Chapter 4

Schedule 6 of the bill: provisions and views

Schedule 6—Transition to MySuper

4.1 Schedule 6 of the bill establishes the requirements for existing member balances to be moved to MySuper products. The government noted in its response to the Cooper Review that existing default funds will be required to transition to MySuper after an appropriate period.[1]

4.2 In April 2012, upon releasing the draft of the third tranche, the government announced that the trustees of superannuation funds offering MySuper products will need to transfer existing default balances of their members to a MySuper product by 1 July 2017. Trustees that do not seek authorisation to offer a MySuper product will also be required to transfer certain balances to a MySuper product in another fund before 1 July 2017.[2]

4.3 In its initial response to the Stronger Super Review, the government announced that existing default amounts would be transitioned to MySuper by 1 July 2015. However, after the Stronger Super consultations, the government amended its position to allow for these amounts to be held outside of the MySuper rules until 1 July 2017.[3]

4.4 The Minister emphasised in the Second Reading Speech on the bill that transferring balances to MySuper will ensure that members are able to obtain the benefits of MySuper, particularly the ban on commissions. He also emphasised that the government's approach in making these transitional arrangements is consistent with the recommendations of the Cooper Review and will allow many funds to simply convert their existing default investment options to a MySuper product.[4]

4.5 The evidence received by this inquiry provides two very different perspectives about the risk and benefits that might arise at the moment of transfer. The retail funds sector raised concerns that if members failed to engage and reconfirm a former

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1 *Stronger Super*, Government response to the Review 2010, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf (accessed 1 October 2012).

2 Explanatory Memorandum, p. 73. New default super contributions must be paid into MySuper from 1 January 2014.

3 See Australian Industry Superannuation Trustees, *Submission 19*, p. 10.

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

investment choice in writing, the bill would move them into a MySuper product with a potentially a higher risk profile and a lesser standard of insurance cover. In contrast, both Treasury and members of the industry fund sector presented a different assessment of risk and benefit from the implementation of the legislation. This chapter is principally concerned with this issue.

Amounts to be moved to MySuper products

4.6 The bill would amend the *Superannuation Industry (Supervision) Act 1993* to introduce the concept of an 'accrued default amount'. This refers to those parts of a member's interest in a fund which must be moved to a MySuper product.[5]

4.7 Proposed section 20B of the SIS Act defines an accrued default amount:

> (1) Subject to this section, an amount is an accrued default amount for a member of a regulated superannuation fund if:
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> > (a) the amount is attributed by the trustee or the trustees of the fund to the member of the fund; and
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> > (b) either:
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> > > (i) the member has not given the trustee, or the trustees, of the fund a direction on the investment option under which an asset (or assets) of the fund, or that part of an asset (or assets) of the fund, attributed to the member in relation to the amount (the member's underlying asset(s)) is to be invested; or
> > >
> > > (ii) the investment option under which the member's underlying asset(s) is invested is one which, under the governing rules of the fund at the time the member's underlying asset(s) was invested, would have been the investment option for the member's underlying asset(s) if no direction had been given.[6]

4.8 The definition of an accrued default amount, therefore, has two limbs. The first is that the member has not given the trustee of the fund any direction. The second limb of the definition relates to members who have chosen a default fund. (Some submitters noted that an example might be a 'cash hub' that is part of a 'wrap platform'.) In this instance, while the member has exercised choice, s/he opted for a default fund, and would therefore fall within the definition of an accrued default amount. This amount would be transferred to a MySuper product. As the EM notes:

> The term therefore captures amounts where the member has either explicitly or implicitly directed that the amount be invested in the default investment option for that member. In this way, members who may have decided to delegate responsibility for investment decisions to the trustee by choosing the default investment option will also be placed in a MySuper

5 Explanatory Memorandum, p. 73.

6 Proposed section 20B of the SIS Act

product. This will also mean funds will not need to operate duplicate investment options—one for MySuper members and one for members wishing to choose the same investment allocation that applies under MySuper.[7]

4.9 Accrued default amounts specifically exclude:

- amounts already attributed to a MySuper product;
- amounts attributed to defined benefit members;
- amounts held in an eligible rollover fund;
- amounts that are invested in:
    - a capital guaranteed life insurance policy where the contributions and accumulated earnings may not be reduced by negative investment returns or any reduction in the value of assets in which the policy is invested;
    - a life policy providing benefits based solely on the realisation of a risk, and not related to the performance of an investment; and
    - an investment account contract that is held solely for the benefit of that member, and relatives and dependants of that member—to cover legacy products such as endowment and whole of life policies.
- amounts that support the payment of a pension.[8]

Election to transfer amounts

4.10 All RSE licensees will have until 1 July 2017 to transfer all accrued default amounts to a MySuper product, unless the member opts-out in writing.

