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Subject: Superannuation Discussion Paper

Dear Sir/Madam

The Financial Services Council (FSC) welcomes the opportunity to comment on the Government's discussion paper *Better regulation and governance, enhanced transparency and improved competition in superannuation*.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing over $2 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC notes that the discussion paper canvasses a range of issues important to the superannuation and funds management industries. The FSC would like to highlight important, near term deadlines concerning some issues that require urgent Government consideration:

- Default funds in modern awards, which is currently subject to a Fair Work Commission process and expected to cause major disruption on 1 January 2015; and
- Systemic transparency changes (dashboard, holdings, MySuper Measures Regulations, s29QB) that require a significant investment by funds to implement before the 1 July 2014 commencement.

We would welcome the opportunity to discuss these important deadlines further with the Government. Please feel free to contact me on 02 9299 3022 if you have any further questions in relation to this submission.

Yours sincerely

ANDREW BRAGG
DIRECTOR, POLICY AND GLOBAL MARKETS

Contents

ENHANCED COMPETITION IN THE DEFAULT SUPERANNUATION MARKET

The FSC supports enhancing competition in the default superannuation market by allowing any MySuper product to compete to be the default superannuation fund of any employer. Consumer, employers and the superannuation industry will benefit from competition in this market.

The current default fund arrangements severely limit competition between funds. A process that requires MySuper products to apply and be vetted once by APRA and twice by the Fair Work Commission (FWC) is not a genuinely competitive process and mires the default system in red tape and unnecessary regulatory costs.

The FSC submits that superannuation terms in modern awards should not name default funds. Modern awards should allow an employer to have the flexibility to choose any MySuper product as the default fund for that workplace. Every employee should also have the flexibility to choose any superannuation fund based on their personal circumstances.

Recommendation: The Government remove default superannuation funds from modern awards and allow an employer to choose any MySuper product to be the default fund for their workplace.

THE FW ACT DEFAULT FUND MODEL IS ANTI-COMPETITIVE

Lower fees and higher returns for consumers in the default market will be driven by competition between superannuation funds that provide MySuper products. The current model provided for in the FW Act stifles competition and hence consumer outcomes.

The stifling of competition in the default superannuation market is a critical economic and public policy issue as the default market directs the flows of "potentially more than $9 billion" annually in contributions[1], or at least 12.5% of total compulsory contributions[2].

The model in the FW Act favours those funds that are owned by registered organisations (unions and employer groups). All funds that offer a MySuper product have the capacity to apply to be included in the default fund list, however only registered organisations have standing to make submissions in relation to the second stage test.

The inability for some superannuation funds to make applications during the second stage test is critical as they are excluded from the Full Bench of the FWC's deliberations on whether a fund on the list is named in a modern award. They are denied procedural fairness due to their inability to not only nominate to be on any particular award, but also their exclusions from responding to submissions in relation to the appropriateness of their application, even where those submissions may be conflicted or simply wrong.

Superannuation funds owned by registered organisations will therefore have a competitive advantage due to the capacity of those registered organisations to make submissions to the second stage test. Those organisations will clearly make applications in support of the superannuation funds they own being named in modern awards, and opposing the naming of funds not owned by registered organisations. There are examples of this behaviour in recent years.

[1] http://www.pc.gov.au/__data/assets/pdf_file/0011/119981/default-super.pdf at 8
[2] http://www.apra.gov.au/MediaReleases/Pages/11_01.aspx

Further, the creation of a co-branded and co-funded Industry Super Funds campaign clearly demonstrates the desire of the industry funds to collectively compete with, and exclude, funds that are not owned by registered organisations from the market. These registered organisations also have a commercial reason for doing so, as some funds owned by registered organisations make payments directly to the registered organisations out of members' monies, through board fees and marketing fees.

Once named in modern awards the named funds also enjoy a competitive advantage over their peers in regards to price and performance. A reliable and predictable flow of contributions arising from the default arrangements allow funds to better manage their liquidity and invest more heavily in assets that generate a liquidity premium.

It is incorrect to conclude that the performance of some default funds relative to their peers warrants their continued enjoyment of default status as it is their default status itself that may have generated the different level of performance. Perpetuating such a market distortion would be a significant failure of competition policy.

Recommendation: The Government abolish the current process for selecting default funds in modern awards in the FW Act because it is anti-competitive, duplicative and unnecessary following the introduction of MySuper.

THE FW ACT MODEL CREATES UNNECESSARY REGULATORY COST

The current model and the model that was proposed by the Productivity Commission both create an unnecessary and costly regulatory burden into the selection of default superannuation funds. The cost of regulation is borne by both the superannuation fund and fund members, through higher fees and lower returns.

The current model requires funds that offer a 'standard MySuper product' and wish to receive default contributions to:

1. Apply for a RSE Licence; and
2. Apply to APRA for a default MySuper authorisation; and
3. Apply to the Fair Work Commission in accordance with s156A(3) of the FW Act to be included in the default superannuation list, subject to an assessment by the Expert Panel; and
4. Liaise with those persons able to make submissions to the Full Bench of the FWC in accordance with s156G(2) of the FW Act to be listed in each individual modern award in which the fund seeks to be named.

The current model also requires superannuation funds that offer an 'Employer MySuper Product' that wish to be available to receive default contributions to:

1. Apply for a RSE Licence; and
2. Apply to APRA for a default MySuper authorisation; and
3. Apply to APRA to authorise each individual tailored, large employer MySuper product; and
4. Apply to the Fair Work Commission in accordance with s156A(5) of the FW Act to be included in the Schedule of Approved Employer MySuper Products.

A process that requires MySuper products to apply and be scrutinised sufficiently to determine the approval of a licence in the first instance by APRA and then "second-guessed" by the FWC is not an efficient process.

The FSC notes that there is a degree of support for the view that it is unnecessary duplication to have the FWC reassess MySuper products that have been authorised by APRA. Club Super and QIEC Super recently submitted to the FWC that it seemed unnecessary and suggested that it would be more appropriate for the FWC "to accept that a MySuper product approved by APRA is automatically suitable for inclusion on the approved 'Default Superannuation List'."[3]

The current model is clearly complex and costly for those trustees who intend that their 'Standard MySuper product(s)' or 'Employer MySuper Product(s)' receive default contributions. This is particularly the case where a public offer fund may wish to be listed in multiple modern awards.

It is not in the interests of fund members and the industry to continue the default fund process as it will create unnecessary compliance costs. It is also not in the interests of the FWC as it unnecessarily creates cost for the Government and complication for employers and employees.

However, in the absence of Government intervention in the FWC process many superannuation funds feel it is necessary to comply with the process or incur the risk of not accessing a portion of at least $9 billion in annual contributions.

The FSC surveyed members and calculated that compliance with the current default fund regime for generic MySuper products will cost superannuation funds:

Table 1. Regulatory costs incurred by super funds as a result of the FWC default fund process

	Cost
Cost per first stage application to FWC (on average)	$200 000
Cost per second stage application (liaising with registered organisations, employees and employers) (on average)[4]	$30 000
Cost per super fund to comply with both stages of FWC process: where the first stage cost is incurred once and the second stage is incurred per application (on average)	$2.42 million
Total cost for the retail superannuation sector	**$25.5 million**

The separate FWC process for tailored MySuper products will cost superannuation funds, on average, an additional $38 000 per application. It is important to note that it is not uncommon for a large superannuation fund to have several hundred employer specific plans, and it would be cost prohibitive to make these applications for each plan.

These estimates include the legal and compliance costs incurred through the application process, associated advocacy and liaison costs with the FWC, APRA, unions and employer organisations, and costs arising from product development.

Recommendation: The Government abolish the current process for selecting default funds in modern awards in the FW Act to:
a) avoid retail superannuation funds incurring $25.5 million in unnecessary regulatory cost; and
b) avoid extra government costs in FWC running the process.

THE FW ACT MODEL IS IMPOSSIBLE TO MEANINGFULLY IMPLEMENT

Who applies?

