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3 October 2012

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

Dear Dr Grant,

SUPERANNUATION LEGISLATION AMENDMENT (FURTHER MYSUPER AND TRANSPARENCY MEASURES) BILL 2012

Thank you for the opportunity to prove comment in relation to the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012* ("Bill").

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 industry. 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.

The Bill

We were pleased to see that a number of amendments had been made to the Exposure Draft of the Bill as a result of the consultation process and engagement with key stakeholders.

We do, however, have some remaining concerns with the Bill, including the definition of accrued default amounts; the undue restrictiveness of the administration fee provisions and the imposition of offences of strict, as opposed to fault, liability.

Furthermore, given that on occasions strict adherence to the provisions of the Bill will cause a number of members being detrimentally affected, and may result in an inordinate increase in costs, we consider it important that an exemptions and modification provision be inserted granting APRA the power to modify how the law applies or to exempt classes of trustees or individual trustees from full compliance, subject to any conditions which APRA may impose.

Comments which relate specifically to other aspects of the Bill have been enclosed in an annexure.

Major issues

1. Definition of "accrued default amount" with respect to amounts which the member has chosen to invest in the default investment option

There should only be two ways in which a person can become a MySuper member: -

- a person who has made no decision about their fund \ investment option and therefore has been defaulted into a fund's MySuper product; or
- a person who has 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 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. Unless the member "opts out", any "accrued default amounts" will need to be moved into a MySuper product, whilst amounts in other investment options will need to remain in \ be placed into a choice product.

We query why – in circumstances where a direction as to the investment option 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's rationale for this - that the member has "explicitly chosen to delegate responsibility for investment decisions to the trustee" – reveals a fundamental misunderstanding of the principles underpinning member investment choice (other than member directed products). 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 member is delegating responsibility to the trustee with respect to 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 diversified investment portfolio.

This definition of "accrued default amount" apparently is based on a policy position that, simply because a member has chosen to have part or all of their money invested in the default investment option, then that money must be treated as "MySuper money".

From a policy perspective this does not appear to be what the Super System Review intended as it made a distinction based on disengaged\MySuper members and engaged\Choice members, as opposed to MySuper and Choice money. From a policy perspective the later distinction makes little sense.

We believe that the purpose of MySuper is to protect the interests of disengaged member who have not made any choices. While we see MySuper as having a valid role to play with respect to: -

- "default" members - who have chosen not to participate in member investment choice; and
- those members who choose to invest in MySuper

for those members who have chosen to participate in member investment choice it is appropriate to treat them as a choice member – they have made choices as to the investment of their money.

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This is not to say they could not choose to place money in a MySuper product, but this would be by their active choice, not by the trustee having to move an "accrued default amount".

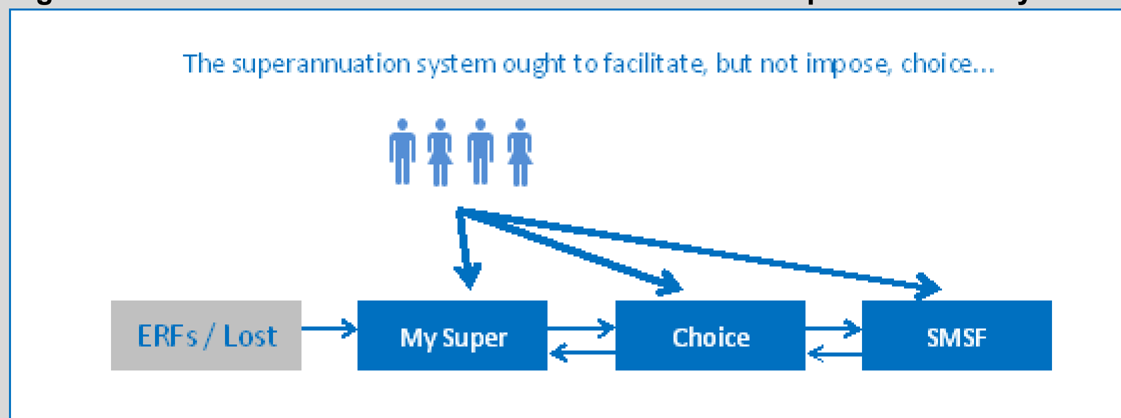
The Super System Review clearly makes reference in a number of places to members being free to "actively choose" or "select" to have their money in a MySuper product. The Bill, in requiring trustees to move "accrued default amounts" into MySuper unless a member "opts out", does not reflect this - in fact quite the opposite.