4.11 The bill proposes that an application by an RSE licensee to APRA for authorisation to offer a MySuper product will need to be accompanied by an election to transfer accrued default amounts held in all funds for which the RSE licensee is trustee to one or more MySuper products. Where the RSE licensee fails to give effect to its election, APRA will be able to cancel the RSE licensee's authority to offer a MySuper product.[9]

4.12 In terms of the election process, before 1 July 2017, all accrued default amounts in the fund must be transferred to an authorised MySuper product offered by the fund, unless the member opts-out in writing. If the member in the fund is not eligible to hold a MySuper product in the fund, or where accrued default amounts are

7 Explanatory Memorandum, p. 76.

8 Explanatory Memorandum, p. 77.

9 Explanatory Memorandum, p. 73.

held for members in other funds for which the RSE licensee is trustee, the RSE licensee must move these amounts to a MySuper product before 1 July 2017.[10]

4.13 The bill would also require that RSE licensees must make a separate election requiring the trustee to take the necessary steps to transfer amounts held in a MySuper product in circumstances where authorisation for a MySuper product is subsequently cancelled.[11]

4.14 The EM states that any trustee that transfers an accrued default amount in accordance with these amendments will not have any liability to a member of their fund in relation to that transfer. In addition, any governing rules that prevent an accrued default amount from being transferred will be void.[12]

4.15 The Trustee Obligations and Prudential Standards Act (the basis for the second tranche of the MySuper reforms) will provide APRA with the ability to make prudential standards. The Further MySuper bill, if enacted, will enable APRA to make prudential standards dealing with transitional matters.[13]

Opposition to proposed subsection 20B(1b)(ii) of the SIS Act

4.16 The majority of comment on the Further MySuper bill concerned the transitional arrangements in Schedule 6. As noted above, several submitters and witnesses expressed concern at the second limb of the definition of an 'accrued default amount' in proposed subsection 20B(1) of the SIS Act. The following section presents the following arguments in opposition to subsection 20B(1b)(ii) of the bill:

- those who have chosen a default fund have exercised choice and should not be moved;
- there may be various unintended consequences from the provision including:
    - the possibility of members being transferred to a MySuper product with a higher (unsuitable) risk profile;
    - the possibility of loss of insurance cover, given that MySuper products would not offer certain types of coverage;
    - the possibility that members may be subject to higher fees in a MySuper product;
- the possibility of trustees being absolved of liability to act in their clients' best interests in giving effect to an election;
- the inappropriate nature of the opt-out process given that:

10 Explanatory Memorandum, p. p. 78.

11 Explanatory Memorandum, p. 79.

12 Explanatory Memorandum, p. 79.

13 Explanatory Memorandum, p. 76.

- some members are simply not engaged with their investment;
- even those that are may be away on leave, sick or may have moved address; and

- the cost of the transfer process and the possibility that this will be borne by those members who transfer.

Members who have chosen a default fund should not be moved

4.17 Some stakeholders noted a contradiction inherent in proposed subsection 20B(1b)(ii) of the bill. The policy premise for the legislation is a focus on those default members who are disengaged. And yet, they argued, the proposed subsection would capture those members who had chosen a default fund as part of their overall investment strategy. These investors, despite having chosen the default option, would have their default fund investment transferred to a MySuper product if they did not opt-out.

4.18 The Corporate Super Specialist Alliance (CSSA) gave the following example:

> ...many members of super funds have chosen an investment option which includes a component of the default investment option. For example, they may have chosen 50 per cent in the default option and 50 per cent in a specific choice option. In this case it is clearer that the member has chosen an investment strategy and not just chosen to place part of their moneys in a default strategy. In many cases this may have been chosen by the member without advice. The choice by the member should be recognised, and the member should not be asked to tick any boxes or rebalance their strategy should moneys be inadvertently switched to MySuper.[14]

4.19 The Financial Services Council (FSC) also expressed concern that the definition of an 'accrued default amount' will capture choice member balances. Mr Andrew Bragg, Senior Policy Manager at the FSC, told the committee:

> The problem really is with the breadth of that drafting. It goes well beyond the current definition of default investment option. It actually captures members who have exercised choice of fund or choice of investment option. Fundamentally we believe that members who have chosen a fund should not be moved into a MySuper product. To do so would be a significant divergence from the central tenet of the MySuper reforms, being to principally protect members invested in workplace or default superannuation funds and in the default investment options.[15]

14 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 10.

15 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, pp 1–2.

4.20 The FSC questioned the 'presumption' that an explicit direction to invest in a default option or to invest in a choice product is a delegation by the member to the trustee for investment decisions. Rather, it argued that the member is exercising either their right to choice of investment option under the SIS Act or their right to select their own superannuation product.[16]

4.21 The FSC argued that the bill's definition would capture the following three classes of members who would have their balances compulsorily transferred as at 1 July 2017:

- members who have exercised choice of investment and invested all or in part in the product's default option (whether or not it is an employer-sponsor or a choice fund);
- members have exercised choice of fund, signed a PDS and elected to invest in a choice product but have not given an explicit investment direction; and
- members who are explicitly invested in a choice superannuation fund that has been subject to a prior a successor fund transfer.[17]

4.22 In evidence to the committee, the FSC gave four examples of investors who had exercised choice, who would nonetheless—under proposed section 20B(1b)(ii) of the SIS Act—have their funds shifted to a MySuper account. These are:

- people who have invested in cash through a platform wrap moved into a balanced investment with high allocation equities;
- people who have invested in a growth fund moved into a balanced fund;
- investments in a lifecycle fund moved into a balanced fund; and
- investments with a chosen provider moved to another.[18]

Claims of unintended consequences from proposed 20B(1b)(ii) of the SIS Act

4.23 The FSC foresaw that proposed section 20B(1b)(ii) of the SIS Act would lead to:

- over one million non-default superannuation members within the choice framework being transferred into MySuper;
- members having their pre-determined risk/return profiles of investments jeopardised at critical stages of their lives (i.e. exposing a large number of pre-retirees to significant levels of sequence investment risk);