[3] www.superreview.com.au/news/superannuation/queensland-industry-funds-query-default-fund-regim

[4] Cost estimates between funds varies due to differing levels of experience in this field, legal costs and economies of scale. $30 000 was the media cost per application, and taken as a conservative estimate. The average cost per second stage application was much larger at $184 000.

Section 156C of the FW Act provides that 'superannuation funds' that offer a standard MySuper product may make an application to the FWC to have the product included on the list. The term 'superannuation fund' is not defined, and other than its common meaning, does not have a legal meaning in either the FW Act or the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

As a result it is not clear who is entitled to make the application to the FWC, a critical issue considering that non compliance may invalidate all of a fund's applications. It is contingent on the FWC to provide further guidance on whether it is:

- the corporate entity or entities that own the trustee;
- the trustee (as defined in s10 of the SIS Act); or
- the CEO of the regulated superannuation fund (as defined in s19 of the FW Act).

How will the FWC interpret the first stage criteria?

The first stage criteria outlined in s156F of the FW Act that must be taken in account when considering an application relate to complex financial services concepts. It is not clear that the FWC or Expert Panel have the requisite skills and information available to assess applications against the criteria.

For example, s156F(e) of the FW Act requires consideration of "whether the superannuation fund's governance practices are consistent with meeting the best interests of members of the fund, including whether there are mechanisms in place to deal with conflicts of interest."

It is not clear whether this indicates the Expert Panel will consider industry best practice, such as the standards set in the ASX Corporate Governance Principles[5] (ASX Principles) which have been determined as such by twenty one leading industry associations, including:

- Association of Superannuation Funds of Australia Ltd (ASFA)
- Australian Council of Superannuation Investors (ACSI)
- Australian Institute of Company Directors (AICD)
- Australian Institute of Superannuation Trustees (AIST)
- Business Council of Australia (BCA)
- Financial Services Council (FSC)
- Law Council of Australia (LCA)

Recommendation 2.1 in the ASX Principles provides that best governance practices require a majority of a board to be independent directors and Recommendation 2.2 provides that the chair of the board should be an independent director.

Clearly, many superannuation funds with the 'equal representation' model do not comply with what is agreed to be best practice by sponsoring organisations, including by AIST, their own industry association.

As another example, s156F of the FW Act requires consideration of the appropriateness of the long term investment return target (s156F(a)) and the appropriateness of the fees and costs of the product (s156F(c)).

The FSC submits that these assessments require a detailed understanding of:

- the investment markets and operating jurisdiction(s);

[5] http://www.asx.com.au/regulation/corporate-governance-council.htm

- data related to potential future market dynamics and global economic trends (local, regional, global);
- an explicit outline of the assumptions the FWC would use in assessing any investment return target or an expert assessment of the fund's assumptions.
- The current and changing nature of the employee and member demographic to which the MySuper product relates. For example, will the MySuper product continue to be available to individuals whose circumstances change (age, industry of employment etc) and will this affect other members' rights, entitlements and services?

An understanding of the demographic characteristics of to whom the award applies is critical for the Full Bench when determining MySuper products to be listed in the modern award.

For example, for a younger cohort of award covered employees it may be appropriate to have the fund invested more aggressively as they have the time to 'ride' through market cycles, and as a result the fund is more likely to be actively managed. This necessarily increases the costs of managing the portfolio but will generate higher returns over the longer term. Other funds, however, have strong data to suggest a single diversified arrangement generates the best returns and potentially at lower cost. Assessing these competing arguments will require both the Expert Panel and the Full Bench to have detailed technical knowledge of investment practices as well as the needs of the members to which the award relates.

It is not clear, however, the demographic characteristics of various groups of employees covered by each modern award or to whom the award applies, particularly given the long term nature of FWC reviews (four yearly cycles). It is therefore impossible for the Expert Panel or the Full Bench to accurately assess whether the long term investment return target suits the employees in question or whether the fees are appropriately set without additional externally gathered information. Further, this is clearly not an appropriate role for Government or the industrial umpire.

Recommendation: The Government abolish the current process for selecting default funds in modern awards in the FW Act because it is impossible to meaningfully implement.

<u>CONFLICTS OF INTEREST WITHIN THE EXPERT PANEL</u>

The FSC is concerned that the Expert Panel appointments do not appear to be free of conflicts of interest in carrying out their duties. Panel members who are on trustee boards of funds named in modern awards would likely apply for listing on the Default Superannuation List. Similarly service providers to funds such as investment managers or administrators have a commercial interest in the outcome of the current process.

It is not clear from the Full Bench statement how the FWC intends to manage conflicts of interest. The FSC seeks the Government to submit to the FWC that the process should be suspended until the conflicts of interest are addressed. The FSC notes that in relation to conflicts of interest the FW Act provides:

> **Subsection 633(3)**
>
> Expert Panel Members
>
> (3) An Expert Panel Member must not engage in any paid work that, in the President's opinion, conflicts or may conflict with the proper performance of his or her duties.
>
> **Subsection 644(2)**
>
> Expert Panel Members

> (2) The Governor-General must terminate the appointment of an Expert Panel Member if the Expert Panel Member engages in paid work that, in the President's opinion, conflicts or may conflict with the proper performance of his or her duties (see subsection 633(3)).

It is not clear, however, at time of submitting, that the FWC will ask the conflicted members of the expert panel to recuse themselves.

Recommendation: The Government submit to the FWC that it suspend the current default fund process until such time as the conflicts of interest arising in relation to two out of three members of the Expert Panel have been addressed.

The FSC submits that it would be prudent for the FWC to have in place a process to:

- identify conflicts of interest;
- assess and evaluate those conflicts;
- decide upon and implement an appropriate response to those conflicts, to control, avoid or disclose such conflicts as appropriate in the circumstances.

As an example, a trustee director on the Panel may have to recuse themselves from some or all of the deliberations around applications to be included on the Default Superannuation List or the Schedule of Approved Employer MySuper Products not just for the fund for which they are a director, but by any fund that currently competes with their fund in the default market.

Particular regard must be had to situations where a trustee director of a fund on the panel:

- Is to consider and review both their own and other funds in contention; and
- Will have access to information in the application which is commercial in confidence and would not otherwise be made public under s156C(6) of the FW Act.

This is consistent with common corporate governance principles developed to comply with the *Corporations Act 2001* whereby conflicted directors excuse themselves from deliberations when a conflict arises.

For service providers, it is the case that they may benefit commercially from the listing of funds to which they provide services. For example, an investment manager may receive investment mandates from a range of funds applying to be listed. Prima facie, this creates a conflict due to their relationship to some of the first stage criteria outlined in s156F of the FW Act being:

(a) The appropriateness of the MySuper product's long term investment return target and risk profile;
(b) The superannuation fund's expected ability to deliver on the MySuper product's long term investment return target, given its risk profile;
(c) The appropriateness of the fees and costs associated with the MySuper product, given:
    (i) Its stated long term investment return target and risk profile; and
    (ii) The quality and timeliness of services provided;
(d) The net returns on contributions invested in the MySuper product;

Employees, contracted staff, consultants and directors of service providers have knowledge of the commercial arrangements between the fund and the fund manager and this may impact on decisions, as may their desire to promote the interests of the funds that have issued a mandate to the service provider to increase the sizes of those funds, and hence the mandates and fee income of those service providers.

Recommendation: The Government submit to the FWC that it publish their processes for managing conflicts of interests (after appropriate consultation) in this instance.

On balance, the FSC believes that one key requirement should be that a trustee director or a service provider on the Panel excuses themselves from participating in deliberations where their fund, or a fund to which they provide services, is an applicant for the Default Superannuation List or the Schedule of Approved Employer MySuper Products.

OPEN COMPETITION MODEL

The FSC submits that a MySuper authorisation alone should be sufficient to allow a fund's MySuper product to be a default fund for any Australian workplace. The very fact a MySuper product has been designed by the government and authorised by APRA ensures that the best interests of employees are being prioritised.

