Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012

October 2012

© Commonwealth of Australia 2012

ISBN 978-1-74229-700-2

Printed by the Senate Printing Unit, Parliament House, Canberra

Members of the Committee

Ms Deborah O'Neill, **Chair**	NSW	ALP
Senator Sue Boyce, **Deputy Chair**	QLD	LP
Senator Mathias Cormann	WA	LP
Senator Rachel Siewert	WA	AG
Senator Matt Thistlethwaite	NSW	ALP
Senator Anne Urquhart	ALP	TAS
Mr Paul Fletcher MP	NSW	LP
The Hon Alan Griffin MP	VIC	ALP
The Hon Tony Smith MP	VIC	LP
Ms Laura Smyth MP	VIC	ALP

SECRETARIAT

Dr Richard Grant, Acting Secretary

Ms Erin East, Principal Research Officer

Ms Natasha Rusjakovski, Research Officer

Ms Ruth Edwards, Administrative Officer

Ms Kate Campbell, Administrative Officer

Suite SG.64
Parliament House
Canberra ACT 2600

T: 61 2 6277 3583
F: 61 2 6277 5719
E: corporations.joint@aph.gov.au
W: www.aph.gov.au/senate/committee/corporations_ctte

Duties of the Committee

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

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

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

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

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

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

Table of Contents

Abbreviations

AIST	Australian Institute of Superannuation Trustees
AFA	Association of Financial Advisers
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
APRA	Australian Prudential Regulation Authority
CSSA	Corporate Specialist Super Alliance
EM	Explanatory Memorandum
ERF	Eligible Rollover Fund
FSC	Financial Services Council
FW Act	*Fair Work Act 2009*
FWA	Fair Work Australia
FOFA	Future of Financial Advice
FSCOD Act	*Financial Sector (Collection of Data) Act 2001*
ISN	Industry Super Network
LCA	Law Council of Australia
MIS	Managed Investment Scheme
PDS	Product Disclosure Statement
RSE	Registrable Superannuation Entity
SG Regulations	Superannuation Guarantee (Administration) Regulations 1993
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SMSF	Self-managed superannuation funds
TPD	Total permanent disability

List of Recommendations

Recommendation 1

3.44 The committee recommends that the Australian Prudential Regulation Authority continue its consultation with stakeholders on the product dashboard with a view to considering:

- a requirement that the investment return target be net of investment and administration fees in proposed subsection 1017BA(2)(a) of the *Corporations Act 2001*;
- how best to quantify the likelihood of a negative return as part of the risk measure in proposed subsection 1017BA(2)(c) of the *Corporations Act 2001*;
- a clear definition of the liquidity measure in proposed subsection 1017BA (2)(d) of the *Corporations Act 2001*; and
- the options to minimise discrepancies between the information in the product dashboard and the information contained in the new short product disclosure statement regime.

Recommendation 2

5.23 The committee recommends that the bill be passed.

Chapter 1

Introduction

1.1 On 20 September 2012, the House Selection Committee referred the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 to the Parliamentary Joint Committee on Corporations and Financial Services ('the committee') for inquiry. The Minister for Financial Services and Superannuation requested that the committee table its report by 9 October 2012.

1.2 The bill is the third tranche of legislation implementing the government's MySuper and governance reforms. This tranche establishes various rules relating to the operation of MySuper products.

1.3 In March this year, the committee tabled its report into the provisions of the first two tranches of these reforms: the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2011.[1] These bills established the framework within which the MySuper products will operate.

Background to the Stronger Super reforms

1.4 The measures proposed in the Further MySuper and Transparency Measures Bill are part of the government's Stronger Super reform package. This package was initiated in response to the government-commissioned Cooper Review of Superannuation, which presented its final report in June 2010.[2] The review panel, led by Mr Jeremy Cooper, was tasked with developing options to improve the regulation of the superannuation system, to promote the best interests of members and maximise retirement incomes for Australians, while reducing business costs.[3] On 30 June 2010, the panel presented 177 recommendations intended to 'enhance Australia's world class

---

1 Parliamentary Joint Committee on Corporations and Financial Services, *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2011*, March 2012.

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

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

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

1.5 The Stronger Super reform package is part of the federal government's broader reform of Australia's superannuation system. On 5 July 2010, the then Minister for Superannuation and Financial Services, the Hon. Chris Bowen MP, noted the government's response to the Cooper Review was one of three stages of reform to superannuation. The other stages are:

- the Future of Financial Advice (FOFA) reform package which applies to financial advice generally, including advice relating to superannuation products; and
- the government's Stronger & Fairer Superannuation reforms, including an increase in the Superannuation Guarantee Charge to 12 per cent.[6]

The government estimates the superannuation reforms will increase retirement superannuation balances by almost $150,000 for a 30 year old worker earning average full-time wages.[7]

1.6 On 1 August 2010, the Prime Minister the Hon. Julia Gillard MP, the Treasurer the Hon. Wayne Swan MP and Minister Bowen announced that, if re-elected, the government would allow superannuation funds to offer a simple, low cost superannuation product. The product would be called MySuper and form part of the government's broader policy objective of increasing the efficiency of the superannuation system and lowering fees.[8]

1.7 On 16 December 2010, the government formally responded to the Cooper Review by releasing 'Stronger Super'. The government's Stronger Super reforms aim to:

- create a simple, low cost default superannuation product called 'MySuper';

---

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

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

6 The Hon. Chris Bowen MP, Minister for Financial Services, 'Superannuation and Corporate Law, Government releases Cooper review into superannuation', *Media Release No. 84*. The increase in the Superannuation Guarantee from 9 to 12 per cent was announced in the 2010 federal budget.

7 *Stronger Super Information Pack*, 21 September 2011, p. v http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf (accessed 24 September 2012).

