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File Name: 2013/36

2 August 2013

Neil Grummitt
General Manager, Policy Development
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Australian Prudential Regulation Authority
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Dear Mr Grummitt,

Supplementary submission: Second set of draft prudential practice guides for superannuation

On 4 July the Association of Superannuation Funds of Australia (ASFA) provided a submission in relation to the second set of draft prudential practice guides (PPGs) for superannuation released by the Australian Prudential Regulation Authority (APRA) on 9 May 2013, consisting of five new superannuation PPGs and three updates to existing superannuation PPGs.

We noted at the time that the intent of the PPGs is to include practical guidance from the Regulator on matters that it considers an RSE licensee may take into account when determining how to meet the requirements in the prudential standards. In that context, it is understood that PPGs are intended to provide guidance on APRA's view of sound practice in particular areas and do not create enforceable requirements.

Following the 1 July commencement date of the requirement to process a rollover within 3 days of receipt many ASFA members have raised issues with the practical implementation of the rules.

In that context, we would like to provide the following additional comments with respect to draft Prudential Practice Guide SPG 280 – Payment Standards.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

APRA's Current position on the 3 day rule

The application of the 3 day rule is dealt with in paragraphs 38 and 39 of the draft PPG:

38. Where the three business-day processing requirement applies (i.e. for standard rollovers or transfers), this applies from when an RSE licensee has received all the mandatory information required from the member. A prudent RSE licensee would ensure that the three business-day processing requirement has been factored into its asset allocation, liquidity and cashflow planning for the RSE or the individual investment strategy. In addition, an RSE licensee would be expected to give consideration to other relevant matters such as normal settlement timeframes for specific types of investments and whether the location of the investments may impact on settlement, e.g. where the investments may be located in overseas jurisdictions.
39. The three business-day processing requirement of the superannuation data and payment regulations and standards does not apply to a closed product or an illiquid investment where an RSE licensee has obtained member consent that a longer redemption period may apply (e.g. because of the illiquid nature of the investment) or where APRA has suspended or varied an RSE licensee's obligation under the portability provisions.¹⁹ Further, APRA considers the standards will generally not apply to unfunded interests, defined benefit interests, pensions other than account-based or allocated pensions or to a rollover or transfer to a New Zealand KiwiSaver scheme.²⁰ In APRA's view, an RSE licensee would not generally be in breach of the three business-day portability requirement where there is either:
 - a) an inexplicable mismatch between information on the application form and the RSE's data or in any of the electronic services provided by the ATO; or
 - b) a suspicious matter has been referred to the ATO IER group and it remains under investigation.

ASFA comments to Treasury on exposure draft regulations

In October 2012 ASFA provided the following comments on the exposure draft *Superannuation Data and Payment Regulations (Rollovers and Contributions)*:

6.34(7)

Regulation 6.34 also states that the information must be complete and that where it is complete the rollover must be completed no later than 3 business days after the trustee received the request (see 6.34(7)).

ASFA is concerned that the provision deals only with receiving the information and not with the accuracy of the information, or any concerns around the identity of the person making the request. That is, the rules operate on the presumption that, having passed the ATO's identification validation process the assumption is that the person who is making the request is the person who owns the benefit. That is, there is no risk of fraud.

ASFA is further concerned that the '3 business day' requirement provision primarily targets members in existing default options and, going forward, in MySuper products. This arises because subregulation 6.34(9) treats an investment in a 'choice' option as an illiquid investment and subject to an 'as soon as is practicable but in no more than 30 days' rollover requirement. As such the 3 day processing requirement:

- Does not recognise existing and long standing arrangements for forward unit pricing,
- Will drive the industry towards the costly introduction of daily unit pricing process and further entrench short-termism in investment decisions (which is counter to the notion of superannuation being a long term savings vehicle)
- Will limit the scope of investment arrangements that trustees will be able to consider for MySuper products to the detriment of members invested through those products.

It also does not contemplate that other member initiated actions may be in process. ASFA's strong preference is that:

- The time frame for default and MySuper members be the same as applies to members who make an investment choice under regulation 4.02. (That is, the provision should be the same as 6.34(9)(a) 'the rollover or transfer is made as soon as practicable, and, in any event, not later than 30 days after:') and
- The regulations define the term 'as soon as practicable' to provide clear guidance to trustees of:
- An expectation that the rollover be completed in 3 business days, and
- The range of matters that may reasonably cause a trustee to delay rolling over the benefit beyond the 3 business days expectation.

ASFA further suggests that the exemption for choice investments made under regulation 4.02 be removed from subregulation 6.34(9) which sits under the heading *Timeframe – illiquid investment on or after 1 July 2007* and be included under the heading *Timeframe – general*. The current location has the potential to mislead members as to the true liquidity of these investments.

ASFA further recommends that the behaviour of the industry be monitored with a view to amending the provision should the Government consider that the objectives of SuperStream are being defeated by unwarranted behaviour by trustees.