The Super System Review final report made the following 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

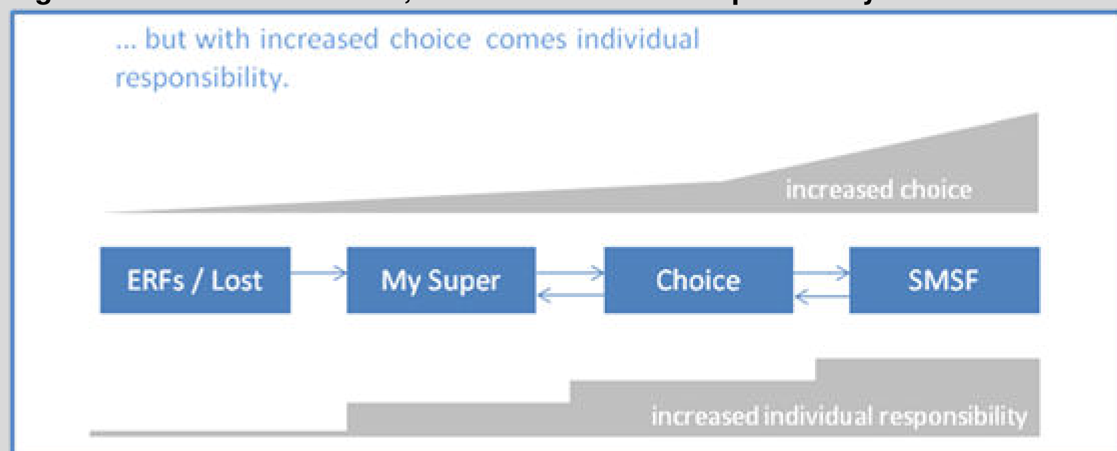
- The Panel believes that there has to be room in a system, where there are compulsory contributions, for a governance model that addresses **not only the disengaged member**, **but also the member who exercises choice** about the **fund** (or **investment option** in the fund) to which they belong.
- 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 <u>who actively choose to be there</u>** 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, **<u>though this would be by active choice</u> (Page 7)**
- the model uses the **<u>conscious choices and choice-related outcomes of individuals</u>** to calibrate the levels of governance, regulation and member protection applicable (Page 8)
- the model accommodates **<u>movement of members between the sectors</u>**, 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)

<u>Purpose of MySuper</u>

- MySuper does not just cater for disengaged members — it is also designed for members who **<u>choose actively to participate in this product</u>** (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 **<u>preferred by the member</u> 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 **<u>actively choose</u>** 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 <u>actively choose</u>** to have their superannuation in MySuper (Page 10).
- MySuper is also for members who **<u>choose</u>** to **rely on an investment strategy** developed, in their interests, by a fund trustee. Employees would therefore also be able to **<u>select</u> 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 **<u>elect</u>** to have their money invested there (or in a combination if MySuper and choice products (Part 1, Page 10).

<u>Implementation</u>

- 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 **<u>could</u>** 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).

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

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 the default option should be treated as a choice member and not have any amounts moved into MySuper.

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 complex insurance and more interactive web access 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 have “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.

Recommendation 1: -We submit that the definition of “accrued default amount” should be amended by deleting sub-paragraph 20B(1)(b)(ii) to remove the reference to members who have exercised investment choice and, in doing so, have chosen to have some or all of their superannuation in the fund’s default investment option.

2. Administration fees - prohibition on fee scales and \ or caps

While this provision is inserted by the “Core Provisions” bill, and was raised in our submission to the Committee with respect to that bill, it is of sufficient importance to raise it again here.

With respect to fees, MySuper members must all be charged the same flat fee or percentage **amount** or combination of the above.

Accordingly, where the trustee has adopted a percentage based fee with respect to administration fees, in whole or in part, they are limited to charging each member the same percentage of their account balance. It is not readily apparent why a ban on capping asset fees is being imposed.

Trustees, in exercising their fiduciary duties, have often developed a reducing fee scale as they have considered that this is in the best interests of members and produces a more equitable result.

Administration costs are not directly proportional to the size of the account and, as such, administration fee scales have been developed. It does not cost 100 times as much to administer an account of $1,000 as it does an account of $100,000 and fee scales have been developed to reflect this.