8 The Hon. Chris Bowen MP, the Hon. Julia Gillard MP,the Hon. Wayne Swan MP, 'Labor helps families save with simpler low-cost super', 1 August 2010 http://www.alp.org.au/federal-government/news/labor-helps-families-save-with-simpler-low-cost-su/

- make the processing of everyday transactions easier, cheaper and faster, through the 'SuperStream' package of measures; and
- strengthen the governance, integrity and regulatory settings of the superannuation system, including in relation to self managed superannuation funds.[9]

1.8 In November 2011, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, stated in the Second Reading Speech to the MySuper Core Provisions Bill:

> ...around 60 per cent of Australians do not make active choices in relation to their superannuation. And this government believes that Australians should not be charged for valet parking when they are catching the train...Having created an industry which flourishes on the back of compulsory savings mandated by legislation, it is fair that this industry, which benefits so much from the compulsory saving system in Australia, contributes to higher retirement savings through greater efficiency and lower fees.[10]

1.9 In a 2010 speech to the Australian Conference of Economists, Dr David Gruen of Treasury, explained the rationale for the MySuper option in the following terms:

> ...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. Freedom of choice is a central feature of the choice architecture model that underpins the MySuper proposal. Actively engaged people can choose a MySuper default option, or they can choose from a potentially wide array of alternative 'choice' options.
>
> The evidence is that around 80 per cent of members of superannuation funds in Australia are invested in the default option in a super fund chosen by their employer or an award. Of that 80 per cent, anecdotal evidence suggests around 20 per cent explicitly choose the default option, with the rest making no active choice.
>
> ...The idea is not to have a centrally determined option for everybody; nor is it laissez faire. While the system compels people to save into super through the Super Guarantee, the Cooper Review's proposed choice architecture means that people are able to choose between the default option (which

9 http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm (accessed 24 September 2012)

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

must be a MySuper product), or opt for a saving plan with greater choice but greater responsibility.[11]

1.10 The introduction of the MySuper product will commence on 1 July 2013. From this date, superannuation funds will be able to offer a simple, low cost default superannuation product called MySuper. This product is intended to improve the simplicity, transparency and comparability of default superannuation products.[12] From 1 October 2013, employers must make contributions for employees who have not made a choice of fund to a fund that offers a MySuper product in order to satisfy superannuation guarantee requirements.[13]

1.11 Already, the proposed legislation is having a positive effect on competition for low cost superannuation products. In September 2012, the Minister for Financial Services and Superannuation officially launched ING Direct's new simple and cost-effective superannuation product. For the first time in Australia, the product will be free of administration, contribution and management fees.[14] The government estimates that by placing downward pressure on fees, the MySuper reforms will save Australian superannuants $1.7 billion in fees annually in the longer term.[15]

1.12 On 1 July 2011, the Government commenced the implementation of SuperStream. The SuperStream reforms are aimed at improving the administration and management of superannuation accounts, to make the processing of transactions easier, cheaper and faster for members and employers.[16] The reforms continue to be implemented.

---

11 Dr David Gruen, 'MySuper—Thinking seriously about the default option', *Paper presented to the special session on Superannuation at the Australian Conference of Economists*, 28 September 2010. http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2010/MySuper-Thinking-seriously-about-the-default-option (accessed 26 September 2012).

12 http://strongersuper.treasury.gov.au/content/Content.aspx?doc=reforms.htm (accessed 24 September 2012).

13 *Stronger Super Information Pack*, 21 September 2011, http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf (accessed 24 September 2012).

14 The Hon. Bill Shorten MP, 'Business embracing government's MySuper reforms', *Media Release No. 057*, 4 September 2012, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/057.htm&pageID=003&min=brs&Year=&DocType= (accessed 24 September 2012). See also Annette Sampson, 'MySuper unleashes competition and value', *Sydney Morning Herald*, 22 September 2012, p. 13.

15 The Hon. Bill Shorten MP, 'Business embracing government's MySuper reforms', *Media Release No. 057*, 4 September 2012.

16 http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm (accessed 24 September 2012)

Consultation on the MySuper and Super Stream reforms

1.13 In February 2011, Mr Paul Costello was appointed Chair of the 'Stronger Super Peak Consultative Group'. This group was formed to advise the government on how best to implement the Stronger Super package. It was comprised of representatives of key stakeholders in the superannuation sector, including employers, employees, industry service providers and consumer advocates supported by specialist working groups.[17] These groups covered MySuper, governance arrangements, self-managed superannuation funds and SuperStream.

1.14 The MySuper working group has to date issued ten issues papers.[18] These cover the following:

- data collection and disclosure;
- Defined Benefit Funds;
- exempt Public Sector Superannuation Schemes and MySuper products;
- the transition to MySuper;
- Retirement Income Products;
- eligible Rollover Funds and Member Protection Rules;
- fees and costs;
- insurance;
- defining MySuper; and
- advice and insurance commissions within super.

1.15 In September 2011, the government released its Stronger Super Information Pack which contained information on key design aspects of the reforms.[19]

Committee inquiries into the MySuper legislation

1.16 As noted above, this committee has examined the provisions of the first two tranches of the MySuper legislation, reporting in March 2012. That report made three recommendations, one of which was that the bills be passed.

---

17 The Hon. Bill Shorten MP, 'Paul Costello to Chair Consultation Panel on Stronger Super Reforms', *Media Release No. 021*, 1 February 2011, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/021.htm&pageID=003&min=brs&Year=&DocType= (accessed 24 September 2012).

18 http://strongersuper.treasury.gov.au/content/Content.aspx?doc=consultations/working_groups/mysuper/default.htm (accessed 24 September 2012).

19 *Stronger Super Information Pack*, 21 September 2011 http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf (accessed 24 September 2012).

1.17 The other recommendations sought clarification of the 'large employer' requirement in proposed subsection 29TB of the Core Provisions Bill. This subsection allows for 'large employers' to offer a tailored MySuper product. The committee recommended that the bill be redrafted:

- to clarify that this requirement needs to be satisfied upon authorisation of the MySuper product and at the end of each annual reporting period; and
- to allow the Australian Prudential Regulation Authority to grant a grace period of up to six months for large employers whose fund members have fallen below the 500 member threshold as part of the annual check.[20]

Committee inquiry into the SuperStream reforms

1.18 On 24 May 2012, the House of Representatives introduced the Superannuation Legislation Amendment (Stronger Super) Bill 2012 and the Superannuation Supervisory Levy Imposition Amendment Bill 2012. It subsequently referred the bills to the committee for inquiry. These bills are part of the package of SuperStream measures which are designed to 'improve the productivity of the superannuation system and make the system easier to use'.[21] As the Explanatory Memorandum to the bills noted:

> The purpose...is to improve the administration and management of super accounts making the processing of everyday transactions easier, cheaper and faster for members and employers.[22]

The committee noted in its report the efforts that had already been taken by industry to adopt the SuperStream measures, and improve efficiencies in the administration of superannuation for the benefit of all employers and superannuation members. It also commended the 'extensive consultation and collaboration' between industry and government officials that had been undertaken on the SuperStream measures.[23]

