SUBMISSION

The Association of Superannuation Funds of Australia Limited
Level 11, 77 Castlereagh Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T +61 2 9264 9300
1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au

ABN 29 002 786 290 CAN 002 786 290

the voice of super

The Treasury

Protecting your Super package regulations and explanatory materials

Consultation Paper

1 March 2019

File: 2019/03

Regulatory Framework Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Lodged via e-mail to superannuation@treasury.gov.au

1 March 2019

Dear Sir/Madam,

Protecting your Super package – regulations and explanatory materials consultation

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Treasury's consultation on the draft regulations and explanatory materials relating to the Protecting your Super package.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 15.6 million Australians with superannuation.

*****

Should you have any queries or comments in relation to the content of our submission, please contact Byron Addison, Senior Policy Adviser on (02) 8079 – 8034 or by email at baddison@superannuation.asn.au.

Yours sincerely

Glen McCrea
Deputy Chief Executive Officer and Chief Policy Officer

General comments

Please find attached ASFA's submission on behalf of our members in response to the consultation for the Protecting you Super (PYS) package regulations and explanatory materials.

At the time of writing this submission, the *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* (PYS Bill) had been passed by Parliament with substantial amendments, but had not yet received Royal Assent. We note that there has been very little time given to respond to the draft regulations and to digest the amendments made to the PYS Bill. A longer consultation period would have permitted a more thorough and considered response however we acknowledge the urgent need to provide clarity to the industry so that the PYS changes can be implemented as quickly as possible and in a way that allows members to be informed about how the changes affect them in a timely fashion.

ASFA supports the protection of low balance account members through a prohibition on exit fees and a 3 per cent cap on fees, although we have some concerns about the application of the fee cap.

We have also long supported giving the ATO the power to actively reunify accounts and we welcome the 28 day deadline for the ATO to complete this task. We note that the auto-consolidation measures will have a significant impact on the ATO and its operations and we recommend that our members be kept informed of the ATO's preparedness to process the account transfers and return them to active member accounts.

However, we have a number of concerns about the PYS package in general and the regulations in particular.

The PYS package places a significant operational burden on funds as they work to implement its various elements, and does so with very tight deadlines. There will need to be system changes, member communications, disclosure updates not to mention the longer-term impact on the terms and pricing of insurance contracts, all of which will have to be done in a very short space of time. At the same time, as our submission shows, there is a still a considerable degree of uncertainty about the impact and application of the various measures in the PYS package.

Our most immediate concern is the unequal treatment of members caught up in the retrospective calculation for the first tranche of inactive insurance accounts. These members will have only one chance to maintain their insurance and if they inadvertently fail to respond they may lose a benefit that is of great value to them. The affected members may have voluntary insurance which they have taken out deliberately or maintained on leaving employment.

We are concerned about the introduction of two new and different inactivity tests (the insurance inactivity test and the low balance inactivity test) in addition to the inactivity, lost and insoluble tests contained in the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (SUMLM Act). This is confusing for members and will be complex for funds to administer. While the amended low balance inactivity account definition could be refined, we consider that this test could also be used for inactive insurance accounts as it better reflects genuine activity, has a low balance threshold and where a member elects to maintain his or her benefit the election is permanent and does not need to be renewed every 15 months.

We remain concerned about the potential for the low balance cap to be used by high balance account holders to minimise fees on a single or ongoing basis by leaving an account balance of less than $6,000 on the review date. This would produce a result which is directly opposite to the aim of protecting low balance accounts by advantaging members with high balance accounts and transferring the cost of those refunds to other members of the fund.

We also recommend that greater consistency be applied to the treatment of accounts where the member has a ‘single beneficial interest’ (or one account) but with multiple components. Treating such accounts differently for insurance inactivity, low balance account inactivity and fee caps will be administratively complex and difficult for members to understand. For example, it appears that an account with MySuper and choice components would be eligible for the fee cap if one of the components is less than $6,000 but that component would not be classed as low balance inactive for ATO consolidation purposes. ASFA considers that what members understand to be their account, their ‘single beneficial interest’ should be the guide in this area and that the regulations should be amended to clarify this.