16 Financial Services Council, *Submission 16*, p. 7.

17 Financial Services Council, *Submission 16*, p. 5.

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

- significant transactional costs and market impact arising from the forced transfer of approximately $43 billion in choice member assets;
- loss of insurance and other member benefits; and
- a high level of post-transfer confusion and costs to unwind if 'opt out' communications are not actioned by each choice member captured by the transfer.[19]

4.24 These consequences were expounded in evidence from various witnesses at the public hearing. The FSC, the Association of Financial Advisers (AFA) and the Corporate Super Specialist Alliance noted that it would be possible that members who had chosen a low risk profile in a default fund could be transitioned to a higher risk profile in a MySuper fund that was less well-suited to their needs.[20] Mr Douglas Latto of the CSSA was asked of the likelihood of this occurring. He responded:

> It is extremely possible. A number of the funds we look after give a range of defaults for the employer to choose from. There could be an employer who chose a conservative default for the members and to go into MySuper, and the MySuper fund could have a higher risk level than the fund that they were in. So the answer is yes, it will be possible, and it will happen in a number of cases.[21]

4.25 Mr Phil Anderson, Chief Operating Officer of the AFA, told the committee;

> We are aware that within many retail master trusts there could be a huge number of employers, each of whom can select a default option. Those default options can be from a 50-50 split all the way up to 85 growth and 15 defensive. The trustees are going to have to choose one MySuper option, which is presumably going to be somewhere in between. So people will have either less exposure to growth assets than they want or more than they want. You cannot get a perfect solution given the variety of default option arrangements.[22]

4.26 Several witnesses claimed that members who had chosen a default fund could also lose some of their insurance cover—such as income protection—when they are transitioned to a MySuper product.[23] The CSSA, for example, told the committee:

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19 Financial Services Council, *Submission 16*, p. 4. Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 2.

20 See Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, pp 4–5; Mr Phil Anderson, Chief Operating Officer, Association of Financial Advisers, *Proof Committee Hansard*, p. 24.

21 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 11.

22 Mr Phil Anderson, Chief Operating Officer, Association of Financial Advisers, *Proof Committee Hansard*, 5 October 2012, p. 22.

23 Mr Nathan Hodge, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 5.

> The CSSA also remains concerned that there will be a loss of insurance benefits as a result of the mandatory transitioning of super accounts to MySuper. CSSA figures show that 81 per cent of default members outside corporate funds with a balance of more than $10,000 have insurance; the majority do have insurance. Thus many members will be transferred to a new MySuper default, and there is a significant risk that the automatic transition of accounts to MySuper by July 17 could see the cessation or reduction of insurance cover. This could have very serious repercussions for these individuals, who may be relying on this insurance protection.[24]

4.27 As noted above, the FSC also noted the possibility that a member who has chosen a default fund would be compulsorily moved into a MySuper product in the event that their fund is merged or there is a successor fund established. Mr Nathan Hodge told the committee:

> Another situation that may occur is that a lot of retail funds like to amalgamate their super funds to create efficiencies for their members. That person may have selected the cash option before the transfer, but because the definition only focuses on elections made to the current trustee, it would not recognise that past transfer, so even though they are in the cash option in the new fund, they would still be caught.[25]

4.28 The CSSA argued that another possible consequence of the transition to a MySuper product is that the member could in fact face higher fees. As Mr Gareth Hall, Treasurer of the CSSA, told the committee:

> ...there seems to be this underlying belief that MySuper is going to be better and less expensive. Let me tell you, there are no fees in cash in most wrap accounts. That is a fee free option. So the client is going to go from somewhere where they are paying no fee to somewhere where they are paying presumably one per cent or something invested in shares or whatever. So the consequences are quite dramatic.[26]

Trustees absolved of liability

4.29 Another theme raised by some witnesses and submitters in relation to the adverse consequences of proposed section 20B of the SIS Act is that the legislation would effectively absolve trustees of responsibility to act in their clients' best interests. Proposed section 29SAA of the SIS Act would provide that an RSE licensee's actions

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24 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 10.

25 Mr Nathan Hodge, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 7.

26 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 13.

in giving effect to an election under new section 29SAA will not give rise to a liability to a member.[27]

4.30 The Association of Financial Advisers questioned the government's approach:

> We are particularly surprised that the government is giving trustees a blanket protection from any action by members. How can a government force members to move but then offer them no protection in the event that something goes wrong? In raising the issue of the annulment of an adviser's commission rights and the directly related issue of acquisition of property rights on unjust terms, many will see this as merely an issue around self-interest. The FOFA legislation, however, has recognised the existence of property rights, as we have just heard, and has therefore put in place grandfathering arrangements for existing clients. We are keen to explore why the government has taken a different approach from what they took with FOFA.[28]

4.31 The CSSA told the committee:

> The proposed legislation transfers the liability of any loss of consumer rights to the trustee and then absolves the trustee of all liability. This leaves the consumer—that is, the member—with no recourse, whether the loss is due to a change in investment strategy, a loss of insurance cover or an error on the part of the fund.[29]

4.32 The FSC also claimed that the bill would absolve the trustee of liability for the loss of insurance.[30] However, as a later section of this chapter notes, other witnesses and submitters were unconvinced of these arguments and did not see the election process in Schedule 6 as absolving trustees of their prudential obligations.

