



# Superannuation Update Cooper Review

July 2010

Commercial in Confidence



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## Summary

The much anticipated final report of the Cooper Review was released on Monday, 5 July 2010 (**the Report**). The review into the governance, efficiency, structure and operation of Australia's superannuation system has been comprehensive. The Report contains some surprises and there are winners and losers, which is inevitable given the diversity of the superannuation industry. This Update provides an overview of the recommendations in the Report but does not include recommendations concerning self managed superannuation funds. The Report suggests a two year transition period and as many of the reforms are significant advanced planning to implement them will be critical to their success.

It is now up to the Government to consider the Report's recommendations (all 117 of them) and give its response. Comments from Minister Bowen suggest that such a response will come after consulting the industry on key proposals. Given that a federal election is imminent it is possible that the Government's response will not be available prior to that election.

The Report recognises that the choice architecture framework has failed to deliver the competition and cost savings originally anticipated and accepts that a large proportion of the Australian population is disengaged with their superannuation and likely to remain so. On that basis the Report divides the superannuation industry into four sectors:

- **MySuper** - for those who are disengaged with their superannuation;
- **Choice** - for those who are engaged with their superannuation and want to exercise a choice;
- **Eligible Rollover Funds (ERFs)**; and
- **Self Managed Superannuation Funds (SMSFs)**.

This is a realistic approach and recognises the different needs of different people within the system. It works with that reality in order to achieve the best outcome for all members involved in contributing to superannuation funds. The Report recommends changes to all four categories.



## Restructure of SIS

One of the recommendations is to restructure the *Superannuation Industry (Supervision) Act 1993 (SIS)* into separate parts. One to deal with legislation relating to all four sectors referred to above; and separate parts to address the specific requirements of each sector. Together with the numerous other recommended changes to SIS throughout the Report, this would require a complete re-write of SIS.

Unfortunately there is no recommendation to deal with the complexities of the disclosure requirements in Chapter 7 of the *Corporations Act 2001* which would have been much more welcome!



# Mysuper

There has already been a lot of information and discussion concerning the MySuper product. The Report acknowledges that MySuper is based on the existing default investment options but claims that the current structure will be enhanced with the objective of achieving better member outcomes. This is to be achieved by shifting the existing emphasis from the superannuation industry to the member.

To offer a MySuper product, the Fund must meet the following requirements:

## Trustee duties

Trustees that offer a MySuper product must comply with the following:

- *Investments* - formulate and give effect to a single diversified investment strategy at an overall cost aimed at optimising member's financial best interests as reflected in the net investment return over the longer term; and
- *Scale* - actively examine and conclude annually if the MySuper product they offer has sufficient scale as a stand alone product based on asset values and member numbers to determine whether it will continue providing optimal benefits to members.

These additional duties need to be compared to the existing duties a Trustee of a superannuation fund currently takes on under common law and under SIS.

## Trustee indemnity Insurance

As a condition of the RSE licence a MySuper trustee would have to hold appropriate indemnity insurance cover and provide APRA annually with a certificate of currency. Most Trustees would already have in place this type of cover as part of their risk management strategy. However, it has not previously been legislated, although this type of insurance is referred to in the Guidance Notes relating to the RSE licence.

## APRA licensing

A special "MySuper" class of RSE licence will be necessary to offer a MySuper product. This may be by variation to an existing RSE licence. As part of qualifying for that licence a trustee would have to demonstrate to APRA that the product has sufficient scale of members and assets to provide optimal benefits to members. Presumably if APRA forms the view that the scale requirement is not met the Fund will not be able to offer this product which would effectively force it to merge.



## Investments

Currently under section 52(2)(f) of SIS a trustee must formulate and adhere to an investment strategy that takes account of risk, diversity, liquidity and the ability to meet liabilities. Provided that it complies with that covenant the Trustee can rely on a statutory defence to any action for loss or damage suffered as a result of making an investment.<sup>1</sup>

A MySuper Trustee may have a much more onerous task based on the recommendations in the Report. Not only must it formulate a single diversified investment strategy, it must do so at a cost that will optimise the financial best interests of members based on the net investment return over the long term.

This is a different standard not simply requiring Trustees to do all the right things to achieve good investment returns, but to consider the cost of those returns in order to increase members ultimate retirement benefits. Whether there will be a corresponding reduction in the statutory defence currently available to Trustees in relation to investments remains to be seen. What consequences will flow for a Trustee who fails to achieve this requirement is also not clear.

## Insurance

No part of an insurance premium paid by a MySuper member can include an up-front or trailing commission or “a like payment”. Recent changes to ban commissions exempted insurance and this would overcome this in relation to group insurance arrangements in MySuper products.

MySuper trustees would be required to proactively offer intra fund advice to members in relation to insurance in MySuper.

Death and total and permanent disablement (TPD) cover would have to be offered on an “opt-out” basis in MySuper products. Income protection cover can be offered if the trustee believes it is in members’ best interest and can be offered on an “opt-out” or “opt-in” basis.