Responses to specific proposals

ASFA considers that the draft regulations require further clarity in a number of areas which we outline in this submission. We also we make a number of comments about the amended PYS Act acknowledging that this is not the direct object of this consultation and that there appears to be limited scope for the Act to be amended in the short term.

1. Insurance information in relation to inactive superannuation accounts

1.1 Unequal treatment of members

ASFA is concerned that the retrospective nature of the inactivity test for insurance will mean that members who are classed as inactive as of 1 April 2019 will receive only one notice about their option to maintain insurance whereas in the future members with inactive accounts will receive three notices before their insurance lapses.

It is easy to imagine a number of scenarios where a member with insurance they wish to maintain his or her insurance but fails to take notice of the single insurance inactivity notice, for example due to foreign travel or extended holidays, or caring duties. This is also concerning because the inactivity test extends to members who have taken out voluntary insurance and who may inadvertently lose it. These members, having deliberately taken out insurance, may also disregard the notice as they may feel that their intention, clearly expressed on commencing the policy, could not be overridden without further active action on their part.

1.2 Insurance inactivity notices

1.2.1 Notices after election is received

It is not clear whether the 12 and 15 month notices need to be sent even if the member has elected to maintain his or her insurance in response to the first notice and further clarity is needed in the regulations.

ASFA recommends that notices cease once an election is received as further notices would lead the member to think that the original election had not been received. 7.9.44B should be amended to reflect this.

1.2.2 Notifying members known to be lost

In some instances, superannuation funds are not able to contact their members, as they do not have up to date information, and have previously tried to make contact without success. The way the regulations are drafted, it gives superannuation funds no flexibility to avoid sending notices to members who are uncontactable.

ASFA recommends that a small amendment be made to the Corporations Regulations 2001, Section 7.9.44B(3) to allow trustees to avoid having to contact members who are lost as defined in the SUMLM Act. This would provide some flexibility and reduce the costs of implementation with no impact to members.

1.2.3 Notification of prior year's premiums versus current premiums

Proposed regulations 7.9.44B(5)(d) and (6)(d) insert a requirement for an insurance inactivity notice and final insurance inactivity notice to state '*the amount of insurance fee* charged in relation to the product for the fund's most recent completed year of income'.

In ASFA's view, the amount of the insurance fee charged should be the current or next year's premiums. It's likely to be misleading and deceptive if the previous year's premiums are used, especially if there has been a significant change to premiums.

From a drafting perspective, ASFA suggests that the regulations could refer to the insurance fee currently charged, or if this is not available at the time the inactivity notice is prepared, the insurance fee charged in the most recent completed year of income.

1.2.4 Notice content

Proposed regulations 7.9.44B(5)(g) and (6)(g) require an insurance inactivity notice and final insurance inactivity notice to explain that *"section 68AAA of the SIS Act does not affect a right of the member in relation to insurance that is covered by subsection 68AAA(7) or (8) of that Act"*.

ASFA considers that the content of the inactivity notices should not be prescribed and the regulations should be amended to include the words 'to the effect of' to permit funds to write communications in plain English suited to their membership.

1.2.5 Flexibility needed for timing of notices

Currently, the time for giving notice for insurance notices for 9 months and 12 months are two weeks after the period. If this was extended to six weeks, it would give additional flexibility to superannuation funds to incorporate these notices with other communications to members with no impact to the member. We understand the criticality of the two week period when a member has been inactive for 15 months.

ASFA recommends that the time given for notices at the 9 and 12 month stages be extended to six weeks to permit incorporation with other standard member communications.