---

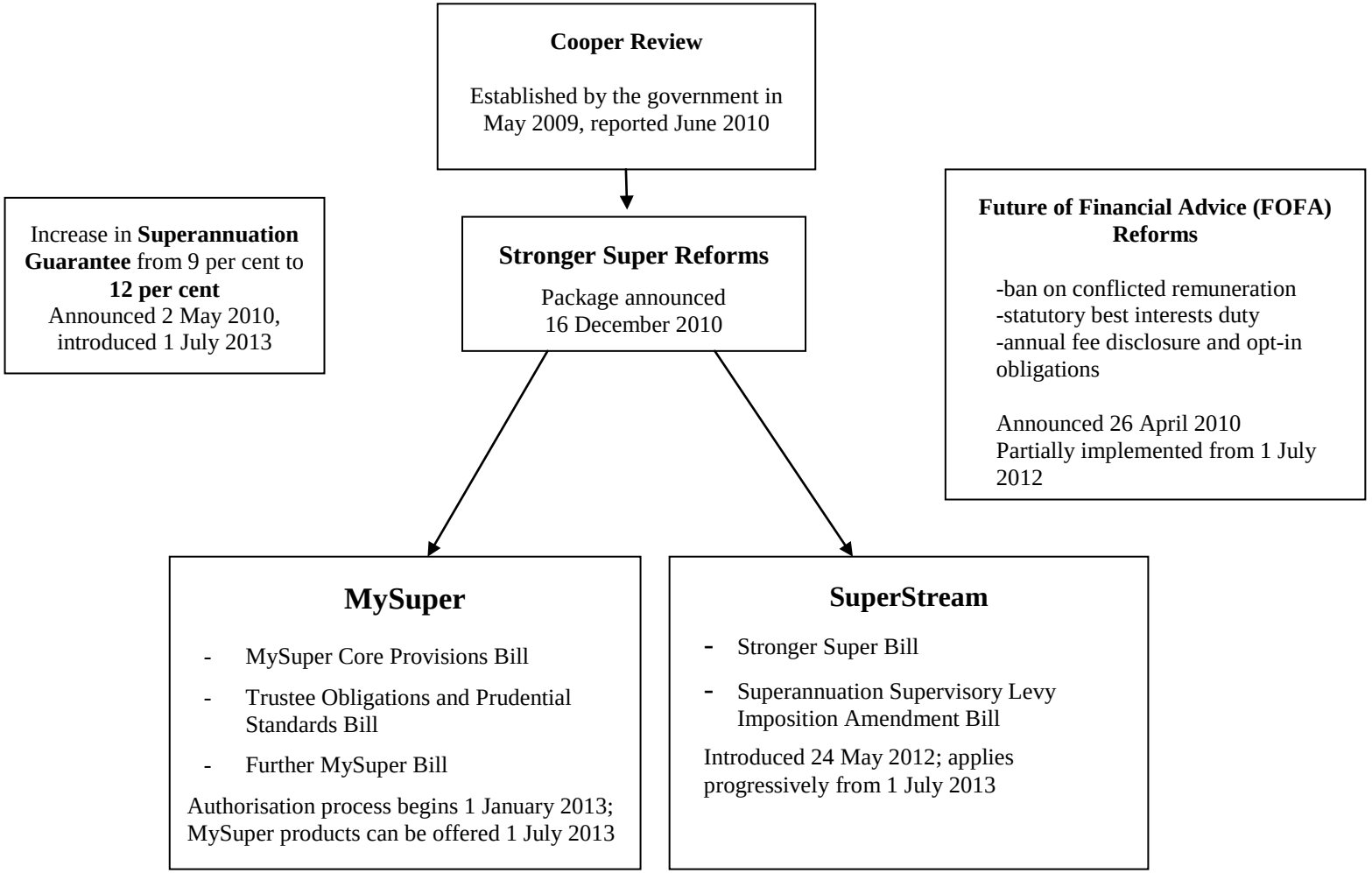
20 Parliamentary Joint Committee on Corporations and Financial Services, *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2011*, March 2012, p. 36.

21 The Treasury, 'Regulation Impact Statement: Stronger Super Implementation', September 2011', p. 40. See the chapter on 'SuperStream' for further details on the reform (pp 40–58).

22 Explanatory Memorandum, Superannuation Legislation Amendment (Stronger Super) Bill 2012, Superannuation Supervisory Levy Imposition Amendment Bill 2012, p. 25.

23 Parliamentary Joint Committee on Corporations and Financial Services, *Superannuation Legislation Amendment (Stronger Super) Bill 2012 and the Superannuation Supervisory Levy Imposition Amendment Bill 2012*, May 2012, p. 33.

Reforms to Australia's superannuation system



Consultation on the third tranche of MySuper

1.19 The committee acknowledges the extensive consultation undertaken by the government on the third tranche of the MySuper reforms. The Australian Institute of Superannuation Trustees (AIST) told the committee that there had been a 'significant and extensive' consultation process over a period of 'about 20 months' dating back to the start of 2011.[24]

1.20 In this context, the committee queries the response from the Law Council of Australia (LCA) that it was involved only to a limited extent in the consultation on the reforms in the third tranche. Ms Michelle Levy of the LCA told the committee that the Council had only been consulted twice when, in June and August 2012, it met with the Australian Prudential Regulation Authority as part of a 'lawyers' liaison group'.[25]

1.21 However, the committee is aware that the LCA had met with various stakeholders including Treasury officials on 3 October 2012, just two days before the hearing.[26] The committee would like to extend to the LCA the opportunity to clarify the record on this matter.

Conduct of the inquiry

1.22 On 21 September 2012, the committee sent invitations to various stakeholder organisations to make a submission to the inquiry. It requested submissions by 3 October 2012. The committee received 29 submissions, as listed in Appendix 1.

1.23 The committee advertised the inquiry in *The Australian* newspaper on 26 September 2012. Details of the inquiry, the bill and associated documents were also made available on the committee's website.

1.24 The committee held a public hearing into the provisions of the bill in Sydney on 5 October 2012. It received evidence from the Financial Planning Association, the Financial Services Council, the Corporate Super Specialist Alliance, the Association of Financial Advisers, the LCA, the Association of Superannuation Funds of Australia, AIST, the Industry Super Network and Treasury officials. The transcript of proceedings is available on the committee's website.

1.26 Given the 'significant and extensive' consultation process over a period of 'about 20 months' dating back to the start of 2011, the committee's enquiries have been invitations to the sector and the broader community, to further participate in the

---

24 Mr Gerard Noonan, Vice President, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 5 October 2012, p. 27.

25 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard*, 5 October 2012, p. 19.

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

MySuper reform process at the time of the tabling of final draft of the legislation. The legislation reviewed at this point has already been amended in response to consultation arising from the draft legislation released in April 2012.

1.25 As with the referral of the first two tranches of the MySuper legislation, the committee has had limited time to inquire into the provisions of the third tranche. Given the reporting time constraints, the committee suggests that this report be read in conjunction with the written submissions that the committee has received.

