Submission to the Australian Prudential Regulation Authority with respect to Draft Prudential Practice Guide SPG 410

16 November 2012

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About ASFA

ASFA is the peak policy, research and advocacy body for Australia's superannuation industry. It is a not-for-profit, sector-neutral, and non-party political national organisation whose aim is to advance effective retirement outcomes for members of funds through research, advocacy and the development of policy and industry best practice.

ASFA's focus is on whole of system issues and its core strategies are aimed at encouraging industry best practice, advocating for a system that plays a productive role in the Australian economy, and ensuring the industry delivers on its primary purpose of delivering decent retirement incomes.

Our membership - which includes superannuation funds from the corporate, industry, retail and public sectors, and, through its service provider membership, self-managed and small APRA funds - represents over 90 per cent of Australians with superannuation.

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Yours sincerely

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Chief Executive Officer

INTRODUCTION

This submission is in two parts, as follows: -

Part A: Context in which all of ASFA's comments on the draft SPPG should be read
Part B: Comments on the draft SPPG

Please note also that, while the draft *Superannuation Legislation Amendment Regulations 2012,* released by Treasury for consultation on 8 November 2012, may affect the subject matter dealt with in the draft SPPG, this submission does not take account any effect these regulation may have.

PART A: CONTEXT IN WHICH ALL OF ASFA'S COMMENTS ON THE DRAFT SPPG SHOULD BE READ

ASFA has a number of concerns with the MySuper bills as drafted. These are outlined below.

Accordingly, the comments we have provided on the draft SPPG are to be read in the context of our concerns about the MySuper bills.

1.1 Issues with paradigm in which MySuper \ Choice has been constructed

As raised with Treasury, ASFA has concerns about the paradigm in which MySuper has been constructed. We consider that the legislative approach of focussing on the underlying investment options and not on the member is flawed.

The Super System Review strongly recommended that the superannuation system should be member centric and advocated a member "choice architecture" model.

As opposed to being member centric, the current paradigm reflected in the legislation is focussed on MySuper money and choice money, leading to outcomes where a member's status as a MySuper member and \ or a choice member can fluctuate daily, or even more frequently, in line with their investment choices. By virtue of investment switches a member could be a MySuper member only one day, both a choice and MySuper member the next, a choice member only the next day and back to being a choice and MySuper member the following day.

The current interpretation effectively denies choices that members have made with respect to their fund and \ or their investment options \ strategies.

Ideally MySuper should have been created as a type of notional "category \ division" of membership as follows: -

- person who joins a fund as a standard employer sponsored member and doesn't participate in investment choice – they are placed into the "MySuper category" with money invested in the "default" option and insurance\fees which pertain to that category of membership;
- person who join as a public offer member or a standard employer sponsored member begins to participates in investment choice – they are placed into a "Choice category" with investment options and insurance\fees which pertain to that "Choice" category.

This “category” paradigm would allow those funds who want to “re-badge” their investment option to do so - insurance and fees across the “categories” would simply be the same.

With such important matters such as insurance and administration fees attaching to the investment options in which a member’s money is invested, as opposed to attaching to the member and their account, the current “investment choice” paradigm creates a number of conceptual and practical difficulties.

We see MySuper as having a valid role to play with respect to: -

- “default” members - who have not made any choices; and
- those members who choose to invest in MySuper.

For those members who have chosen to participate in a particular fund or in investment choice, however, it is appropriate to treat them as a choice member – they have made choices as to their fund and \ or as to the investment of their money. This is not to say they could not choose to place money in a MySuper product but this would be by their active choice.

The Super System Review final report makes a number of statements about MySuper and choice members and to members being free to “actively choose” or “select” to have their money in a MySuper product. These have been extracted into **Annexure A.**

As can be seen from the extracts in Annexure A, the Super System Review repeatedly referred to members “actively choosing” to have their money in MySuper, not opting out of having it transferred there.

The Bill does not reflect this - in fact quite the opposite.

