Australian Institute of Superannuation Trustees

16 August 2012

Manager
Contributions and Accumulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: intrafundconsolidation@treasury.gov.au

Dear Sir/Madam,

INTRA FUND CONSOLIDATION OF SUPERANNUATION INTERESTS

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's $450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

In this letter, AIST comments on the exposure draft for the intrafund consolidation of superannuation interests and the accompanying explanatory materials.

AIST has made numerous submissions to Treasury and Parliamentary Committees during the Stronger Super consultation process, as well as submissions to both the Super System Review ("the Cooper Review"). Many of these submissions have included commentary on account consolidation and AIST continues to support measures to facilitate and encourage the consolidation of superannuation accounts.

As a participant in the SuperStream Working Group, AIST also commented on a previous confidential iteration of this legislation.

Overall position

AIST supports the creation of an additional condition upon superannuation trustees to require the merger of multiple interests where this is in a member's best interests. AIST further supports the requirement that this done by means of requiring the establishment of specific rules.

Superannuation "interests" versus "accounts"

While the Explanatory Memorandum acknowledges that the legislation is designed to encourage or require trustees to merge accounts, the legislation refers to 'superannuation interests' rather than 'accounts' on the grounds that the latter is difficult to define in legal terms.

While this may be the case, the policy problem that the Government is seeking to address is the proliferation of accounts, rather than the proliferation of interests. The problem is not so much that many members have multiple interests within a fund; the problem is one of record-keeping.

Many members have multiple accounts where their benefits are invested in exactly the same assets, and have access to the same services – only that they pay more than once for this. Their interest is artificially divided into multiple records. For example, a member may have their superannuation interest allocated across different records in the same default option of a super fund. While a member may have multiple interests across a super fund, this is likely to be far less prevalent than multiple accounts within one class of interest.

The reality that this is much more about duplicate record-keeping than multiple superannuation interests needs to be reflected in the legislation. Even the Explanatory Memorandum cannot maintain the fiction that this is about superannuation interests, and continually slips into using the terminology of "accounts" – the term is used no fewer than 17 times in a relatively short document. Similarly, the Government's policy announcements (prior to this legislation) in this area have all addressed "account consolidation" rather than "superannuation interest consolidation".

The attachment to this submission provides worked examples showing the significance of the difference between interests and accounts.

AIST recommends that references in the legislation to "interests" be replaced by references to "accounts", and that an "account" be defined as a record maintained by the trustee to record some or all of a member's superannuation interest in the fund.

"Not practicable" exemption

Proposed section 108A of the SIS Act sets out various elements in a trustee's duty to identify multiple interests of members in a superannuation entity.

However, proposed subsection 108(1A) states that the requirement to merge multiple accounts if it is in the best interests of the members to do so does not apply "if it is not practicable in the circumstances to do so".

AIST submits that it is not a good policy position for a lack of practicality to displace a measure that is in a member's best interest.

AIST recommends that proposed subsection 108(1A) be deleted.

The Explanatory Memorandum does not provide any explanation or clarification defining a lack of practicality, nor does it provide any examples. As well as not being good policy, subsection 108(1A) leaves the intra-fund consolidation measure open to abuse and avoidance.

This exemption, and its capacity for abuse, is analogous to the exemption from the definition of lost members which is "an inactive member who has indicated by a positive act (for example, deferring a benefit in the fund) that he or she wishes to continue to be a member of the fund" (SIS Reg 1.03(2)(a)). It is believed that this exemption has been abused by some superannuation funds that have interpreted this provision to mean that any contact between the fund and the member means that he or she wishes to continue to be a member of the fund. For example, this could mean the apparent receipt of a member statement (ie, the mail has been returned to sender).

In the event that the Government does not agree to the deletion of the proposed subsection 108(1A), AIST submits that the Explanatory Memorandum explicitly identify examples of reasons that are not allowable for a fund to justify that it is not practicable to merge accounts.

These not allowable reasons should include:

- There is a cost associated with implementation of the rules.
- There are other operational requirements that the fund determines to have a higher priority.
- Contributions have been received in both accounts considered for merger in the current reporting period.
- An account is subject to the member protection rules, and so there might not be duplicate fees paid by the member.
- Accounts considered for merger are located on different IT platforms.
- Not being prepared to use available tools for the identification of possible multiple accounts (eg, forthcoming ATO Member Identity Verification Services).
- Citing higher per account costs that may arise as a result of the super fund administering a smaller number of accounts.