1.2.6 Members should have the option of notifying their fund electronically

The Explanatory Memorandum to the PYS Bill indicates that notices from the customer regarding their insurance election will be covered by the *Electronic Transactions Act 1999* (ETA) and therefore can be made electronically (EM para 3.19). However, Schedule 1 of the *Electronic Transactions Regulations 2000* currently excludes most communications under the *Superannuation Industry (Supervision) Act 1993* from the application of the ETA.

ASFA recommends that the Electronic Transactions Regulations be amended so that members can communicate their insurance preference to the fund in digital or the traditional written format according to their preference.

1.2.7 Policies with an inactivity period shorter than 16 months

Some funds have policies with an inactivity period shorter than the PYS 16 month threshold. It is unclear whether the inactivity notice requirements still apply to these members, for example at 9 and 12 months, even though separate notices would have been sent out for the shorter inactivity period.

ASFA recommends that proposed regulation 7.9.44B be amended to require notices be sent out 7, 3 and 1 month(s) prior to the policy's inactivity period, whatever that might be, if less than the statutory 16 months.

1.3 Reinstatement of insurance cover

It is not clear what the intention of the package is with regard to circumstances where cover might be reinstated. For example, what is the expectation where an employer contribution or a late election to maintain cover is received shortly after cancellation of cover. In the longer term, if employer contributions or a member election are received could cover only be reinstated through underwriting?

The Insurance in Superannuation Voluntary Code of Practice gives eligible members 60 calendar days to reinstate cover which has ceased due to lack of contributions. Further advice is sought as to whether this reinstatement of cover model is permitted or expected under the PYS Bill and these regulations.

A member has also raised the question about how policies which currently permit recommencement of cover at certain life events, such as turning 30 or getting married, would operate or be permitted under this model. Would the cancellation of cover due to inactivity prevent a fund offering recommencement in these circumstances?

ASFA seeks further clarity on the intended treatment of the reinstatement of cover. ASFA supports the reinstatement of cover provisions within the Insurance in Superannuation Code of Practice and recommends this approach be incorporated in the regulations.

1.4 Legacy Traditional Products (Whole of Life & Endowment)

Whole of Life and Endowment life insurance policies are designed with the primary aim of providing life cover over a person's lifetime. In some cases they also build up a tax-effective superannuation investment. The life insurance policy is guaranteed to remain in force for the insured's entire lifetime, provided required premiums are paid, or in the case of Endowment to an agreed maturity date. Policyholders can elect for their policy to be made 'paid up' so that no further premiums (that is, contributions) become payable and the sum assured adjusted accordingly. Such policyholders will then become inactive under the insurance inactivity test.

As there is no separation of the investment and insurance elements of the policy it cannot be unbundled. A "forced removal" of the life cover component can only be effected through termination of the policy. In this case an early surrender value may (or may not) be payable based on the time the policy has been in force, the premium paying term and the age of the life insured. This may not be in the interests of a policyholder when compared with either the maturity value or sum assured. If a policyholder does not meet a condition of release on automatic termination, they'll then also be required to provide direction to the trustee as to which fund the nominal cash surrender value is to be rolled into.

ASFA recommends that these products be excluded under the regulations (using proposed regulations 7.9.44B(3) and 7.9.44C(3) potentially) as the potential for member detriment is significant and the maintenance of such benefits does not lead to account erosion through premium deductions.

1.5 Inactivity test should be limited to low balance accounts for Death and Total and Permanent Disability cover

In line with our previous submissions ASFA considers that there should be a low balance cap on the insurance inactivity definition as specified in the Insurance in the Superannuation Voluntary Code of Practice. Members with high balance accounts and those who have taken out voluntary insurance should not be subject to a test which is part of a package whose stated primary purpose is the protection of low balance accounts.

2. Fee protection

ASFA is supportive of the fee protection proposals in general but we have a number of comments about their application.