## Retirement product

A MySuper product must include a retirement income stream product within the Fund or in conjunction with another provider. This is to ensure the product is a “whole of life” product.

## No costs cross-subsidisation

There can be no direct or indirect cross-subsidisation of costs between a MySuper product and other products offered by a trustee, whether within the same Registered Superannuation Entity (RSE) or not.

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<sup>1</sup> Section 55(5) of the SIS Act.



## **Buy sell spreads**

Buy and sell spreads can only be charged if they are closely linked to the demonstrable costs incurred by the Fund i.e. actual transaction costs incurred in investing contributions and paying benefits. The charges must be paid to the Fund and not to the trustee in its personal capacity or to any other party.

## **Switching fees**

Switching fees can be charged provided they are paid to the Fund and not the trustee in its personal capacity or to any other party.

## **Performance based investment management fees**

Performance fees cannot be charged unless they comply with the performance fee standard. The Report indicates performance fees should be the exception rather than the rule for superannuation fund investments. It recommends a performance fee standard be developed by APRA and adopted by trustees of MySuper products.

## **E-Super disclosure**

Reduced member disclosure obligations will apply to MySuper products due to their simplicity and to assist in lowering costs. As entry to a MySuper product is not based on informed choice no product disclosure statement would be required. The intention is that joining will occur online, but those without internet access could obtain hard copies of the information. Benefit statements continue but members could elect to receive them online.

## **Entry and exit fees**

No entry fees can be charged, including on rollovers. No exit fees except on a cost recovery basis.

## **Benchmarking survey**

A trustee offering a MySuper product will be required to participate in APRA approved benchmarking surveys measuring their relative efficiency against peers in a number of key areas. This would include administration costs per member and service standards. The review would be in accordance with an Outcomes Reporting Standard developed by APRA in consultation with ASIC and the industry. APRA would be required to publish the results of such a benchmarking survey.



### **Intra-fund advice**

Trustees offering a MySuper product must maintain a facility for providing “intra-fund” advice. Given the Government’s intention to extend “intra-fund” advice to include new topics it is considered appropriate for this type of product. The cost of this advice can be shared across the membership, or charged on a user pays basis which appears to put it outside of the prohibition on cross subsidisation. This remains subject to the SIS sole purpose test.

### **Ongoing advice – yearly opt-in**

Members of MySuper products can only be provided with advice about superannuation (other than intra fund advice) under arrangements requiring them to renew the advice service each year using a renewal notice from the advisor. Therefore the member would have to opt in to continue receiving the advice service each year and the onus would be on the advisor to provide the renewal notice.

This would avoid the situation where financial planners use the fee for service model for ongoing financial advice as a substitute for the current trailing commissions. A standard form would be developed by ASIC in consultation with the industry for this purpose.

### **Advice on switching**

The Report recommends that legislation impose, through conduct and enquiry, duties on persons (including trustees) providing advice to MySuper members to move out of the MySuper product. This means if a member is advised to switch out of a MySuper product specific obligations should be imposed on the person giving that advice.

The recommendation suggests that those obligations be based on the requirements of section 947D of the Corporations Act. That section requires additional information to be given where advice is given to replace one product with another. The additional information provided by section 947D is as follows:

- information about any charges the person will incur regarding disposal of the MySuper product and acquisition of the new product;
- any pecuniary or other benefits that the person will or may lose as a consequence of following the advice;
- information about other significant consequences to the person as a consequence of following the advice which the advisor knows or ought reasonably to know are likely; and
- all amounts are to be stated in dollars.



## Commissions

A trustee of a MySuper product will not be able to pay or fund any product-based up-front or trailing commission or other similar payment, or make or fund any payment that relates to volume.

## Default funds

Recommendations include:

- Amending the *Superannuation Guarantee (Administration) Act 1992 (SG Act)* so only a MySuper product will be eligible to be a default fund nominated by an employer.
- Amending the relevant legislation so only MySuper products are eligible to be nominated, and all MySuper products are able to be nominated, as default funds in industrial awards approved by Fair Work Australia.

Opening up default funds in industrial awards to all MySuper products will create a level playing field and presents a real threat to industry funds who currently occupy this space. The recommendation that the Productivity Commission review the process by which default funds are nominated in industrial awards to determine whether that process is sufficiently open and competitive in 2012, adds to that concern.

## Successor funds

Where a successor fund is a MySuper product to a default fund under an industrial award it will automatically be accepted as the default fund under that award, removing any impediment to consolidation. This addresses a concern relating to the modern award changes which failed to deal with the impact of successor fund transfers on default funds named in an award. However, it is not clear whether this would extend to all successor fund transfers or just those involving a MySuper product.

## Defined benefit funds

If the Fund is a hybrid fund the MySuper criteria must be met for accumulation members for the Fund to be accepted as a default fund under the SG Act concerning those members.

Where a member holds both a defined benefit and accumulation benefit as part of a defined benefit fund's benefit design and the accumulation benefit is not required in order to meet the employers' SG Act obligations, then the MySuper criteria does not have to be met concerning those members.



