Institute of Actuaries of Australia

18th July 2003

The Secretary
Senate Select Committee on Superannuation
Parliament House
Canberra ACT 2600

Dear Sir/Madam

The Institute of Actuaries of Australia (IAAust) appreciates the opportunity of commenting on the draft portability regulations for superannuation, being the draft Superannuation Industry (Supervision) Amendment Regulations 2003 and the draft Retirement Savings Accounts Amendment Regulations 2003.

The following submission was made in almost identical terms to Treasury on 12 June 2003 in response to its recent consultation on the draft portability regulations.

The IAAust is pleased that, in drafting the regulations, the Government has decided to:

- Provide an exemption from portability for defined benefit components; and
- Provide exemption from member protection requirements in relation to members who have previously transferred benefits under the portability requirements.

The IAAust supported these exemptions in our earlier submission to Treasury dated 17 February 2003 (see attached).

We are however concerned with the following issues which are covered in more detail below:

- The wording of the exemption for defined benefit components is likely to cause confusion and in our view does not adequately cover the intended terms of exemption;
- Very significant surcharge reporting and payment implications;
- The draft Regulations do not address the proposals suggested by the IAAust to minimise the cost to funds and members that will be incurred by the new requirements;
- The potential for members to inadvertently lose insurance cover;
- Partially vested arrangements;
- Disclosure;

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- Linkage with Choice of Fund;
- Protection for trustees and employers.

Exemption for defined benefit components

The draft Regulations propose an exemption from the portability requirements **"**in respect of a defined benefit component of a superannuation interest in a defined benefit fund, if the member who holds the interest is eligible to contribute to the fund under the governing rules of the fund".

We believe that these words do not adequately describe the intended exemption.

In particular, we are concerned with the requirement that the employee must be eligible to contribute to the fund. Some defined benefit funds do not have a provision to enable members to contribute. Under the proposed words, such funds would be required to meet the portability requirements even though the benefits are defined benefits which are continuing to accrue. We do not believe that this is the intention. Whether the member can or cannot contribute to the fund should not be the determining factor.

On the other hand, some funds may allow members to continue contributing (for accumulation benefits) after they have left the service of the sponsoring employer. In such cases, any remaining defined benefit component would be exempt from portability. However, another fund, with the same defined benefit, which does not allow members to contribute for accumulation benefits after the member leaves the sponsoring employer, would not be exempt. Such distinction appears unreasonable.

We believe that these anomalies would be removed if the exemption was rephrased as "in respect of a defined benefit component of a superannuation interest in a defined benefit fund, if the member who holds the interest is a standard employer sponsored member of the fund".

Such wording would provide an exemption for the defined benefit component whilst the member continues in the employment of the employer sponsoring the defined benefit fund but the exemption would cease if the member left service.

We also consider that the definition of "defined benefit component" would be clarified by changing the first 3 lines to:

> "Subject to subregulation (3), a ***defined benefit component*** of a superannuation interest is a component in which the benefit that would apply in 1 or more circumstances is defined by reference to 1 or more of the following:"

Surcharge Reporting and Administration

The reporting of surchargeable contributions, and the receipt, analysis and payment of surcharge assessments are already complex operations for superannuation funds. These complexities are magnified when benefits are rolled over to another fund.

Administration systems have, at significant cost, been designed to cope with existing requirements.
However the introduction of portability will introduce new complexities regarding surcharge. We understand that existing systems will need to be modified in order to cope with the reporting of contributions in a year in which a member transfers part or all of his/her benefit and contributions continue.
Further changes to existing systems will need to be made in relation to the receipt, analysis and payment of surcharge assessments. New rules will need to be established in relation to determining which fund is the holder of the contributions where portability has applied. Unless changes are made we expect that there will be considerable dispute over which fund holds the contributions.

We suspect that changes to one or more of the surcharge legislation, regulations and reporting requirements may be necessary to enable funds to cope with the surcharge aspects of portability.

Such changes will not only add further to the costs of administering a fund but will also create a considerable resourcing problem for funds trying to implement the necessary changes. In view of the complexities of surcharge, we recommend that the industry be given at least 12 months after any necessary changes to the surcharge legislation and reporting are finalised, before portability is introduced.

Cost implications

One of the IAAust's main concerns with the implementation of any new initiative is that of cost. Initiatives such as this should be designed in a manner that minimises the cost impact on funds, members and employers.

