Dissenting Report by Coalition Members of the Committee

This Bill is the third tranche of legislation implementing a recommendation of the Cooper Review into Australia's Superannuation system to introduce a new, low-cost superannuation product known as *MySuper* to replace existing default superannuation fund products.

The Bill is more than 100 pages long and makes fundamental and controversial changes to Australia's superannuation retirement system.

Yet again, the Government has exempted the most contentious changes in this legislation from its own basic regulatory impact assessment requirements.

This Bill has been subjected to inadequate scrutiny by this Committee because the Labor government, aided and abetted by Majority members of this committee, have forced a truncated and rushed inquiry.

Witnesses had only very limited time to make submissions. As Ms Michelle Levy of the Superannuation Committee of the Law Council of Australia noted, the process has been highly unsatisfactory:

> I will spend one minute on process. We, the committee, spend a lot of time trying to prepare careful responses to legislation and often the time period—and I know it is not just for us; it is for everybody—is just too short. It is not possible to prepare a well-reasoned and thought-through submission in a week. For the trustee obligations bill the submission timetable was shorter than the period within which the committee was meant to release its report. I suppose people have a lack of confidence in the system given this timing.[1]

Only a half day hearing was set aside, with witnesses limited to just 30 minutes for each organisation, meaning the full range of issues has not been publicly canvassed.

Worse still, Committee members have only had days in which to assess the very complex evidence presented and draft reports and recommendations.

The Parliamentary Joint Committee on Corporations and Financial Services has a reputation as providing high quality, frank and fearless, and often bipartisan reports.

The current rushed inquiry has damaged that reputation.

Even with the very limited time available to the Committee, it is clear that this legislation is fundamentally flawed.

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

Coalition members of the Committee call on the government to recognise the flaws in its legislation and the problems with this inquiry and withdraw this legislation from the Parliament for appropriately thorough consideration.

This should be accompanied by the preparation of a complete Regulatory Impact Statement (RIS) for the final draft of the Bill, which is consistent with the requirements supposedly enforced by the government's own Office of Best Practice Regulation. At this time no complete RIS is available – in part because contentious aspects of the Bill were exempted from the RIS process and because the RIS which was prepared was based on an earlier draft of the legislation.

Without a complete and current Regulatory Impact Statement the Parliament has every right to assume that this Bill does not meet legislative best practice requirements.

The schedules in this Bill:

- Ban conflicted remuneration and entry fees and limits other fees to cost recovery;
- Require that MySuper include life and TPD insurance on an opt-out basis;
- Provide for new data collection and publication powers for APRA and requirements for product 'dashboards';
- Amend the Fair Work Act to ensure any MySuper product can be nominated in a Modern Award or enterprise agreement;
- Exempt defined benefit funds from the MySuper regime;
- Require that trustees transfer 'accrued default amounts' to a MySuper product by 1 July 2017; and
- Introduce new authorisation requirements for eligible roll-over funds.

Coalition members of the Committee set out below a number of issues raised by stakeholders, particularly in relation to Schedules 1, 3 and 6. Because of the haste of this inquiry, this is not an exhaustive discussion of all the problems with this Bill.

Coalition members are particularly concerned about Schedule 6. This schedule governs the treatment of 'accrued default amounts' and has the potential to automatically move large amounts of money to a MySuper default product from funds where individuals have made a clear and active choice about their superannuation.

This has the potential for significant adverse effects on individuals concerned (see below -Schedule 6).

The Majority Report seeks to give the impression that the provisions of the Bill simply implement the Cooper Review, for example stating that ‘the Cooper Review

specifically recommended transitioning existing default amounts to MySuper.'[2] In fact the Cooper Review had very little to say about the details of the transfer, as the Association of Superannuation Funds of Australia (ASFA) explained to the Committee:

> In the 500-page report [of the Cooper Review] there are literally only a couple of lines that talk about transition—the moving of accrued default amounts. The focus is on what MySuper should look like in the future, what the default member experience should be like and what choice members experiences should be like. There really is not a full consideration of the transition issues.[3]

The Majority Report later concedes that 'opt-out' was a choice made by Treasury, not a recommendation by the Cooper Review.[4]

Given the significant implications of this legislation, including adverse financial consequences for a material number of individual super fund members, Coalition Members and Senator recommend that:

> **The Government withdraw this Bill pending further consultation across the superannuation industry to address the serious flaws identified in this rushed inquiry and to allow for the preparation of a full Regulatory Impact Statement for the whole Bill actually before the Parliament, which is compliant with the government's own best practice regulation requirements.**

Schedule 1

A number of concerns were raised about the operation of the intrafund advice provisions and grandfathering arrangements for existing payment structures.