1.26 The committee understands the government's eagerness to secure the passage of the legislation, and the importance of the underpinning public policy objectives. It supports the government's timeframe for the consideration of this tranche of the legislation in the parliament. It also believes that the proposed commencement date for the MySuper reforms of 1 July 2013 is both reasonable and appropriate. As Mr Andrew Bragg of the Financial Services Sector told the committee:

> I think to be fair we have had a long period of consultation and the government has been very reasonable in providing basically 2011 to have a process, which was led by Paul Costello, to look at how the elements of the reforms should be crafted in legislation.[27]

Acknowledgements

1.27 The committee thanks the organisations and individuals who made submissions to the inquiry and who appeared to give evidence at the public hearing in Sydney.

Structure of the report

1.28 The Superannuation Legislation Amendment (Further MySuper and Transparency) Bill 2012 amends the following Acts to implement the remaining measures relating to the MySuper reforms:

- the *Superannuation Industry (Supervision) Act 1993* (the SIS Act);
- the *Superannuation Guarantee Administration Act 1992*;
- the *Corporations Act 2001*; and
- the *Fair Work Act 2009*.

1.29 The bill has seven schedules:

- fees, costs and intrafund advice (Schedule 1);
- insurance (Schedule 2);
- the collection and disclosure of information (Schedule 3);

27 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 5 October 2012, p. 7.

- modern awards and enterprise agreements (Schedule 4);
- Defined Benefit Members (Schedule 5);
- the transition to MySuper (Schedule 6); and
- Eligible Rollover Funds (Schedule 7).

1.30 Chapter 2 of this report examines the provisions of, and views on Schedules 1 and 2 of the bill. Chapter 3 examines Schedules 3, 4 and 5 of the bill. Chapter 4 focuses on Schedule 6 and stakeholders' views on the provisions to move accrued default amounts to MySuper products where members do not 'opt-out'. Chapter 5 looks at Schedule 7 of the bill authorising trustees to operate Eligible Rollover Funds. It also presents a final committee comment.

Chapter 2

Schedules 1 and 2 of the bill: provisions and views

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

Schedule 1: fees, costs and intrafund advice

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

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

Conflicted remuneration

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

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

---

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

2 Explanatory Memorandum, p. 8.

3 Explanatory Memorandum, p. 11.

Performance-based fees

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

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

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

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

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

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

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

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

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

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

---

4 Explanatory Memorandum, p. 7.

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

6 Explanatory Memorandum, pp 12–13.

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

Intrafund advice

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

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

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

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

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

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

---

7 Explanatory Memorandum, p. 14.

8 Explanatory Memorandum, p. 14.

9 Explanatory Memorandum, p. 16.

10 Explanatory Memorandum, p. 15.

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

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

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

General fee rules

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

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

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

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

12 Explanatory Memorandum, p. 15.

13 Explanatory Memorandum, p. 15.

14 Proposed subsection 99A of the SIS Act

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

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

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

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

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

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

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

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

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

15 Explanatory Memorandum, p. 31.

16 Explanatory Memorandum, p. 18.

(i) a trustee of the entity; or

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

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

Submitters' views on Schedule 1

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

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

Views on intrafund advice

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

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

2.25 He added:

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

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

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

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

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

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

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

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

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

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

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

Grandfathering arrangements

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

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

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

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

2.32 She added:

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

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

---

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

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

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

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

Performance-based fees

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

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

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

Views on the administration fee exemption

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

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

---

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

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

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

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

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

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

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

Views on the cost of financial product advice

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Impact of superannuation business models

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

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

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

---

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

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

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

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

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

Committee view on Schedule 1

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

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

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

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

Schedule 2—Insurance

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

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

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

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

Minimum level of life insurance

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

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

Default insurance

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

---

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

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

42 Explanatory Memorandum, p. 25.

43 Explanatory Memorandum, p. 26.

44 Explanatory Memorandum, p. 27.

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

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

Self insurance

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

Committee view on Schedule 2

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

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

45 Explanatory Memorandum, p. 27.

46 Explanatory Memorandum, p. 27.

47 Explanatory Memorandum, p. 24.

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

Chapter 3

Schedules 3, 4 and 5 of the bill: provisions and views

Schedule 3—Collection and disclosure of information

3.1 Schedule 3 of the bill amends the *Australian Prudential Regulation Act 1998*, the *Corporations Act 2001*, the *Financial Sector (Collection of Data) Act 2001* (FSCOD Act) and the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). It expands the coverage of Australian Prudential Regulation Authority's (APRA) data collection, ensures the publication of data on MySuper products, and improves disclosure for superannuation.[1]

3.2 The Cooper Review noted in its final report that:

> Transparency and comparability are critical to the efficiency and operation of a market-based savings system, even where participation is compulsory. The Panel believes that there is presently a lack of transparency, comparability and, ultimately, accountability in the Australian superannuation system that can only be effectively improved through targeted and proportionate regulation.[2]

3.3 The Panel added:

> There is no standardised methodology for calculating and disclosing relevant fund or investment option information. Members often rely inappropriately on historical investment return data which gives no information about the risk attaching to those returns.[3]

3.4 The Explanatory Memorandum (EM) notes that MySuper products are intended to set a new benchmark for superannuation in the level of transparency and comparability of key performance information.[4]

Data collection

3.5 APRA will have an expanded role in the collection and publication of data on superannuation entities. This data will allow members, employers, the industry and other stakeholders with information to compare the performance of superannuation

---

1 Explanatory Memorandum, p. 31.

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

3 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 99.

4 Explanatory Memorandum, p. 31.

products. As the EM notes, this will enhance the accountability of trustees to their members.[5]

3.6 The bill would amend APRA's secrecy obligations with the effect that the Authority's decisions on the confidentiality of a document are streamlined. Currently, under section 57 of the APRA Act, the Authority can make a determination on the non-confidentiality of a *particular* reporting document required to be given by a registered entity to APRA under the FSCOD Act. The bill would enable APRA to make a determination on a *class* of reporting document that is required to be given by a registered entity to APRA under the FSCOD Act. The EM notes that under the proposed law, APRA will be able to determine that information reported in specified line items of a particular reporting form is non-confidential.[6] APRA will thereby not be required to repeat confidentiality determinations for each particular document.

3.7 The Cooper Review panel recognised that currently, superannuation funds' information is 'to a fairly detailed level' disclosed to APRA under the FSCOD Act through the APRA annual and quarterly returns. It noted that these returns capture a fund's financial performance, financial position, derivative financial instruments, transactions with associated parties, and membership and superannuation entity profile.

