

15 July 2003

The Committee Secretary  
Senate Select Committee on Superannuation  
(VIA EMAIL)

Dear Secretary

**Subject: Draft Portability Regulations**

Watson Wyatt Australia provides the following submission in relation to the Government's draft Portability Regulations.

At the outset, it is important to be clear that the Portability Regulations will effectively implement "choice of fund" without the Government having legislated to achieve "choice of fund". It is, therefore, inappropriate for these Regulations to pass before the "choice of fund" legislation is passed.

Further, we note that the draft Regulations contain more extensive "choice of fund" provisions than the "choice of fund" legislation, as the Regulations apply to a member's total accrued benefits, not just to the benefits produced by future Superannuation Guarantee contributions.

Clearly, the Regulations should be consistent with, and follow from, the "choice of funds" legislation – and not go beyond, or indeed be in advance of, the "choice of funds" legislation.

In terms of more specific issues with the draft Regulations, we make the following comments in relation to regulated corporate superannuation funds.

**1. Defined Benefits**

It should be very clear by now, from the experiences with surcharge and family law, that there are significant practical and legal issues associated with carving out an amount from a member's defined benefit promise, prior to the date when the member leaves service.

It should be noted that the only completely financially neutral solution to a defined benefit "carve out" is to establish a debit account in the defined benefit fund, which accumulates with future fund returns. The debit account would then be applied against the member's defined benefit formula amount when they eventually left service.



The proposed Regulations would allow a non-contributory defined benefit member to take the whole of their withdrawal benefit at any time. Under certain very reasonable circumstances (which will eventually be targeted by well informed members), there would arise the situation where the debit account could actually exceed the eventual defined benefit formula. The shortfall would then need to be met by the sponsoring employer or the other fund members, which is clearly inappropriate, as it would be impossible to retrieve the shortfall from the member.

Although proposed Regulation 6.37 provides an avenue for a trustee to handle the above issue, there has been no indication to date as to how APRA will administer Regulation 6.37 in practice.

We believe that a far better approach would be:

- a) to automatically exclude all defined benefit interests in the first instance; but
- b) to give defined benefit trustees discretion to allow portability transfers, where the circumstances are appropriate, and where a maximum transferable amount can be set by the trustee that takes into account the benefit design and financial position of the fund (ie not necessarily the full withdrawal benefit).

## **2. Non-Contributory Defined Benefits**

Further to the previous item, we note that there is currently already an exclusion for contributory defined benefit interests (under draft Regulation 6.30(2)(c)).

However, it is difficult to understand why there is a distinction made between contributory and non-contributory defined benefit interests:

- a) given the problems above relating to early “carve outs”, which apply to all defined benefit interests;
- b) given that there is no exclusion for contributory accumulation interests.

The treatment of both types of defined benefit interest should be consistent.

## **3. Costs**

Allowing partial transfers of withdrawal benefits at any time will increase fund costs, due to items such as additional benefit processing, additional surcharge reporting (noting that the surcharge legislation requires splitting of surchargeable contributions attributable to benefits that are partially transferred to another fund) and investment costs.

The legislation should make it clear that the additional costs incurred from portability are able to be allocated (equitably) to those members who use the facility.



#### **4. Surcharge**

The Portability Regulations will place added pressure on existing administration systems in terms of coping with the surcharge reporting. The administration of the surcharge has been a most complex and difficult process. Surcharge administration would be even further complicated by the ability of members to make full or partial withdrawals of their benefits. When a partial withdrawal is made, the portion of the member's surchargeable contributions attributable to the withdrawal may not be clear, and hence the fund may not be the holder of certain surchargeable contributions when a surcharge assessment is received. Hence, there is clearly a potential for surcharge administration to become more complicated under the portability proposals.

#### **5. Insurance Cover**

Often the cost of insurance is financed through a deduction from a member's account. The ability for members to take out a full account balance may mean that there is insufficient money to cover insurance premiums, resulting in a loss of insurance.

This, of course, may be an unintended consequence of the withdrawal of a member's account balance, but the potential for members to be uninsured must increase under these proposals.

One way of possibly guarding against this occurring is to give trustees the power to withhold monies in a member's account to cover expected future insurance costs. But even this is not foolproof, and indeed will be difficult to administer in practice (and hence increase costs).

#### **6. Churning**

There will be an increased instance of churning, as people are encouraged to transfer accrued superannuation entitlements from one fund to the next. We note that the Government is expecting that the disclosure obligations of the FSR regime will counter the impact of churning. However, the FSR regime has been developed in an environment where choice of fund and portability does not yet exist.

Overseas experience suggests that churning will be a problem and, indeed, will be an even more intense problem under the portability proposals, which allow transfer of existing account balances, than under the choice of funds legislation, which only applies to future SG contributions.

#### **7. Adjustment to Remaining Benefits**

Even with fully vested accumulation benefits, complications will arise with the adjustment to member's benefits to allow for a partial transfer of withdrawal benefits.

As an example, certain funds provide a fixed death and disablement benefit which includes the member's fund account. The appropriate way of modifying the death/disablement benefit in the event of a partial transfer will vary from fund to fund. For example, in a fund where the employer pays the cost of the insurance, the employer would possibly require the overall death/disablement benefit to be reduced by the transferred amount, in order to maintain the employer's cost at the same level.



Accordingly, the Regulations should make it clear that the adjustment to the member's overall package of remaining benefits should be:

- a) at the discretion of the trustee; and
- b) communicated to members (along with costs) prior to their making a decision to partially transfer their benefit to another fund.

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We would be pleased to answer any questions on this matter.

Yours sincerely

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Review: *GF*