The Association of Financial Advisers (AFA) stated that intrafund advice will not serve the best interests of clients because:

> ...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?[5]

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2 Majority Report para 4.47

3 Ms Fiona Galbraith, Senior Policy Adviser, Association of Superannuation Funds of Australia *Proof Committee Hansard*, 5 October 2012, p. 33.

4 Majority Report para 4.49

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

> 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, 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.[6]

The AFA's has argued that advice 'poses a very serious risk' if it does not focus on a client's personal circumstances. The Bill creates the potential for advice to be given without the advice being based on personal circumstances.

The Law Council of Australia raised the potential conflict for trustees given the different grandfathering arrangements under this Bill and the Government's Future of Financial Advice (FOFA) changes:

> 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.[7]

> 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.[8]

The Law Council of Australia also raised a number of technical concerns about the Bill, including performance based-fees and cost of financial product advice

> ...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'.[9]

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

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

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

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

> ...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.[10]

The Corporate Super Specialist Alliance expressed strong concern that it can no longer charge a collective fee for its services under MySuper:

> ...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.[11]

These concerns are indicative of the lack of adequate consultation on the Bill and the failure of the government to consider all the implications of these changes.

It also highlights the unnecessarily hasty and botched handling of this inquiry by majority members of this Committee who have refused to have a thorough and considered examination of this Bill.

Schedule 3

A range of concerns were raised in the Inquiry about the practicality of the product dashboard.

The Industry Super Network (ISN) said there was a 'serious risk of outcomes that could lead to members being misled about products and trustees being encouraged to make sub-optimal investment decisions'.[12] The ISN highlighted a number of serious problems, inluding:

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

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

12 Industry Super Network, *Submission 20*, pp 2–3.

- the investment return target (proposed section 1017BA (2)(a)) does not require that the target is net of all fees (investment and administration) and as a consequence will overstate the level of returns to which a member would actually be entitled;
- the risk measure (proposed section 1017BA (2)(c)) specifies the likelihood of a negative return (exclusive of some costs) but provides no guidance as to the quantum of such a negative return;
- the liquidity measure (proposed section 1017BA (2)(d)) is not clearly defined and is likely to overstate the proportion of illiquid assets in a product. The ISN suggested that this requirement be omitted from the bill and considered in the subsequent tranche of reforms;
- a number of carve outs from the product dashboard (proposed section 1017BA(4)) are 'inappropriate'. The ISN criticised the exemption of pension products and fund of fund investment options that are delivered through a platform noting that consumers would benefit from their inclusion;
- the product dashboard measures will differ from those contained in the new short PDS regime. The ISN shared the Law Council's concerns that consumers could receive contradictory information and be misled depending on which disclosure they rely on.

The ISN recommended that proposed amendments to sections 1017BA–1017BE of the Corporations Act be omitted from the Bill.

The Australian Institute of Superannuation Trustees (AIST) are so concerned about the potential for misleading information being supplied on the product dashboard that they recommended its complete removal:

> ...the product dashboard provisions should be excised from this tranche of the legislation, subject to further consultation with the super industry, and be reintroduced in a clearer, more consumer-friendly version in the fourth tranche of the MySuper legislation.[13]

The Law Council of Australia highlighted the reliance of trustees on third party information and the lack of adequate defences under the Bill:

> [T[he defences which protect trustees who take reasonable steps to ensure that their dashboards are up-to-date and not misleading or deceptive should be broadened so as to clarify that those defences will be available in cases where trustees reasonably rely upon third parties in connection with the preparation of dashboards. For example, beyond making due diligence enquiries, a trustee is entirely dependent upon a third party fund manager to have correctly calculated their historical performance and therefore in ascertaining how many times the performance objective has been achieved.[14]

13 Mr David Haynes, *Proof Committee Hansard*, 5 October 2012, p. 28.

14 Law Council of Australia, *Submission 10*, p. 9.

It is pleasing that at least in one small area government members of the Committee have recognised that legislation lacks clarity about what is required by the 'dashboard' and are recommending greater certainty for industry participants regarding this measure. Unfortunately the recommendation is of little value as it merely calls for APRA to conduct further consultation with industry; it does not call for any change to the legislation.

