File Name: 2017/09

20 February 2017

Ms Heidi Richards

General Manager, Policy Development

Australian Prudential Regulation Authority

GPO Box 9836

SYDNEY NSW 2001

via e-mail to: superannuation.policy@apra.gov.au

Dear Ms. Richards,

Re: Consultation on draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (draft SPG 227)

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission in response to the consultation on draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (draft SPG 227).

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire Australian superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through our service provider membership, represents over 90 per cent of the 14.8 million Australians with superannuation.

1. Comments on the draft SPG 227

1.1. General observation

ASFA welcomes the updated guidance with respect to successor fund transfers and the development of draft SPG 227 to provide prudential guidance on successor fund transfers and wind-ups.

Members have raised a concern, however, that draft SPG 227 does not address section 52 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), through which trustee covenants are included in governing rules.

Of particular relevance to successor fund transfers is the covenant in paragraph 52(2)(b) of the SIS Act to *exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity.* The existence of this covenant, as well as a trustee's fiduciary duties under general law, means that a trustee must have regards to a broader range of considerations than just the requirements of the legislation with respect to successor fund transfers.

Related to this is the issue of liability.

Given the covenant in paragraph 52(2)(b) it can be argued that a trustee of a superannuation fund is held to a higher standard that the board of any other entity. Furthermore, under section 52A of the SIS Act, a director of a superannuation trustee company can be personally liable for a breach of a director's covenant.

In determining a successor fund transfer, prudent trustee companies and directors would have regard to any potential loss of a right to indemnification, which may otherwise have been available to them, through a failure to follow a reasonable process. The statutory defences available under sub-sections 55(5) and 55 (6) are limited to the making of an investment and the management of any reserves respectively.

Accordingly, we submit that draft SPG 227 needs to be framed in the broader context of the trustee's covenants and its fiduciary and other duties under the general law, in addtion to the regulatory requirements with respect to successor fund transfers.

1.2. Specific comment

Members have raised some concerns with respect to paragraph 30 of draft SPG 227, which states as follows: -

> *30. APRA considers that the equivalence test will generally be met, and an SFT can therefore occur, in the following types of scenarios:*
>
> > *a) a transfer from a MySuper product with a single diversified investment strategy to a MySuper product with a lifecycle investment option; and*
> >
> > *b) a transfer between MySuper products with different features such as a different asset allocation or investment strategy, different applicable fees or different insurance offerings.*

With reference to paragraph a), members have queried whether this is intended to suggest that the reverse case is not true – that a transfer from a MySuper product with a lifecycle investment option to a MySuper product with a single diversified investment strategy would not meet the equivalence test.

A number of funds have decided that a single diversified MySuper option is in the best interest of their members. Some funds have raised a concern that – if a transfer from a MySuper product with a lifecycle investment option to a MySuper product with a single diversified investment strategy is not considered to meet the equivalence test - this would significantly reduce the potential opportunities for them to act as a 'receiving' fund in a successor fund transfer.

Paragraph 29 states that

> *APRA considers that MySuper members do not have a right to be in a particular type of MySuper product. Accordingly, for the equivalence test to be met, it is APRA's view that it is not necessary for a proposed receiving RSE in an SFT to have an equivalent type of MySuper product, nor is it necessary for the receiving RSE to have identical features to the transferring RSE, provided that it is in the best interests of members to transfer to the chosen RSE*.

We submit that, given this, it is unclear why a transfer from a MySuper product with a lifecycle investment option to a MySuper product with a single diversified investment strategy could not be considered to meet the equivalence test.

2. Legislative issue as a result of the Stronger Super/MySuper amendments

One of the legislative amendments to effect the MySuper changes was the insertion of section 29WA into the SIS Act by the *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011*.

Section 29WA requires the trustee to allocate contributions received to a MySuper product unless they have received a direction in writing from the member to the contrary (i.e. directing the contributions to a 'choice' product).

Section 29WA states as follows: -

> ***29WA Contributions in relation to which no election is made are to be paid into MySuper product***
>
> *(1) This section applies if:*
>
> *(a) a person is a member of a regulated superannuation fund (other than a defined benefit member); and*
>
> *(b) a contribution to the fund is made for the benefit of the person; and*
>
> *(c) either:*
>
> *(i) the **person has not given the trustee**, or the trustees, **of the fund** a direction that the contribution is to be invested under one or more specified investment options; or*
>
> *(ii) the **person has given the trustee**, or the trustees**, of the fund** a direction that some of the contribution is to be invested under one or more specified investment options, but no such direction has been made in relation to the remainder of the contribution' (emphasis added).*

ASFA repeatedly has raised concerns that section 29WA fails to recognise that the direction may have been given to a 'predecessor' trustee – including the trustee of a fund that has utilised the successor fund transfer provisions to transfer members to a successor fund.