2.1 Potential for 'gaming' or inadvertent benefits for high balance account holders

We are concerned that the annual balance test could have unintended consequences or be used to minimise fees in high balance accounts as the balance day test, or the test for the day the member ceases to hold the account, does not appear to allow for the possibility of the account having had a higher balance in the previous 12 months.

To demonstrate with an example, a member with a balance of $500,000 retires and transfers $495,000 to an account-based pension but maintains a $5,000 accumulation scheme account because she knows that she will continue to work occasionally and needs an account to accept employer contributions. It would appear that the proposed method for determining the fee cap in that year would use the $5,000 to set the dollar fee limit (assuming a full year 3% x $5,000 = $150) for the previous 12 months even though the actual fees would have been much higher in dollar terms. For example a total investment and administration expense of 1.5% would translate to $7,500 for a full year. It is obviously not the intention of the fee cap in this example for $7,350 to be refunded to the member but this would seem to be how the fee cap would operate in this scenario.

There is also the reverse scenario where a member has an account balance of less than $6,000 for 11 months and then receives a rollover or contribution which takes them over the $6,000 threshold just before the review date. The member would miss out on the fee cap benefit even though he or she would have been eligible for most of the period.

ASFA recommends that the fee cap be limited to accounts which have remained below $6,000 on average for the previous 12 months. An alternative would be for daily or weekly calculations that ensure that fees do not exceed 3% on a pro rata basis for the time the account remains below $6,000.

2.2 Fee cap refunds

Assuming that fee cap refunds are due for exits outside the end date of the fund's income period, we consider that further clarity is required for the operation of refunds which are processed in the three month window after the original benefit has been paid out or transferred as there appears to be potential for administrative complexity. The creation of small residual amounts and the potential for funds not to be able to pay those amounts according to the member's original payment instructions is not in members' best interests.

Given this uncertainty, superannuation funds will find it difficult to implement a timely solution to support individuals who exit their superannuation fund shortly after the commencement date after 1 July 2019. A transitional period of six months would allow an appropriate time for superannuation funds to build appropriate solutions to support members.

Generally speaking, it is more efficient and less confusing for a fund member if superannution funds are able to process everything associated with that member leaving the fund when it happens. As proposed, a member leaving on July 2, may not receive a refund up to 15 months after exiting the fund requiring significant administrative overheads for a very small amount of money. This is inefficient and costly.

Some of our members have questioned whether the legislation achieves its aim of requiring fee cap calculations and refunds where applicable to be applied when members exit a fund on a day other than the review date.

ASFA proposes that for member exits that occur during the year, superannuation funds can have a policy to reasonably estimate indirect costs so the excess fees over the cap can be refunded at the time when a member is leaving a fund. This avoids significant overheads for a trustee and provides a simpler experience for superannuation members. This could be achieved by making amendments to section 9.50 of the Superannuation Industry Supervision Regulations allowing costs to be estimated.

2.3 Account components for fee cap calculation

Further clarity is required for the application of the fee cap to accounts with multiple components but which the member would regard as being a 'single beneficial interest'. As we have submitted previously, we recommend that the total account be regarded as a single interest as the alternative is administratively complex and inconsistent with the stated intent of the proposal. Some ASFA members remain unsure about whether the policy extends to individual asset class investment strategies within a choice product and the potential for 'gaming' this approach might support.

There are also arrangements where members have adopted a Transition to Retirement pension with an attached accumulation benefit which can often have a low balance. A member in these circumstances may have a low balance account but his or her single beneficial interest is generally high balance. Applying the fee cap to the accumulation balance when lower than $6,000 would lead to higher costs overall and be of little if any benefit to the member.

ASFA supports the concept of a 'single beneficial interest' and that it be applied to the fee cap, as well as the insurance and low balance inactivity tests. We recommend that the regulations be amended to reflect this.

2.4 When a trustee may refuse to roll over or transfer an amount

A number of ASFA members are concerned about the amendment of para 6.35(1)(b) from $5,000 to $6,000 as $6,000 can easily be reduced to a lower amount through deductions relating to investment premiums or administration fees or negative investment returns. This would bring the remaining balance below the low balance threshold for the fee cap.