Coalition Members recommend that Schedule 3 be withdrawn from the Bill to allow for further consultation, in view of the evidence that across many different sectors of the superannuation industry there is strong disquiet about the practical workability of the product dashboard provisions set out in Schedule 3.

Schedule 4

This Schedule amends the Fair Work Act to ensure any MySuper product can be nominated in a Modern Award or enterprise agreement.

However, the government has made no attempt to address the current closed shop, secretive and anti-competitive arrangements for the selection of default funds under Modern Awards.

That is, while every default fund has to be a MySuper product, not every MySuper product will be able to compete freely as a default superannuation fund under modern awards. As a result, the decision on which funds are selected as default funds under modern awards remains therefore with Fair Work Australia through the current widely discredited process.

Even the government had to recognise before the last election that the current process, which heavily and inappropriately favours union dominated industry superannuation funds, is not open, transparent and competitive. In August 2010 the Labor Party made a promise that a re-elected Gillard government would ask the Productivity Commission to design a transparent, evidence based and competitive process for the selection of default funds under Modern Awards.

It took him until early 2012 to finally commission that review and even before the Productivity Commission had issued its final report Minister Shorten had already ruled out allowing for fair, open and transparent competition in the default fund market. He inappropriately continues to persist with his efforts to protect the current competitive advantage for union dominated industry super funds for as long as possible.

The Government is now seeking to introduce a branded default superannuation product but remains unwilling to allow these products to compete, with the clear objective to continue to protect union financial interests. This refusal to provide for a competitively neutral market for default superannuation funds undermines the underlying intentions behind the MySuper reforms.

That is why Coalition members of this Committee recommend that the Parliament use this opportunity to ensure the introduction of genuine competition in the default superannuation fund market by moving relevant amendments to this Bill.

Given the consumer safeguards prescribed for MySuper products under this legislation, any MySuper product should be available for selection by any employer as a default fund to make default super contributions for employees who have not chosen a fund.

Such an amendment would create a more level playing field, break the current quasi-monopoly of industry superannuation funds in the default fund market, provide genuine choice and competition when it comes to the selection of default funds and help maximise value for employees who end up in a default superannuation fund.

Schedule 6

Schedule 6 contains the requirements for existing member balances to be transferred to My Super products and the relevant transitional rules. A number of serious concerns were raised about the provisions of schedule 6 but two stand out.

Firstly, the Bill casts a very wide net as to which existing member balances held in existing superannuation funds will be required to be transferred into a MySuper product. Proposed section 20B of the SIS Act provides a new definition, 'accrued default amount', which defines the parts of a member's existing balance that must be transferred to a My Super product. The first limb of the definition is relatively straightforward: an amount in respect of which the member has not exercised an investment choice. The second limb however is highly controversial: any amounts held in a default investment option of a fund. Critically, this limb will apply *even if* the member had made an active choice of that particular option; all that is required is that the option happens to have been labelled as the default option of that fund.

Secondly, the mechanism set out in Schedule 6 is an 'opt-out' mechanism. Funds have until 1 July 2017 to transfer all 'accrued default amounts' to a MySuper product unless the member opts-out in writing. By that date the trustee of a fund must contact all members having 'accrued default amounts' and notify them of the proposed transfer of those amounts into a MySuper product. If the member does not opt-out (in writing) by the end of a 90 day period, the trustee is obliged to go ahead and carry out the transfer. This means that without members being aware that this is happening, the nature of their superannuation product is going to change – and in a material number of cases that change will be adverse to the member's interests.

The first concern means that in many cases members who have exercised a choice will have that choice overridden. Put another way, under the drafting, the government has not distinguished between default and personal (non-default) funds. This means the range of accounts which will be compulsorily transferred (unless the member opts-out of the transfer) will be considerably broader than was recommended by the Cooper Review or envisaged in prior Ministerial statements.