Notification and consent

The legislation itself is silent on whether the merging of accounts takes place on an opt-in or an opt-out basis, however the Explanatory Memorandum clarifies (in paragraph 1.15) that trustees do not require the consent of the member. Paragraph 1.15 goes on to note that trustees can use an opt-out model where "significant" interests are involved. This approach is supported by industry

experience demonstrating that members overwhelmingly do not respond to invitations to have their accounts consolidated, even when it is clearly in their interests to do so.

AIST recommends that the legislation be amended to explicitly state that trustees do not require the consent of the member but that trustees can specify the amount of a significant interest above which a member is given the opportunity to opt-out

AIST also submits that the Explanatory Memorandum be amended to specify notification requirements. AIST supports the view that consent is not generally required but does support the need for member notification where this is possible and appropriate.

AIST recommends that trustees be required to notify a member about the merging of accounts provided:

- *The fund is able to contact the member by any means; and*
- *A member has previously been advised about the existence of multiple accounts (eg, if accounts are merged prior to a member being advised of a new account being opened on their behalf); and*
- *That notification requirements can be met by notification made either before or after the account consolidation.*

Insurance

Paragraph 1.15 states that trustees will need to comply with any ASIC significant event notification. AIST submits that these significant event requirements may come into effect when a member has chosen insurance cover in excess of that provided by default cover, and that no further prescription is required in relation to insurance.

Identifying the ongoing account

In any event, AIST expects that trustees will have regard to relative insurance cover, account balances, most recent contributions and frequency of contribution in establishing rules about intra-fund consolidation.

Example 1.2 involves a trustee closing the account with the smallest account balance. The Explanatory Memorandum should make it clear that while this is an option available to a trustee it is illustrative rather than mandatory. In fact, it is far more common for a fund's existing de-duplication process to give priority to the most recently active account, and to consider account size as a secondary matter. The key point is that funds should be required to take into account all of the factors identified in the first paragraph of this section in establishing their intra-fund advice rules.

Tax data

On 1 July 2007, the taxation of superannuation changed in a variety of ways.

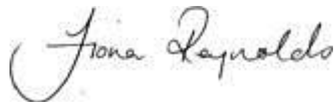
One of the changes caused a loss of the right of superannuation members to choose the tax component that they could draw benefits from. A number of members of superannuation funds were advised prior to that date to move tax-free or significantly tax-free amounts into separate accounts to preserve these monies tax-free status for a variety of reasons.

An ability to mix these monies has the potential to remove advantages to members that would not necessarily be apparent to superannuation trustees. An example of this would have been where a member had quarantined tax-free amounts in one account and taxable amounts in another with different estate planning intentions.

In a situation such as the paragraph above, acting in what a trustee may believe to be the member's best interest may be contrary to the member's intentions. Such an example would be useful in illustrating the importance of providing members with a significant interest with an 'opt-out'.

If you have any further questions regarding this submission, please contact AIST Project Director David Haynes on (03) 8677 3803 or dhaynes@aist.asn.au.