A MySuper product is specifically designed for default superannuation members and is a highly regulated regime with strict obligations on trustees. APRA ensures that all MySuper products comply with the regulatory requirements before the MySuper product receives authorisation to be sold to the public and APRA also provides continuous oversight as prudential regulator.

Superannuation funds who have received a MySuper authorisation have already been through a quality filter making it appropriate that any MySuper product may be an eligible default product for any Australian employee.

Selection cost for employers

The Productivity Commission was concerned that if an employer was required to choose a default fund for their employees from any eligible MySuper, the number of eligible MySuper products could potentially be very large. For this reason it felt it was appropriate to pre-emptively narrow the possible selection by including shorter lists in modern awards.

In practice, the Productivity Commission's concerns have proven unfounded. The number of approved public offer MySuper products is currently 81 and is not expected to increase substantially as most funds have had their applications considered.[6]

It is also important to note the extent of industry consolidation currently underway as subscale funds merger as a result of the Stronger Super reforms. For example, between 1996 and 2012, the number of superannuation funds regulated by APRA decreased by 93%, from 4747 to 352.[7] It is expected this trend will continue in the near term reducing significantly the number of funds from which an employer can choose a default fund for their workplace.

Selection costs for employers will therefore certainly be far lower than originally feared. Further, there will be considerable public information available for employers to choose a default MySuper for their workplace:

- APRA is responsible for publishing a list of all superannuation funds that have received a MySuper authorisation; and
- APRA will also publish MySuper investment performance, fees and costs information in quarterly public reports.

This information will be readily available to employers and employees. It will also be widely reported in the media, as is currently the practice.

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[6] http://www.fwc.gov.au/index.cfm?pagename=superreview&page=introduction
[7] http://www.pc.gov.au/__data/assets/pdf_file/0011/119981/default-super.pdf at 33

The FSC is of the view that no additional information need be provided by the Government in relation to what will be a very competitive marketplace. Additional intervention by the Government will distort the market and inherently be based on limited, point in time assessments about the relative performance of MySuper products. Nor will those assessments necessarily be relevant to the financial arrangements of individuals.

The FSC notes that it is common for employers to make regular decisions in relation to their service providers. The FSC recommendation will give them the flexibility to rationalise the number of default funds they must pay into when their employees are covered by multiple awards. Employers are well equipped to make a decision in relation to which superannuation fund provides a MySuper product that suits the needs of their employees and workplace.

Recommendation: The Government remove default superannuation funds from modern awards and allow an employer to choose any MySuper product to be the default fund for their workplace.

Recommendation: The Government recognise that employers will be able to access adequate information on MySuper products from APRA publications and are well positioned to choose a default superannuation fund for their employees.

GRANDFATHER EXISTING DEFAULT ARRANGEMENTS AND CORPORATE FUNDS

To minimise disruptions for employers and employees, existing default arrangements should be grandfathered, including those funds named in both modern awards and pre-modern award instruments (pre-modern award federal awards, state awards and enterprise awards).

In 2009, Fair Work Australia instituted a flexibility arrangement to ensure that employers contributing to existing superannuation funds could continue making contributions despite such funds not being a named fund in a Modern Award. The clause stated that an employer could satisfy their legal obligations by contributing to:

> any superannuation fund to which the employer was making superannuation contributions for the benefit of its employees before 12 September 2008, provided the superannuation fund is an eligible choice fund.[8]

Similar arrangements are required should the Government decide to adopt the FSC's recommendation in relation to the default market. The grandfathering arrangement should be extended to those funds currently named in modern awards.

If an employer is currently paying into a MySuper product as a result of it being named in their modern award or enterprise award, the employer should be entitled to continue paying into that MySuper product until such time as the employer decides to change the default MySuper product for their employees, or the employee choses a different superannuation fund.

Recommendation: Existing default arrangements should be grandfathered.

[8] For example, see the Banking, Finance and Insurance Award 2010

ENDING THE CURRENT DEFAULT FUND PROCESS

FWC is required to continue to implement the new regime for the selection of default funds in modern awards in accordance with the previous Government's amendments to the *Fair Work Act 2009*. As such, it is possible that the FWC will determine new default fund listings and contributions will be required to be paid into those funds from 1 January 2015.

Existing MySuper funds that are currently listed in modern awards may not be listed after the FWC process. These funds are at risk of not being able to accept default superannuation contributions on behalf of award employees.

Further, to the extent that an existing employer's fund is not listed they can apply to have a specific corporate or tailored MySuper plan to be listed separately by the FWC, subject to the same two stage approval process. However, this concession is insufficient to protect many existing employers from the risk that they may at some point be contributing to MySuper products which may not be approved for default purposes. It also does not apply at all where the MySuper product is non-corporate or non-tailored.

If the Government chooses to reform the model in a manner consistent with the FSC's recommendations, the new regime may not be operational prior to the 1 January 2015 deadline. As such, there may be a period of time between 1 January 2015 and the commencement of the new Government's regime, where an employer is unable to pay contributions into a fund that it may otherwise wish to continue to do so.

There are at least 25 modern awards that will necessarily be subject to change through the current arrangement as they either have no default fund named in the award or only one default fund[9], and the FW Act requires at least two default funds per award after the review.

Requiring employers and default fund employees to change their superannuation arrangements for a short period of time would cause enormous dislocation in the market, poor member outcomes and significant cost for employers, employees and superannuation funds:

- New superannuation accounts would be created for potentially millions of employees, exacerbating the current industry wide problem of multiple accounts per Australian;
- Contributions likely in the billions of dollars would be made and invested on behalf of members, likely needing to be sold shortly afterwards if members act to consolidate their funds; and
- Employers would incur the cost of interacting with a new fund and establishing new payroll arrangements.

The FSC recommends that the Government, as a matter of urgency, submit to the FWC that it should include in all modern award determinations that the superannuation terms of modern awards should allow employers to continue to pay into their current default MySuper fund until 1 July 2015 so as to avoid an unnecessary dislocation of current arrangements.

This would provide certainty for employers and superannuation funds and avoid the creation of duplicate superannuation accounts for employees.

Recommendation: The Government urgently submit to the FWC as part of the current default fund process that future determinations amend awards to delay the requirement that default contributions be paid into named MySuper products until 1 July 2015.

[9] http://www.pc.gov.au/__data/assets/pdf_file/0011/119981/default-super.pdf at 6

ENTERPRISE AGREEMENTS

The benefits of a competitive default superannuation market are undermined by allowing enterprise agreement to prevent individual employees from choosing to have their employer make superannuation contributions into a fund other than the fund named in the agreement.

Enterprise agreements can require all employees covered by the agreement to have their superannuation payments be made into a specific fund. This is clearly uncompetitive, particularly where the parties to that enterprise agreement also have a relationship with the superannuation fund and may not undertake a competitive selection process to determine which fund best suits the needs of the employees covered by the agreement.

It is not uncommon for organisations that are parties to an agreement to have board representation on the fund named in the agreement or to receive payments from the fund.