It is quite common for funds to either use administration fee scales and \ or capping the maximum amount of administration fee which is charged. This is done, for example, by charging: -

- a fixed percentage of assets on, say, the first $100,000 of the account balance;
- a lower percentage on, say, the next $100,000 of the account balance; and
- no fee with respect to the balance of the account.

This should be allowed to continue.

It is important to note in this context that all members are charged the same percentage by reference to the same scale, however, the actual percentage charged to each member will be a function of where their account balance falls along the scale.

Recommendation 2: -The provision which states that all members should be charged the same percentage **amount** should be replaced with a requirement that all MySuper members must be charged a fee in accordance with the same percentage **scale**.

3. Strict liability provisions

Considerable concern has been expressed that, given the nature of the obligations in the Bill, the imposition of strict liability offences is inappropriate.

We submit that the strict liability provisions should be amended to "at fault" provisions. This recognises the need for there to be an offence with respect to deliberate or systemic failures, however, it also reflects that liability will be a function of undesirable behaviour or conduct, as opposed to arising through inadvertent administrative or operational errors or omissions.

Failing that, consideration should be given to introducing explicit reasonable steps, or safe harbour, defences.

Recommendation 3: – That the strict liability provisions be replaced with fault provisions to the effect that "A person who intentionally or recklessly contravenes [relevant provision] is guilty of an offence punishable on conviction by a fine not exceeding [X] penalty units".

4. Need for exemptions and modification power

Given the diversity and complexity of superannuation funds, forcing trustee to adhere strictly to "one size fits all" legislation may, on occasions, cause a number of members to be detrimentally affected. One of the fundamental duties of a superannuation trustee is to act in the best interests of members, and as such it is a sub-optimal outcome if complying with the legislation leads to outcomes where members are worse off.

In addition, strict compliance may cause a trustee to incur costs which are considerably in excess of those which would be necessitated by complying with slightly modified provisions, while still achieving substantially similar outcomes.

There are already precedents in the legislation where a trustee does not have to comply with particular provision if the trustee considers that it's not in the best interests of members to do so. One such example of this is the provision with respect to performance fees (section 29VD).

Accordingly, we consider it important that an exemptions and modification provision be inserted granting APRA the power to modify how the law applies or to exempt classes of trustees or individual trustees from full compliance, subject to any conditions which APRA may impose. It is would have the protection of being administered by PARA, while have the flexibility to accommodate specific circumstances.

Recommendation 4: – That that an exemptions and modification provision be inserted granting APRA the power to modify how the law applies or to exempt classes of trustees or individual trustees from full compliance, subject to any conditions which APRA may impose.

If you have any queries or comments regarding the contents of our submission, please contact Fiona Galbraith on (03) 9225 - 4021 or 0431 4902 40 or email fgalbraith@superannuation.asn.au or me on 0433 169 342 or email pvamos@superannuation.asn.au.

Yours sincerely

Pauline Vamos
Chief Executive Officer

SPECIFIC ISSUES WITH THE BILL

A) <u>FEES AND COSTS</u>
Schedule 1 (Page 6)
Part 1 – Amendments

1) Conflicted remuneration
Section 29SAC (Page 8)

It is unclear as to whether a trustee who remits money to an advice provider or pays an external adviser for intra-fund advice services provided to its members may possibly breach the conflicted remuneration provisions. Accordingly, it would assist if the Bill would be amended to clarify that the trustee is able to remit money to an advice provider without being in breach of the conflicted remuneration provisions.

2) Performance-based fees
Section 29VD (Page 10)

There is a view that the inclusion of mandated performance fee requirements is a step too far and that trustees should be free to manage their investments, and the costs associated therewith, as they consider appropriate, having regard to their fiduciary duties.

The exemption under sub-section 29VD(8) effectively states that a trustee does not breach the section if – despite the fact that the arrangement does not comply with one or more provisions of the section – the arrangement promote the financial interests of the MySuper beneficiaries. Surely this should be the guiding principle.

If this provision is to remain then guidance will be required as to the basis on which such a determination is to be made.

It should be noted as a matter of practicality that the criteria will present some significant challenges for alternatives and unlisted managers.