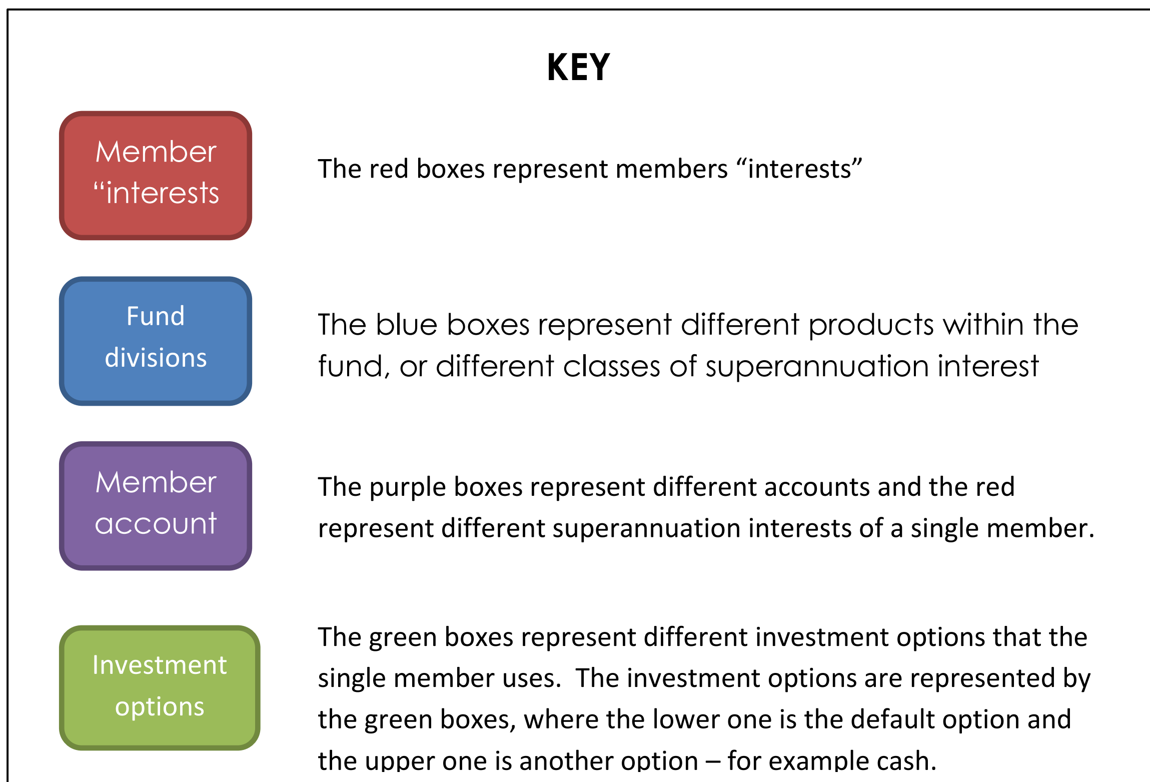
Yours sincerely,



Fiona Reynolds
Chief Executive Officer

Appendix - Worked examples

For the purposes of these examples we have assumed a member of a fund has a number of accounts with the same superannuation fund, across two different products. Each product is a different class of interest which has the same features and benefits for their members, except where the members have chosen different options. Insurance has been disregarded in these first examples.



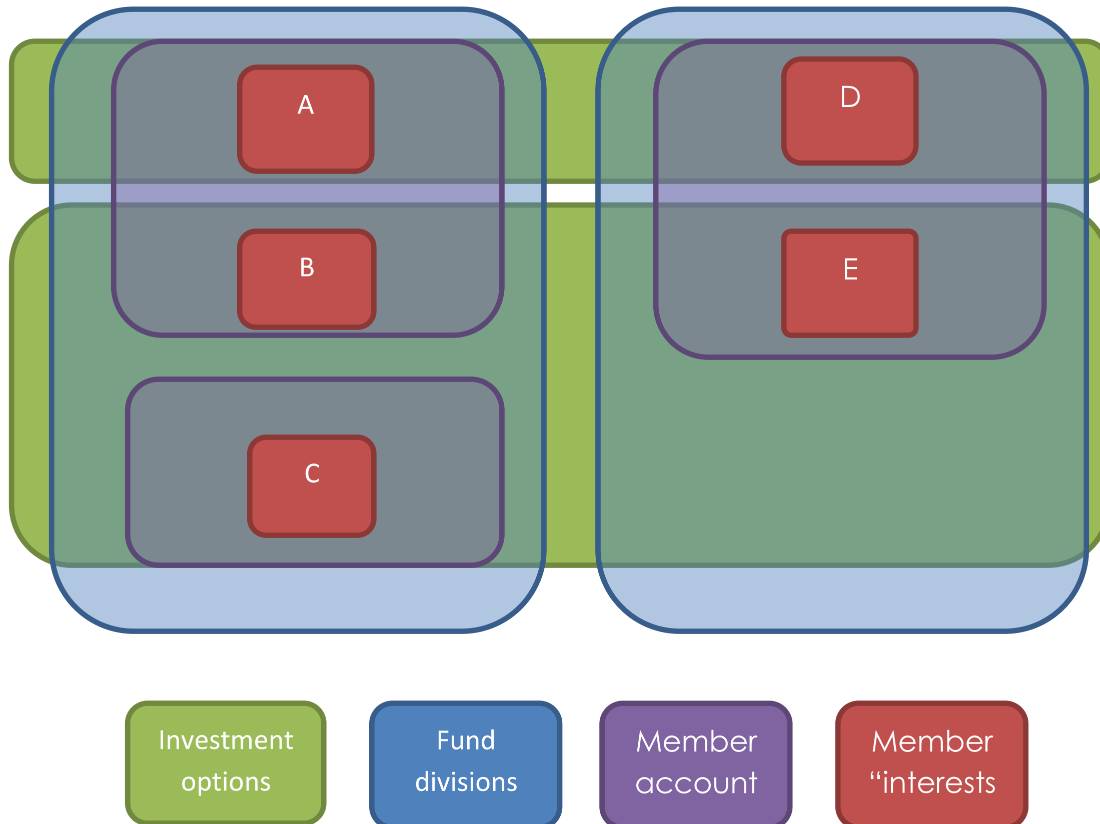
In the example, the first class of interest is defined as “Regular” and the second one, “Platinum”. Platinum has slightly different terms and conditions and account keeping fees, however the investment management fees are identical – the first investment option (cash) charges 0.10% the second one (balanced) charges 0.50% - across both classes. The balanced option is the default option for both.