## Choice Sector

The report accepts that a trustee should be protected from liability when a member selects their own investment option, but stresses the need for the trustee to accept responsibility to “apply a greater level of scrutiny to the sorts of products that are offered to superannuation fund members in the master trusts, platforms or wrap environment”. The Report indicates that it should not be possible for trustees merely to “preside over a menu of investment options principally selected by “dealer groups” or other external parties<sup>2</sup>.

Clearly these comments are directed to the retail part of the industry, rather than the not-for-profit sector. The Report identifies a gap in the regulatory regime concerning this type of product which can be made available to retail investors within a superannuation fund.

No assessment as to the suitability of this type of product to an investor is made and instead the emphasis is on disclosure and the onus is on investors to make their own decisions as to the appropriateness of the product.

### **Due diligence duty for Choice trustees**

The Report sees this as exposing members to choosing risky and illiquid investments that may be unsuitable as retirement products. Consequently it recommends a refined duty to be imposed only on Choice trustees requiring them to conduct appropriate due diligence and monitoring of investment options that they offer. It is arguable that such a duty already exists under the common law and the SIS requirements to act in the best interests of members. However, the Report identifies this as a new duty to be “fleshed out” in standards that will be developed by APRA in consultation with the industry.

Other changes recommended in the Choice Sector are:

- No entry fees can be charged and exit fees can only be charged on a cost recovery basis.
- Advice to members (other than intra fund advice) and to employers cannot be bundled with choice products or with other products in the choice architecture model, including products offered to SMSFs. Members must request the advice and the Trustee can only deduct the cost from a members account with the member's written agreement. Members should only be provided with advice concerning superannuation (other than intra fund advice) where they are required to “opt in” annually using a renewal notice provided by the advisor.

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<sup>2</sup> Paragraph 5.1.2 of the Cooper Report.



- Trustees of choice products should not pay or fund any product based on up front or trailing commissions or “other similar payment”, or make or fund any payment that relates to volume concerning superannuation advice or other products or services provided to members.

The reference to “similar payment” appears throughout the Report in the context of bans on commissions. The term is broad enough to include soft dollar or other incentives not currently prohibited.

- No premiums for insured benefits through a choice product should include or fund up-front or trailing commissions or “like payment”.
- A Choice Trustee will have to offer a range of options sufficient to allow a member to obtain a diversified asset mix if they choose. However, members are free to choose an undiversified asset mix and in those circumstances the Trustee has no obligation to assess the appropriateness of the investment strategy chosen by the member. This is subject to the due diligence duty referred to above. Provided it complies with that requirement a Choice Trustee should not be subject to civil liability if the member suffers loss.



# Governance

## New office of trustee-director

A new office of “trustee-director” will be created. A trustee-director will have duties, powers and standards set out entirely in SIS. This recommendation would “clarify” existing duties in section 52(2) of SIS and incorporate into SIS director duties under Chapter 2D of the Corporations Act.

The intention appears to codify in the one Act all of the director and trustee duties and impose them on one office to be known as a trustee-director. However, the Report does not recommend removing the overlay of the common law of trust and therefore falls short of a complete codification.

The covenant under section 52(2)(b) of SIS would be modified to reflect the common law duty of care. This covenant currently requires the exercise of the same degree of care, skill and diligence as an *ordinary prudent person* would exercise in dealing with the property of another for whom they felt morally bound to provide. This would be changed to the common law duty of *an ordinary prudent person of business*, therefore introducing a higher standard of care not previously required under SIS.

## Conflicts of interest

Although the Report acknowledges that the common law already covers conflicts relating to trustees it felt there was still a need for greater clarity of what is required of a superannuation fund trustee. The recommendations are:

- That APRA develop a prudential standard that sets out examples of conflicts of interest and conflicts of duty to illustrate behaviour not permissible for any APRA/regulator funds to ensure trustee-directors and trustees observe their duty of loyalty to members.
- Trustees of APRA/regulator funds should, as a condition of their RSE licence, be required to state and comply with a conflicts policy specifically tailored to their business structure addressing all relevant issues concerning their role under SIS and as a fiduciary to the members of the Fund.

Trustees are already required under common law to deal with conflicts of interest. They are also subject to requirements under SIS and the Corporations Act. It is a requirement of the RSE licence that conflicts be dealt with and most Trustees would already have in place a conflicts policy.

Given that this body of regulation already exists and is directly connected to the RSE licence it is not clear how much more will be expected under the recommendations made in the Report.



## Equal representation

Part 9 of SIS deals with equal representation and applies only to standard employer sponsored funds (Section 86). Although the report is not directly recommending removal of equal representation it seems to be trying to water it down by using the need for independent directors on the board. For example the Report recommends that SIS be amended so that:

- equal representation is non-mandatory, and that requirement should be removed from the constitution of trustee companies;
- where the board does not have equal representation it must have a majority of "non-associated" trustee-directors;
- no less than one-third of the total number of member representatives and employer representatives are non-associated directors.