For example, the Coles Supermarkets Australia Pty Ltd and Bi-Lo Pty Limited Retail Agreement 2011 requires all superannuation contributions to be paid to REST.[10] The agreement provides:

> **APPENDIX G - SUPERANNUATION**
>
> 1.1 Superannuation
>
> 1.1.1 The Company shall be and remain a participating employer of the Retail Employees Superannuation Trust (REST) and shall participate in accordance with the Fund Trust Deed.
>
> 1.1.2 The Company shall contribute monthly to REST on behalf of each eligible team member in accordance with the Superannuation Guarantee legislation. An eligible team member is one who:
>
> (a) earns $450 or more in ordinary time earnings in any month; and
> (b) in the case of a team member aged below 18 years, works at least 30 hour per week.
>
> ...
>
> 1.1.3 The Company shall provide each team member upon commencement of employment with the appropriate membership application form(s) of REST and shall forward the completed form(s) to REST within 14 days of the team member returning completed forms to the Company.
>
> ...
>
> 1.2 Occupational superannuation - transitional arrangements - Northern Territory, Queensland and Q Stores
>
> 1.2.1 Northern Territory (Coles only)
>
> (a) Team members who at the time of the commencement of the Coles Supermarkets Australia Pty Ltd Retail Award 1993 were eligible to be or are enrolled in the following Superannuation Funds:
> - ARF
> - MIESF
> - CARE
>
> shall either continue to be members of the Fund, and shall have contributions paid on their behalf whilst they remain team members of Coles Supermarkets Australia Pty. Ltd, or they may elect to be enrolled in, and have contributions paid on their behalf, to REST as provided for under the Coles Myer Occupational Superannuation Award 1992. Provided a team member may elect at any time to transfer to the REST Scheme under the above conditions, but shall forgo the right to transfer back into the former fund.
>
> ...

[10] [2011] FWAA 6105, http://www.fwc.gov.au/documents/agreements/fwa/AE888094.pdf

(c) All team members engaged on or subsequent to 1 February 1994, shall be enrolled in REST under the conditions of the Coles Myer Occupational Superannuation Award 1992.

...

1.2.5 All team members engaged on or subsequent to the date of commencement of this Agreement will be enrolled in REST under the conditions of the Coles Myer Occupational Superannuation Award 1992.

Even where a Coles or Bi-Lo employee may wish to join a different fund the enterprise agreement prevents an employee from exercising that choice. REST is under no competitive pressure to improve its performance or product offering as a result of this arrangement. The FSC notes that the ATO has outlined the legality of this arrangement[11].

It is important to note that two of the parties to the negotiations for that enterprise agreement also have nomination rights to the board of REST. It is safe to conclude that for this reason no other funds have been afforded the opportunity to compete with REST to be the fund named in the enterprise agreement.

The Coles and Bi-Lo agreement is used as a single illustrative example of a common, anti-competitive practice within the industry, chosen because the agreement applies to over 100 000 employees.[12] As such, it is likely the mandated contributions to REST as a result of this single enterprise arrangement equate to over $340 million per annum, contributions that no other superannuation fund can compete for.[13]

It is not clear why a consumer's right to choose their superannuation fund should be limited in this manner. For employees not covered by an award, the option to choose a super fund under the super guarantee started on 1 July 2005 (almost 10 years ago). Choosing a super fund was also extended in July 2006 to employees working for corporations under former state awards. It would be appropriate to extend choice to all employees during these reforms.

The inability of an employee to choose a fund:

a) Is counterproductive to the Stronger Super reforms;
b) Undermines competition in the industry which is predicated on the ability of employees to change funds where another fund's offering is more competitive;
c) Increases the number of superannuation accounts per Australian (particularly where a person holds more than one employment arrangement); and
d) Increases the fees Australians pay (due to the necessity to have multiple superannuation accounts).

Should these anti-competitive arrangements be amended, individual fund members could choose a superannuation fund that:

- Offers superior levels of insurance (death, disability or incapacity;
- Provides r or better service at a lower cost;
- Offers more investment options that suit an individual's arrangements; or
- Consistently generates higher returns.

Recommendation: The Government amend the Choice framework to not allow an employer to refuse to process a Choice form when presented. An employer would also need to be protected against claims that the employer has breached such clauses in enterprise agreements.

[11] http://www.ato.gov.au/Business/Employers-super/In-detail/Choice-of-super-fund/Choice-of-super-fund---meeting-your-obligations/

[12] http://www.coles.com.au/about-coles/the-coles-story

[13] Conservatively assuming the average Coles and Bi-Lo employee earns half of AWOTE, or approximately $37 000pa.

BETTER GOVERNANCE

The FSC recognises that the mandatory nature of the superannuation system leads the Australian public to expect superannuation funds will comply with the highest level of corporate governance standards.

The FSC also recognises that superannuation funds are responsible for overseeing the investment of $1.75 trillion in retirement savings on behalf of members, more than Australia's GDP. The weight of capital under management necessitates trustees to establish high quality boards, sourced from the top talent in Australia.

APRA Member Helen Rowell recently commented that:

> The average level of professionalism and soundness in the super industry is somewhat behind [other APRA regulated sectors]. The super industry is on the start of a journey.
>
> …
>
> The gap [between levels of operational and performance standards] is probably wider. There are more [super funds] with average to poor practices.
>
> …
>
> We certainly think that having independent directors adds value. We would harmonise the prudential standards [between the sectors APRA regulates].[14]

In recognition of the importance of superannuation to fund members, and also to the Australian economy, the FSC announced in February 2012 that it was time to raise the governance standards in the absence of legislation after the Cooper Review. Subsequently, the FSC introduced Standard No. 20, *Superannuation Governance Policy* (FSC Standard 20) to set the standard for the highest level of corporate governance in the Australian superannuation system. The Standard is binding upon FSC members who are trustees holding a public offer or extended public offer licence to operate a registrable superannuation entity (RSE).

Important areas of the governance standard that are relevant to the Government's discussion paper are summarised below, however FSC Standard No. 20, *Superannuation Governance Policy* can be accessed here in full:
www.fsc.org.au/downloads/file/FSCStandards/FINALFSCStandardNo20SUPERANNUATIONGOVERNANCE.pdf

The FSC Standard was issued on 26 March 2013, following extensive consultation with members and the industry more broadly, and commenced operation on 1 July 2013 on a voluntary compliance basis. Full compliance with the Standard is mandatory from 1 July 2014. The FSC understands that early, voluntary compliance with the Standard by FSC members is already common.

MAJORITY INDEPENDENT DIRECTORS AND INDEPENDENT CHAIR

Section 5 of the FSC Standard provides that:

> (a) … the governance arrangements necessary to satisfy an independence criterion for relevant licensees. This has the following distinct elements (which require disclosure to RSE Members):
> (i) a requirement that the Chair of the entity's Board be independent;
> (ii) a requirement that a majority of directors of that Board be independent; and
> (iii) a requirement that a quorum for proceedings of the Board (when acting as the Board) is satisfied only if independent directors constitute a majority of directors present and entitled to vote at those proceedings;

[14] S. Patten, APRA tells super funds to lift their game, Australian Financial Review, 9 December 2013

(b) particularises a requirement that directors of a relevant licensee should not accept or hold multiple and competing positions on RSE Boards;

(c) requires a relevant licensee to develop and implement (and disclose to RSE Members) in relation to each RSE it operates that has a MySuper option, an ESG risk management policy for that option.

(d) requires a relevant licensee to develop and implement in relation to each RSE it operates, a policy concerning diversity of Board membership and disclose to RSE Members the policy or a summary of that policy (with the policy including a requirement for the Board to establish measurable objectives for achieving gender diversity and for the Board to assess annually both the objectives and progress in achieving them and to disclose to RSE Members that information); and

(e) requires a relevant licensee to develop and publicly disclose to RSE Members in relation to each RSE it operates, its voting policy and to publish its Australian proxy voting record in accordance with FSC Standard 13 Voting Policy, Voting Record and Disclosure.

More details on these elements are outlined below where they are relevant to the specific focus questions raised in the Government's discussion paper.

THE INDEPENDENCE CRITERION

For a board with a majority of independent directors and an independent chair the definition of independence is critical to the board's integrity and its effective functioning.

The FSC notes that the relevant APRA standards for banks and life insurers have set a strong definition of independence for other prudentially regulated sectors that the Government may wish to consider in the context of a compulsory superannuation system of systemic importance to the Australian economy.

The FSC Standard requires:

1) a majority of directors of the Board of a relevant licensee must be independent directors;
2) the quorum for Board proceedings(acting as the Board) of a relevant licensee must be that of the Directors present and entitled to vote, there is present a majority of independent Directors (which may include the Chair); and
3) the Board of a relevant licensee must be chaired by an independent director.

