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Submission to the Treasury with respect to Stronger Super Regulations – Insurance and MySuper

23 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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Should you have any queries regarding the contents of this submission, please do not hesitate to contact me on (03) 9225 - 4021 or 0431 490 240 or fgalbraith@superannuation.asn.au.

Yours sincerely

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ASFA members have raised some questions and concerns with the draft regulations, which are outlined below.

1. <u>Schedule 1</u>
Item 1 – proposed new sub-regulation 7.9.11H(1A) (Page 3)

Firstly, it is not apparent what is meant by "suggestion". This term does not appear to have been defined.

This proposed new sub-regulation imposes an obligation that, where a trustee or an associate of the trustee recommends the replacement of a Mysuper product, the trustee is required to treat this as triggering the significant event notice requirements.

It is not readily apparent why this amendment is being made.

All advisers who make financial recommendations, whether they are employed by the trustee or are an associate of the trustee, must operate under an AFSL authorising them to provide personal advice. Any time an adviser provides advice to a member with respect to investment switching they must provide the member with a Statement of Advice ("SOA"). This is the appropriate mechanism, and person, by which information should be disclosed to the member.

It is not readily apparent why advice provided by an adviser employed by the trustee, or by an adviser who is an associate of the trustee, would be considered to trigger the significant event notice requirements.

As a matter of policy, there are three material differences between the circumstances in which the significant event notices were designed to be provided to members and the circumstances referred to here. Significant event notices

- are with respect to a **decision of the trustee** (such as to wind-up the fund and transfer the members to another fund as part of a successor fund transfer, or to increase fees payable by members) over which the member has no control;
- disclose to a member what will occur if the member does **not** take some action (such as instructing the trustee to roll-over their benefit to another fund) i.e. the "default" position for the member; and
- are at a **fund**, or **class of member**, level, not at the level of an individual member (e.g. a change in fees which will be charged to all, or a sub-set, of members).

None of these applies in this circumstance of the member receiving advice, which is with respect to

- a (potential) **member** decision, not a trustee one;
- which will affect the member **only if they decide to act** on the recommendation, not if they do not act (i.e. does **not** relate to a "default" position); and
- applies at an **individual member** level.

From a practical perspective, this is largely unworkable. It would mean that, if the recommendation involved an increase in fees for that member, a trustee would be required to give the member the significant event notice thirty days before the recommendation can be acted upon. In respect of investment choice switches, this 30-day advance notice requirement could mean that, the member is penalised by the trustee not being able to give effect to the investment switch at the point in time when the member would like it to do so.

It is important to note that there is an anomaly being created here whereby a member who receives advice from an adviser who is not employed by, or an associate of, the trustee, will only be provided with an SOA. This is, of course, acceptable, because the standards applying to adviser with respect to the provision of advice and SOAs are such that the adviser will have need to have taken into consideration such matters as any increase in fees and to have documented them in the SOA. Why is this not considered to be sufficient protection?

Finally, it appears as though item one is proposing to insert the new sub-regulation into a part of the Corporations Regulations which deals with margin loans not with superannuation products.

2. <u>Schedule 2</u>
Item 1 - SGA Regulation 9A (Page 4)

This regulation introduces the new requirement of "providing" insurance for MySuper members, while retaining the old terminology of "offering" insurance in relation to non-MySuper members and MySuper members who have opted out. Members have raised that the use of the word “providing” is confusing as it does not reflect the situation that a member may not be eligible to receive automatic cover and could require underwriting for cover, which may not be granted by the insurer.

As such, we suggest that clarification is required that “providing” does not connote that a member will necessarily be provided with insurance, as under the “reasonable conditions” provisions of the bill they may not be entitled to insurance.

Further, in sub-regulations 9A(1), 9A(1A) and 9A(1B), it is not clear that only one of paragraphs (a),(b) or (c) need to apply.

Finally, we note that proposed new regulations 9A(1) and 9A(1A) include provisions covering defined benefit members even though both regulations are intended to apply only to MySuper members.

3. <u>Schedule 3</u>
Item 1 - SIS Regulation 1.03C
New definition of Permanent Incapacity (Page 6)

Again, while we accept the use of this definition in MySuper products, we query why choice products are not able to offer insurance which is broader than this definition.

If the concern is that amounts may not be able to be released at the time of disability then we strongly suggest that the conditions of release be reviewed and amended, rather than unnecessarily restricting funds from offering insurance which can be of considerable value to some members.

Further, it has been identified by a member that, although the Government's intention is to make related provisions more consistent, the current drafting would potentially introduce additional inconsistencies between the SIS legislation and the tax provisions with respect to the deductibility of insurance premiums (notably ITA Regulation 295.465.01 and ATO Tax Ruling 2012/6).