We again urge the Government to assist funds control costs by allowing trustees to limit the number of transfer requests from any member to no more than say, once a year.

Further discretion to allow:

- Trustees to refuse requests for partial transfers - ie any request must be for the total withdrawal benefit at the time; and
- Trustees and employers to impose rules that no further contributions be accepted following the transfer of benefits (under the portability rules) to another fund;

should also be considered.

Whether a trustee of a particular fund imposes such restrictions should be a matter for the trustee. (We note that it should be possible for the member to be readmitted as a new member, subject to the rules of the fund.)

We understand that restrictions on portability along these lines would also minimise the impact on surcharge administration.

Loss of Insurance Cover

After a member has transferred benefits to another fund under the portability requirements, the member's remaining account balance may be very low. Yet it may be necessary to continue debiting administration and insurance costs (and potentially surcharge assessments) to the member's account. In many cases the account balance may reduce to zero before further contributions are received.

In such cases the member is at risk of inadvertently losing his/her death and disability insurance cover as premiums will not be paid and there is no guarantee that the fund will receive further contributions. Even when contributions are received, it may be necessary for the member to supply new health evidence in order to apply for renewed insurance.

A suggested solution to this would be for funds to be able to hold back portion of the member's benefit. The amount held back could be up to say, 6 months insurance and administration fees. With SG contributions being remitted at least quarterly, the amount held back should be sufficient to cover ongoing insurance costs and administration costs until the next contribution is received (assuming that appropriate changes to surcharge procedures are adopted to avoid the amount held back being eroded by surcharge assessments.)

Partially Vested Arrangements

Portability will cause considerable difficulty for partially vested schemes. Significant changes to governing rules and administration systems will be required to properly cope with the new requirements.

For example, assume that a member has $10,000 in a partially vested account which is currently 60% vested. The current resignation benefit is $6,000. Under the portability regulations, the member transfers $6,000 to another fund, leaving $4,000 in the account. If the governing rules are not changed, then the next day the member may still be eligible to receive a resignation benefit of 60% ($2,400) of the remaining balance. In such an example, the member would be able to significantly increase the total resignation benefit by using the portability provisions. In most cases, it would be possible for the trustee to amend the governing rules to avoid this situation. This could be achieved by not reducing the partially vested account when the benefit is transferred. Rather a negative "transfer" account would need to be established with an initial value equal to the amount transferred. This negative account would be accumulated with interest and deducted from any future benefit. This would also require changes to the fund's administration system as well as creating difficulties in future reporting of benefits to the member. These issues could be avoided if the trustee were able to terminate the membership of the member if the member elects to transfer benefits under the portability provisions (refer to cost section above).

Disclosure

In any environment where members have a right to portability and or choice of fund, issues of disclosure are very important. Members need to be able compare different funds to enable them to make an appropriate choice.

The IAAust has previously made submissions on disclosure in relation to choice of fund. Many of those issues are also valid for portability.

In particular, it is important that standard disclosure requirements are introduced in relation to fees and charges and investment returns before or in conjunction with portability. We can provide further detail on the IAAust's views on these matters if required.

Linkage with Choice of Fund

The IAAust is concerned that portability may be introduced without Choice of Fund. We consider that this is inappropriate as it may lead to multiple transfers of benefits from one fund to another.

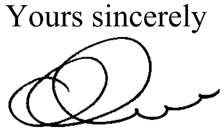
If a member wishes to use a different fund, it would be significantly more efficient to select the desired fund under Choice of Fund and then transfer the existing assets under the portability rules. If Choice of Fund is not introduced, then the member will need to transfer amounts under the portability rules on a regular basis as benefits continually build up in the non-preferred fund.

Protection for employers and trustees

We note that the draft regulations provide no protection for either trustees or employers against claims made by members who have made an inappropriate choice to transfer out of a particular fund. Trustees and employers should not be held responsible for such decisions and should not be required to provide advice to members considering transferring. The FSR legislation will strengthen many disclosure requirements and trustees and employers should not be expected to provide any more information than is required by that legislation (including any additional disclosure on fees and charges and investment returns as referred to above.) The IAAust believes that appropriate protection for trustees and employers should be incorporated in the Regulations.

We would be happy to arrange further discussions on these issues if required. Please contact Catherine Beall, Chief Executive on (02) 9239-6106 should you require further information or wish to arrange a meeting.

Yours sincerely



Chris Lewis
President