The Majority Report seeks to defend this result by referring to comments made by Treasury economist Dr David Gruen:

> ...a key driving principle behind MySuper is that, for those people who do not actively choose an option for their superannuation savings, we want public policy to mandate a default option with carefully designed features that we judge will promote the wellbeing of those who use this option.
>
> Crucially, this mandated default option is not imposed on anyone.[15]

In fact this inadvertently highlights the serious problem with these provisions: their practical effect will be precisely the evil which Dr Gruen says is to be avoided, namely the imposition of the mandated default option on many members without them realising it is happening.

That is, the broad definition will result in transfers of investments from choice funds to MySuper products where a member has specifically elected a particular fund and also has directed that their superannuation be invested in the fund's default option.

All existing default fund (workplace) accounts as well as the balances of individuals who have previously exercised choice of fund but who remain in the default investment option of their chosen fund, will be swept up into the new default MySuper product.

It is quite extraordinary that the government is legislating to nullify the choice that a member has previously exercised. It is also highly deceptive. These members will quite reasonably not expect that any further action is required of them to maintain their choice in operation. If a private company attempted to change the terms of its contract with its customers in a similar way it would breach consumer law.

Concern about the impacts of these provisions was well articulated by a number of witnesses.

The Financial Services Council pointed out that the compulsory transfer could move members from a risk allocation which suited them to one which did not:

> 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… Over one million non-default superannuation members within the choice framework will be transferred into MySuper. Members would have their predetermined risk/return profiles of their investment jeopardised at potentially critical stages of their lives such as pre-retirement.[16]

The Association of Superannuation Funds of Australia highlighted the risk of members having their fund balance split into two separate components, each attracting fees:

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15 Majority Report para 1.9 quoting Dr David Gruen.

16 Mr Andrew Bragg, *Proof Committee Hansard*, 5 October 2012, pp. 4-5.

> We are looking at MySuper money and choice money so we have a phenomenon where members will be both MySuper members and choice members, which Cooper only visualised if members chose to be in MySuper and chose to go into a product as well—not that this would happen by virtue of investment switches. So you also have this phenomenon like in accrued default amounts; it is only certain amounts that are moved but the rest of the amount gets left behind. There are out workings to this. With the accrued default amount, it is partly a concept of overriding choice but the insurance issue is very real.[17]

It is noteworthy that this is a widely held concern across all parts of the superannuation industry, with a major not-for-profit fund, First State Super, having raised similar concerns. First State Super is a not-for-profit (industry) fund with $32 billion in funds under management and more than 770,000 members. First State Super raised two main concerns regarding the transitioning of funds from Choice products.

Firstly, they are concerned about the risk of member claims against the fund, given they have given the fund explicit instruction as to how their money should be held:

> …the fund believes there is increased risk of a claim against the Fund in the event of a future change to these members' investment options, counter to their explicit instructions and acknowledgement. [18]

First State Super is also concerned that the automatic movement of balances where members have made explicit choices will confuse members and they will 'not respond favourably' to the changes.

They conclude:

> First State Super considers it more appropriate that the legislation allow for recognition of members who have made a full or partial investment choice, regardless of whether the investment option is also a default/ MySuper option, continue to be treated as Choice members.

Coalition Members note that the Majority Report is wrong to claim, at paragraph 4.5 that there are two perspectives on these provisions, a retail funds perspective and an industry fund perspective. As the submission from First State Super clearly shows, the Labor Majority's view on this issue is far too simplistic.

The expansive approach taken in this Bill will significantly expand the number of members who will be automatically transitioned into MySuper. This could have significant financial consequences for individual super fund members - including those who have previously exercised their right through an application form and PDS to actively choose their own fund.

Trustees are unable to object to the transfer even where the transfer would result in the member being placed in a lower returning, higher fee paying or higher risk investment option as a consequence of the transfer.

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17 Ms Fiona Galbraith, Senior Policy Adviser, Association of Superannuation Funds of Australia *Proof Committee Hansard*, 5 October 2012, p. 33.

18 First State Super, *Submission 12*, p 2

At a systemic level, the broad operation of the transfer to My Super products creates a market impact risk as billions of dollars of superannuation investments will be transferred as a result of this Bill:

> According to a preliminary assessment of FSC member data, at least one million Australians with chosen (**non-default**) superannuation accounts valued at approximately $43 billion would have their superannuation balances transferred due to this legislation.
>
> These are balances which should not be captured as part of the transfer as these members have either opted for a choice product or have explicitly invested in a particular option.[19]

There are other significant concerns regarding the wide range of account balances to be transferred into MySuper.