The FSC recognises that there are a number of different formulations in the Australian regulatory context of the concept of an external or independent director. Each of these is expressed in slightly different terms.

The 'Test of Independence' under the FSC Standard, in order to remove any perception of conflict, is a modified version of the Blue Book, ASX Corporate Governance Principles and SPS 510/CPS 510 concepts. Under this modified formulation, as a general proposition, and subject to a no conflicts rule, an independent director cannot hold office in nor have employment with another relevant entity in the group, as detailed in the following section.

DEFINITION OF INDEPENDENCE

For the purposes of the FSC Standard, subject to the no conflict rule set out below, a director will qualify as an independent director of the relevant licensee where the director is not an employee (and thus a non-executive director) of the relevant licensee or a related body corporate or a related entity of either and who:

1) does not have a substantial holding in the relevant licensee or any of its related bodies corporate or is not an officer of such a relevant entity, or otherwise associated directly or indirectly with, a person having a substantial shareholding in a relevant entity;
2) within the last three years, has not been employed in an executive capacity by a relevant entity or been a director of a relevant entity after ceasing to hold any such employment;
3) has not within the last three years been a principal or employee of a material professional adviser or a material consultant to a relevant entity;
4) is not a material supplier or customer of a relevant entity or an officer of or otherwise associated directly or indirectly with, a material supplier or customer of any relevant entity;
5) has no material contractual relationship with a relevant entity, and;
6) is free from any interest and any business or other relationship which could, or reasonably could be perceived to materially interfere with the director's ability to act in the best interests of the relevant RSE's beneficiaries.

The concept of what is material for these purposes is discussed in more detail below.

Under the FSC Standard, a parent company director cannot be treated as independent on a subsidiary RSE licensee board under any circumstances.

Further, under the FSC Standard, an independent director of a parent company of the RSE licensee cannot also be treated as an independent director of the related RSE licensee. If such a director sits on both the parent company and the RSE licensee Boards, the director will fail the independence test (at the RSE licensee level) of the Standard.

Recommendation: Independence should be defined in a manner consistent with the FSC standard as outlined above.

NO CONFLICTS RULE

Independent directors of related entities of an RSE licensee or sibling entities may only be treated as an independent director of the RSE licensee if the No Conflicts rule is satisfied

The No Conflicts Rule:

> *Holding of a directorship in both an RSE licensee and another relevant group entity, in the particular circumstances, may not give rise to any real or sensible conflict or the possibility of such a conflict.*[15]

For example, there may be an entity within the group that provides external services (such as insurance) to retail customers and is a sibling entity of the RSE licensee. In this instance, provided the sibling entity did not provide (or propose to provide) insurance services to the RSE Licensee, an independent non-executive director of the RSE licensee normally would have no conflict of duty and/or interest in also acting as an independent non-executive director of the sibling entity (and vice versa).

By way of contrast, it is likely to be difficult to contend that there would be no such conflict, or the real, sensible possibility of it, if an independent non-executive director of the parent entity (of the RSE licensee) were sought to be appointed in that capacity to the board of an RSE licensee. This is because generally the role of a director of a parent is to maximise returns to the parent in dividend or capital growth. The role of a director of an RSE licensee is to ensure that ultimately the RSE licensee acts in the best interests of the RSE beneficiaries. This is where an insoluble conflict of duty may arise.

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[15] www.fsc.org.au/downloads/file/FSCStandards/FINALFSCStandardNo20SUPERANNUATIONGOVERNANCE.pdf

MATERIALITY AND THE CONCEPT OF INDEPENDENCE

FSC Members are required to carefully consider various relationships and contractual arrangements and take their own advice on whether the relationship is such that it is material in a manner that affects the independence of an independent director or Chair.

The FSC Standard notes that one measure in determining materiality is set out in Accounting Standard AASB 1031 Materiality (AASB 1031). Thus, an amount which is equal to or greater than 10 per cent of the “appropriate base amount” within a 12 month period may be presumed to be material unless there is evidence or convincing argument to the contrary. An amount which is equal to or less than 5 per cent of the “appropriate base amount” may be presumed not to be material unless there is evidence or convincing argument to the contrary. The FSC Standard advises trustee that this may be a useful starting point for determining levels of materiality in terms of any relationship.

The FSC Standard also notes that although a particular relationship may not be “material” having regard to AASB 1031, it is appropriate to take into account the qualitative aspect of the relationship as a whole in determining materiality.

As stated in the Blue Book:

> This Guideline uses the word ‘material’ in a number of places. The word ‘material’ has not been defined as it will depend on the circumstances of each person as to whether their interests result in a material relationship with the company. It is important that the board addresses these issues appropriately to ensure that there is no perception that a particular relationship provides a possible conflict of interest that will interfere with the director's responsibility to act in the best interests of the company.[16]

These comments are equally applicable in the case of directors of a relevant licensee and their ability to act in the best interests of the RSE Members.

The FSC Standard also provides that, in the absence of any APRA guidance on this topic, one area which may be useful for an RSE licensee and its directors to consider in the context of independence is the tenure of independent directors. SPS 510 does require that the Board have in place a formal policy on Board renewal.

However, it may be the case that a long-standing director, by reason of that longevity and relationship with the RSE licensee, ceases to be independent. This must necessarily be determined by the circumstances and it may be the case of course, where the longevity of the relationship cannot be said to lead to this conclusion.

DISCLOSURE TO MEMBERS

It is a requirement of the FSC Standard that trustees disclose to fund members their compliance or otherwise with the Standard at least once each financial year. This may be way of specific inclusion in an Annual Report to RSE Members or via website or other means of readily accessible information.

[16] http://www.fsc.org.au/downloads/file/IFSAGuidanceNotes/2GN_2_Corporate_Governance_2009.pdf

ENHANCED TRANSPARENCY

CHOICE PRODUCT DASHBOARD

The FSC submits that the Product Dashboard requirements should not apply to choice products.

At the very least, the application of product dashboard requirements to choice products necessitates further scrutiny and analysis, including a cost benefit analysis in line with Office of Best Practice Regulation principles. This should be accompanied by comprehensive consumer testing specific to choice superannuation members.

Dashboards are enabled in MySuper by the fact MySuper is a standardised offer (same and limited fee types, similar investment profile, etc). This standardisation does not apply to choice options and the full PDS and annual update information is required for any meaningful comparison.

Choice Product Dashboards had several carve-outs which were strongly supported by the FSC members. However, to address efficiency and cost effectiveness in the industry we would like to articulate the nature of the various problems with expanded choice reporting (SRF 701.0) to demonstrate significant problems that would arise if the Choice Product Dashboard is implemented:

- The single asset test is not clear. The intent was probably to carve out investments that were listed and investments such as term deposits, however the treatment of Exchange Traded Funds (ETFs) and Listed Investment Companies (LICs) which contain other assets and are arguably not a “single asset”. ASX reporting fully satisfies transparency for such vehicles.
- Legacy products which have been closed for a number of years have fewer and fewer members to recoup the high costs associated with the production and ongoing maintenance of Choice investment reporting. Thus any “last men standing” would pay disproportionately higher costs for a service that mostly would not be utilised by the members. Trustees are bound to do what is in the member’s best interest, and this is clearly not in their best interest.
- In the past, the cost effectiveness of wrap products has been maintained by their ability to utilise wholesale data across the platform. However, the planned Choice Investment reporting would result, for one industry provider, in 300 funds x 20 product variations = 6000 individual reports being published onto various websites and 6000 SRF reports being submitted to APRA for these products twice a year. For large trustees this is a considerable cost for limited member benefit and it presents a large compliance risk.
- In the retail sector with high net worth clients, some advisers (through the Statement of Advice) suggest fifteen or more Choice investments to sophisticated investors to truly diversify their client’s superannuation investments and to shield the portfolio from adverse market fluctuations. In cases like these, Choice dashboards will add fifteen or more physical pages to the member’s statement which will clearly be excessive, expensive and will dis-engage members. One industry provider has a member with 40 such funds which will add 40 pages to the member’s statement.
- Trustees who have supported portability of superannuation have hundreds of off-menu investments on their books (one FSC member has approximately 500 of these “off menu” funds). These funds will only have a handful (or even a single member) in such investments due to in-specie transfers.

