee does emphasise the need for the government to continue communicating with stakeholders assist them to understand and comply with the MySuper legislation.

Schedule 2—Insurance

2.50 Superannuation insurance protects members against the risk of not being able to accumulate sufficient retirement savings—for themselves or their dependents—due to ceasing work as a result of injury, illness or death. However, as the Cooper Review noted, 'insurance cover embedded in super comes at the cost of foregone retirement savings and earnings'. The Review's expert panel argued that in this context, trustees have 'an important role in setting appropriate insurance offerings for their members', including:

- default insurance tailored for members who do not consider their insurance needs, and who rely on the trustee's judgment for adequate insurance;
- death and total and permanent disability (TPD) insurance to meet the needs of members so that they have sufficient benefits in the event that they need to access their retirement savings early; and

- income protection insurance which can complement these types of insurance by providing benefits when disability is believed to be temporary, not permanent.[40]

2.51 The panel emphasised that no other type of insurance is consistent with the objectives of superannuation and nor should it be paid for from member super savings. It thereby argued the need for all trustees 'to develop a considered insurance strategy and monitor its implementation'. The panel added that the risks associated with fund self-insurance of life and TPD benefits are high and so self-insurance should only be permitted in limited circumstances.[41]

Minimum level of life insurance

2.52 In response, the government announced that trustees will be required to provide minimum levels of default life insurance and TPD insurance to members of their fund that hold the MySuper product on an opt-out basis. The EM notes that currently, to accept contributions from an employer on behalf of an employee that does not have a chosen fund, a fund must offer a minimum level of life insurance as set out in the SG Regulations. The amount of life insurance must be at least the minimum set by SG Regulations. The EM states that these minimum requirements will provide a safety net to members who are least likely to give consideration to their insurance needs.

2.53 The bill proposes to change this requirement so that a fund that accepts contributions for employees must actually provide benefits to each MySuper member in respect of death at the minimum level set out in the SG Regulations. However, the member can elect that these benefits not be provided or that they wish to hold a lower amount of life insurance.[42]

Default insurance

2.54 The bill establishes that the trustee must provide benefits by taking out an insurance policy or through self-insurance.[43] Each member of a fund that holds the MySuper product must be offered benefits that are supported by life and TPD insurance, with the ability to opt-out of these benefits. An RSE licensee may require a member to elect to opt-out of both life and TPD insurance. It may also provide members the flexibility to opt-out of one type of insurance if they wish.[44]

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40 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 14 http://www.supersystemreview.gov.au/ (accessed 24 September 2012).

41 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 14 http://www.supersystemreview.gov.au/ (accessed 24 September 2012).

42 Explanatory Memorandum, p. 25.

43 Explanatory Memorandum, p. 26.

44 Explanatory Memorandum, p. 27.

2.55 'Opting-out' allows members to protect their balance while accepting the financial risks of death and permanent incapacity if they choose. Should the member opt-out, he or she can obtain insurance cover outside of superannuation. The trustee is not required to provide this insurance to the member.[45]

2.56 The EM notes that trustees will have the discretion to determine minimum levels of insurance they may provide for their members depending on what is in members' best interests. They may offer each member of the fund the same minimum level of fault life and TPD insurance or they may vary the minimum level either across different workplaces or at the member level. The EM adds that trustees would have the option of providing different levels of default insurance cover to different categories of employees within a workplace that reflects their different insurance needs.[46]

Self insurance

2.57 The government also announced that funds would be prohibited from self-insuring any benefits of the fund including life and TPD insurance benefits. The EM noted that the ban on self-insurance will address the risks of any short fall in insurance benefits being funded from other member balances. It also ensures that insurance benefits are paid from authorised insurance institutions that are required to comply with relevant prudential regulation.[47]

Committee view on Schedule 2

2.58 Some submitters did raise concerns with Schedule 2 of the bill. Professional Finance Solutions, for example, raised several technical issues relating to terminology, definitions and a proposed amendment to proposed subsection 68AA(6) to allow funds let members opt out of TPD insurance but retain death insurance.[48]

2.59 The committee believes that Schedule 2 is clearly drafted and based on sound principles. It commends the government for retaining the existing requirement that a fund offers a minimum level of life insurance in order to accept contributions for employees that do not have a chosen fund will be retained. This is important. It is also appropriate that members can elect that benefits not be provided or (if permitted by the fund) to hold a lower amount of life insurance. This approach of a basic insurance safety net with in-built choice is the optimum arrangement.

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45 Explanatory Memorandum, p. 27.

46 Explanatory Memorandum, p. 27.

47 Explanatory Memorandum, p. 24.

48 Professional Finance Solutions, *Submission 29*, p. 4.