4.33 AMP raised the issue of 'grandfathering' in relation to the bill's requirement to move accrued default amounts to a MySuper product by 1 July 2017. It argued that the proposals in the bill 'effectively impose a retrospective application of the legislation, under the guise of a transition period'. AMP claimed that the requirement to transfer all accrued default accounts to a MySuper offer by 1 July 2017:

> ...effectively prevents future commission payments to an adviser on the ADA, even though the adviser holds a contractual right to receive those payments prior to the introduction of the legislation. The government has in their recent development of the Future of Financial Advice (FoFA)

27 Explanatory Memorandum, p. 79.

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

29 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, pp 11–12.

30 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 5.

> legislation recognised the existence of legitimate contractual arrangements across the financial services industry.[31]

4.34 The committee asked Treasury its view of the discrepancy between the FOFA and MySuper grandfathering arrangements. Treasury responded:

> The essential arrangement here is quite different. Under FOFA, we were talking about two parties to a transaction—an adviser and a client—who had entered into an arrangement which may or may not have included commissions. There is nothing in this legislation which forces any contractual arrangement to be overturned. If there are contractual arrangements in question when a trustee has to move balances to a MySuper product, that is a matter between trustees and the other parties to those contracts. In fact, this was one of the reasons that industry sought a long transition period to resolve some of those contractual issues. The government provided a long transitional period in case there were any contractual issues that needed to be sorted, but, where a fund is offering MySuper, the legislation does not overturn any of those arrangements. In fact, the trustee elects to go down that path. In the other scenario, where a fund is not offering MySuper, there is a read-down provision that says that, in the event that there is an acquisition of property, the provisions do not apply.[32]

Member (dis)engagement and the 'opt-out' provision

4.35 Those witnesses who expressed concern with the drafting of proposed section 20B(1b)(ii) of the SIS Act, also doubted the practical effectiveness of the 'opt-out' provision. In essence, the argument is twofold. First, members who have chosen a default fund are not necessarily engaged with their investment. As the FSC noted:

> ...members of superannuation funds irregularly respond to requests providing in writing from their chosen fund – often because members feel that they have established their financial arrangements and should not need to alter them subsequently.[33]

> There will be some people who have established arrangements with a particular chosen fund, and they often tend to set and forget. Once people turn their minds to their financial affairs—which often the last thing they want to do—they sit down with an adviser or a fund and put in place their arrangements, but they do not want to touch it again.[34]

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31 AMP, *Submission 18*, p. 2.

32 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 44.

33 Financial Services Council, *Submission 16*, pp 8–9.

34 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 3.

4.36 The CSSA told the committee that in the case of members investing in a platform wrap with a cash hub, some have established these arrangements without the help of a financial adviser. As Mr Latto explained:

> People do not go into wrap accounts just because of advisors. Some people can go directly. Those sorts of people are just going to get caught. Even a lot of those members who have made a choice—50 per cent in default and 50 per cent somewhere else—are often not advised; they are by themselves. So no adviser is going to ring them up and say, 'Remember to do this.' They have got to do it themselves.[35]

4.37 Second, it was argued that there are reasons other than disengagement that may lead to a member who has chosen a default fund to fail to 'opt-out'. The FSC explained that:

> There are many reasons why a member may not respond to the notice such as where letters are lost in the mail, superannuation funds are not always provided with a member's current address, members may be on holidays during the notice period or a member may simply forget to respond.[36]

4.38 Similarly, Mr Gareth Hall of the CSSA noted that a member might be 'incredibly engaged' with their superannuation and their insurances but might be overseas and fail to 'opt-out'. He noted the potentially severe consequence of older members failing to respond to their mail:

> So you may find people in their 50s and 60s that have $1 million-plus of life insurance and their salary continuance insurance inside their superannuation fund. If these people happen to be travelling the world or doing something and they do not open the mail that is sent to them saying, 'Please do something or we're going to transition you to MySuper,' their whole family's financial security could be destroyed.[37]

4.39 The 'opt-out' process was also criticised for the process that it would involve if the member was engaged and aware of the need to do so. Mr Bragg gave the example of an employee whose default fund is Australian Super and is seeking to invest in a direct product, BT Super For Life. He noted that in this example:

> I would have to go to the website, look at the PDS, sign an application form and establish that fund. Then I would have to take that to my employer and say: 'I don't want you to pay it into Australian Super anymore. I want you to pay it into this fund'.[38]

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35 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 12.

36 Financial Services Council, *Submission 16*, p. 8.

37 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 14.

38 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 4.

The cost of moving accrued default amounts

4.40 The AFA argued that the transition of accrued default amounts to MySuper products will be 'an extremely expensive exercise to undertake'. It claimed that this would particularly be the case for the retail funds.[39] Mr Richard Klipin, Chief Executive Officer of the APA, foresaw considerable time and expense as part of the election and 'opt-out' process:

> Maybe someone has assumed this is a simple exercise, given that in one fund there may be hundreds of different employees and employers, that there may have been a different decision made about what kind of default option they should choose, and that this may change over time. The determination of which members have an accrued default amount across hundreds of thousands of members will be a huge challenge for trustees.
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> ...It is a pity that the regulatory impact statement made no effort to quantify cost. We question whether other MySuper members will need to pick up the costs of this huge transfer exercise as it is totally unreasonable to pass any of these costs on to fund members who have chosen a choice fund. Is the cost of this exercise justifiable particularly in the context of the risks these pose and the lack of consumer protection?[40]

Alternative approaches

4.41 Some witnesses proposed an alternative approach to the current drafting of proposed section 20B(1b)(ii) of the SIS Act and the 'opt-out' requirement. The CSSA, for example, argued an 'opt-in' requirement to MySuper products would be more appropriate:

> The implementation of MySuper and the transition process will be of considerable costs to funds without any apparent benefit. These costs will inevitably be passed on to the member. The whole process is extremely complex, and in many cases identifying the accrued default amounts will be a very difficult process. We are firmly of the view that automatic transfers should not occur. Transfers should be made on an opt-in basis rather than on an opt-out basis. It is not the role of government to suggest that the current investment strategy is incorrect and mandatorily transfer their moneys.[41]

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

40 Mr Richard Klipin, *Proof Committee Hansard*, 5 October 2012, pp 21–22.

41 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 5 October 2012, p. 11.