While implementation \ placement strategies does refer to members invested in default being placed into MySuper we note that: -

- this is the only reference to this in over 500 pages of final report;
- given there was only one paragraph \ two sentences with respect to this it may be appropriate to characterise this more along the lines of preliminary thinking than a fully fleshed out final position; and
- the use in this context of the word “could” - not “should” or “would” but “could”.

Accordingly, we suggest that members who have chosen to have an amount invested in a default option should be treated as a choice member and not have any amounts moved into MySuper.

1.2 Definition of "accrued default amount" - three amendments required

Following on from the above, there are three main issues with the current definition of "accrued default amount" as follows: -

a) it does not recognise directions given to trustees of previous funds, where the member has been transferred into the fund concerned as a result of a successor fund transfer;
b) it includes members who "chose the fund and joined as a public offer member;
c) it includes members who have given directions as to investment choice.

a) Direction to trustee of previous fund - successor fund transfers

The legislation currently refers to directions given to the trustee. In circumstances where a successor fund transfer has occurred, frequently directions as to investment choice options will have been given to the trustee of the previous fund, not the trustee of the current successor fund.

As such, the legislation should recognise the validity of a direction given to the trustee of a previous fund, where the member has been transferred into the current fund as the result of a successor fund transfer.

b) members who "chose the fund and joined as a public offer member
c) members who have given directions as to investment choice
Validating member choices – Stronger Super Review's Choice Architecture Model

As per the Stronger Super review and the discussion above, there should only be two ways in which a person can become a MySuper member: -

- they have made no decision about their fund \ investment option and therefore have been defaulted into a fund's MySuper product; or
- they have actively chosen the MySuper product, either because they do not want to participate in investment choice or for some other reason, such as lower fees.

Considerable concern has been expressed by our members about the definition of "accrued default amount", which includes amounts

- where the member has chosen to invest in the fund (pubic offer members); or
- has given the trustee a direction as to where to invest their account balance and some, or possibly all, of their account balance has been invested in the "default" investment option.

We query why – in circumstances where a fund has been chosen or a direction as to the investment option or product has been given – an amount is to be treated as an "accrued default amount". This amounts to the government interfering with, and effectively overriding, valid financial decisions made by the member.

The explanatory memorandum with respect to actives choices of the "default option" - that the member has "explicitly chosen to delegate responsibility for investment decisions to the trustee" – reveals a fundamental misunderstanding of the principles underpinning investment choice. When a member exercises investment choice they are choosing between various investment options, in respect of ALL of which the trustee is ultimately responsible, and the trustee is responsible for ALL of those investment options.

There is nothing inherently special about the “default” investment option per se other than – as the name implies - it is the one into which members who have not made a choice have their contributions “defaulted”. For members who have chosen to have part or all of their account balance invested in this option it is just like any other investment option – part of their investment portfolio.

Furthermore, there is the matter with respect to the fair allocation of costs between MySuper and choice products and the charging of administration fees. It is likely that choice products will offer enhanced product features, such as member investment choice, more interactive web access and possibly more complex insurance and as such will be more expensive.

Under the Bill, with the current definition of “accrued default amounts”, a member who is participating in member investment choice could have part of their benefit in one or more investment options offer by a choice product and part in the MySuper product. It is unclear as to the position of the trustee with respect to charging administration fees to that member.

MySuper and Choice products to have separate, cost recovery, administration fees but it is not at all apparent how this will work in practice. In particular, it would appear that a member who had money in both MySuper and Choice products may need to be charged two administration fees, one with respect to each product.

Furthermore, there are considerable practical difficulties with respect to funds which currently have, or will adopt for MySuper, “lifecycle” investing, as they will have a number of different default options depending on the age of the member and the cohort to which they belong. It is not clear how the definition of “accrued default amounts” is to be applied in these funds.

PART B: COMMENTS ON THE DRAFT SPPG

We have provided comments in the same order as the draft SPPG.

All headings and numbers refer to the paragraph numbers in the draft SPPG.

Introduction

3. As per above, we disagree – as a matter of policy – that members who have exercised choice need to opt out of having all or part of their account balanced transferred to a MySuper product. We have a concern with the statements "APRA expects the attribution of accrued default amounts to a MySuper product to occur at the earliest opportunity possible where it is in the best interests of beneficiaries to do so". We believe that this should simply read "APRA expects the attribution of accrued default amounts to a MySuper product to occur when it is in the best interests of beneficiaries to do so".