3.8 However, the panel also observed that while APRA returns contain more detail than the audited financial statements:

> ...many costs are not disclosed or are disclosed only in highly aggregated form. This problem can arise because some of the costs are incurred in 'downstream' entities, rather than in the fund itself. This typically occurs when the trustee owns a subsidiary administrator that provides all services for the trustee as well as the fund; where the trustee is itself owned by an administrator; or where all investment services for the fund are provided by a third party, whether or not that third party is related to the trustee. Another shortcoming is that some of the data is not publicly reported by APRA for confidentiality reasons.[7]

3.9 The EM presents a diagram to illustrate this case. It shows a member's assets earning a return of 6.5 per cent from which an investment manager deducts a fee of one per cent and the managed investment scheme deducts a fee of 0.5 per cent. An investment return of 5 per cent is returned to the Registrable Superannuation Entity (RSE) licensee that provides it to members. The licensee in turn charges an explicit fee of 1 per cent to members. The member is only aware of this 1 per cent fee; the

---

5 Explanatory Memorandum, p. 35.

6 Explanatory Memorandum, pp 35–36.

7 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 120 http://www.supersystemreview.gov.au/ (accessed 24 September 2012).

additional 1.5 per cent fee taken by the investment manager and the managed investment scheme (MIS) is hidden.[8]

3.10 The bill seeks to provide APRA with powers to examine the 'hidden' fee component, ensuring that the full costs of investing the assets of members are provided to APRA and to members. Proposed subsection 13(4A) of the FSCOD Act gives APRA explicit power to require RSE licensees to provide investment information on their assets (or assets derived from their assets) by:

- a related body corporate of the licensee;
- a custodian holding the RSE's superannuation assets; or
- a person under a contract or arrangement with the licensee.

3.11 APRA would have power to establish a reporting standard that requires information on underlying investments and/or deductions on net returns by third parties. This could be the assets invested in a MIS, which has in turn invested the assets in financial products or property.[9] Where these assets are invested under contract or other arrangement between the RSE licensee and a person connected with the RSE licensee, the contract or arrangement must have an implied term:

- requiring the RSE licensee to notify the connected person that the assets are derived from a RSE; and
- requiring the connected person to provide the RSE licensee with the required information. If the RSE licensee invests its fund's assets in an investment life policy issued by a related life company, which in turn invests in a MIS in which another related body corporate is the responsible entity, both the life company and the responsible entity will be persons connected with the RSE licensee. APRA may, therefore, have a reporting standard requiring the RSE licensee to report on the underlying investments of the MIS and the deductions on net returns imposed by the responsible entity and life company.[10]

3.12 The EM gives the example of an RSE licensee investing in a MIS (that is not a related body corporate of the RSE) through a custodian. In this instance:

- the RSE licensee must notify the custodian the assets are its own;
- the custodian must notify the MIS that it is investing assets of the RSE licensee;
- the MIS must provide the custodian details of the costs it deducts from the investment return, and the custodian provides this information and details of

8 Explanatory Memorandum, p. 37.

9 Explanatory Memorandum, p. 38.

10 Explanatory Memorandum, paragraph 3.29, p. 38.

the costs it deducts from the investment return it received from the MIS to the RSE licensee.[11]

The product dashboard

3.13 The Cooper Review noted that in order to make meaningful choices, or even to understand their personal situation, members need to be able to make 'like with like' comparisons between competing superannuation products. With a view to providing transparency and more meaningful information, the Review argued that standard product 'dashboards' and standardised investment performance reporting would 'lift the fog that has clouded this area so far'. It added:

> [T]he new 'forward looking' investment option disclosure 'dashboard' would enable members to examine likely future performance, rather than basing investment choice on past investment performance. The Panel believes that this way of preparing and disclosing investment option data will aid members in figuring out some of the technical information that is associated with their super.[12]

3.14 The bill would require that RSE licensees publish a product dashboard for each of the fund's MySuper and choice products.[13] This information should be made available on the RSE's website such that it is accessible to the public at all times and updated as required.[14] The bill would require that the following information is provided:

- the investment return target;
- the number of times the current target has been met in the last ten financial years (or for the period the product has been offered if it has been offered for less than ten financial years);
- the level of investment risk;
- a statement about the liquidity of the product, and the average amount of fees (excluding activity fees, advice fees and insurance fees) in relation to the product; and
- other costs such as embedded investment costs in relation to the MySuper product or investment option during the last quarter, expressed as a percentage of the assets of the fund attributable to the MySuper product or investment option.[15]

---

11 Explanatory Memorandum, p. 39.

12 *Review into the governance, efficiency, structure and operation of Australia's superannuation system*, 2010, p. 21 http://www.supersystemreview.gov.au/ (accessed 24 September 2012).

13 Explanatory Memorandum, p. 32.

14 Explanatory Memorandum, p. 40.

15 Explanatory Memorandum, p. 41.

3.15 It will be an offence for the trustee, who is required to publish a product dashboard, not to do so (proposed subsection 1021NA(1) of the Corporations Act). It will be a strict offence for a trustee to publish a product dashboard containing defective information (proposed subsections 1021NA(2) and (3) of the Corporations Act), fail to update the product dashboard as required and omit information from the product dashboard or fail to update as required.[16]

3.16 Proposed subsection 1021NA(5) of the Corporations Act does provide a defence where it has taken reasonable steps to ensure that the dashboard was updated as required, not misleading or deceptive, and contained no omissions.

3.17 The EM notes that civil action against the trustee will be able to be taken by a person who suffers loss or damage as a result of the trustee's product dashboard not containing the required information, not being updated as required, containing misleading or deceptive information, or if there is an omission.[17]

3.18 The bill would exempt certain investment options within a choice product from publishing a product dashboard. These options are:

- 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.[18]

3.19 The requirement of publishing a product dashboard would also not apply if the sole purpose of the investment option is the payment of a pension to members, or if the assets of the fund are only invested in another single asset, such as individual financial products offered on a platform (proposed subsection 1017BA(4) of the Corporations Act).

3.20 The product dashboard will not apply to defined benefit arrangements. To ensure that this is the case, the bill would define a choice product as a class of beneficial interest in a regulated superannuation fund, unless all the members of the fund who hold the class of beneficial interest in the fund are defined benefit members or the class of beneficial interest is a MySuper product.[19]

---

16 Explanatory Memorandum, p. 42.

17 Explanatory Memorandum, p. 42.

18 Explanatory Memorandum, p. 42.

19 Proposed subsection 10(1) of the SIS Act, Explanatory Memorandum, p. 43.

Disclosure of remuneration

3.21 The bill would require an RSE licensee to disclose the remuneration details of each executive officer in cases where the licensee is a body corporate, or each trustee if the RSE licensee is a group of individual trustees. This requirement will be set out in the regulations.[20]

3.22 The Cooper Review recommended that trustees should allow a beneficiary access to any prescribed information or any prescribed documents. The EM notes that the regulations will also specify certain documents that will have to be published on the public section of the fund's website.[21] These documents include the net returns of all MySuper and investment options over the past ten years and the investment return target for all MySuper and investment options for choice products. It also includes the fund's most recent audited financial and actuarial report, product disclosure statements and annual report. ASIC will be responsible for ensuring that trustees comply with these disclosure requirements. Failure to publish up to date information on the fund's website at all times will be a strict liability offence carrying a penalty of 50 penalty units.