4.42 The AFA's preference is also for an 'opt-in' approach.[42] However, it emphasised that if the proposed 'opt-out' approach is taken:

> ...there needs to be extensive consultation with members, advertising that the government runs, mail-outs—all those sorts of things. One simple communication will not get the attention of members. And it puts so much of the emphasis on the trustees, when this is actually a government-driven initiative.[43]

4.43 The FSC recommended amending proposed subsection 20B(1b)(ii) of the SIS Act to state that an amount is an accrued default amount if:

> (b) the member is a standard employer sponsored member of the fund and the investment option applying to the member's entire balance in the fund under which the asset (or assets) of the fund attributed to the member in relation to the amount (the underlying asset(s)) is invested is one which, under the governing rules of the fund, would be the investment option for the underlying asset(s) if no direction were given except where the member has given a direction to the trustee to invest in that investment option or to the trustee of any previous fund prior to the transfer of benefits to the fund or to any predecessor of that fund as a successor fund to invest in an equivalent investment option.[44]

4.44 The Council explained that by using the existing definition of 'employer sponsor' in the SIS Act, this definition would ensure that members who have exercised choice of fund and are no longer members of employer sponsored superannuation fund are not captured by the definition. It also argued that this definition would assure members who have instructed a trustee to invest their superannuation in an investment option captured by the 'accrued default amount' definition, that their investment will not be moved.[45]

4.45 Mr Bragg commented that the FSC's proposed definition of an 'accrued default amount' is in accordance with how it believed the transition process had always been envisioned. As he told the committee:

> The Cooper review, the Stronger Super consultation process that was chaired by Paul Costello, all the ministerial policy statements and indeed the regulatory impact statement all talk about default members; they have never discussed or canvassed in any way, shape or form transitioning choice members into the MySuper environment by force of statute.[46]

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42 Mr Phil Anderson, Chief Operating Officer, Association of Financial Advisers, *Proof Committee Hansard*, p. 24.

43 Mr Phil Anderson, *Proof Committee Hansard*, p. 23.

44 Financial Services Council, *Submission 16*, p. 13.

45 Financial Services Council, *Submission 16*, p. 13.

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

4.46 The FSC argued that where trustees receive a direction from a member relating to the fund's default option or a particular superannuation product prior to 1 July 2017, the trustee 'should not have to revalidate the initial direction'.[47]

Support for proposed subsection 20B(1b) of the SIS Act

4.47 The various views presented above are in sharp contrast to those of other witnesses and submitters, who strongly supported the definition of an accrued default amount in Schedule 6 of the bill. These rejoinders are based on the following considerations:

- the Cooper Review specifically recommended transitioning existing default amounts to MySuper;
- proposed section 20B(1b) will minimise the fees and commissions paid by members to costly and substandard superannuation products through transferring more members to MySuper products (than if only members who had not given a direction were to be transferred);
- trustees must ensure that their design product does not disadvantage their members. If this cannot be done, proposed APRA prudential standard SPS 410 obliges the trustee to take other steps to protect the interests of members;[48]
- government's role is not to 'second-guess' the motivations of those members who chose a default fund. Accordingly, it is appropriate they be given the option to choose the fund in the knowledge that if they do not, their balance will be transferred to a MySuper product;
- the example of a 'cash hub' may not necessarily be captured by the definition of an 'accrued default amount' in the bill; and
- members of a MySuper product can choose the additional insurance within an existing default product transferred.

Copying Cooper

4.48 Treasury was asked its response to the argument that those who have chosen a default fund have already exercised choice, and should therefore not be moved to a MySuper product. It responded:

> Treasury, in working on the design of this legislation, has taken the Cooper review as the blueprint for the reforms. Going forward the Cooper review saw, and stated in the review report, that MySuper would replace existing default investment options in funds. In fact, Cooper said MySuper had been

47 Financial Services Council, *Submission 16*, pp 7–8.

48 Australian Prudential Regulation Authority, Draft Prudential Standard SPS 410, http://www.apra.gov.au/Super/PrudentialFramework/Documents/Draft-Prudential-Standard-SPS-410-MySuper-Transition-(May-2012).pdf (accessed 5 October 2012).