Further, with respect to some offshore managers with high demand for their capacity, this effectively may act as a “barrier to entry” which may result in their disengaging from the Australian market. This risks isolating Australia from significant offshore investment management talent. If a Trustee forms the belief that a particular manager is an appropriate investment, and is happy to pay for their services on agreed terms, then why should they not be free to do so in an open, competitive market.

3) Insurance fee
Section 29VA (Page 12)

Given that this fee is an amalgam of insurance premiums paid to the insurer and administration fees with respect to administering insured benefits, it will need to be clarified how this fee is to be disclosed for the purpose of the Corporations Act disclosure regime, in particular the PDS fee table and periodic statements.

Further, with respect to funds which are currently, or will continue to, self insure, the reference to "insurance premiums paid" should be modified to clarify that this includes "notional' premiums which are deducted from a member's benefit but which, instead of being "paid" to an external insurer, are instead held in a reserve to provision for contingent death and disability benefits.

Part 11A – General Fee rules

1) Buy \ sell spreads to be charged on a cost recovery basis Section 99C(Page 16)

Buy-sell spreads are estimates of likely transaction costs, however, section 99C requires that a buy-sell spread must be no more than it would be if it were charged on a "cost recovery" basis.

As charging on the basis of recovering actual transaction costs may not be practical to apply, or to disclose, we submit that it should be clarified in the Bill that buy \ sell spreads based on a realistic, reasonable estimate of likely transaction costs would be compliant with this obligation.

2) Cost of financial product advice Section 99F (Page 17)

It is not clear whether the word "periodic" in paragraph 99F(1)(iv) just qualifies the word "review" or whether it extend as far as "providing further advice" and "monitor" as well.

The language used in the explanatory memorandum to describe the distinction which is being made, and the exclusion from intra-fund advice, as being between an "on-going advice relationship" (excluded) as opposed to "one-off" or "transactional" advice (intra-fund advice). Accordingly, the distinction will need to be drawn clearly between where the member has a reasonable expectation that there will be "periodic" review, provision of further advice and monitoring performed by the adviser as part of the advice relationship and where there is simply a "follow-up" with respect to "one-off", or transactional, piece of advice.

As such, we submit that sub-paragraph (iv) should be re-worded to clarify that the word "periodic" qualifies all of the activities of "review", provide further advice" and "monitor recommendations".

Furthermore, there are considerable practical difficulties with implementing the distinction between intra- fund advice and advice falling outside intra fund advice, when it comes to charging members.

It is commonplace for members seeking personal advice to be given both intra-fund advice and incidental non intra-fund advice at the same time in their appointment with a financial adviser, as the advice can often segue from being intra-fund advice one minute to being outside intra-fund advice the next.

By way of example, a member may seek advice as to how to boost their retirement savings, however, one of the strategies identifies that the member could make a spouse contribution. As this is not with respect to the member's interest in the fund this is not intra-fund advice and the financial adviser will be required to advise the member that they will have to be charged a direct fee for this component of the advice. As it may be in the best interests of the member to consider making a spouse contribution, the adviser would be remiss if they were not to advise upon this, however, it would be a ludicrous outcome if the adviser had to break off the advice at this point and negotiate what would be a relatively insignificant fee for this component of the advice. Not only

would this amount to a poor member experience, the costs of charging for the advice could largely outweigh the revenue.

It could prove difficult for the financial adviser to proportion the advice provided into intra-fund and non intra-fund advice and near impossible to explain to the members the magic line which has been crossed which has caused the member to incur a charge. This will be made even more difficult when the member only sought intra-fund advice initially but during the course of the meeting the adviser considers it in the best interests of the member to raise a matter which is not intra-fund advice.

We would ask that consideration be given to this. One possibility may be that, if as a result of the best interests duty, a small piece of incidental advice which is not intra fund advice is given to the member then, provided the advice is reasonably related to the intra-fund advice, a fee does not have to be charged.

B) <u>PROVISION OF BENEFITS (INSURANCE)</u>

Schedule 2 (Page 20)

3) Benefits for permanent incapacity and death – MySuper member

Sub-section 68AA(1) (Page 21)

Concern has also been expressed that the reference to "reasonable conditions" in sub-clause (3) may not be sufficient to "override" the requirement in paragraph 29TC(1)(b) that a MySuper product must offer the same benefits. Accordingly, we submit either that paragraph 29TC(1)(b) should be subject to sub-section 68AA(3) or that sub-section 68AA(3) should prevail over paragraph 29TC(1)(b), perhaps by the insertion of the word "notwithstanding".