Consistent information

3.23 The EM states that inconsistent information provided through multiple means 'can cause significant damage to members of superannuation funds and inhibit informed decision-making'.[22] The bill would also require RSE licensees to give any person information that is calculated in the same way as required under APRA's reporting standard. Regulations may prescribe an exemption to this requirement. Notwithstanding these, failure to provide information calculated on the same basis will be a strict liability offence carrying a penalty of 50 penalty units.

Portfolio holdings

3.24 A further area of disclosure set out in Schedule 3 of the bill relates to the requirement for RSE licensees to disclose their portfolio holdings twice annually. Licensees must publish this information on the fund's website within 90 days of the reporting day (30 June or 31 December) and the information must remain on the fund's website until it is updated. The key information requirements are to disclose each financial product, the value of the RSE's investment in that product.[23] It will

20 Explanatory Memorandum, p. 42.

21 *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).

22 Explanatory Memorandum, p. 45.

23 Explanatory Memorandum, p. 46.

include financial products in which the assets are derived from assets of the RSE, such as through multiple levels of pooled investments include MISs.[24]

3.25 The EM notes that the regulations will be able to prescribe a materiality threshold for the information that must be published on an RSE licensee's website. It notes that the government will give consideration to this threshold 'to strike a balance between the compliance costs and the benefits for members from portfolio holdings disclosure'.[25]

3.26 The bill would impose a penalty of 100 penalty units or two years' imprisonment or both for an RSE licensee that fails to publish details of its portfolio holdings on its website. It is a defence to show that the RSE licensee would have published the information, but for the fact that the trustee was not provided with the required information.[26] The penalty for RSE licensees who knowingly publish misleading or deceptive information, or information containing omissions, is 200 penalty units or imprisonment for five years, or both. The bill has a corresponding strict liability offence of 100 penalty units or imprisonment for two years or both.[27]

Obligations on other parties on ensure disclosure of portfolio holdings

3.27 The bill's requirement for disclosure of portfolio holdings is accompanied by obligations on parties that acquire a financial product using the assets of an RSE. The EM describes a situation where a person (the first party) enters into a contract with another person (the second party) to acquire a financial product using the assets (or assets derived from the assets) of an RSE. It notes that:

> If a financial product is acquired under the contract or arrangement, the second party will have an obligation to provide the RSE licensee with information sufficient to identify the financial product acquired and any financial products or other property that the second party knows, or reasonably ought to know, will be acquired using the assets, or assets derived from the assets, of the RSE.[28]

3.28 The EM gives the example of an RSE investing its funds through a custodian in assets in a financial product provided by MIS 1. This MIS—a fund of funds—purchases units in a financial product offered by MIS 2. In this case, the custodian must notify MIS 1 that the assets invested are those of the RSE. Then:

- MIS 1 will have an obligation to provide information to the RSE that is sufficient to identify:

---

24 Paragraphs 1017BB(1)(a) and (b)

25 Explanatory Memorandum, p. 46.

26 Subsections 1021NB(1) and (5)

27 Explanatory Memorandum, p. 51.

28 Explanatory Memorandum, p. 48.

    - its financial product;
    - the financial products it acquires with the assets that it acquires with the assets; and
    - the value of the RSE's investments.
- MIS 1 must then notify MIS 2 that it is investing assets derived from the assets of the RSE.
- MIS 2 will subsequently have an obligation to provide information directly to the RSE to identify:
    - its financial product;
    - the financial products it acquires with the assets that it acquires with the assets; and
    - the value of the RSE's investments.[29]

3.29 Parties who do not notify another party that a contract or arrangement invests assets of an RSE, or assets derived from the assets of an RSE, or who fail to notify other parties of the details of the RSE licensee commit an offence. This offence carries a penalty of 100 penalty units or imprisonment for 2 years, or both.

3.30 Parties commit an offence when they knowingly omit, or knowingly provide misleading or deceptive, information when:

- notifying another party that a contract or arrangement invests assets of an RSE;
- notifying another party of the details of the trustee; or
- notifying and not providing the relevant information to the RSE licensee.

3.31 This offence carries a penalty of 200 penalty units or imprisonment for 5 years, or both. There is a corresponding strict liability offence of 100 penalty units or imprisonment for two years or both.

3.32 It is a defence to the charge of not providing relevant information to show that the person took reasonable steps to ensure there would not be an omission in providing the information. Alternatively, it is a defence to show that the information was omitted because it would have been misleading or deceptive, and that the person took reasonable steps to obtain information that would not have been misleading or deceptive.[30]

29 Explanatory Memorandum, p. 49.

30 Explanatory Memorandum, p. 52.

Views on Schedule 3

The product dashboard

3.33 The majority of submitters' comments relating to Schedule 3 of the bill concerned the product dashboard and in particular, the limitations of its design and practical difficulties in interpreting the information.

3.34 The Law Council of Australia (LCA) told the committee that it would be difficult to provide and calculate some of the product dashboard information. It also expressed concern at the 'mismatch' between other published information, particularly in product disclosure statements and the material that is on the dashboard.[31]

3.35 The LCA argued that the information in the Product Disclosure Statement (PDS) should 'in most instances be the most accurate estimate of what the annual fees and charges are likely to be'. For instance, it noted that the PDS already includes a historical figure reflecting total management costs, in percentage terms, for the most recently completed financial year.[32]

3.36 Indeed, the LCA argued that the new information which would be required to be included in the product dashboard could be significantly different from the published data in the PDS including other fee information in the PDS. This could cause confusion among members. It also observed that the new requirements 'seem to focus on fees and charges incurred in a quarter', which could create confusion given that percentage-based fees are usually expressed on a per annum basis.[33]

3.37 The LCA also expressed concern with the bill's obligations in terms of 'platform wraps' or 'superannuation wraps'. These are arrangements whereby a member can have a large range of investment options (that are financial products in their own right) that are typically provided by third party fund managers. The LCA noted that it is likely that trustees will be 'heavily reliant' upon those third parties to provide the dashboard data or actually to prepare the dashboard.[34] Given this, it argued that:

> [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

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

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

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

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

> have correctly calculated their historical performance and therefore in ascertaining how many times the performance objective has been achieved.[35]

3.38 The Australian Institute of Superannuation Trustees (AIST) told the committee that while disclosure is 'critically important', 'it must not be misleading and it must be designed to provide members with a real, accurate and useful understanding of a super product and assist comparisons with other super products'.[36] On this basis, it argued that there are problems with both the framework for the product dashboard in the bill and the more detailed structure released by APRA in a recent discussion paper. Accordingly, AIST recommended that:

> ...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.[37]

3.39 The Industry Super Network (ISN) also expressed concerns. Based on the early indications from APRA consultations on the measures which began on 19 September 2012, it foresaw a 'serious risk of outcomes that could lead to members being misled about products and trustees being encouraged to make sub-optimal investment decisions'.[38] Specifically, the ISN identified the following weaknesses:

- the investment return target (proposed subsection 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 subsection 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 subsection 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 subsection 1017BA(4)) are 'inappropriate'. The ISN criticised the exemption of pension products and fund of fund investment options delivered through a platform claiming consumers. It argued that consumers would benefit from their inclusion;

---

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

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

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

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

- 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.