First, the scope of the transfer gives rise to a number of serious consumer protection issues. A wide range of choice members will be inappropriately swept up and are likely to find that because of Labor government legislation, they are invested in an investment option which no longer reflects their personal circumstances or wishes.

Secondly, such members will also have incurred transaction costs from the selling and re-buying of assets as a result of the transfer – unnecessarily crystallising any capital gains.

Thirdly, there are potential implications for the insurance arrangements individual Australians with a choice default fund have organised within that superannuation fund, given the MySuper death and TPD insurance cover could well be lower than that currently enjoyed by the member in their choice default fund.

Even worse, some people who have been covered within their chosen fund for a long time may not be able to qualify for life insurance or will only qualify on inferior terms given the changes in their personal circumstances since the original cover was taken out in their current fund.

Where a trustee does not offer a MySuper product, they will be required to transfer all accrued default amounts to a third-party MySuper provider.

This transfer will take place on an opt-out basis, meaning if a member does not opt-out, their superannuation account balance will be transferred out of its current investment option/fund and into a MySuper product chosen by the trustee of their current fund.

Coalition members of the Committee point to a number of other issues raised in the Inquiry.

For example, in AMP's submission the additional problems with Schedule 6 are raised:

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19 Financial Services Council, *Submission 16*, p. 4.

- Grandfathering - The Bill requires that no commissions are able to be deducted from a MySuper offer from the date of commencement. However, the requirement to transfer all accrued default amounts within the superannuation system to a MySuper offer by 1 July 2017 effectively prevents future commission payments to an adviser on the accrued default amount, even though the adviser holds a contractual right to receive those payments prior to the introduction of the legislation. As noted in the submission, the financial advisers are not employed by AMP. They are all either self-employed or operate a small business, contributing to jobs and employment in their local communities.

- Breach of Contract - From no later than 1 July 2017 all default superannuation accounts, from which the adviser's commissions were previously deducted in accordance with their legitimate contractual arrangements, become MySuper accounts. Therefore, the Bill has the practical effect of legislating these contracts away. In other words the financial adviser's pre-existing contract would be broken, resulting in a loss of income to the advisers.

- Constitutional Issues - A number of the financial advisers have raised the issue of whether the proposed legislation is a breach of section 51(xxxi) of the Constitution, the section that deals with the acquisition of property on just terms.

In AMP's submission:

> "There are many financial advisers in the community whose business is predominantly or solely corporate superannuation.
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> "Their view is that the effect of these provisions, which have a retrospective impact, will force them out of their advice business. AMP considers that it is quite unconscionable for the Parliament to deliberately effectively legislate away an individual's income and livelihood when that livelihood is based upon a legal contract."[20]

In light of the testimony from a range of witnesses, Coalition members of the Committee recommend that an amendment be moved to the Bill to provide that any amount in respect of which a member has made an active choice is not an 'accrued default amount' and should not be moved to a MySuper product (either within or outside their chosen fund).

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20 AMP, *Submission 18*, p. 4.

The amendment would have the support of First State Super, the Financial Services Council, AMP and commercial superannuation funds and is succinctly summarised by the Law Council of Australia which stated in its submission to the Committee:

> "Members who have chosen the default option should not have their existing balance moved to a MySuper product without their consent.[21]

Recommendations

1. **That the Government withdraw the Bill pending further consultation across the superannuation industry to address the serious flaws identified in this inquiry and to allow for the preparation of a full and compliant Regulatory Impact Statement for the whole Bill actually before the Parliament.**

2. **If the government insists on proceeding with this Bill in its current flawed form that the Bill at least be amended to ensure that:**
   a. **a member who has previously exercised choice of fund while also opting for the default investment option of that chosen fund cannot be automatically transferred into a MySuper product by having previous contributions defined as an 'accrued default amount';**
   b. **Any product which qualifies as a MySuper product is able to compete freely in the default superannuation fund market.**

Senator Sue Boyce **Senator Mathias Cormann**

Paul Fletcher MP **Tony Smith MP**

[21] *Submission 10*, p. 12.