In addition, considerable concern has been expressed that, notwithstanding that sub-clause 68AA(3) states that a trustee may determine reasonable conditions to which the provision of an insured death and TPD benefit is subject, nevertheless this obligation may be interpreted as meaning that the provision of such coverage is compulsory for all members.

Accordingly, we would submit that confirmation is required, perhaps by means of a note inserted into the Bill, that the determination of reasonable conditions may result in some members not being provided with cover, while the cover provided to others may vary in sum insured \ premiums \ exclusions etc. in accordance with the terms and conditions of the policy and \ or the governing rules.

Further - given: -

- the obligation in paragraph 29TC(1)(b) – that a MySuper product must offer the same options, benefits and facilities; and
- the absence of a "free-standing", express "reasonable conditions" provision such as that found in sub-section 68AA(3)

this may create difficulties with respect to the provision of insurance cover other than death \ TPD, such as a total but temporary disability income benefit.

Accordingly, we submit that paragraph 29TC(1)(b) should be amended to clarified that all insurance benefits may be offered subject to "reasonable conditions", which may result in some members, for example, not being eligible for automatic acceptance or not being eligible for that type of insurance.

Finally, there is the issue with respect to members who, for example: -

- leave and re-join the fund in the MySuper product; or
- whose insurance lapsed some time ago; or
- move monies from a MySuper investment option (where they had opted out of insurance) to a choice investment option and then, some time later, move back to the MySuper investment option; or
- after years in a choice product with no insurance, decide to move into a MySuper product.

All of these may, to some degree, represent a risk of the member selecting against the fund \ insurer.

Clarification is required as to the extent to which the ability to make the insurance offering "subject to reasonable conditions" would allow the trustee to, for example, impose conditions that in some or all of these circumstances a member was not eligible for cover, or at least for automatic acceptance.

In other words, it is not apparent whether the obligation to "offer" insurance applies only on a member initially joining the fund in a MySuper product, or whether it is on-going. In particular, it is unclear, where a member who has previously opted out of insurance and has moved their money out of a MySuper investment option to a choice investment option, must be offered insurance again in the event they move some of their money back into MySuper.

With respect to members who have "opted out" of insurances, we note the insertion into the Bill, after the exposure draft, a new provision with respect to elections made before commencement (page 23). We submit that a similar provision needs to be inserted with respect to elections made by a member at any time, so that if a member has opted out once they no longer have to be offered insurance in the fund during their membership. This is not to say, of course, that they could not apply for insurance at any time (subject to any reasonable conditions in the Trust Deed and insurance policy) but simply that the trustee would not have to offer it again.

4) Payable only if the member is suffering permanent incapacity

a) Why is "own occupation" being phased out in choice products?

A number of members have queried the policy underlying the phasing out "own occupation" TPD cover, especially in choice products.

We agree that there may be an argument that the higher "own occupation" premiums, and the less than full deductibility of premiums, may not be appropriate in a MySuper product.

Specialised and senior management employees, however, may be highly educated, skilled or experienced. As such, despite the fact that they are disabled to the extent that they are unable to continue in their own occupation, they are often considered not to meet the permanent incapacity test as they would be able to obtain employment, albeit a lower level \ grade or in a lesser position. Frequently, however, this results in a significant reduction in their salary and a corresponding diminution in their retirement income savings.

For such employees the option of being able to access "own occupation" insurance in a choice product is a valid one and should remain. The amount of insurance paid into their superannuation

fund, to be accessed upon retirement, would reflect the higher retirement income they would otherwise have had but for the disability.

Group life insurance within superannuation is often an affordable option for those members who need this kind cover. Compelling people to seek this cover on an individual basis outside superannuation will see a significant increase in costs \ premiums and a number of members unable to obtain replacement cover.

Accordingly, we suggest that consideration be given to allowing choice products, but not MySuper products, to offer "own occupation" insurance. If considered necessary this could be accompanied with requirements as to disclosure, to ensure members appreciate the difference between "own occupation" and "any occupation" insurance.

b) Possible alternative – amendment of conditions of release to allow "own occupation"

One possible alternative mooted by some members is to give consideration to amending the conditions of release such that amounts paid in the event that a member is disabled, such that they are unable to continue in their own occupation, are able to be released.