   - Providers will be disadvantaged for doing the right thing in the past (for supporting in-specie transfers).
   - The future of in-specie transfers (portability) will be threatened if the cost of maintaining and reporting 10,000 (500x20) off-menu fund dashboards is too onerous.

Recommendation: All Choice product dashboard reporting requirements (within SRF 701.0, choice dashboards on the web, and in statement reporting) be abolished.

In addition to the above recommendation, the FSC also provides the comments below in relation to specific topics raised by the discussion paper.

Requirement to publish product dashboards in periodic and exit statements

ASIC Class Order 13/1534 was registered on 12 December 2013 and extends the timeframe to include product dashboards in periodic statements to 1 January 2015 (as long as a reference to the website address for the latest product dashboard appears in periodic statementsnow for MySuper dashboards and 1 July 2014 for choice dashboards).

Firstly, we request that there is a deferral of the requirement to reference the website address for the latest product dashboard until 1 July 2015, either via regulation or via an amendment to ASIC Class order 13/1354. It is unclear why ASIC has only provided relief until this point in time, despite being aware of further consultation in relation to the product dashboard requirements.

It is difficult for trustees to include these disclosures in, for example, exit statements from 1 July 2014, as statement changes generally take at least six months to implement. At this point in time, choice product providers are unable to reference any website address as there are no product dashboard requirements in place nor any web based solutions to deliver any requirements (that may or may not arise dependant on Government's decision in relation to matters of policy and form).

Further, there is no clear policy rationale for inclusion of product dashboards in exit statements (once the member has chosen to leave the particular investment). This does not make sense from either a MySuper or choice member's perspective as the member has already made the decision to exit the product and the information in the dashboard has no relevance to the member.

Secondly, rather than just delay implementation, we encourage Government to completely re-consider the necessity of including product dashboards in periodic statements for MySuper and choice products at all. The primary purpose of periodic statements is to provide members with current information about the status of their superannuation account balance and insurance benefits. Statements are not designed to be broader product disclosures incorporating generic investment option level information. This has typically been left to the PDS including material incorporated by reference on the product issuer's website.

The requirement to publish product dashboards in periodic statement poses some risk of eroding the annual statement's primary purpose to the detriment of members. To illustrate this point, analysis of the approximately 655 000 superannuation accounts issued by one FSC member company confirms that in conjunction with each periodic statement sent:

- Approximately 7 million additional pages would be required to be sent with statements each year (assumes two pages per Product dashboard).
- About 10% of members (+65 000) would receive 6 or more product dashboards per statement.

- Some members hold over 40 individual investment options in a product so would receive +40 Product dashboards with their statement.

As noted above, it is not uncommon for choice members to hold an interest in more than 5 investment options within the product offering. Receiving multiple Product dashboards with their statements will not improve member engagement and will likely create significant frustration with members both in terms of wastage and relevance.

We estimate that the cost of including the product dashboard in periodic statements will far exceed the cost of developing product dashboard website disclosures. In a choice environment the FSC would emphasise the ongoing cost impact of building the required technology to facilitate the intelligent matching of a member's individual holdings (at a specific point in time) with the specific product dashboard template that would need to be inserted into their mail pack. IT development, printing and mail-out costs will increase substantially.

Given these significant initial and ongoing costs and potentially detrimental member impacts, we do not believe there is sufficient basis to justify this statement requirement in the absence of a complete RIS. We also query whether the policy is aligned with the industry's shift towards centralised "pull" disclosure and government policies such as shorter PDSs that seek to provide members with simplified disclosure, with additional information to be accessed via a central repository e.g. a website or a query direct to the trustee.

Incorporation by reference is a prime example. As noted by ASIC:

> Incorporation by reference is designed to help product issuers reduce the length of disclosure documents by allowing some of the required information to be incorporated by providing a reference in the PDS to another document instead of including the information in the full PDS.[17]

ASIC have previously communicated that it is good practice to undertake some level of consumer acceptance testing of PDSs either at an industry or issuer level, particularly for complex products.[18] We believe it is reasonable to infer the same standard upon these substantive requirements.

Choice product return targets

The FSC submits that it is not appropriate to use a single benchmark (CPI plus percentage return) for all choice product return targets.

The performance target should align with how the relevant investment portfolios are managed. Choice investment options are often provided so that members (with assistance of advisers) can choose asset allocations to suit their risk profile. In doing so, they generally choose the asset class they want exposure to and then select the specific option.

A performance benchmark linked to CPI is not relevant to either the member or the asset manager.

Net investment return

The additional content would likely add confusion and therefore should not be added. It is not feasible for wrap products to provide net investment returns because these will be different for

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[17] ASIC RG 168.110: Disclosure: Product Disclosure Statements (and other disclosure obligations)
[18] ASIC RG 168.100: Disclosure: Product Disclosure Statements (and other disclosure obligations)

each member but this could be remedied by confirming that wrap products are excluded from the requirement to provide dashboards.

Liquidity measure

As we believe that it will prove too difficult to come up with a meaningful liquidity measure that would be understandable to members, we recommend this option be excluded from the dashboard.

Measures of risk

The Standard Risk Measure (SRM) was jointly developed by the FSC and ASFA in consultation with both APRA and ASIC and other industry participants.

The FSC recognises that there are many possible measures of risk, both short and long term, and relating to a range of measures, such as market volatility, inflation and currency fluctuations. Each measure of risk has limitations and may or may not be relevant to any individual investor.

Requiring funds to report an additional risk measure is likely to add only complexity and therefore increase the likelihood of members misinterpreting the information. Consistency across disclosure mediums (eg PDSs and statements) should be consistent therefore the FSC recommends that superannuation funds continue with the SRM alone.

An additional measure of risk would also be expensive for industry to develop, calculate and build into existing reporting, at no clear advantage to consumers.

Furthermore, as part of the SRM self-regulatory framework, the FSC and ASFA have committed to reviewing the SRM as an appropriate measure of risk once it has been implemented and member experiences can be gauged. SRM was implemented in 2013 and as such it would be appropriate for industry to commence this review process in 2014.

The FSC and ASFA have commenced discussions around how this review process should proceed and will commence consultations with other industry participants over coming months. It would be premature for the Government to proceed with a mandated, additional measure of risk until this review has taken place and there is industry agreement around the effectiveness of SRM or whether a different or complimentary measure would be more suitable.

Choice Product Dashboard 'carve outs'

The FSC recommends that dashboards should be removed in the choice environment completely. To aid the Government to understand the rationale for this position, the reasons for each potential exclusion are dealt with in turn below:

Wrap products

Wrap platform superannuation products offer investment strategies through member investment choice. Given the typically broad nature of the available investment menu (across managed investments, ASX listed securities, term deposits and other cash products), this would result in the Trustee being required to display returns for each individual investment, detracting from both the usefulness and transparency of the Product Dashboard.

Wrap products are required to provide the underlying Product Disclosure Statement (PDS) of the managed fund, and the dashboard information is, to a large extent, contained in those documents. The only way to access the investment the wrap platform is via a financial adviser.

Due to white label structures, the costs of preparing dashboards for each specific option would be prohibitive (given the various fee arrangements between platforms and distributors) for different labels. One provider estimates producing 4000 dashboards every 6 months based on the current requirements.

Single sector investment options

The primary mechanism for providing relevant information to members is via the PDS which includes all information required for the member to make an informed decision. The Product dashboard has only very limited information and is insufficient for members to base a decision on to invest into potentially highly concentrated and volatile investments. It is considered inappropriate to provide such a limited form of disclosure for investments of this nature.