3.40 ISN thereby recommended that proposed amendments to sections 1017BA–1017BE of the Corporations Act be omitted from the bill.[39]

Committee view on the product dashboard

3.41 The committee believes that the case for introducing a product dashboard for each of a fund's MySuper products is compelling. The Cooper Review found there is a lack of transparency, comparability and accountability in the superannuation system. Further, portfolio disclosure in Australia does not meet global best practice. A product dashboard would introduce a standardised methodology for calculating and disclosing relevant fund or investment option information. It would rightly provide information on the investment return target, the investment risk, the liquidity of the investment and the average amount of fees and costs in relation to the MySuper product in the last quarter.

3.42 Schedule 3 of the bill would establish this basic framework in legislation. The committee supports its passage through Parliament and believes the carve-outs in proposed section 1017BA(4) of the Corporations Act are justified.

3.43 However, it is true that the real benefit from this dashboard to both trustees and members will depend on how the details are put in place. The committee notes that the negotiations with APRA that began in September 2012 appear to have uncovered several areas of potential difficulty and confusion. It urges APRA in further consultations with stakeholders to examine these issues carefully. The prime consideration must be the usefulness of the information to members and to ensure that any confusion that may arise from information through other sources is minimised.

Recommendation 1

3.44 The committee recommends that the Australian Prudential Regulation Authority continue its consultation with stakeholders on the product dashboard with a view to considering:

- **a requirement that the investment return target be net of investment and administration fees in proposed subsection 1017BA(2)(a) of the *Corporations Act 2001*;**
- **how best to quantify the likelihood of a negative return as part of the risk measure in proposed subsection 1017BA(2)(c) of the *Corporations Act 2001*;**

39 Industry Super Network, *Submission 20*, p. 3.

- **a clear definition of the liquidity measure in proposed subsection 1017BA (2)(d) of the *Corporations Act 2001*; and**
- **the options to minimise discrepancies between the information in the product dashboard and the information contained in the new short product disclosure statement regime.**

Views on publishing information about underlying holdings

3.45 Proposed section 1017BB of the Corporations Act would require the publication of investment information. The LCA observed that a trustee may not have all of the information and may not be in a position to comply fully because it is reliant on action from other entities.[40] It stated in its submission:

> The provision is extremely unclear and potentially very onerous. Just as an example, it requires trustees to identify:
>
> > …each of the financial products or other property in which assets, or assets derived from assets, of the entity are invested…
>
> It is intended to create some kind of flow-through into underlying investments, but the language is very unclear. It also raises the problem of double counting, which could arise if you had to delve through many layers of investments. A small but important point is that this information is required to be disclosed on a whole-of-fund basis, whereas members' interests are usually calculated by reference to their investment options. We query why you would not want this kind of information on a per-investment-option basis.[41]

Views on the strict liability provisions

3.46 The LCA was also critical of the strict liability provisions for trustees in relation to the failure to provide the requisite information on the product dashboard. It argued that a better option would be to have an offence where the trustee has failed to use best endeavours to comply with provisions. It viewed this provision as preferable to forcing a trustee into a position where they are in breach 'and then have to defend what may well be completely reasonable'.[42]

3.47 The Association of Superannuation Funds of Australia (ASFA) also expressed concern with the strict liability provisions in Schedule 3 of the bill. It also proposed amending the strict liability offences to 'at fault' provisions. ASFA noted that this amendment would recognise the need for there to be an offence with respect to

---

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

41 Ms Michelle Levy, Law Council of Australia, *Proof Committee Hansard,* 5 October 2012, p. 16 and p. 20.

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

deliberate or systemic failures, but also that liability will be a function of undesirable behaviour or conduct as opposed to inadvertent administrative or operational errors or omissions. If 'at fault' provisions are not legislated, ASFA argued that consideration should be given to introducing explicit reasonable steps, or safe harbour defences.[43]

Committee view on strict liability offences

3.48 The committee emphasises that the strict liability provisions in relation to the product dashboard reflect the benefit of these disclosures for consumers and the importance that trustees maintain a level of vigilance to ensure that the information is provided in an accurate and timely manner. It also notes that the strict liability offence is the same as similar offences that apply to other disclosures such as a product disclosure statement.

3.49 The committee also highlights that a trustee will have a defence where it has taken reasonable steps to ensure that the dashboard was updated as required, was not misleading or deceptive, and contained no omissions. Again, this is consistent with defences for other disclosure offences.

Schedule 4—Modern awards and enterprise agreements

3.50 Currently, most modern awards specify a particular fund or funds to which employers must make compulsory superannuation contributions for the benefit of employees covered by the award who have not chosen a fund. Employers who fail to make contributions for employees to a 'default fund' listed in the award are in contravention of the award, and liable to penalties under the *Fair Work Act 2009* (FW Act).[44]

3.51 The bill proposes that from 1 January 2014, only a fund that offers a MySuper product may be nominated in a modern Award or enterprise agreement. As the Minister explained in the Second Reading Speech:

> [T]his will ensure that employees that have their contributions directed to a fund nominated in a modern award or an enterprise agreement will benefit from having their contributions placed in a MySuper product if they do not wish to choose another superannuation product.[45]

3.52 An 'exempt public sector superannuation scheme', within the meaning given by the SIS Act, will also be permitted to be included as a default fund in a modern

43 Association of Superannuation Funds of Australia, *Submission 17*, p. 6.

44 Explanatory Memorandum, p. 55.

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

award. Exempt public sector superannuation schemes are not regulated by APRA and therefore cannot be authorised to offer a MySuper product.[46]

3.53 A term of a modern Award will be invalid if it does not nominate a fund that offers a MySuper product as a default fund. Fair Work Australia (FWA) will be required to conduct a 'one-off' process to ensure that on 1 January 2014 modern awards do not purport to nominate default funds that are not authorised by APRA as a MySuper product.[47] The object of this process is to avoid confusion for employees and employers.