Key milestones

4. We note the need for a transition plan to be prepared prior to applying for a MySuper authorisation.

With respect to the obligation by 30 September 2013 to "[i]dentify all members with an accrued default amount, and the amount of that balance" – it is unclear whether this means:-

- the total amount of all accrued default amounts; or
- the amount of each accrued default amount.

In either event it is unclear as to why it is necessary to identify the amounts involved. If it is still considered necessary then it should be the total amount of all accrued default amounts.

With respect to the obligation "[i]n conjunction with the regular member statement - Provide information to members with an accrued default amount as specified in the Corporations Regulations 2001" – it is unclear as to what: -

- "the regular member statement" refers (presumably periodic statements). Is this each periodic statement issued after 1 July 2013 \ 1 January 2014? Irrespective of the duration of the member reporting period and how frequently the statements are issued? Or does the obligation just apply to the first statement issued after the effective date of the obligation?
- "as specified in the Corporations Regulations 2001" means? Presumably this refers to significant event disclosure. It would be preferable if this exact nature and precise scope of this "one of" disclosure obligation (which only applies during the transition period) could be spelt out in full, as opposed to relying on a cross reference to a generic obligation.

Similarly, with respect the obligation "[p]rior to moving a member's accrued default amount to a MySuper product - Provide information to the member about the proposed move as specified in the Corporations Regulations 2001" – it is not clear to what this refers (presumably significant event notice). Again, it would be preferable if the exact nature and precise scope of the trustee's obligations could be documented in the SPPG.

Similarly, it is unclear as to what "the specified information" refers – presumably this is a reference to the disclosure obligation on the Prudential Standard (PS), in which case this should be identified by cross-reference to the PS.

Further we believe, a trustee should be able to accept a "contrary instruction ... provided by the member" up until a determined cut-off date prior to the transfer, even if this occurs after the expiry of the three months but before the 120 days. It does not make sense, for example, that a trustee cannot give effect to a member instruction received three months and one day, or three months and one week, after the "specified information" was provided, even if this is a week or two before the cut-off date for the transfer.

Rebadging an existing default option

7. We refer to the requirement that "APRA considers that paragraph 4(b) of SPS 410 would be satisfied if the conditions experienced by each relevant cohort were improved or unchanged in the MySuper product". This may be an issue either where administration or other fees may have to be increased as a result of complying with the legislation or where the insurance conditions applying to a member, or class of members, may be altered as a result of circumstances unrelated to MySuper, such as an increase in premiums or change in policy terms. It may be preferable to adopt the "bundle of benefits" approach which is referred to in paragraph 16.

Identifying accrued default amounts

10. With respect to the reference to "APRA expects that an RSE licensee would have processes for determining whether a member has given a direction regarding the investment of their assets" – we suggest there are two major issues re this: -

- while the trustee of a fund which is the successor fund in a successor fund transfer will be aware of each transferring members investment options, frequently they will not be provided with copies of the direction;
- while the trustee of the fund will know that a member has given a direction regarding the investment of their account balance and \ or contribution in-flow – generally they will not be able to readily identify when this direction was given. This is especially the case with successor fund transfers but is often the case with directions to the trustee – this would necessitate an interrogation of the audit trails on the system.

Also, while the legislation refers to a member giving "a direction regarding the investment of their assets", technically a member does not invest assets per se. With the exception of SMSFs and member directed investments, a member's entitlement is simply to be paid an amount of money, the value of which is determined by reference to the value of underlying assets in which that money is invested. Members do not invest in assets as such. While the legislation does utilise this language it would be preferable if APRA were to refer to a member giving directions regarding the investment of their account or their entitlement, as opposed the investment of their assets.

11. We refer to the statement that "[t]he types of records that an RSE licensee may hold with respect to a member giving a direction include, but are not limited to, paper documents, email communication, records of phone conversations or documentation of member decisions from a web page". As per above, with respect to successor fund transfers the trustee of the successor fund frequently is not given copies of records with respect to member investment option directions.

