

# Chapter 5

## Schedule 7 and a final comment

5.1 The final chapter of this report looks at the provisions and views on the final Schedule of the bill. Schedule 7 introduces new authorisation requirements for eligible rollover funds (ERFs) to ensure that the Australian Prudential Regulation Authority (APRA) is able to assess that ERFs are meeting their intended objective of reconnecting members with their lost superannuation.<sup>1</sup>

5.2 Eligible Rollover Funds (ERFs) are maintained for the sole purpose of a temporary repository for the interests of members who have lost connection with their superannuation accounts. ERFs accept superannuation money from other funds where the member has become 'lost'. They are intended to hold superannuation interests and preserve their value until they can be reconnected with the member. For this, ERFs rely on the trustee to protect their interests.<sup>2</sup>

5.3 Currently, ERFs must accept rollovers and transfers of superannuation from all other regulated superannuation funds and in circumstances specified in the SIS Regulations. The EM notes that the amounts transferred to ERFs are typically small inactive amounts or other amounts for members that cannot continue to be a member of their original fund.<sup>3</sup>

5.4 The Cooper Review found that ERFs were not, in general, effectively fulfilling their function. It cited several reasons why this was the case including that:

- some funds do not send small inactive accounts to ERFs;
- some ERFs appear to have made little effort to re-connect people with their super. There is little incentive to align members with their money because of the cost of matching and because ERFs continue to collect ongoing fees on these 'inactive' accounts;
- there has been no unique member identifier to aid the process; and
- matching lost members with unclaimed super is costly, reliant on the volume of matches.<sup>4</sup>

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

2 Explanatory Memorandum, p. 76.

3 Explanatory Memorandum, p. 76.

4 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 293 <http://www.supersystemreview.gov.au/> (accessed 24 September 2012).

5.5 The Review recommended that:

[T]he SIS Act should be amended to create a specific RSE licence class for trustees of ERFs. ERF trustees should be subject to very similar duties as apply to MySuper trustees (bearing in mind the different functions and characteristics of ERFs).<sup>5</sup>

5.6 Further, the Review recommended that:

In order to have ERFs more effectively fulfil their intended function:

- The RSE licence for each trustee of an ERF should be subject to the condition that they actively cross match with any active fund seeking the service. All ERF licensees must provide an online facility for people to search for lost super; and
- All funds should be required to cross match with ERFs for a new member.<sup>6</sup>

5.7 Schedule 7 of the bill amends the SIS Act to require trustees to obtain authorisation from APRA to operate an ERF. The EM notes that it is 'expected' that the regulations will prescribe that only RSE licensees with a public offer class of license or an extended public offer class of license will be able to apply for authorisation for an ERF.

5.8 If by 1 January 2014 an application for authorisation has not been made, or if APRA has refused authorisation, all balances in an existing ERF are required to be transferred into an authorised ERF or a fund that offers a MySuper product within 90 days.<sup>7</sup>

5.9 The bill would establish that to operate an ERF, the RSE licensee must elect to:

- transfer amounts held in the ERF as required by prudential standards if authorisation is cancelled; and
- not charge members of the ERF a fee that relates to the costs of paying conflicted remuneration or paying an amount to another person that the RSE licensee knows, or reasonably ought to know, relates to the payment of conflicted remuneration.<sup>8</sup>

5.10 The bill would also introduce new enhanced obligations for trustees of an RSE that has been authorised by APRA to offer an ERF. These obligations require

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5 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 30 <http://www.supersystemreview.gov.au/> (accessed 24 September 2012).

6 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 30 <http://www.supersystemreview.gov.au/> (accessed 24 September 2012).

7 Explanatory Memorandum, p. 84.

8 Explanatory Memorandum, p. 84.

trustees to comply with a duty to promote the financial interests of members of the fund.<sup>9</sup>

### *Views on Schedule 7 of the bill*

5.11 Although the committee's evidence on Schedule 7 was limited, some stakeholders did emphasise that the provisions relating to ERFs in the context of MySuper products should be strengthened. The Australian Institute of Superannuation Trustees (AIST), notably, put the case for the MySuper legislation to specifically regulate the use of ERFs. Mr David Haynes, Project Director at AIST, told the committee:

Historically, and with the noted exception of AUSfund, ...eligible rollover funds have tended not to take steps to relocate those members with their active super, or indeed to find current addresses for those members. A number of years ago the Inspector-General of Taxation found that if the tax office was allowed to use all the tools at its disposal it in fact would be able to find homes for \$19 billion of the \$20 billion worth of lost super money. What we are saying is that, as a superannuation fund with a special role, that special role should be clearly and explicitly identified within the additional trustee obligations of ERFs—one, that they should find current addresses for lost members; two, that they should take active steps to encourage those members to be reunited with their lost super; and, three, that the process of transitioning from a MySuper product into an eligible rollover fund should be subject to the same anti-flipping rules that protect members against being charged higher fees.<sup>10</sup>