To provide an adequate cushion against this likelihood it is recommended that this amount be amended in para 6.35(1)(b) of the *Superannuation Industry (Supervision) Regulations 1994* to a higher figure such as $8,000.

3. Reunification of superannuation account balances

3.1 Election to maintain a low balance inactive account

The PYS Bill requires that a member who wishes to prevent his or benefit being transferred to the ATO needs to 'by written notice given to the Commissioner, declare that the member was not a member of an inactive low-balance account'.

The regulations should be amended to make clear how this is to work in practice.

ASFA recommends that the regulations be amended to make it clear that the notice from the member can be made to the fund, who would then notify the Commissioner, or to the Commissioner directly if the member so chooses. Most members have no direct relationship with the Commissioner in relation to their superannuation benefit unless it is already held at the ATO and it would not be efficient for the member to correspond with the Commissioner on this one topic.

3.2 ATO resourcing and notification to funds

ASFA members strongly support the reunification of small accounts from the Commissioner of Taxation, and on an ongoing basis, superannuation funds will be able to ensure accounts are allocated to superannuation members quickly. However, the initial volume of payments (once-off) from the Commissioner to superannuation funds will be significant as there are large number of unclaimed super accounts to be reunited with an active superannuation account.

Upon the commencement of this policy initiative, millions of superannuation accounts will be reunited back to superannuation funds one time only and this will cause some operational difficulties for superannuation funds. In order to allocate this once-off significant volume of superannuation accounts to members within the current three day timeframe allowed in regulation 6.34D of the *Superannuation Industry (Supervision) Regulations 1994*, superannuation funds will need to increase their information technology capabilities and their staffing levels for a one time only event. Some flexibility in the timeframe allowed to allocate money to members, would reduce the costs of implementation and compliance.

A minor amendment to regulation 6.34D(2) could allow the three day allocation standard to be adhered to in "three days or in a timeframe approved by the regulator" (such as this type of initiative). This would give APRA an appropriate level of flexibility in managing compliance.

Some ASFA members have also asked for the ATO to notify them in advance of the transfers so that they can better manage their staffing and resource allocation, especially as it is not clear given the expected volume of accounts involved how quickly the ATO will be able to transfer back to superannuation funds the initial tranche of accounts transferred to the ATO on 31 October 2019.

ASFA recommends that section 6.34D(2) be amended to permit the three day allocation standard to be made more flexible when circumstances require.

We also recommend that the ATO keep superannuation funds informed about the timing of transfers back to members' accounts as this will have a temporary but significant impact on fund resources.

3.3 Hierarchy for reuniting member accounts

ASFA is supportive of this proposal.

4. Disclosure

4.1 Timing

The new regulation 10.29.03 of the *Corporations Regulations 2001* and various items of the draft regulations require significant amendments to product disclosure statements. ASFA recommends that the start date be shifted to 30 September 2019 to give funds more time to accommodate them and to align with the usual RG 97 rollover date.

The commencement date for 10.29.04 of the Corporations Regulations should also be moved to 30 September 2019 for alignment.

ASFA recommends that the start date be shifted to 30 September 2019 to give funds more time to accommodate them and to align with the usual RG 97 rollover date.

The commencement date for 10.29.04 of the Corporations Regulations should also be moved to 30 September 2019 for alignment.

4.2 Periodic statements

New regulation 10.29.04 of the Corporations Regulations states that the amendments apply to periodic statements **given** on or after 1 July 2019. In our view, these amendments should only apply to reporting periods **commencing** on or after 1 July 2019 as reporting the changes made on 1 July for the prior period ending 30 June would be difficult to implement, be of no benefit to members and potentially confusing.

ASFA recommends that 10.29.04 be amended to show that the PYS amendments should only apply to reporting periods on or after 1 July 2019.