Transition plan

14. Reference is made to "an RSE licensee ... regularly review[ing]" the transition plan. It is unclear how frequent this "regular review" should take place or why, in the absence of any material \ significant change in circumstances, why this should be necessary.

15. As per above, we are concerned about “APRA[‘s] expect[ation] that the attribution to a MySuper product would be made much earlier than 1 July 2017 when it is in the best interests of members”. We submit that the expectation should be that the attribution to a MySuper product would be made when it is in the best interests of members to do so.

20. As per above, we query, in the absence of any material \ significant change in circumstances, why there is a need for “the transition plan [to] be regularly reviewed”.

23. With respect to the reference to “APRA expects the RSE licensee to ... have articulated processes and timetables for identifying solutions to issues that arise during the transition process” – we note that it may be difficult to articulate the processes and timetables for identifying solutions until such time as the issues have arisen.

Identifying a suitable MySuper product

26. We note that, where the member has chosen for part of their account balance to be in the default option and part in one or more “choice” options, transferring the accrued default amount to another RSE will cause the member to have multiple accounts across different funds, which generally is not in the best interests of a member.

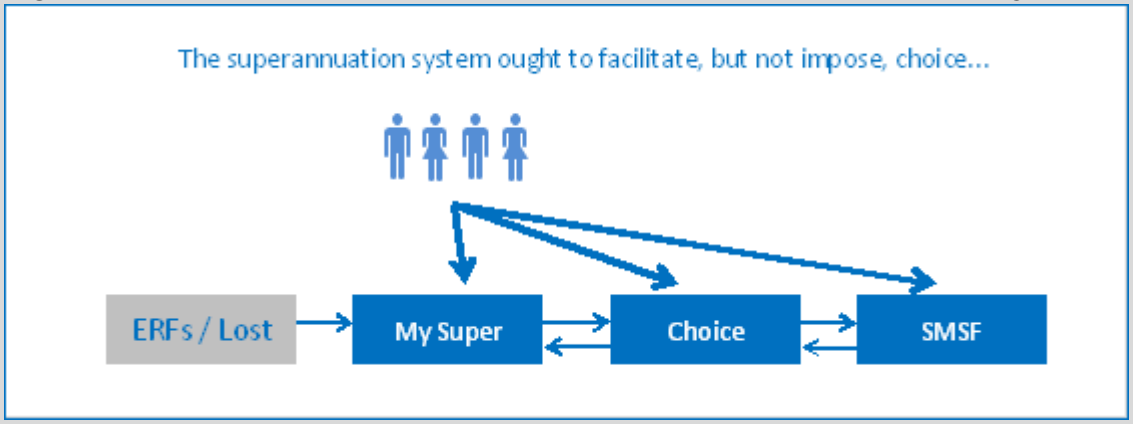
ANNEXURE A

The Super System Review final report makes a number of statements about MySuper and choice members and how members would come to have an interest in a MySuper product (references are to Part 2 unless otherwise indicated, emphasis has been added): -