In 2013 Section 29WA was amended by the *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* to insert a new sub-section 5 as follows

> *(5) The regulations may prescribe circumstances in which a direction given to the trustee, or the trustees, of one regulated superannuation fund is to be taken to be a direction given to the trustee, or the trustees, of another regulated superannuation fund for the purposes of this section.*

The Revised Explanatory Memorandum (Revised EM) states as follows: -

> 6.*73 New subsection 29WA(5) will provide a regulation making power to prescribe the circumstances in which a direction, relating to the investment of contributions, given to the trustee of one regulated superannuation fund is to be taken to be a direction given to the trustee of another regulated superannuation fund for the purposes of the relevant sections. [Schedule 1, item 46, subsection 29WA(5)]*
>
> *6.74 It is intended that* ***the regulations to be made*** *under this subsection* ***will address the circumstances where a member has been moved from one fund to another under a successor fund transfer*** *(emphasis added).*

This clearly indicated an intent by the government to make regulations which recognise directions given to a 'predecessor trustee' in a successor fund transfer as a '*circumstance in which a direction given to the trustee, or the trustees, of one regulated superannuation fund is to be taken to be a direction given to the trustee or the trustees, of another regulated superannuation fund'.* Unfortunately no such regulations have been made.

By way of contrast, sub-section 20B(3A) of the SIS Act, definition of Accrued Default Amount (ADA), provides as follows: -

> ***20B Accrued default amounts***
>
> *(1) Subject to this section, the total amount attributed by the trustee, or the trustees, of a regulated superannuation fund to a member of the fund is an accrued default amount for the member if subsection (1A) or (1B) is satisfied.*
>
> *(1A) This subsection is satisfied* ***if the member has given the trustee, or the trustees****, of the fund* ***no direction*** *on the investment option under which the asset (or assets) of the fund attributed to the member in relation to the amount (the member's underlying asset(s)) is to be invested.*
>
> *…..*
>
> *(3A) For the purposes of subsection (1A), if:*
>
> > *(a)* ***benefits*** *of a person in a regulated superannuation fund (the earlier fund)* ***are transferred to another regulated superannuation fund*** *(the later fund);* ***and***
> >
> > *(b)* ***the person gave*** *or (because of a previous application of this subsection) is taken to have given* ***the trustee****, or the trustees,* ***of the earlier fund a direction*** *on the investment option under which an asset (or assets) of the earlier fund is to be invested;* ***and***

> *(c)* ***an amount*** *attributable to the person* ***is invested under an equivalent investment option offered by the later fund*** *(the equivalent investment option);*
>
> *the person is* ***taken to have given the trustee****, or the trustees,* ***of the later fund a direction*** *to invest in the equivalent investment option any asset (or assets) of the later fund that is attributed to the person in relation to an amount attributed to the person (emphasis added).*

Unlike contributions, this provision recognises an investment choice in the transferring fund with respect to balances effectively can be 'carried across' to the successor fund. As a result, there is no requirement to place balances transferred from a chosen investment option in the former fund into a MySuper product, instead, the successor fund trustee is able to credit such balances in an equivalent investment option in the successor fund.

Accordingly while

- under the definition of ADA - a 'choice' member's account balance can be transferred to an 'equivalent choice' option in the successor fund;
- as a result of the failure to make regulations under sub-section 19WA(5) - a member's ongoing 'choice' contributions must be directed into a MySuper product until such time as the successor fund trustee receives a new, written, choice election from the member.

This represents an outcome which does not accord with the member's wishes and which is significantly inefficient and costly for the fund and members to rectify.

There does not appear to be an underlying policy rationale to distinguish between, and treat differently, investment choices with respect to existing investments and future contributions flows. Further, when introducing sub-section 29WA(5), the Revised EM clearly stated that it was 'intended that the regulations to be made under this subsection will address the circumstances where a member has been moved from one fund to another under a successor fund transfer'.

Accordingly, we submit that regulations for the purposes of sub-section 29WA(5) should be made as a matter of urgency.

****

We would like to thank you for the opportunity to provide comments on the draft SPG 227 and would welcome the opportunity to discuss with APRA the matters raised in this submission.

Should you have any questions on any of the matters raised in this submission please do not hesitate to contact me on +61(0)3 9225 4021 or +61(0)431 490 240 or via fgalbraith@superannuation.asn.au.

Yours sincerely

Fiona Galbraith
Director, Policy