The not for profit sector has already raised concerns regarding these recommendations.

The Report also recommends amendment of SIS to remove the mandatory requirement for a Policy Committee where the trustee board does not have equal representation.

## Trustees to give reasons for their decisions

The Report recommends that section 101 of SIS should be amended to require a Trustee to provide a member with reasons for its decision concerning a member complaint. This has been a contentious issue as under the common law the only basis for which a Trustee's decision can be reviewed is where it voluntarily releases its reasons. As this will require the reasons to be provided by compulsion of law it is likely to be regarded by most trustees as a relief.

## Multiple board positions

The Report recommends that where a person wants to be a trustee-director on more than one board of a superannuation fund, the person and the boards they want to join must attest to APRA that when appointed there is no reasonably foreseeable conflict between their duty to members of each Fund and their duty to each trustee company.

It is proposed that there would be a transitional period for existing trustee-directors holding multiple board positions and APRA would require the necessary regulatory tools to administer this requirement.



## Code of trustee governance

The Report recommends establishing a code of trustee governance (**the Code**) which would not be binding at law. The justification for this is that the Code would be more flexible than legislation and able to keep pace with changes in the industry. The Code is to be developed by the industry itself although it is not clear how or what value a non-legally binding code would offer given the amount of legislation and other regulatory guides the industry is already subject to. The recommendation states that an “industry council” coordinated by APRA should develop the code in consultation with all stakeholders. Presumably this will see organisations like ASFA, AIST and IFSA all vying for the privilege of setting what would be an industry wide best practice standard. Given the diversity of the industry a “one size fits all” approach will not work.

A recommendation is also made that if the industry council cannot work together or a code cannot be finalised within 2 years APRA should step in and create the Code itself. Presumably this is Cooper’s way of responding to the different factions involved in the industry and their inability sometimes to reach agreement!

An annual audit of the trustee-directors’ performance against the requirements of this Code will be required and the results must be made available on the Fund’s website. Issues that this Code would cover include the following:

- a higher standard of competence and a greater commitment of time from the Chairperson than is currently required of other trustee-directors;
- board size should be addressed including a maximum and any transition period for successor fund transfers and mergers;
- length of time to be in office and retirement by rotation;
- development of enhanced conflicts handling policy including maintenance of an affected/decisions register and regular reporting to APRA;
- skill set for each Director to demonstrate within the first 12 months of appointment;
- a skills matrix for the trustee board and analysis of how the current composition of the board provides the skills required under the matrix;
- procedure for a vigorous and independent annual review of the performance of each trustee-director and the overall collective competence and performance of the board;
- gender and other diversity requirements;
- tendering for and benchmarking service providers; and



- minimum ongoing training requirements.

Many of these requirements will be familiar as they are currently already covered in the Fit and Proper Policy of Boards.

### Gifts

It is recommended that a record of all gifts, emoluments and benefits (subject to a materiality threshold) be provided to trustees, trustee-directors and management in the form of a register maintained by the Trustee and disclosed to APRA annually in addition to the annual fund report to members and should also be displayed on the Fund's website.

### Enforcement

The Report recommends the enforcement sections of SIS and the Corporations Act should be reviewed and an appropriate proportionate penalty regime designed to take into account the new duties to be imposed on trustees and trustee-directors.

### Trustee-directors – skills and training

Trustee-directors are not required to have specific pre-appointment skills or training according to the Report, but it recommends APRA consider further strengthening its administration of the “fitness” test under SIS. This includes:

- requiring potential trustee-directors to be fully briefed before accepting the position, or seeking nomination, as to their responsibilities and potential liabilities;
- that the Code address the ongoing training requirements that a trustee or trustee-directors must meet on an annual basis, and
- that the board demonstrate annually it has the collective skill set to govern the Fund or Funds it is responsible for.



## Capital Reserves

The Report recommends establishment of capital reserves by superannuation funds to cover operational risks like unit pricing errors. This is not a new proposal and has been comprehensively debated and rejected by previous Government enquiries. In the case of not-for-profit funds where the trustee has no assets of its own such a reserve could only be funded from members' account balances. The only concession made in the Report to this fact is that the requirement will be phased in.

## Investments

The Report recognises that much of the complexity of investments is outsourced by trustees. Consequently the Report focuses on the process of appointment and monitoring of these service providers.

The Report does not support the Government mandating Trustees to invest in particular investment classes or vehicles including infrastructure.

### **After-tax returns**

The Report recommends that SIS be amended so that trustees are obliged to have regard to the tax consequences of their investment strategies. Therefore when setting an investment strategy under Section 52(2)(f) of SIS, in addition to taking into account risk, diversification, liquidity and meeting liabilities, a trustee will also need to ensure that the strategy is tax effective.

### **Voting proxy**

The Report recommends that all large APRA Funds should publish their proxy voting policies and procedures, and disclose their voting behaviour to members on their websites.