The SIS conditions of release could be amended such that an "own occupation" definition of total and permanent disability is included as a condition of release. This would result in superannuation benefits being paid to claimants at an earlier time and may result in less reliance on disability benefits, reflecting a net transference of the risk from the public sector to the private sector.

c) Grandfathering of members who already have "own occupation"

The phasing out of "own occupation" insurance over a transition period is likely to create considerable difficulties for trustees, for members who currently have this type of cover and for insurers.

There is a question as to whether such a transition can occur without the member's consent. What happens if a member is materially disadvantaged by being unable to obtain replacement cover at comparable rates, or at all?

It is questionable the extent to which this can be considered to be in the best interests of the members who currently have "own occupation" insurance cover.

Accordingly, we submit that any prohibition on "own occupation" insurance should be "grandfathered" such that it is able to be continued for such members for as a long as it is feasible for the trustee and insurer to do so.

In addition we submit that there should be statutory protection for trustees and insures with respect to members who claim a loss arising from these changes. While this would serve to protect the trustee and insurer, such losses are, of course, not in the best interests of the member concerned.

Trustees will need sufficient time to renegotiate group insurance policies and to make the necessary changes to Product Disclosure Statements and insurance disclosure materials for new members This will be a costly exercise, which will have to be borne by the members of the fund.

5) Trustees may require MySuper members to opt-out of both permanent incapacity and death benefit
Sub-section 68AA(6) (Page 22)

Sub-section (5) requires the trustee to ensure that each MySuper member may elect that either a permanent incapacity benefit and \ or a death benefit will not be provided by the fund.

A number of life insurance companies will not accept the risk for TPD cover only, which is what results if a member is allowed to elect not to have a death benefit but is able to retain a TPD benefit. Accordingly, we submitted that, while members should be able to elect not to have either death or TPD, or not to have TPD, they should not be able to elect not to have death but to retain TPD.

New sub-section (6) now allows trustees to require MySuper members to opt-out of both permanent incapacity and death benefit. While the insurance policy \ governing rules may permit members to opt out of both it does not, however, provide for another common scenario – allowing members to opt out of permanent incapacity while retaining an insured death benefit.

Furthermore, with respect to funds which are currently self insured, there is a need for a transition period during which members are not able to opt-out during the period the trustee is transitioning across to being externally insured. We would anticipate that this transition to external insurance could take between two and three years, and possibly up to five.

C) <u>COLLECTION AND DISCLOSURE OF INFORMATION</u>
Schedule 3 (Page 24)
Part 1 – Amendments

ASFA is supportive of the principle of full, transparent disclosure of information to superannuation fund members.

Having said that, we do have some specific concerns with respect to some aspects of the Bill.

6) Product dashboard
Section 1017BA (Page 27)

a) Updating of information
Paragraph 1017BA(1)(c)

The requirement is to update information about the average amount of fees and other costs, expressed as a percentage of the assets of the fund, within 14 days after the end of each quarter.

Funds are reliant on third parties, such as custodians and investment managers, to provide information with respect to the value of the assets of the fund. While some assets are valued daily, or even intra-day, others are valued less frequently.

Accordingly, 14 days is too short a time in which to obtain valuation of assets, determine fees and cost, perform and verify calculations, subject to due diligence review and then update and publish the dashboard. We submit that a significantly longer period is required.

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It should be noted in this context that the obligation to publish portfolio holdings, without calculations, is 90 days after period end.

b) Updating of information
Paragraph 1017BA(1)(d) (Page 27)

The requirement is to update information (other than the average amount of fees and other costs) within 14 days after any change to the information.

It is unclear as to what this means, especially with respect to such matters as the level of investment risk, which may fluctuate daily. There needs to be a definition or principle with respect to how often updating is required with respect to each element.

Furthermore, we submit that the concepts of: -

- the trustee "becoming aware of the change; and
- materiality

should be introduced in order to make these provisions workable.

c) Level of investment risk
New paragraphs 1017BA(2)(c) and 1017BA(3)(c) (Page 27)

It is unclear as to how this to be defined and measured. There are a number of measures of investment risk, such as downside deviation; risk of capital loss; cash-flow risk; diversification risk; liquidity risk; valuation risk; tax risk; expense risk etc.