A New Architecture for Super

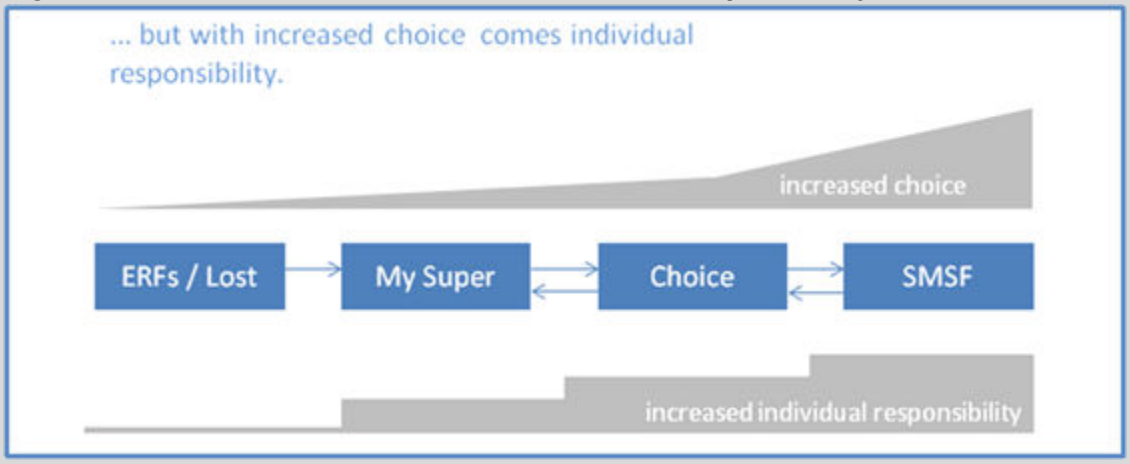
- The Panel believes that there has to be room in a system, where there are compulsory contributions, for a governance model that addresses **not only the disengaged member**, **but also the member who exercises choice** about the **fund** (or **investment option** in the fund) to which they belong.
- Figure 1.1 below sets out an approach which starts from a member, rather than a product or industry sector, perspective. In behavioural economics terms, this is a 'choice architecture' mode

Figure 1.1: A choice architecture model for Australia's superannuation system



- The model **classifies members into three main types** — MySuper, choice and SMSFs — **on the basis of whether or not they have made a choice about their superannuation** and the nature of the choice made. A number of submissions indicated a desire to see differentiation along these lines (Page 6);

Figure 1.2: Increased choice, increased member responsibility



- **MySuper** would be **available to those who actively choose to be there** and the **choice sector caters for those who wish to tailor their super** (Page 7);
- People could have interests in both MySuper and choice products at the same time, **though this would be by active choice (Page 7)**

- the model uses the **conscious choices and choice - related outcomes of individuals** to calibrate the levels of governance, regulation and member protection applicable (Page 8)
- the model accommodates **movement of members between the sectors**, albeit with some regulation. The potential for moral hazard and the removal of layers of protection mean that **movement towards sectors offering increasing choice** (that is, **to the right in the choice architecture model** in Figure 1.2) cannot be allowed to be inadvertent. Participants moving in that direction must **signal their intention expressly and unambiguously**. Having done so, they should **be allowed to move** with minimal friction and cost. On the other hand, no special restrictions need to be placed on **member movement in the other direction** (for example, a move from an SMSF to MySuper) (Page 8)

Purpose of MySuper

- MySuper does not just cater for disengaged members — it is also designed for members who **choose actively to participate in this product** (Page 9).
- the Australian superannuation system should be able to ensure that there is a **value for money, simple and effective product** for members to rely on - whether that reliance is **preferred by the member or** is **due to an inability or disinclination to choose** (Page 9)
- With the lower costs and traditional trustee obligations, the Panel believes that many engaged investors will **actively choose** to have **their superannuation** in MySuper (Page 9)
- Also, as noted, MySuper is not just for people who are disengaged. With the lower costs and traditional trustee obligations, the Panel believes that many **engaged investors will actively choose** to have their superannuation in MySuper (Page 10).
- MySuper is also for members who **choose** to **rely on an investment strategy** developed, in their interests, by a fund trustee. Employees would therefore also be able to **select MySuper products as a 'choice of fund'** for SG Act purposes (Page 10).
- There are some members who want to exercise choice over the investment strategies applied to their superannuation balances, but want to have their accounts administered for them. These members can elect to be in the choice segment, though they might decide that a MySuper product meets their needs and **elect** to have their money invested there (or in a combination if MySuper and choice products (Part 1, Page 10).

Implementation

- Although new employees would be in a MySuper product unless they made an active choice in favour of a choice product, trustees would need placement strategies for existing fund members until otherwise directed by the member. These would include:

(a) members with benefits wholly in the default investment option could be placed into the MySuper product;

(b) members with benefits spread over a default option and other investment options **could** be placed in both the MySuper product and the choice product, with the trustee obliged to give effect to any existing arrangement to split future employer SG contributions between the products; and

(c) members with no benefits in the default investment option could be placed into a choice product based on their selected investment option (Page 29).

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