Both lots of account keeping fees are dollar based, where Regular charges $1.50 per week and Platinum charges $2.00 per week. Platinum, however, gives a rebate back into members’ accounts for larger amounts invested.

The member has a claim on each of the 5 red interests in the diagram, or if you like, all three blue accounts.

The question is, is it in the member's best interests to merge any or all of these superannuation interests?

Schematic of Example



Scenario 1: Merge interests B and C together

Assuming that:

- The top account and the bottom account have **low** account balances, and
- The top account is split equally between the cash and balanced investment options (50:50), and
- The bottom account is solely invested in the balanced investment option

Then, it may be in the best interests of the member to merge these accounts. Under our interpretation of this bill, this would result in three "superannuation interests" becoming two.

Assuming that each account has a $7,000 balance, the before and after of each account looks like this:

(Before)

Upper account:

- Cash option $3,500
- Balanced option $3,500
- Total balance $7,000

Lower account:

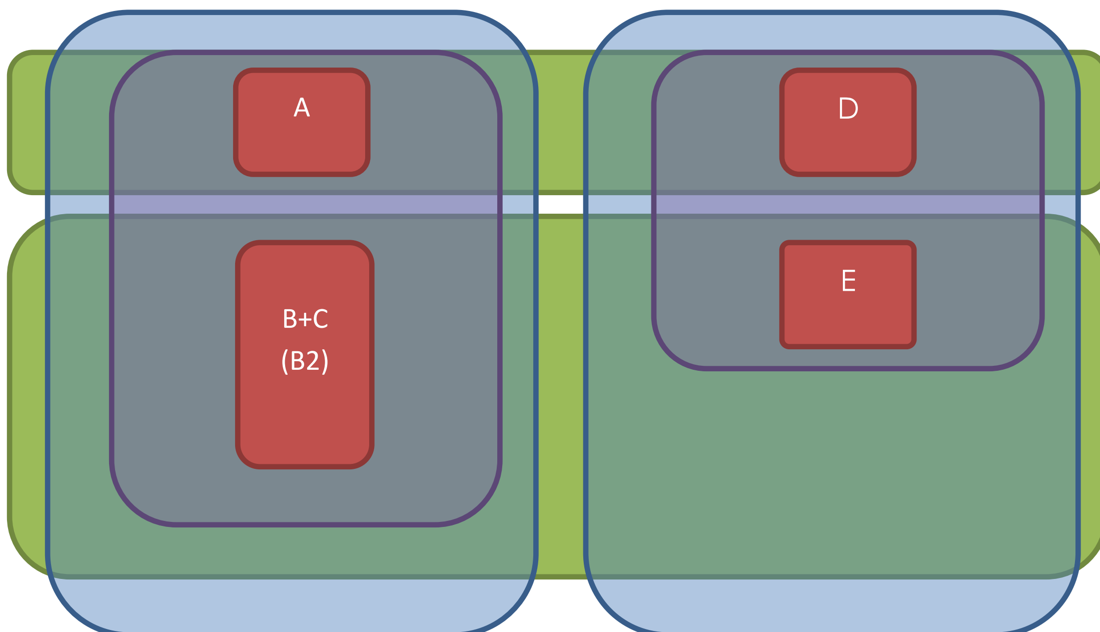
- Balanced option $7,000
- Total balance $7,000

(After)

Combined account:

- Cash option $3,500
- Balanced option $10,500
- Total balance $14,000

The after is below.