3.54 The EM also notes that there will also be an ongoing obligation on FWA to remove any invalid references to non-compliant funds in modern awards 'as soon as practicable' after receiving a written notification from APRA that a fund has ceased to offer any MySuper product (or ceased to be an exempt public sector superannuation scheme and does not offer a MySuper product).[48] The onus will be on APRA to notify FWA if a fund is no longer authorised to offer a MySuper product.

3.55 The EM clarifies that if the authorisation of a fund to offer a MySuper product is cancelled, a term in a modern award will be invalid to the extent that it nominates that fund as a default fund from the time of the cancellation. The EM clarifies that this will ensure that employers are not obligated to make contributions to a fund under the terms of a modern award when they would be subject to penalties under the SG Act for doing so.[49]

3.56 The bill would require FWA to include a new term in modern awards that permits employers to make contributions to a fund for an employee who is a defined benefit member of that fund. This will allow contributions to defined benefit schemes even if the fund is not specified in the modern award and does not offer a MySuper product.[50]

3.57 The bill would amend the FW Act such that an enterprise agreement approved by FWA on or after 1 January 2014 will only be able to nominate a default fund (or scheme) that is either:

46 Explanatory Memorandum, pgs 56 and 60.

47 Explanatory Memorandum, p. 57.

48 Explanatory Memorandum, p. 55.

49 Explanatory Memorandum, p. 61.

50 Explanatory Memorandum, p. 57.

- a fund that offers a MySuper product;
- a fund that only receives contributions in respect of employees of the relevant employer who have not chosen a fund if such employees are defined benefit members; or
- an exempt public sector superannuation scheme.[51]

Schedule 5—Defined benefit members

3.58 A defined benefit fund is a superannuation fund that pays a final benefit based on a formula that takes into account an employee's final salary and the number of years worked. The bill would allow for defined benefit arrangements to be used by an employer as a default fund, regardless of whether the fund offers a MySuper product. In terms of defined benefit members, there will also be an exemption to the trustee's obligation to pay contributions into a MySuper product for members that have not given the trustee an election in writing that their contributions are to be paid into a specified choice product.[52]

3.59 Under the MySuper Core Provisions Bill, employers are required to make contributions for employees that do not have a chosen fund to a fund that offers a MySuper product. Schedule 5 of the Further MySuper bill allows for employers to make contributions to a fund for employees that do not have a chosen fund but are a defined benefit member of that fund, regardless of whether it offers a MySuper product. Accordingly, trustees will not be limited to which product they pay contributions to for defined benefit members.[53]

3.60 However, the bill would also provide that defined benefit members are not able to be counted for purposes of determining whether an employer is a 'large employer' to gain authorisation of a MySuper product under section 29TB of the MySuper Core Provisions Bill. The EM states that defined benefit members will 'generally not have any contributions held within a MySuper product, and therefore, should not be counted for the purposes of working out whether an employer can be offered a separate MySuper product'.[54]

3.61 The EM notes that regulations may be made to prescribe whether a member of a superannuation fund is, or is not a defined benefit member for the purpose of certain

51 Explanatory Memorandum, p. 57.

52 Explanatory Memorandum, p. 68.

53 Explanatory Memorandum, p. 68.

54 Explanatory Memorandum, p. 70.

provisions of the *Superannuation Guarantee Act* and the *Superannuation Industry (Supervision) Act 1993*.[55]

3.62 Schedules 4 and 5 of the Further MySuper Bill received little comment in this inquiry. The committee supports both the principles underlying these amendments and the drafting of the provisions.

55 Explanatory Memorandum, p. 70.

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

---

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:
>
> > (a) the amount is attributed by the trustee or the trustees of the fund to the member of the fund; and
> >
> > (b) either:
> >
> > > (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:

---

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

---

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]

---

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]

---

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.
>
> ...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]

---

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]

---

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]
>
> ...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.
>
> ...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

---

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]

---

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]

---

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.
>
> ...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.
>
> ... 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]

---

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:

---

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:

---

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.

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.[1]

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.[2]

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.[3]

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.[4]

---

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).[5]

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.[6]

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.[7]

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.[8]

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

---

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.[9]

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.[10]

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.[11]

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.[12]

---

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).[13]

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.[14]

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'.[15]

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.[16]

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.

---

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.[17] 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

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

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.

---

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]

---

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]

---

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:

---

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:

---

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.

---

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:

---

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.
>
> "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).

---

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.

Appendix 1

Submissions received

1	Pattinson Financial Services
2	Consumers Federation of Australia
3	Verum Financial Partners
4	Actuaries Institute
5	Denis Durand, Fortnum Financial Advisers
6	Institute of Public Accountants
7	Virtue and Partners
8	Austcover
9	Sandhurst Trustee Ltd
10	Law Council of Australia
11	Ascent Financial Strategies Pty Limited
12	First State Super
13	Certainty Financial
14	Mercer (Australia) Pty Ltd
15	Australian Administration Services
16	Financial Services Council
17	The Association of Superannuation Funds of Australia Limited
18	AMP
19	AIST
20	Industry Super Network
21	Confidential
22	Australian Chamber of Commerce and Industry
23	Principal Edge Financial Services
24	Financial Planning Association
25	Corporate Super Association
26	UniSuper
27	Financial Services Institute of Australasia
28	Association of Financial Advisers Ltd
29	Professional Finance Solutions

Appendix 2

Public Hearing

Friday 5 October 2012

Witnesses

Financial Services Council
Mr Andrew Bragg, Senior policy Manager
Mr Nathan Hodge

Financial Planning Association
Mr Dante De Gori, General Manager, Policy and Government Relations

Corporate Superannuation Specialist Alliance
Mr Douglass Latto, President
Mr Gareth Hall, Treasurer

Law Council of Australia
Ms Michelle Levy, Member

Association of Financial Advisers
Mr Richard Klipin, Chief Executive Officer
Mr Phil Anderson, Chief Operating Officer
Mr Marc Bineham, Director

Australian Institute of Superannuation Trustees
Mr David Haynes, Project Director
Mr Gerard Noonan, Vice-President

Association of Superannuation Funds of Australia
Ms Fiona Galbraith, Senior Policy Officer

Industry Super Network
Mr Matthew Linden, Chief Policy Adviser
Mr Richard Watts, External Relations Manager and Legal Counsel

The Treasury
Mr Adam Hawkins, Policy Analyst, Financial System Division
Jonathan Rollings, Principal Advisor, Financial Services Division
Mr Richard Sandlant, Manager, Financial Advice Reform Unit, Retail Investor Division