4. Schedule 3
Item 2 – proposed new regulation 4.07D. Operating standard – self-insurance (Page 6)

The operating standard on self-insurance appears not to contemplate that a self-insured defined benefit fund might seek to offer a MySuper product. It is not clear how the operating standard's three year transition period to wind back self-insurance for accumulation members interacts with the requirement in section 68AA of the SIS Act that insurance for MySuper members must be provided by insurance.

As such, clarification on this point would be extremely useful.

5. Schedule 3
Item 6 - Part 9A – Requirements relating to MySuper products
Regulation 9.46 – Notification – accrued default amount attributed to MySuper product (Page 10)

Firstly – it is unclear whether regulation 9.46 applies in circumstances where RSE licensee is authorised to re-badge its default option to become the MySuper option. Arguably, the requirement to provide notification should only apply where there is a requirement to actually transfer accrued default amounts. This needs to be clarified.

The explanatory memorandum accompanying the tranche 3 bill made it clear that it was expected that, where a provider simply rebadged the default option, a notice could be given to members after the change (attribution) had occurred.

A number of providers are rebadging the default option across all their divisions, with no changes to fees or insurance, while a few are retaining their public offer divisions as pure Choice divisions and are going to transfer their public offer members with accrued default amounts to the main employer sponsored division, subject to notification and opt out. The numbers of these members affected are very small. A number of providers have specifically stated in their draft transition plans to APRA that they would not be reporting to members until post-attribution, based on their understanding of the requirements.

Unless the regulation is amended to apply only in the case of transfer, for a provider who is authorised to provide a MySuper product as at 1 July 2013, attribution cannot take effect any earlier than 28 September 2013. Based on the explanatory memorandum for the tranche 3 bill, a number of providers had the view that they may be in a position to attribute the majority of accrued default amounts not long after they were authorised to offer their MySuper product, virtually seamlessly, and could then communicate this as part of the annual member statement pack. One member has advised that this new requirement will mean an additional cost burden of around $1.25 per affected member to issue a notice in writing, with an opt out form and a return envelope.

Further, this would mean a large number of providers would need to send notices at the same time to the majority of their members. Given the volumes involved, mail houses would need to stagger the mailing over a number of weeks.

Having launched MySuper with a new PDS in place, the provider then has to be able to cater for new members into MySuper from that date.

It is unclear as to how a provider could rebadge and also comply with the regulation, particularly if the provider rebadges right down to the investment option level. By way of example, a simple, non-public offer provider with one division will have accrued default amounts sitting in the same investment pool as new MySuper members, as there is only one investment option. For new members this is supposed to be the MySuper product but for existing members with accrued default amounts it is not until 90 days have passed or they advise that they want to opt out to one or more choice options.

This serves to suggest that a provider cannot just simply rebadge as previously thought. The provider would need to be able to distinguish which members are MySuper, and which are not, for service and reporting purposes prior to attribution. This could only be achieved through a convoluted method based on flagging accrued default amounts rather than the significantly more straightforward and efficient approach of attributing amounts to the investment option.

Turning to the specific content of the notices, a number of members have expressed concern that the notice to members must specify "*the amount that will be attributed or transferred*".

This would appear to necessitate an individual, tailored notice being sent to each member. This will have a significant impact on costs.

Further to this, the actual dollar amount to be attributed or transferred will be unknown ninety days prior to the attribution \ transfer, as it will fluctuate due to investment earnings, contributions, investment switches and roll-overs \ withdrawals. As such a figure is not meaningful, we query why disclosure of a dollar amount is considered necessary.

We would like to see the requirement be amended such that that affected members are advised that the amount in "investment option X" or "product Y" or "fund Z", as at the effective date, will be attributed or transferred to MySuper. This is sufficient to inform the member about what will occur, while allowing providers to notify members via a letter, or something similar, which does not have to be tailored with member specific information.

Similarly, new paragraph 9.46(4)(e) and sub-regulation 9.46(5) require details of any change to a fee or charge, on transfer of an accrued default amount, to be disclosed to the member in dollars. Fees for MySuper products, however, are permitted by the fee rules to be in the form of a percentage (or a dollar amount plus a percentage).

Requiring disclosure in dollars will mean funds will need to create, develop and implement a program in order to be able to calculate the dollar impact with respect to each member, based on an estimated account balance 90 days' before. This will add considerably to the cost of the notice. One member has indicated that they have a number of smaller clients who are intending to be choice only and this additional cost will significantly disadvantage their members.

The regulations should reflect the permitted fee rules for MySuper products and it should be sufficient for the trustee to disclose the basis upon which fees will be charged in the MySuper product.

It is similarly essential that "any change to the member's insured benefits" (paragraph 9.46(4)(f)) should be permitted to be described in general terms and not require programming of the MySuper product's insured benefits into the transferring fund's administration system in order to produce the accrued default amount notice.