Given that there is only one standard risk measure across this industry – the ASFA \ FSC risk measure which identifies the risk of a negative return in any 20 year period –, there is a considerable risk that the information will be reported on an inconsistent basis. This will produce misleading results if used to compare information across products, unless regulations prescribe the basis upon which various risk measures are to be determined.

d) Statement about liquidity
New paragraphs 1017BA(2)(d) and 1017BA(3)(d) (Pages 27 \ 28)

At a minimum, "liquidity", and the method of measurement, will need to be defined, otherwise liquidity measures across funds \ products will not be comparable.

We suggest, however, that the requirement for a statement of liquidity in the product dashboard be reconsidered and that it be left to the prudential standards, as it is not clear what is being measured and for what purpose. In particular, does this include contributions which are made into the product \ option, as well as the underlying investment made by the fund, as for some funds incoming contributions will be considerable for some time to come and will serve to ensure that a product \ option is essentially liquid.

e) Average amount of fees and other costs in relation to the product
Paragraphs 1017BA(2)(e) and 1017BA(3)(e) (Pages 27 \ 28)

It is unclear why fees and costs are being added together, as fees are levied against members to recoup costs incurred by the trustee in administering and operating the product. If fees and costs are added together this will result in significant double-counting.

There is also a question as to how to treat cost recovery which is embedded in the unit price, as opposed to specific fees which are charged. Trying to combine the two gives a meaningless figure that only works for the account balance used in the calculation.

As the definition of fee appears to be restricted to fees charged by the trustee and appears to include exit fees and switching fees as well as administration and investment fees, this would serve to inflate the average fees for funds

- where there are more exits or switching; and
- which choose to include the fee for provision of financial advice in the administration fee, as opposed to as an activity fee, as the latter is excluded from the definition of fee in section 1017BA.

Concern has also been expressed about the costs to manage all of this.

7) Requirement to publish portfolio holdings
Section 1017BB (Page 29)

a) General Comments

i) Self-regulation

There is a strong argument that – as opposed to imposing prescriptive statutory obligations – the industry should be allowed to self-regulate, utilising a combination of industry standards and market forces to produce a result which is appropriate and reflects stakeholder interests.

Discussion with ASIC had been based on self-regulation, with industry bodies providing guiding principles and there would be a long lead time to implement.

ii) Difficulties for trustees in obtaining and publishing information

We note that creation of new regulation-making powers to enable regulations to be made which may provide that investment in a financial product or other property is not a material investment and therefore, in prescribed circumstances, information relating to the investment is not required to be made publically available.

Notwithstanding this, there would be major difficulties on obtaining this information, especially with respect to managed investment schemes and fund of fund managers, where holdings are bundled and commercially sensitive such that not even the custodian is aware of them. It is not apparent whether many custodians would be able to provide this type of reporting.

Further difficulties are created for trustees who invest through a PST and unit trust into an underlying unrelated fund. This will result in a very long chain of reporting and at each level the RE or trustee at that level will have to work out the proportion applicable to the investor the next level up the chain. This will represent an inordinate amount of work and cost for little appreciable benefit, especially with respect to MySuper members who are not participating in investment choice.

iii) Costs

The cost of publishing all of the required information would appear to be prohibitive, especially when compared to any potential value it may provide for members.

We query the policy objectives, beyond increased transparency. Realistically, it is most unlikely to be used to inform consumer decision making.

The amount of information required to meet the obligation to publish portfolio holdings is extreme and of little value to the member.

Accordingly, the compliance costs of this obligation as currently framed are likely to far outweigh any benefit to fund members, who ultimately will be bearing the brunt of the costs. As such, this obligation should be subject to a proper cost \ benefit analysis as part of the regulatory impact statement.

iv) Alternative approach 1 - impose obligation directly into investment managers

If it is decided to persevere with the full disclosure then an alternative to trustees being forced to police investment manager disclosure would be for portfolio managers, managed investment schemes and find of funds to be required to make full disclosure. Superannuation funds could then publish links to the investment managers' web-sites to enable the complete portfolio holdings to be available. This approach would provide transparency while avoiding the need for onerous contracts, monitoring, and systems changes for superannuation funds.