## Outcomes Reporting Standards

The Report notes a lack of transparency, comparability and accountability in the superannuation system. It recommends giving APRA an enhanced rule making power, in consultation with ASIC and the industry, to develop “outcomes reporting standards” on the way large APRA Funds report and advertise their investment performance and costs of the investment options. Under these standards trustees would be required to:

- publish on their websites an investment option performance table showing:
  - gross investment returns;
  - costs and investment returns net of all costs and taxes for investment options for 1, 5 and 10 year periods; and
  - the number of quarters of negative investment returns the investment option has incurred in the past 10 years, or a proxy figure developed using data published by APRA for those options with a history of less than 10 years at investment options level;
- report past performance in a standard format that discloses the uncertainty or volatility associated with the return;
- calculate all cost and fee disclosure should be on a pre-tax basis (i.e. gross of tax);
- report costs on a consistent basis by:
  - “cost categories” and their composition;
  - that “cost categories” be subject to an annual audit;
  - “cost categories” to be reported in the APRA annual return at the whole of Fund and MySuper levels;
- disclose costs to at least the first non-associated entity level; and
- calculate investment returns gross and net of all costs and taxes and disclosed in a format set out in the standards.



## Product dashboard

On the basis members require a minimum amount of information when considering their investment options the Report recommends development of a plain English product “dashboard” to provide members with a standardised format to compare.

- the investment options risk and return targets;
- whether the investment option was illiquid; and
- fees and costs including a projected Total Annual Expense Ratio (TAER).

A similar approach is recommended for undiversified options with the underlying asset class or classes being disclosed in place of the “investment return target”.

The outcomes reporting standard should deal with all the requirements of the product “dashboard” which should include:

- net investment return target (after tax) expressed as a percentage above CPI over a rolling 10 year period;
- range possible outcomes for investment options (i.e. risk target) over a 10 year period in a visual, diagrammatic format;
- projected liquidity of the investment option;
- projected TAER to capture all projected costs to at least the first non-associated entity level; and
- relative ranking of overall fees (as collected and published by APRA).



## Collection of data

The report recommends APRA have explicit powers to collect superannuation fund data on a “look through basis” to achieve an understanding of the Fund’s asset allocation of risk, returns and costs.

Large APRA Funds would be required to disclose their complete portfolio holdings six monthly under an outcomes reporting standard developed by APRA requiring disclosure within 60 days of the end of each 6 month period coinciding with normal financial years and half years. Public disclosure of the same information would be required on the Fund’s website 3 months later.

Large APRA Funds would be required to maintain a website providing free of charge systemic transparency about the Fund and its management. Trustees would have to retain that information and make it available on the Fund’s website for the previous 10 years.

## ASIC central website

ASIC should establish a central website about superannuation to bring together features including standard disclosure of legislative, tax and other super related features and to be a portal to other superannuation related information. All large APRA Funds would have to link their websites to this central website.



# Insurance

## Insurance default

The Report recommends default insurance offered by a superannuation fund should be tailored for members who don't consider their insurance needs and rely on the Trustee's judgment for adequate insurance. Consequently it also recommends the minimum level of insurance required to be offered by an eligible choice fund should be repealed.

## Self-insurance

The risks relating to self-insurers are considered high and therefore the Report indicates that self-insurance should only be permitted in limited circumstances. The Report recommends self-insurance should not be permitted in any large APRA Fund except for Defined Benefit Funds (or sub-plans) that are currently permitted to self-insure. A "suitable transition period" would apply.

It is also recommended that a statutory duty to manage insurance with the sole aim of benefiting members should be imposed on trustees. This would include:

- amend SIS to require trustees offering insurance to devise and implement an insurance strategy specifying the types of insurance to be offered, the default and permissible maximum levels of cover to be offered;
- selecting insurance cover having regard to cost and value-for-money for members;
- negotiating the terms of the insurance contract, including adequacy of the level of the default cover; and
- pursuing claims that the insurer has denied where there is a reasonable expectation of success.

All of the above are already part of a trustee's fiduciary duty to members and therefore the recommendation seems superfluous. It is difficult to see what value this recommendation would add given that these issues would all be addressed and documented in the insurance policy itself.



## Superannuation Complaints Tribunal – TPD Jurisdiction

The Report recommends amendment of the *Superannuation (Resolutions Complaints) Act 1993* to extend the time period within which a member can make a complaint regarding total and permanent disablement (TPD). Currently a TPD complaint must be made to the SCT within two years of the trustee's decision and the claim must be lodged with the trustee within two years after the person permanently ceases employment. The Report recommends that the period from ceasing employment be extended from two years to six years.

Trustees and the SCT already struggle with TPD claims made years after the member has left employment. It is extremely difficult to establish whether a member was TPD years prior to the claim being made. There are also issues around whether the member's disablement occurred after termination of employment. If this recommendation is adopted decisions concerning these claims will become even more difficult.

The Report also recommends that SIS be amended so Trustees of large APRA Funds are deemed to define TPD in the same way as the relevant insurance policy. This would remove situations where the definition in the trust deed differs from that in the group insurance policy creating different outcomes for the insured component of the benefit compared to the account balance held by the Trustee.