Legacy personal superannuation products

There will be a significant burden on trustees with multiple legacy systems in establishing mechanisms to meet the requirements. Upgrading legacy systems may result in material increases in cost recoveries and ongoing fees for members. Importantly, members of legacy products cannot be simply picked up and transferred into a new product without incurring significant cost, disruption and long lead times.

In particular for legacy products, displaying a Product dashboard could be misleading as this does not alert the member the potential consequences of leaving the product. While defined benefits have been excluded there are other products which may have exit penalties or corporate plans that have bonuses which are dependent on a member's tenure in the fund, not to mention more favourable insurance cover.

ASIC Regulatory Guide 182: Dollar Disclosure sets an important precedent, illustrating ASIC's prior recognition of the need to consider whether exclusion of legacy products from particular disclosure requirements is warranted. ASIC state:

> We recognise that there may be circumstances where it will be unreasonably burdensome or not in the interests of clients to require compliance with the dollar disclosure provisions for legacy products[19]

In relation to the meaning of legacy products, we note that ASIC is familiar with these concepts; see for example CO *06/602* and Table 6 of *Regulatory Guide 182: Dollar Disclosure*. There is also a "negative definition" in Section 20B (3)(c)SIS-definition of "accrued default amount".

Risk only superannuation products (where there is no accumulation component)

These products are insurance policies where the on-going premiums are paid with superannuation money. There is no investment component hence the Product dashboard requirements cannot sensibly apply to these products.

Commencement date

[19] ASIC RG 182 Dollar Disclosure - RG 182.72

The development of the choice dashboards cannot start until the regulations are finalised. Because of the large number of dashboards that will be required, we recommend commencement be deferred to 1 July 2015 at the earliest and at least 12 months from finalisation of the regulations.

S*ummary*

We feel strongly that choice investment options should be excluded from the requirement to provide dashboards.

The intent of the dashboard is to provide a concise, easily understood comparative tool for individuals to compare products. This is achievable where the products being compared are relatively uncomplicated and have a high level of commonality, such as MySuper products, but is not so with other choice options and particularly with superannuation wrap platforms.

Overall,

- Members invest in choice products and wrap platforms in particular to achieve diversity across multiple asset classes and investment options. The concept of having a product dashboard for a single investment is not consistent with the usage of these products and will be likely to confuse members.
- Unadvised members make up a very small percentage of members using choice options. Members generally rely on advisers to select both platforms and investment options within these platforms. The cost/benefit analysis would not justify this initiative.
- The sheer number of dashboards that would be produced in the industry would detract from their effectiveness.
- Providing very limited information on higher risk, more volatile investment options could lead to members allocating higher portions (or even all) their funds to inappropriate options.

Recommendation:
1) Choice investment options should be excluded from the requirement to provide dashboards (websites, member statements and APRA reporting).
2) MySuper dashboards should be permanently removed from periodic and exit member statements.

PORTFOLIO HOLDINGS DISCLOSURE

The FSC supports the rationale and policy of portfolio holdings disclosure. We believe that members of superannuation funds and investors in managed investment schemes have the right to understand where their investment resides.

The manner and depth to which disclosure occurs is critical to the success of the policy. Factors such as cost, efficiency, intellectual property and investor access must be considered.

The model FSC and ASFA developed in 2012 delivers a complete picture of a superannuation fund and managed investment scheme's holdings in a manner which an investor could easily comprehend, is cost-effective, efficient and protects intellectual property of investment managers. The FSC is of the view that industry could work together to self regulate in a manner consistent with the model ASFA and the FSC developed in 2012.

This model is one which requires a super trustee to disclose their holdings[20] (such as units in managed investment schemes[21]) and a corresponding obligation upon a managed investment scheme operator to disclose their holdings (whether they are units or actual assets). This would deliver a complete picture of each investment vehicle's holdings. This requirement would not be extraterritorial.

Recommendation: The Government allow the industry to self regulate a portfolio holdings disclosure regime consistent with the one detailed above.

In the previous Government's draft Regulations, portfolio holdings disclosure was proposed to occur through both an aggregated and disaggregated form.

This means that superannuation trustees would be required to publish a table of portfolio holdings at a "whole of investment option" level across each underlying investment vehicle, but also publish the contents of each underlying vehicle (such as managed investment schemes).

> Example: In a diversified fund, there would be in the order of 8000 holdings. If such a fund were to hold a 0.001% interest in another similar fund, then the disaggregated holdings would be 16000 investments requiring aggregation by the trustee.

To the knowledge of the FSC, this approach is not used in other markets with portfolio holdings disclosure. In other jurisdictions, portfolio holdings disclosure is driven by financial reporting or custodian systems which record the assets of the fund based on the securities it has beneficial ownership of, whether that be a listed stock, bond or unit in an unlisted fund. These systems do not typically have the capacity to report on a look through basis, nor is it common practice for such information to flow via these channels.

More broadly, for the goals of portfolio holdings disclosure to be achieved it should be applied to RSEs and MISs, which is the approach in the FSC/ASFA model.

A consistent approach recognises the interconnectedness of the superannuation and investment areas today and also lays a better foundation for efficient developments within the superannuation industry in the future.

No guidance on the application of the 'tracing' rules to foreign investments (extra-territoriality)

Section 1017BC(1)(c) of the *Corporations Act 2001* (Cth)[22], provides that the obligation on a product issuer to disclose portfolio holdings information to an RSE trustee will only apply where the financial product in question is acquired 'in this jurisdiction'.

However, the corresponding obligation on RSE licensees to disclose portfolio holdings under section 1017BB(1) of the Act is absolute, and contains no equivalent exemption.

The Explanatory Memorandum to the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth) provides that

> *"the RSE licensee is not required to publish information relating to financial products or other property which is not acquired in this jurisdiction unless the RSE licensee knew, or*

[20] Disclose on a biannual basis with a 90 day lag

[21] Other than a scheme in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme.

[22] As inserted by the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth) effective from 1 July 2013.

reasonably ought to know, information sufficient to identify the financial products or other property acquired."

However, this commentary in the Explanatory Memorandum is not reflected in the legislation.

Under the FSC / ASFA model, the onus on determining jurisdiction would be shared between each individual RSE and the Managed Investment Scheme operators in relation to assets which they would have clear knowledge of and are within their control which will make it considerably easier and more cost effective for the assets to be valued. The FSC / ASFA proposal also reduces the duplication of effort to collect the information across the industry that is characteristic of the proposed legislation.

Under section 1021NB of the Act, an RSE trustee commits an offense of strict liability if it fails to comply with its portfolio holdings disclosure obligations. Subsection 1021NB(5) provides a defence where the information would have been made publicly available but for the fact that the RSE trustee was "unable to obtain the information after taking reasonable steps to do so".

The legislation provides a defence to criminal liability where the information would have been made publicly available but for the fact that the RSE trustee was "unable to obtain the information after taking reasonable steps to do so". There are also statutory defences to both criminal and civil liability where the information was omitted because it would have been misleading or deceptive and the trustee took reasonable steps to obtain information that would not have been misleading or deceptive.

In light of this, and also in light of an RSE licensee's statutory and general law duty to act in the best interests of members, we anticipate that trustees will feel obligated to, at the very least, take reasonable steps to compel foreign product issuers to provide disclosure of underlying investments. This gives rise to a number of issues, including the following:

- Trustees will be required to devote resources to chasing foreign product issuers with whom they may have no direct relationship and on whom there is no statutory obligation to disclose portfolio holdings information to the RSE licensee and trying to compel them to provide information about their portfolio holdings, which in many cases may be considered to be proprietary trading information that is commercially sensitive.
- There will be inconsistencies in the level of detail provided by RSE licensees about foreign investments, depending on the rigour of the RSE licensee's processes, its bargaining power and also on the willingness of the foreign product issuers in which they invest (either directly or indirectly) to provide information about their portfolio holdings. There will also be inconsistencies depending on whether the investment was an existing investment or a new investment.
- RSE licensees may be exposed to claims where they are unable to compel foreign product issuers to provide information about their portfolio holdings, through no fault of the RSE licensees.
- To avoid breaching these requirements, an RSE licensee may feel obligated to only invest in foreign investments where the foreign product issuer is willing to provide information about their portfolio holdings. This may reduce the spectrum of investments that are available to the trustee in the pursuit of superior returns for members, which may not be in the best interests of members. This may also act as a deterrent for foreign product issuers in dealing with Australian superannuation funds.
- Where an RSE licensee invests in a foreign investment where the foreign product issuer is not willing to provide information about their portfolio holdings, the RSE licensee may feel compelled to continue to pursue the data and to continually assess whether the investment remains a viable option for the portfolio, having regard to the risk that

the RSE licensee may be regarded as being in breach of the portfolio holdings disclosure regime. This could be for no other reason than these provisions. In effect, the lack of clarity on this issue could cause the investment process to become costly and convoluted.