> specifically designed around the concept of a default investment option to ease, for many funds, the transition to the new regime.[49]
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> ...Cooper talked about transitioning the existing default amounts to MySuper. He did not go into the detail of specifying the member communication process, whether it would be an opt-out process. However, his starting point was that MySuper would replace the existing default investment options that currently exist.[50]

4.49 While the Cooper Review had not recommended an 'opt-out' process, Treasury had considered other options and concluded that 'opt-out' best suited the key policy objective that the Review had identified.[51]

More members transferred, lower fees

4.50 The Australian Institute of Superannuation Trustees (AIST), notably, supported both the identification and transition of all Accrued Default Amounts and urged the committee 'to resist calls to water down these provisions'.[52] Mr David Haynes, Project Director at AIST, told the committee:

> The arrangements for identification of accrued default amounts...are a sensible approach to transition that offer the best transition for the largest number of people.
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> ...There should be no further carve-outs from the transition of accrued default amounts on to MySuper. The idea that accrued default amounts have to meet some sort of additional criteria is, we think, unhelpful and wrong-headed.[53]

4.51 The Industry Super Network (ISN) was also strongly supportive of Schedule 6 of the bill. In its submission to the inquiry, the ISN emphasised that the transfer of existing default member balances to MySuper:

> ...will ensure that existing superannuation savings held in retail default products that pay commissions are not eroded indefinitely and members benefit from the consolidation of their savings. These provisions and the definition of accrued default balances contained in the Bill are strongly supported and will ensure individuals who are paying commissions on

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49 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 42.

50 Mr Adam Hawkins, Analyst, Financial Systems Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 42.

51 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 42.

52 Australian Institute of Superannuation Trustees, *Submission 19*, p. 9.

53 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 5 October 2012, p. 27.

> default superannuation balances but have never seen a financial planner will have their savings protected into the future.[54]

4.52 ISN drew attention to a July 2011 Roy Morgan Research survey which found that among those who identified themselves as retail fund members, 23 per cent communicated yearly with their financial planner while 52 per cent have never communicated with their planner.[55]

4.53 ISN then compared these responses with official APRA data on retail super fund segments and market share. It found that almost 2.2 million retail super fund members (out of nearly 5 million members) are paying commissions to a financial planner whom they have never met.[56] The Network referred to these commissions as 'unethical' and described the transition period of 1 July 2017 as 'more than generous'.[57]

The key role of trustees and draft prudential standard SPS 410

4.54 AIST countered the arguments of the FSC, AFA, the CSSA and the LCA that members who have chosen a default fund and do not 'opt-out' would be transferred to a MySuper product that was not suited to their needs. Mr Haynes claimed that these predictions discounted the important role and obligations of trustees and APRA's prudential standard SPS 410 dealing with the MySuper transition. He argued that:

> These comments did not acknowledge the active role of trustees in designing a suitable MySuper product for their members. My response is that funds will not be hamstrung to the extent that was suggested and this is a process that funds in both the retail and the not-for-profit sector are involved in as we speak.
>
> The trustees will have some control over the process and structure of their MySuper offerings. Each trustee offering a MySuper product needs to design a product that meets the needs of their members and be MySuper compliant. This is not a role for government or the regulator; it is a responsibility of the trustee. Each trustee must ensure that their design product does not disadvantage their members. If they cannot do that then the proposed APRA prudential standard dealing with MySuper transition—that is, SPS 410—obliges the trustee to take other steps to protect the interests of members. For example, funds can have a cash heavy default option now and can have the same investment option as their MySuper investment asset allocation, provided that they can satisfy APRA that this is

54 Industry Super Network, *Submission 20*, p. 17. See also Nr Matthew Linden, Chief Policy Officer, Super Industry Network, *Proof Committee Hansard*, 5 October 2012, p. 39.

55 'Retirement Planning Report', July 2011.

56 Industry Super Network, *Submission 20*, p. 17.

57 Industry Super Network, *Submission 20*, p. 18.

> the appropriate diversified investment option having regard to the nature of their members.[58]

4.55 Mr Haynes told the committee that draft prudential standard SPS 410 provides for two mechanisms for the transition of members from an existing default into a MySuper product:

> One of those is in relation to funds who effectively just rebadge their existing default option as MySuper, and that is a fast-track mechanism. For funds who decide to have a different MySuper product, including in relation to changes in fees, changes in investment strategy or changes in insurance, that will trigger additional notification requirements and APRA will be actively engaged with those funds to make sure that the members of those funds are not disadvantaged....
>
> I would imagine that APRA will take all necessary steps to ensure that members are not disadvantaged in the transition process.[59]

4.56 Treasury was asked its view of the possibility of a member of a default fund being shifted to a MySuper product with a higher weighting of risky assets. It responded:

> ...you could equally have members who were in a very risky option previously, potentially too risky an option, who will now be able to see what the trustees' new assessment of the best asset mix is, make an assessment of whether that is the option they want to be in and make their own choice of where they want to be. We heard from some witnesses this morning about the large number of default investment options that exist, particularly in some master trust situations, where employers have played a role in selecting those investment options on behalf of their employees. It was a clear conclusion of the Cooper review that that is not an appropriate role for employers. The appropriate accountability in the system for default investment options is with the trustee, unless a member themselves makes a relevant choice.[60]

4.57 Treasury also emphasised that where balances do have to be moved to another fund, the trustee and APRA must work according to conditions of the prudential standard to find a fund that is suitable to the member's needs. It noted that this occurrence of moving balances to another fund happens 'reasonably regularly' under successive fund transfer situations.[61]

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58 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 5 October 2012, p. 27.

59 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 30.

60 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 46.

61 Mr Jonathan Rollings, *Proof Committee Hansard*, 5 October 2012, p. 43.

Transferring insurance arrangements

4.58 The committee also received important evidence qualifying the claims of various stakeholders in relation to the loss of insurance for members who move to a MySuper product.