One other area of the draft regulation which has been subject to debate is the term "*in writing"* utilised in proposed new sub-regulation 9.46(7). There is concern that the use of the term "*in writing"* specifically excludes electronic notification and therefore means that the notification must be paper based. If this is the case it will increase costs considerably.

Finally, proposed new paragraphs 9.46(2)(d) and 9.46(4)(h) require an accrued default amount notice to include "any other information that the member needs to understand the attribution or transfer". The draft explanatory memorandum explains this as "any other information *the RSE licensee considers* the member needs …", but the reference to the RSE licensee's consideration is missing from the regulation and needs to be inserted.

6. <u>Schedule 3</u>
Sub-regulation 4.07E(2)

As per above, while we accept the use of this definition in MySuper products, we query why choice products are not able to offer insurance which is broader than this definition.

We strongly suggest that the conditions of release be reviewed and amended, rather than unnecessarily restricting funds from offering insurance which can be of considerable value to some members.

It is unclear how are components of existing policy definitions of TPD - relating to loss of limbs\sight, cognitive loss and inability to perform the activities of daily living - to be interpreted. Are such components required to be removed from policies or are trustees able to interpret these on a claim by claim basis?

By way of example, for many occupations a member who lost both feet would be likely to satisfy the definition of permanent incapacity in the SIS regulations, however, if a professional were to do so it is likely they would not satisfy the definition. Many insurance policies will provide TPD cover based on these three components to members who are not currently in, or have not recently been in, paid employment (e.g. retained\personal members or spouse members). Such members may have sufficient employment history for an assessment to be made by the trustee as to whether they would satisfy the permanent incapacity condition of release, which in some instances they would and in others not. Removing those components of TPD definitions from policies could leave such members with no TPD cover.

We note that draft sub-regulation 4.07E(2) would not prohibit a trustee from acquiring an insurance policy which had terms and conditions which did not align with a condition of release but merely prohibit a benefit that includes such insurance from being paid to a member unless one of the specified conditions of release are satisfied. This means that a trustee, such as the trustee of an SMSF, could still acquire such policies, such as a trauma policy, with the intention of allocating any proceeds to a reserve.

Further, the draft regulation largely replicates how the SIS conditions of release currently work. By way of example, if a trustee were to receive the proceeds of a TPD "own occupation" policy those proceeds would be preserved until the member satisfied a condition of release. The only difference under the proposed regulations is that the trustee would only be permitted to pay the proceeds as a benefit in the event of subsequent death, terminal illness, total and permanent incapacity or temporary incapacity and not, for example, in the case of any of the other conditions of release, such as retirement.

7. <u>Schedule 3</u>
Sub-regulation 4.07E(3)

We seek confirmation that the grandfathering provided by sub-regulation 4.07E(3) would extend to successor fund transfers ("joined **a** fund before 1 July 2013").

If this is not the case it would act as a significant barrier to successor fund transfers.

Members have sought clarification as to the precise meaning to be attributed to paragraph 4.07E(3)(a).

We have taken "the continued provision of benefits to members who joined a fund before 1 July 2013" to: -

- refer to members of the fund who, as at 1 July 2013, are insured for an insured benefit which does not comply with sub-regulation (2);
- not refer to members who, despite having joined the fund prior to 1 July 2013, are not insured on this basis as at 1 July 2013; and
- allow a trustee to acquire a new policy \ renew an existing policy after 1 July 2013, provided the lives insured under that new policy are all members who had that type of insurance cover in place as at 1 July 2013.

Finally, one member has raised that, given that there will be a need to: -

- upgrade policy administration systems, given existing system architecture will in a number of cases not cater for multiple premium tables that will now be required to enable accurate mapping at a member \ insurance policy \ product level;
- draft new insurance policies, update governing rules, negotiate pricing and receive Board approval;
- as there will need to communications to members with regard to the change in a short timeframe, develop materials to minimise confusion for members and their advisers;
- implement two sets of claims procedures, draft new PDSs and policy documentation, train staff and develop communication documents for advisers; and
- add complexity to the required Insurance Strategies and Frameworks as per SPS250

consideration should be given to the requirements in sub-regulations 4.07E(2) and 4.07E(3) applying from 1 July 2015. This will give trustees with non-aligned definitions sufficient time to amend their insurance arrangements, make the required system upgrades and communicate with members and advisers.

Further, this member has suggested that RSEs should be provided with protection in cases where the RE deems it is not appropriate, on the basis of cost or administrative complexity, to operate different individual or group insurance policies for different members within the one fund. This will provide RSEs with the requisite flexibility to move all members (including pre-1 July 2013 insured members) to the new definitions required by sub-regulation 4.07E(2) to mitigating some of the aforementioned impacts.

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