For subsequent examples, we'll call the newly merged B+C "B2".

This end result implies that there are two distinct "superannuation interests" remaining. The member is only paying one set of account keeping fees, therefore saving $1.50 per week, or $78 per year.

This scenario is covered under the proposed new section 108A(1)(c) with reference to proposed section 108A(2). Examples 1.1 and 1.2 of the EM refer to this scenario.

Scenario 2: Merge B2 with A (after scenario 1)

The next logical step would involve whether it is in the best interests of the member to amalgamate what is now in their cash option and their balanced option.

It is implied that this member is reasonably engaged if they have previously given instructions to have their first account invested in two separate investment options.

However, in the second example, paragraph 1.28 has this to say about keeping interests together within the same account:

> *In an alternative case, where the expected additional earnings only marginally outweigh the additional fees and charges, the trustee may judge that the additional earnings may not outweigh the additional risk, and merge the interests.*

What paragraph 1.28 (which appears very general for a specific situation and this is concerning) could also be applied to, is a situation where interests are merged in the same account. In this situation, merging the A interest into the B2 interest will have the reverse effect where, to use the words contained in the explanatory memorandum,

> **It is possible** *that where the expected additional earnings* **from merging interests** *only marginally outweigh the additional fees and charges, the trustee may judge that the additional earnings may not outweigh the additional risk, and* **leave** *the interests* **separate***.*

We should recommend that the above text be used in an example to illustrate this.

Returning to this example, at no point is the question addressed of what might happen if A and B2 are merged from the member's perspective. The possible outcomes are below.

In the case of our member above, however, it is hard to argue that it might be in their best interest to merge A and B2 together. This would be regardless of balance

What if this went the other way, from B2 into A?

Under the fee structure for the Regular product, it's difficult to defend this, also.

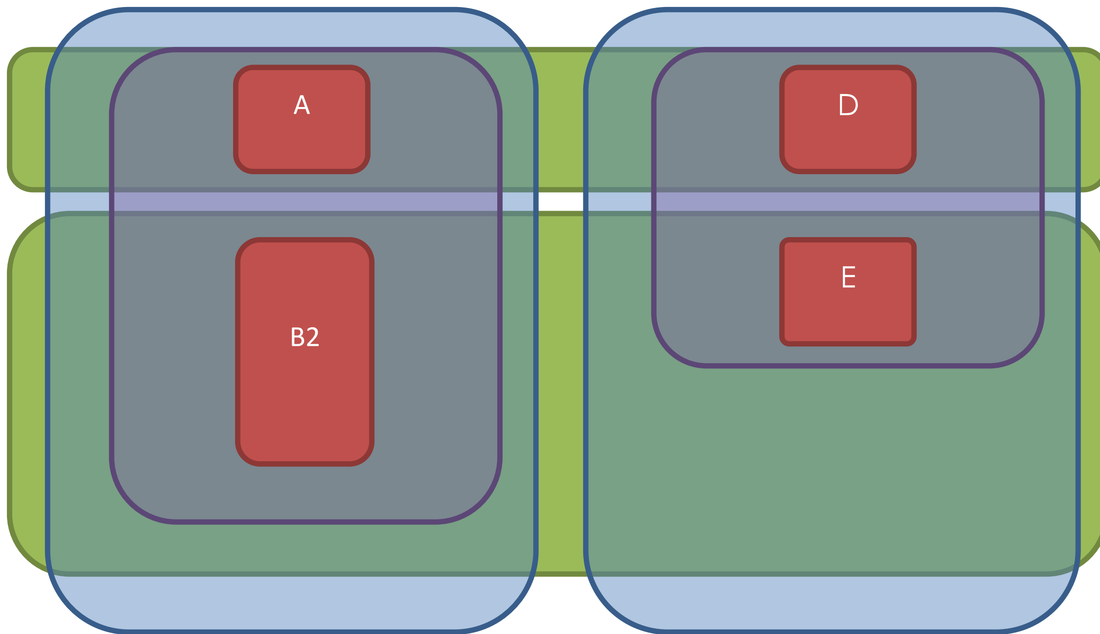
Ground Floor
215 Spring St
Melbourne VIC 3000

T +61 3 8677 3800
F +61 3 8677 3801

info@aist.asn.au
www.aist.asn.au

We probably should propose that paragraph 1.28 be either re-written and given greater prominence in the EM, or that it appear multiple times. In any event, this paragraph can apply to a variety of situations, not just the one that it presently refers to.