### Publication on website

The Report recommends that large APRA Super Funds should publish on their website the terms and conditions applicable to each type of insurance they offer, together with information relevant to members including:

- plain English explanation of the policy terms;
- premium tables showing gross premium for each category of member (if relevant) at each \$1,000 of cover at current age with a standard frequency of payment - any additional cost associated with the insurance should be noted as part of this disclosure; and
- TPD claims success rate on a basis to be determined after consultation with the industry.

All of this information, with the exception of the success rate, would already be contained in the product disclosure statement. It is not clear whether that would be sufficient or if trustees would have to create a separate page on the website to contain this information. The Report indicates that the success rate is one measure of the quality of insurance cover a member receives. This may or may not be true as group policies often have multiple definitions of TPD. In addition there can be differences between the tests applied such as "own occupation" and "any occupation" with members selecting the test they want and paying a higher or lower premium depending on that selection. There are a number of variables that underpin success rates.



## Binding death benefit nominations

SIS would be amended to change the requirements concerning binding death benefit nominations (**BDB nominations**) so that they would become invalid on the occurrence of certain life events. This would be similar to how a person's will can become invalid under State laws e.g. on marriage or divorce. It would avoid situations where a member fails to change his or her BDB nomination and Trustee's have no right to refuse to pay a death benefit in accordance with a valid BDB nomination.

The Report also recommends extending the period for which a BDB nomination remains valid from 3 years to 5 years.



## Licensing Administrators

The recommendations suggest amending SIS to:

- define the meaning of “superannuation administrator” and empower APRA to license administrators on conditions based on those applicable to RSE licensees, including risk weighted capital requirements;
- ensure trustees can only use a superannuation administrator licensed by APRA for functions covered by the Outsourcing Operating Standard and funded by a levy on administrators;
- require Commercial Clearing Houses to be licensed as administrators; and
- make clear that trustee remains liable for the member even if it outsources its administration to a licensed administrator.

There is nothing to indicate whether these amendments would, as with Custodians and Funds Managers, address specific clauses in the Agreement with the administrator. In particular, whether there would be a provision similar to section 116 of SIS dealing with Investment Management Agreements whereby any provision in the Administration Agreement which exempts the administrator from liability for negligence or limits that liability would be void.

There is a current trend for administrators to include in their Administration Agreements caps on liabilities, leaving the Trustees exposed for any loss exceeding that cap. It is hoped that if administrators do become APRA regulated that this will be addressed in the legislative amendments.

The licence conditions for external administrators is recommended to replicate or vary as appropriate the licence conditions of RSE licensees that operate an in-house administration system.



## Defined Benefits

The following recommendations are made specifically in relation to defined benefit (DB) funds:

- APRA to issue a prudential standard focussing on funding to protect vested benefits, specifying the time period within which a DB Fund that is in an unsatisfactory financial position must be restored to a satisfactory financial position in the same way SIS presently addresses insolvency of superannuation funds and minimum requisite benefits.
- Amend the SIS so DB Funds that are technically insolvent are not permitted to accept SG Act contributions unless the Fund Actuary and Trustee agree it is reasonable to believe the Fund will be restored to solvency within a prescribed period under SIS.
- Define “superannuation contributions” in the Corporations Act to clarify that DB contributions have the same protection as accumulation contributions. DB funds should automatically qualify as “default funds” for SG Act purposes concerning defined benefits provided to members, provided the Fund meets the requirements of the SG Act to receive contributions.

The trustee of DB Funds (or sub-plans) presently permitted to self-insure death and TPD benefits should be permitted to continue to do so.



# Super Stream

SuperStream is a package of measures intended to enhance the current “back office” of superannuation. It includes new standards to improve quality of data provided by employers, to use tax file numbers (TFNs) as a primary identifier and requires the use of technology to improve processing efficiency. It also includes improvements to the way Fund to Fund rollovers should be processed and the way contributions are made.

The recommendations are as follows:

## Provision of information by employer

The Report recommends amendment to legislation to require employers when dealing with accumulation members to provide the Fund (or Clearing House) with its ABN and as a minimum the following information:

- **first contribution** - the full name, date of birth, current address, email address (if known), mobile phone number (if known) and TFN of the employee, date of commencement of employment and the amount of the contribution being remitted in respect of that employee.
- **subsequent contributions** - the employees name, TFN and the amount being contributed. Where the contribution is paid by a Clearing House the Fund's SPIN should also be given.
- If the employer fails to comply with the above it becomes liable for an administrative financial penalty payable to the Australian Taxation Office (ATO) for each employee and each day it fails to meet the obligations. Obviously this is potentially a significant penalty depending on the number of employees involved and the period of the default.

However, the ATO does have some discretion about collection of the penalty. Alternatively the Report recommends that if the penalty regime is unacceptable that an employer who fails to meet these standards should be deemed to have **not** met their SG obligations and be subject to the relevant penalties under the SG Act.