Discussions with ASIC to date have centred on disclosure by trustees at the first legal level with investment managers to disclose further on their own websites.

v) Alternative approach 2 – scale back obligation to make more meaningful and cost effective

This obligation should be scaled back to something more meaningful to the member and cost effective, such as more analytical summaries on the funds characteristics and risk profiles. This could include information about such matters as the location (country and sub-sector) of different groups of assets but may stop short of dollar values \ percentages of each asset.

b) Specific comments re the Bill

i) Information sufficient to identify each financial products in which assets invested
Sub-section 1017BB(1) (Page 29)

It is unclear here as to what is meant by "financial product". The explanatory memorandum says the intention is to organise by each MySuper and choice product but it is arguable that the correct interpretation of this provision in the Bill is that the obligation is to publish information relating to each financial product *in which the fund is invested*.

Data collection organised by investment products – MySuper and choice - as proposed in the explanatory memorandum will be complex and costly for many funds and \ or custodians, especially where look through to underlying managed investment schemes, derivatives etc. is required.

ii) Obligation to provide information relating to investment of assets Section 1017BC (Page 30)

There is an obligation on investment managers to provide the data to the trustee if they enter unto an arrangement on or after the date of Royal Assent. Where there is an ongoing appointment of an investment manager which pre-dates Royal Assent the trustee will have to rely on the co-operation of the investment manager to obtain the data.

If the trustee inadvertently publishes inaccurate or incomplete date it will be committing an offence punishable with a penalty of 100 penalty units or imprisonment for 2 years or both.

In the absence of co-operation by the investment manager the trustee will be forced to rely on the defence. This is totally inappropriate.

Where the trustee is unable to compel a commitment from the investment manager it should not have to demonstrate that it took reasonable steps to ensure that the information would not be misleading or deceptive.

Further, as the obligation to provide information only applies to new contracts entered into from the day of Royal Assent, this could result in a long period where the information published is incomplete because trustees are unable to obtain some of the information, further impacting on the usefulness of the information.

These are further reasons why the Corporations Act should be amended to impose a direct obligation upon investment managers to disclose such information.

iii) Strict liability offence – trustees obligation to publish information Paragraphs 1021NB (Page 37)

Concern has been expressed that imposing strict liability offences with respect to these obligations is totally inappropriate. This is especially the case as there is a limit to the extent to which the board can exercise governance oversight, particularly with respect to third parties, and having regard to the somewhat limited nature of any potential harm which may be considered to arise.

It is also considered that the level of penalties also appears to be far too onerous, particularly as it is an offence irrespective of whether the information is known to be defective. Given the current approach, trustees are being forced to rely on their investment managers and custodians – they are not in a position to verify that the information is correct.

If the strict liability provisions are not removed they should be modified to allow trustees to reasonably rely on the information provided to them and exceptions from timing rules created conflicted where the data cannot be sourced in the time specified.

iv) Strict liability offence – third parties obligation to provide information Paragraphs 1021NC (Page 39)

It is unclear as to how the offence provisions in relation to failure to notify will work in the case of overseas managers – presumably they would be unenforceable.

8) Reporting Standards

Quarterly reports about superannuation
Section 348A (Page 51)

It has been questioned why an undue focus has been placed on short-term returns through the mechanism of publishing quarterly MySuper returns. There is considerable tension here between adopting the long-term view appropriate to superannuation and the publication of date quarterly, which only serves to encourage short-term thinking.

Concern was also expressed about the need for all funds to produce a new quarterly return of information to APRA and the costs which this would necessitate.

D) DEFINED BENEFIT MEMBERS

Schedule 5 – Page 62

There may be an issue with respect to defined benefit members whose benefit has crystallised. If the trustee is compelled to move the accrued default amounts of former defined benefit members into another product, especially if this is in another fund, this may cause the member to lose any rights they may have had to recommence the accrual of their defined benefit should they be re-employed by a participating employer.

Accordingly, we suggest that the definition of defined benefit member include former defined benefit members whose benefit has been crystallised.

There is an additional issue with respect to tailored, large employer MySuper products. The 500 employee measure for large employers excludes defined benefit members from the head count, however, it is conceivable that, for example, an employer \ trustee may want to offer a tailored employer product for 500 or more employees where the benefit design would be comprised of hybrid defined benefits. In addition, hybrid funds may have a closed defined benefit division and a growing, but still less than 500, accumulation division. We query the policy rationale which would preclude the employer \ trustee from being able to provide as a large employer sub-plan in the above circumstances.

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