Moving on, we will continue our scenario with the expectation that merging A with B2 in any form is not in the member's best interest. This leaves our scenario as follows:



Scenario 3: Merge D and E with A and B2

Most likely, the possibility that this member has two accounts in different divisions would arise where the member has worked for different employers. Crucially, this also applies where a member might also have been flipped into an ex-employees' division, and is now a member of a different division.

If we continue to assume that our existing fees apply, it is easy to use this legislation to merge interest E with interest B2 and Interest D in with interest A within the one account. Which account would be most appropriate? For low balances, it might be most appropriate to retain these interests within the left account; however, if the balances are high enough, the account on the right may be the most appropriate.

If we assume that any benefits lost in moving out of the Platinum division into the Regular one are minor or insubstantial, then the following illustrates one possible outcome which can be illustrated as follows. If we assume that the Platinum account (the account on the right in the previous diagram) has an additional $7,000 and that this is equally split (50:50) between the cash and the balanced option, the figures below would reflect the before and after of this:

(Before)

Left (Regular) account:

- Cash option $3,500
- Balanced option $10,500
- Total balance $14,000

Right (Platinum) account:

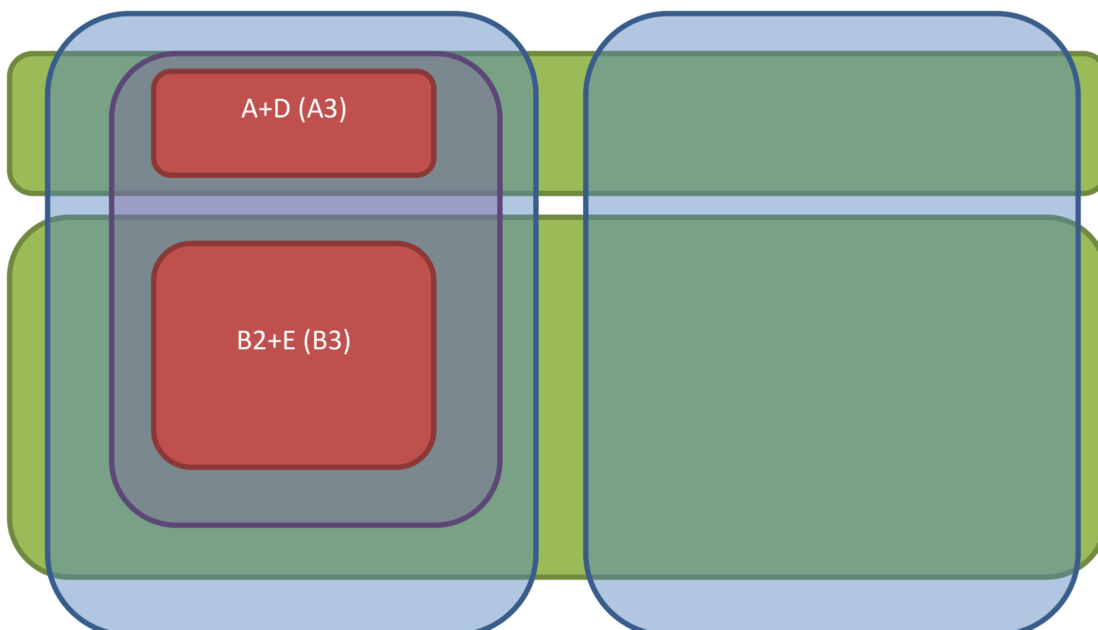
- Cash option $3,500
- Balanced option $3,500
- Total balance $7,000

(After)

Combined (Regular) account:

- Cash option $7,000
- Balanced option $14,000
- Total balance $21,000

This can be illustrated as follows:



The same reasoning that has been applied in examples 1.1, 1.2 and 1.3 has been used above. There is a caveat that if there are other benefits lost in moving out of the Platinum division, this may NOT be in the member's best interests.

An alternative might be to house all four interests within the one account that spans the different divisions of the fund; however we are not aware of such an arrangement in existence.

Ground Floor
215 Spring St
Melbourne VIC 3000

T +61 3 8677 3800
F +61 3 8677 3801

info@aist.asn.au
www.aist.asn.au