- Funds should be prohibited from accepting members where insufficient identification data (i.e. the full name, address and date of birth) have not been provided and should not be able to accept any contributions where they are unable to identify which member they apply to.

Obviously this would overcome data issues experienced by many Funds who have inadequate information concerning members. However, how this would be enforced is unclear. Obviously if the Fund can simply reject accepting the member or any contributions that are provided without the requisite information, that



solves the problem for the Fund although it misses out on the contributions. It does not however solve the problem for the member.

How the ATO will be advised in order to impose the penalty is a critical part of this arrangement. If the person is already a member of the Fund and the Trustee must refuse a contribution because it has inadequate information, then the Trustee would have an obligation to the member to advise them. However, where there is no existing relationship with the member, how the member would be informed that their employer has not met its obligations needs to be addressed.

The Report also recommends the removal of the superannuation fund exemption from initial customer identification under the *Anti-Money and Counter Terrorism Financing Act 2006 (AML/CTF)*. This is on the basis that the identification data would be provided at the time the member joins the Fund under the proposed changes.

#### **Failure of the employee to provide a TFN or identification details to employer**

In these circumstances the Report recommends that the employer be able to electronically give the employee identification details it holds to the ATO with the relevant contribution. The ATO would then treat the contribution as unclaimed money. If the TFN is subsequently provided the ATO would remit the contribution it holds to the employee's default fund with the employee's TFN and identification details.

The ATO should establish an employment webpage where an employer can register the tax status of a new employee in lieu of completing the TFN declaration form, and can simultaneously advise the Fund to which superannuation contributions would be paid. The ATO would then communicate the new member details to the Fund electronically.

#### **Standardised form**

The Report recommends APRA establish a stakeholder group to develop on-line forms covering all the common processes between employers and Fund members and Fund to Fund communications such as rollovers. It also recommends that the Government should mandate use of these funds unless it is satisfied there is "near universal voluntary take-up".

#### **Fees payable by the employer**

If the employer makes a contribution other than in electronic form with the prescribed details to identify the member, the Report recommends that the employer be required to pay the Fund a prescribed fee. The fee would apply, for example where the contribution was paid by cheque, or where payment is received without information to adequately identify the member it relates to.



The recommendation suggests an education campaign concerning the fee and an appropriate transition phase. The report does not address issues concerning small businesses that may be reluctant or unable to adopt the technology needed to advance contributions electronically. It is unclear who would be paying for the education campaign for the employers. From a trustee perspective, maintaining good relations with the employer sponsors is vital and this would undoubtedly necessitate the Trustees taking action to ensure their employer sponsors are aware of the consequences of not submitting contributions electronically.

### Tax File Numbers (TFNs)

Legislative amendments are recommended to allow trustees and their agents to use TFNs as a primary search key to:

- link contributions and rollovers with member accounts;
- seek confirmation from the ATO that TFNs provided by new members are correct;
- seek confirmation from the ATO that the member who provided the TFN for each requested rollover to an SMSF is in fact a member of that SMSF; and
- exchange the TFN with other trustees to identify accounts in multiple Funds by the same person; and allow the Trustee of the Fund to which contributions are currently made to "*invite the member*" to initiate consolidation of the accounts.

The Report recommends that legislation be enacted to allow Trustees to automatically consolidate accounts without reference to the member where multiple accumulation accounts within a single fund share a common TFN, and member's surname and multiple accounts have not been established by deliberate elections by the member concerned.

The Report does not allow automatic consolidation of accounts across different superannuation funds by using a TFN. The need to "*invite the member*" to initiate consolidation of the accounts adds to the administrative burden of the Trustee and hence the cost. Invariably when members are invited to do anything they usually opt to do nothing. A better approach would be to allow for a consolidation with notice to the member that the consolidation has occurred or even to give notice to the member that consolidation will occur unless they take action within a set period of time.

The report also recommends that the ATO develop an electronic means to display all super Funds a person is currently a member of and an electronic facility to include all member accounts for which it holds a TFN.



## Consolidation of multiple accounts

In order to facilitate consolidation of multiple accounts the report recommends that:

- the ATO establish procedures with administrators and Clearing Houses requiring them to validate the TFN of any new member with the ATO to ensure it is correct; and
- simultaneously the ATO should check its database to see whether it holds unclaimed money for that member, and if so advise the administrator and transfer the money.

The ATO would also be required to determine whether the member has more than one account and if so, would notify the administrator who must then determine with the member whether they wish to consolidate their accounts.

While this process would be a significant improvement on the current procedures, the fact that the consolidation requires the member's consent will not overcome all of the issues involved in consolidating multiple accounts.