4.59 AIST told the committee that 'there is no evidence to suggest that funds will be unable to obtain suitable insurance cover for their members in a MySuper product at least at the level that applies' (in the default fund).[62] It put two arguments to support this view. The first is that the financial institution that has designed the existing default option and the existing insurance option will be designing the MySuper offering. In other words: 'it is really their choice about whether there will be a significant difference in the existing default option'.[63] The second argument is that members of a MySuper product can choose the additional insurance within an existing default product transferred. As Mr Haynes explained:

> There are limitations on the sorts of insurance that can be offered within superannuation generally, and that is reflected within the MySuper product. But a person can have additional insurance within a MySuper product. They can have additional insurance within an existing default product, and they can have that additional insurance within an existing default product transferred—it will be automatically transferred—across to their MySuper product. So they will not lose insurance in that circumstance.[64]

4.60 AIST did note that the exception is own-occupation insurance. While AIST supports ongoing access to own-occupation insurance, the prohibition on this type of insurance is not specific to MySuper.[65]

4.61 The ISN described the risk that members who are defaulted into a MySuper product losing insurance coverage as 'quite small'. Mr Linden noted that these challenges occur currently in relation to successor fund arrangements or where member balances are transferred from one fund to another.[66] Further, he pointed out that to the extent that people have made conscious decisions about their superannuation in the past, 'we would expect that they would be a relatively active member if they have made choices about those things'.[67]

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62 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 30.

63 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 30.

64 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 29.

65 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 29.

66 Mr Matthew Linden, Chief Policy Adviser, Industry Super Network, *Proof Committee Hansard*, 5 October 2012, p. 40.

67 Mr Matthew Linden, *Proof Committee Hansard*, 5 October 2012, p. 41.

4.62 Treasury was asked its view whether there was a chance that a member in a default fund, who did not opt-out, could be worse off when moved to a MySuper product. It responded:

> ...the risk of this is very, very small... In terms of fees and charges and given that MySuper will be commission free, you would expect that it is in the hands of the trustees to design a MySuper product that is going to be put into APRA league tables. There will be a much greater degree of transparency. They will be wanting to put forward a product that is competitive.
>
> ...We have heard other witnesses say that as a matter of practice you can expect all funds to want to be offering a MySuper product because, with up to 80 per cent of members potentially being default members, unless the fund wants to count themselves out of that business going forward they will need to offer a MySuper product. So we would expect nearly all funds to offer a MySuper product.
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> ...So we would expect that, in the vast majority of—if not nearly all—circumstances, it will be possible for trustees to continue the existing insurance arrangements which members may have and which may have more favourable terms, conditions or benefits, so long as those arrangements are on an op-out basis. Our understanding is that in many cases these policies are already opt-out policies and that, if they are, it is a relatively simple matter to make them opt-out policies whilst retaining the level of cover that members have previously had. In the—what we think will be—small likelihood that a fund does not offer a MySuper product, the trustee is required to transfer balances to another fund offering a MySuper product.[68]

Government's role is not to guess member's motives

4.63 Treasury also emphasised that the inclusion of proposed subsection 20B(1b)(ii) reflected the fact that it is difficult to determine the motivation for a member being in a default investment option. When asked about the effect of this subsection in terms of treating those who have made an active choice as disengaged members, Treasury responded:

> I would come back to the rationale for MySuper and its role in replacing default investment options rather than saying that this is an issue purely about engagement or disengagement. Where someone is in a default investment option, whether they have defaulted into it or whether they have selected to be in there, it is very difficult to know with any certainty what the motivation was for their selecting to be in there in particular.
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> ... It could be that the person has decided, 'For a proportion of my money I am happy for it to be in the option that the trustee is holding out as the default, which in some way reflects the trustee's view of the asset mix that

68 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 43.

> will cater for the broad membership, and I just want some small amount in this other option that I select by myself.' Again, it is virtually impossible for anyone other than the member themselves to know what the motivation was for the selection of some proportion to go into the default option, which is why the reliable way of determining is to ask the member.[69]

4.64 Indeed, Treasury even queried whether the example of the cash hub would actually be caught by the definition of an 'accrued default amount'. It noted that in some circumstances it could be open to interpretation whether the money is there as a result of a lack of an investment choice by the member or whether it is actually a mandatory requirement of the product that the money be put there. Treasury also suggested that cash hubs are 'a pretty small portion of the landscape that we are looking at here'. [70]

Committee view on proposed section 20B(1b) of the SIS Act

4.65 The committee believes that some stakeholders' concerns about members' loss of insurance and changes to their investment risk profile as a consequence of the proposed subsection 20B(1b)(ii) of the SIS Act are overstated. There are several reasons why it holds this view.

4.66 First, members will be contacted by their fund to notify them that their default investment will be moved to a MySuper product. This will give these members ample opportunity to opt-out of a MySuper product. The committee understands that the regulations will provide that a notice must be given 90 days in advance of an accrued default amount being moved where it will result in a change to the fees, insurance or investment strategy of the member's interest.[71]

4.67 Second, the committee believes that arguments about the low level of engagement of those members who would be subject to proposed subsection 20B(1b)(ii) of the SIS Act are exaggerated. The point was made during the hearing that these members have already actively engaged with their superannuation affairs by choosing a default product. If they have made the choice once, it seems highly unlikely that—having been contacted by their fund—they would fail to make the choice to 'opt-out' if they so wished. It is also important to note that all members will be notified before a transfer occurs and no member will be forced to transfer their balance to MySuper if they do not want to.[72]

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69 Mr Jonathan Rollings, *Proof Committee Hansard*, 5 October 2012, p. 43.