5.12 AIST drew to the committee's attention to potential problems from allowing ERFs to continue to charge fees. It explained that:

This will arise in two ways. One, there is no requirement in the bill for an eligible rollover fund to locate missing members and reunite them with their missing super. Two, flipping of members into ERF in order to extract higher fees remains possible, even though many other avenues for flipping have been closed off.<sup>11</sup>

5.13 In its submission, AIST recommended that the bill be amended to provide an additional obligation on ERF trustees to locate and reunite their members with their active superannuation. It also proposed an explicit prohibition on 'flipping' to ERFs, where transfers to an ERF are a means of extracting higher fees from a member without their knowledge or consent.<sup>12</sup>

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9 Proposed section 242K of the SIS Act

10 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 5 October 2012, p. 29.

11 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 5 October 2012, p. 28.

12 Australian Institute of Superannuation Trustees, *Submission 19*, p. 12.

5.14 The Industry Super Network (ISN) also argued that the provisions on Schedule 7 of the bill should be further strengthened. It noted that many ERF's 'represent very poor value and needlessly erode member savings'. While the ISN welcomed the enhanced director obligations in Schedule 7, it argued:

this will not necessarily guarantee that ERF pricing is reasonable and appropriately reflects the lower costs which should be realised from maintaining an ERF (both administrative and investment costs should be significantly lower than a fund with active members and regular contributions).<sup>13</sup>

5.15 The ISN stressed the importance of APRA rigorously enforcing the director obligations to ensure that ERFs are not utilised as an avenue to 'flip' members from a discounted MySuper product and inferior ERF. No explicit member consent is required to transfer an interest from a MySuper product to an ERF.<sup>14</sup>

5.16 The ISN recommended that a requirement be added in the bill and the Explanatory Memorandum to ensure that trustees take 'necessary and prudent steps to reconnect funds held with the beneficiaries of those amounts'.<sup>15</sup>

5.17 The Cooper Review recognised that there would be scope for flipping in MySuper products in master trusts. In other words, a member could be moved from a MySuper product, without his or her active choice, into another MySuper product in the personal division of the corporate master trust. However, the Review added:

The inbuilt criteria of a MySuper product, at both ends of this member movement, would remove many of the concerns identified with flipping. The Panel believes that this would be a matter for the trustee whether a MySuper corporate master trust product engages in such flipping; the trustee could decide to retain the member and accumulated balance in the original MySuper corporate master fund product.<sup>16</sup>

## **Final comment on the bill**

5.18 The Further MySuper bill represents a significant reform to Australia's superannuation system. It is built on sound principles of transparency, accountability and value for money for members. Those same principles were identified in the Cooper Review as in need of attention. Several aspects of the bill are based on the Cooper Review's recommendations.

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13 Industry Super Network, *Submission 20*, p. 4.

14 Industry Super Network, *Submission 20*, p. 4.

15 Industry Super Network, *Submission 20*, p. 4.

16 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, Final Report, Part 2, 2010, p. 25 <http://www.supersystemreview.gov.au/> (accessed 24 September 2012).

5.19 Consultations on this legislation have been substantive over a period of several months. And the government has been responsive. The Financial Services Council noted that the government has 'materially improved' the Further MySuper Bill from the April 2012 Exposure Draft on matters such as insurance and portfolio holdings disclosure.<sup>17</sup> This inquiry has offered further opportunity for comment.

5.20 This report has recognised various stakeholder concerns, particularly with provisions in Schedules 1, 3, 6 and 7 of the bill. The committee believes that while these concerns may have some legitimacy, they are not grounds to amend or delay the passage of the legislation. As this report has emphasised, the provisions in the bill are based on important principles that should not be diluted. There is an expectation that the regulators and stakeholders will develop sound practices that adhere to the provisions.

5.21 The product dashboard is a good example. As chapter 3 noted, there do seem to be various issues of a technical nature that need to be resolved if the dashboard is to work effectively. However, the bill's proposed amendments to section 1017 of the Corporations Act correctly identify the type of information that must be on the dashboard. It is now up to APRA, in consultation with stakeholders, to develop a system that enables to view and compare the key performance information of MySuper and choice products.

5.22 The committee believes that many of the concerns relating to the transfer of members who have chosen a default fund into a MySuper fund are exaggerated. For the reasons given in chapter 4, the committee believes that proposed subsection 20B(1) of the SIS Act is drafted appropriately. It upholds the key policy objective of minimising the fees and commissions paid by members to costly and substandard superannuation products. And it does not, as some claim, absolve trustees of a responsibility to act in the best interests of their members. In those cases where members currently in default funds have not 'opted-out' and are placed in a MySuper product, the trustee and APRA will have obligations to ensure that the new product does not disadvantage the member. The committee has confidence that these processes will be effective.

## **Recommendation 2**

**5.23 The committee recommends that the bill be passed.**

**Ms Deborah O'Neill**  
**Chair**

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17 Financial Services Council, *Submission 16*, p. 3.