## Employers

The Report recommends amendments to legislation relating to employer obligations:

- An employer would be required to remit salary sacrifice and superannuation guarantee contributions no less frequently than members after tax contributions.
- Once SuperStream is implemented the timing of SG payments should be aligned with the employers' payroll cycles. This would mean employees paid fortnightly would have their SG contributions paid to their superannuation fund fortnightly instead of quarterly as required by the SG Act. This would be a significant and welcome change, from the perspective of members and superannuation funds. It may be less welcome for employers. Due to compounding interest more frequent payments of SG contributions could significantly add to the end retirement benefit.
- The employer will be required to report on each payslip the amount of superannuation paid to the employer's superannuation fund, whether that is the SG contribution, salary sacrifice or after tax contributions.
- If an employee makes a complaint to the ATO of non payment of an SG contribution the ATO should continue on a risk assessed basis to assess the employers' compliance with its SG Act obligation for all of its employees and not just the Complainant.



# Regulators

## Increasing APRA powers

The report recommends that APRA be given a standards making power to allow it to take on the significant task of overseeing and promoting industry efficiency in addition to its prudential role. This is not a new idea and has been debated previously and was strenuously resisted by the industry. The concerns expressed then will apply equally now. Namely, that this permits APRA to introduce rules with the force of law without any parliamentary scrutiny.

The Report also recommends broadening APRA's mandate to allow collection and publication of data relating to the efficiency and outcomes of superannuation funds. The burden of providing data to APRA is an ongoing concern to superannuation funds and should this be implemented it would probably become more onerous. Publication of this information would be consistent with the Report's view on the need for transparency. However, Funds will need to be assured of the accuracy and comparability of the data collected and published.

As part of the increase in APRA's powers, the Report recommends legislative amendments to give APRA power to impose fines as an alternative to criminal prosecution under SIS.

## Merger of regulators

The Report recommends that the Government explore with APRA and ASIC ways the two regulators could work more closely together concerning superannuation, and in particular the implementation of the Report's recommendations on MySuper and increased efficiency more generally. The report states as follows:

"The Panel is of the view that efficiency can also be achieved by enhanced cooperation and coordination between the Regulators with respect to their superannuation functions. This could take several forms including secondment arrangements between ASIC and APRA, or *an operational merger of their superannuation capabilities* with or without a co-location in major offices."  
(emphasis added)

This looks very much like the creation of a single entity to regulate superannuation by merging the functions of ASIC and APRA. If that were the case it would be a welcome change to the existing arrangement and the difficulties of overlap between the functions of the two Regulators which have been a source of contention to the industry for some time. Given the importance of the superannuation industry to the National economy, and to the people of Australia, it would be entirely justifiable for that industry to have a discrete regulator.



# Legacy Products & Successor Fund Transfers

The Report suggests that the equivalence test for successor fund transfers be changed to a test of “no overall disadvantage” with the intention of allowing more successor fund transfers to proceed particularly for legacy products.

Currently SIS requires a successor fund to confer on members equivalent rights to the rights they had under the original Fund concerning their benefits. APRA Superannuation Circular No. I.C.4 dealing with equivalent rights concerning successor fund transfers provides as follows:

“To satisfy the requirement for equivalent rights, the member’s position and rights in the new Fund must be effectively the same as those in the original Fund so as not to disadvantage the member. That is, the member’s rights (in respect of benefits) in the new Fund should be equivalent in value, measure, force and effect to their rights (in respect of benefits) in the original Fund. Although special consideration should be given to significant rights, any judgment of whether rights are equivalent should not be assessed solely on an individual change to a specific right but on the equivalency of the bundle of rights (which includes rights to contingent benefits).”

The Report states as follows concerning the new “no overall disadvantage” test:

“Generally, “no overall disadvantage” would mean that, on balance, the total package of rights and entitlements that the member has in the existing fund must not be diminished in the new fund.”

The Report also proposes that the Federal Court would be given jurisdiction to determine superannuation product rationalisation where the successor fund transfer test cannot be met. The recommendation indicates that this step would be taken in circumstances where the amended successor fund transfer test is applied but still does not achieve the legacy product rationalisation objectives.

Current Capital Gains tax relief is recommended to be expanded and made permanent.



## Eligible Rollover Funds (ERFs)

The Report recommends the abolition of member protection. The reason given is that subsidisation of “protected” members by “unprotected” members should not continue to occur. If this change is accepted Funds may opt to retain small accounts within the Fund rather than roll them over to an ERF. ERF’s would also be released from member protection and eventually small account balances will be completely depleted by fees unless consolidated.

The Report recommends an amendment to SIS to create a specific RSE licence class for Trustees of ERFs. These ERF Trustees would be subject to similar duties to those applicable to the MySuper Trustees. ERF Trustees would be required to actively cross-match with any active Fund and provide an on-line facility for people to search for lost super. All ERFs would be required to cross-match with ERFs for a new member.

## Conclusion

The impact of the Report on the superannuation industry will depend on the Government’s response and the outcome of the upcoming election. If the recommendations are adopted they will impose even more regulation on an industry which is already subject to significant regulation. Given one of the objectives of the Report was efficiency many of the additional requirements are unnecessary and will duplicate what is already in place. It can only be hoped that the consultation process will be able to take what is good in the Report and overcome what is unnecessary.



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