70 Mr Jonathan Rollings, *Proof Committee Hansard*, 5 October 2012, p. 43.

71 Explanatory Memorandum, p. 78.

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

4.68 Third, and crucially, the committee contests the view that the bill effectively absolves trustees of liability to act in their members' best interests. The EM is clear: RSE licensees which are required to transfer accrued default amounts to another superannuation fund will have to comply with requirements set out in regulations and relevant APRA prudential standards.[73]

4.69 The committee does emphasise that APRA's prudential standard SPS 410 must be clearly communicated to trustees and properly enforced. It is particularly important that APRA is alert to those (relatively rare) cases where a member who has chosen a default fund with one trustee is then moved to a MySuper product managed by a different trustee.

4.70 It is also important that proposed section 29SAA of the SIS Act is not interpreted by trustees that they will not be in any way responsible for the new circumstances of members who are moved to a MySuper product. This is certainly not the understanding of the AIST, and nor is it that of the committee. Trustees must design a MySuper product that does not disadvantage their members.

4.71 Fourth, and relatedly, trustees will have until 1 July 2017 to transfer amounts to a MySuper product. It is the committee's view that this is a considerable, but appropriate period of time to ensure that trustees communicate properly with members who need to be notified that they will be moved to a MySuper product. The committee has confidence that the four and a half year timeframe will enable trustees to develop clear and effective communication strategies with these members to ensure that the difficulties foreseen by some stakeholders are minimised.

4.72 Fifth, the committee does not believe the transition to MySuper arrangements in Schedule 6 of the bill will pose difficulties for members that are transferred to MySuper products in terms of losing insurance. The trustee of the MySuper product and the chosen default fund will generally be same entity, and the trustee will continue to have a close relationship with its insurer.

4.73 Finally, the committee emphasises the basic intent of the MySuper legislation: namely, to ensure that members of superannuation funds, particularly inactive members, are not paying commissions for services they are not aware of or do not get any benefit from. This was the main reason that the Cooper Review recommended the MySuper proposal. Unfortunately, this issue has been clouded in the debate on Schedule 6 of the bill.

4.74 The committee emphasises that minimising fees for members is an important and laudable goal. The difficulties that may be faced in making the transition to MySuper must always be seen in this light. As the Minister emphasised in his Second Reading Speech:

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73 Explanatory Memorandum, p. 80.

> Treasury estimate that the definition in the bill could result in $90 billion more being moved to MySuper than the approach suggested by stakeholders. Based on the assumptions of the Cooper review, this translates to approximately $100 million per annum in fees being saved in the best interests of superannuation fund members.[74]

Constitutional concerns with the election process

4.75 The LCA raised a possible constitutional complication with the provisions in Schedule 6 to elect to transfer accrued default amounts. Specifically, it noted the possibility that the obligation on the trustee to transfer assets from one portfolio to another with different fees will mean that a trustee will be giving up those fee entitlements which is, arguably, an acquisition of property rights.[75] This could be an unjust acquisition of property rights and in breach of section 51(xxxi) of the Constitution. As Ms Levy of the LCA told the committee:

> ...it appears to be a view that has been taken by government because they think that is the only way to account for the election process. So what the legislation requires is that, instead of saying you must transfer to MySuper, it says if you apply for a MySuper authorisation you must elect to do this where you are granted a My Super authorisation. Even if you are not, in fact, you must make this election. So I think the argument would be that there could be no unjust acquisition of property where you have elected or chosen to do something.[76]

4.76 Ms Levy agreed with the statement that if a challenge were brought on the grounds that the legislation breached section 51(xxxi) of the Constitution, the argument could be put that in substance it is not an election because the trustee essentially has no option but to make the election.[77] She agreed with the proposition that the bill is drafted the way it is in terms of the election process because the government thinks there is a risk that a challenge could be brought. However, she also agreed that this drafting technique is no guarantee that a constitutional challenge will not occur.[78]

4.77 In its submission to this inquiry, the LCA argued:

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

75 The LCA also raised this issue of constitutionality in relation to the effective requirement for trustees to "elect" to not charge fees relating to paying conflicted remuneration. *Submission 10*, p. 3.

76 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 17.

77 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 17.

78 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 17.

> ...it is the Government's responsibility to take legal advice about whether paragraph 51(xxxi) applies to a particular provision of this Bill or not. Following that advice, it should form a view. If it forms the view that it does apply, the legislation should not ask trustees to elect to do something which the Government could not require them to do; if it forms the view that it does not apply, then it should require trustees to do that thing by means of a direct obligation.[79]

Treasury's view and the Committee's view

4.78 Treasury was asked its view on the potential constitutional issues arising from the transfer of balances to a MySuper product. It responded:

> Whenever Commonwealth legislation is developed, advice is sought—where necessary—to ensure that the legislation brought before the parliament is considered to be effective. This is no different: we have received advice along the way. The government believes that the legislation will operate as it is intended to.[80]

4.79 The committee is satisfied that the government's approach in Schedule 6 meets the policy objective and places appropriate requirements on trustees.

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

80 Mr Jonathan Rollings, Principal Adviser, Superannuation, Financial System Division, Treasury, *Proof Committee Hansard*, 5 October 2012, p. 43.