As an alternative to the current design, perhaps consideration could be given to having a single rule such that once the trustee is satisfied with the bona fides of the applicant, the members benefit entitlement amount has been identified and the members benefit has been converted to cash (where necessary), the benefit must be rolled over or transferred within 3 business days. Separate provisions would continue to apply with regards to the notification of members about the liquidity of investments.

Supplementary comments on SPG 280

The final regulations, while addressing some of these issues, did not address the significant issues of:

- Funds that have forward unit pricing.
- The presence of family law, bankruptcy and AML/CTF suspicious matters flags.
- The lodgment of the rollover request triggering a flag in the fund's fraud control system.

ASFA will be separately pursuing resolution of the above issues through a change in the regulations. However, given the impending election and that funds are subject to the three day rule from 1 July ASFA is seeking an interim resolution through recognition of the issues in PPG 280 and the adoption of the practical solution proposed below.

Forward unit pricing

Under forward unit pricing, a member wishing to transfer their benefit has the value of their benefit calculated by reference to a price that is set at a future point in time. While backward unit pricing would enable speedier processing of payment requests, trustees were aware that using backward looking prices in a falling market poses a risk of arbitrage, whereby departing members enrich themselves to the detriment of the remaining fund members.

For this reason many trustees have adopted forward looking unit pricing.

One aspect of forward looking unit pricing is that the value of a benefit payment cannot be finalised until the price has been set.

Daily unit pricing is significantly more costly to administer than weekly unit pricing and the increased frequency of pricing does not lead to significantly improved accuracy in pricing. Trustees, in considering the merits of daily versus weekly unit pricing, often consider that the additional cost of daily unit pricing that would be imposed on all members outweighs any benefit gained by departing members from the reduction in processing time from daily unit pricing.

For the above reasons, we recommend that PPG 280 should recognise that, where trustees utilise forward unit pricing on a basis less frequent than daily, they are not in a position to effect the rollover until such time as the next forward unit price has been struck.. That is, the day on which the unit price is struck should be counted as day zero and the rollover must be processed within the next three days, provided the entire transaction is completed within 30 days of receiving the completed request.

Family law and other flags

While the vast majority of members' superannuation affairs are straightforward, there are members whose benefits are subject to specific legislative requirements such as those imposed under family law, bankruptcy law and anti-money laundering and counter terrorism financing legislation. Such members will have a flag on their account which identifies that the trustee must satisfy the requirements of the relevant law prior to any benefits being paid, including the rolling over of the benefit to another fund.

ASFA recommends that PPG 280 should recognise that the trustee is not in a position to rollover the benefit until the outstanding legal issue are resolved and that the day on which this occurs should be counted as day zero, after which the rollover must be processed within the next three days.

Fund fraud control systems

Funds are required to manage risks and part of this is the establishment of fraud control systems.

While these systems and controls take many forms, in general they focus on member interactions with funds. A basic and common fraud control trigger is a change in member details followed by a rollover or benefit payment request. Where a red flag is raised in the context of a rollover request we recommend that PPG 280 recognise the need to resolve these matters prior to processing the rollover. The day on which the potential fraud matter is resolved should be counted as day zero and the rollover must be processed within the next three days.

Recommendation

In its present form the draft PPG recognises that there may be an inexplicable mismatch between information on the application form and the RSE's data or in any of the electronic services provided by the ATO. It also recognises that it would be inappropriate for a trustee to process a rollover within three days where there is an unresolved suspicious matter, provided it has been referred to the ATO IER group.

ASFA requests that SPG 280:

- Expand paragraph 39 to reflect that the obligation to transfer or rollover a benefit in response to a request from a member does not commence until the trustee is in a position to give effect to that request.
- clarify that, in APRA's view, an RSE licensee generally would not be in breach of the three business-day portability requirement where: :
 - there is an inexplicable mismatch between information on the application form and information in the trustee's records and an unresolved suspicious matter that has been referred to the ATO IER group (present examples);
 - there is a family law, bankruptcy, AML/CTF suspicious matter, or other flag on the member account that first requires resolution;
 - the fund uses forward unit pricing (on a basis less frequently than daily);and
 - the lodgment of the rollover or transfer request triggers the raising of a flag in the fund's fraud control system.
- Make clear that the regulator's expectation is that any delaying factors are resolved as soon as practicable and that the rollover is completed within 3 days of the legal or suspicious matter being resolved or the forward unit price being struck. In the case of forward unit pricing the rollover must be completed no later than 30 days after the rollover request is received.

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If you have any queries or comments regarding the contents of this supplementary submission, please contact ASFA's Principal Policy Adviser, Robert Hodge, on (02) 8079 0830 or by email rhodge@superannuation.asn.au.

Separately we will keep you informed of our approaches to Government for legislative change to resolve the issue.

Yours sincerely



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