The issues with collecting information from foreign product issuers is compounded in light of the obligation to collect additional information from those same foreign product issuers for APRA reporting purposes. However, there are differences in the two regimes which increases the risk of breaches. These differences include:

(a) Notice obligations under the portfolio holdings rules have an express jurisdictional limit to financial products acquired in Australia. There is no such jurisdictional limit for the notice rules under APRA reporting. Accordingly, one set of notice rules can apply to foreign product issuers but not the other.

(b) Breach of the notice obligations in the portfolio holding rules is a criminal offence carrying fines. Breach of the notice obligations in the APRA reporting rules is a breach of an implied contractual term and is not a criminal offence.

(c) Look-through information must be provided directly to the trustee under the portfolio holdings rules, but must be provided through successive investment layers under APRA reporting.

Section 1017BB(4) and (5) of the Act collectively provide that the Regulations may deem information about certain investments to be excluded from the information that is required to be made publicly available by RSE trustees under subsection (1).

Recommendation: Where a financial product not located in this jurisdiction is and the assets invested in that financial product will be used by another person to acquire another financial product or other property, the investment of those assets will not be a material investment.

The effect of this recommendation is that an RSE licensee would be required to disclose the value of an interest in a foreign financial product, but not be obliged to disclose the underlying investments of that financial product.

Disclosure of commercially sensitive information

Requiring disclosure of the value of unlisted assets such as interests in real property could have a negative impact on the value of that investment in certain circumstances.

For example, if an RSE trustee holds a direct interest in a commercial office building and is seeking to dispose of that interest, disclosure of the value that the RSE trustee attributes to that interest in its books could adversely affect the RSE trustee's ability to obtain a superior sale price.

This would seem to create a perverse outcome from a policy perspective, as members of the superannuation fund will ultimately be disadvantaged if disclosure of the value of an asset causes the value of their interest in the superannuation fund to be detrimentally affected.

The difficulties with disclosing sensitive information can also apply where the investment strategy is considered commercially sensitive information (e.g. an Investment Manager's small cap fund, private equity fund, hedge fund or the investment is into markets where the Investment Manager has conducted considerable research).

The difficulties with disclosing sensitive information can also apply to the assets themselves where a foreign jurisdiction prevents this information from being made publicly available.

Recommendation: Where an RSE trustee reasonably believes that the identification and/or value of an asset is commercially sensitive and that disclosure of the value of that asset is not in the best interests of members, the investment will not be considered to be a material investment.

Alternatively, where an RSE trustee reasonably believes that the identity and/or value of an asset is commercially sensitive and that disclosure of the identity and/or value of that asset is not in the best interests of members, information about such assets can be disclosed under the designation "Other" without detailed disclosure of the details of that asset.

Disclosure of underlying investments of a hedge fund or private equity fund

The previous Government's draft regulations required portfolio holdings information to be disclosed in a format that would show an RSE trustee's investments in each financial product, together with information about the assets that each of those products invests in.

For private equity funds and hedge funds in particular, disclosure of the underlying assets in which they invest is a commercially sensitive matter and one that could have a significant adverse effect on the value of investments in those funds.

Recommendation: Where a trustee invests in a private equity or hedge fund, either directly or indirectly, and the assets invested in that private equity or hedge fund will be used by another person to acquire another financial product or other property, the investment is not a material investment and should be protected under the 5% rule proposed by the FSC/ASFA model.

Alternatively, investments in hedge fund and private equity assets should be aggregated under "Other" with disclosure limited to the details of the sub-asset sectors or strategies which those funds invest in.

Legacy Product and Off-Menu Exclusion

We are concerned that there will be negative unintended consequences for members in legacy superannuation products as a result of the operation of a portfolio holdings disclosure requirement.

For certain RSE licensees with large legacy books and associated systems, the set-up and maintenance cost of a separate trustee website may unnecessarily add to the costs of running such products. Indeed, based on previous precedents such as dollar disclosure, there will be a significant cost burden in updating multiple legacy product systems. This will likely result in an increase in costs to members who wish to remain in their legacy product. Given these products are now closed to new members, the significant costs of adopting the reforms for legacy products will prove unjustifiable.

Additionally, there are legacy products that don't have an inherent investment risk (capital guarantee) as this is borne by the life company. The life company is contractually obliged to meet their liabilities to the policyholder in the event of surrender or vesting. It is not relevant to the policyholder what assets the life company holds against its liabilities, it is only relevant that the Life Company is able to meet its obligations to the policyholder. There is recognition of this in relation to product dashboards, as these products are excluded from the operation of the product dashboard legislation.

Further, trustees who have supported portability of superannuation might have hundreds of off-menu investments with only a handful (or even a single member) in such investments due to in-specie transfers. These providers will be disadvantaged as a result. In addition, the future of in-specie transfers (portability) will be threatened without a carve out for off-menu funds.

Recommendation: Legacy products and off-menu funds be excluded from the portfolio holdings disclosure regime.

Life Policy Disclosures in Portfolio Holdings Reports

There are varying types of financial products offered by life insurance companies. This submission is specifically in regards to 'Life Investment contracts' which are contracts regulated under the Life Act but which do not meet the definition of life insurance contracts under AASB 1038 Life Insurance Contracts.

Broadly life investment contracts can be classified as 'investment linked life policies' and 'guaranteed return life policies'. A guaranteed return life policy is a secure investment that provides investors with a series of regular payments, which may be a combination of interest income and capital depending and which may be either fixed or linked to an index, such as CPI, on the nature of the product.

This provides investors with certainty of cash flows as the issuer (an APRA regulated life insurance company) bears all the investment risk. Investors can rely on these guaranteed regular payments even through times of market volatility.

For an investment linked life policy the value of the policy at any point in time will be determined by a discrete pool of underlying assets. The definition of an investing product means a financial product that invests the asset, or an asset derived from an asset, of a registrable superannuation entity in another financial product or property.

Under the current definition of investment product it may be arguable that both investment linked life policies and guaranteed return life policies would meet this definition.

These types of life products have vastly different characteristics and consequently should be disclosed differently to superannuation investors in order to avoid misleading the user of this information.

Recommendation: Define investing product as "Investing Product means a financial product that imparts a beneficial ownership into one or more other financial products or property". [23]

Implementation Timing

It is unlikely that the industry will have certainty around the final regime in time for a 1 July 2014 commencement considering the current consultation process and the necessary software development lead times (allowing for requirements documentation, architectural analysis, building, testing, rollout).

[23] This would align the definition to the Corporations Act and ensure that the Final Products reported in the portfolio holding disclosures are representative of assets which will determine the investment experience of the superannuation assets. This will avoid the misrepresentations that would be made to members under the current portfolio holdings disclosures regulations which are outlined above.

This change is complicated by the need to also source the missing data from local and international parties that also have to do their own software development to supply data in accordance with any changed requirements.

Recommendation: Portfolio Holdings Disclosure implementation commence from the 30 June 2015 reporting date (i.e. within 90 days of that date).

Materiality threshold

With some diversified funds holding in excess of 8000 direct investments, and many multiples of that within in-direct holdings, materiality becomes a valid consideration. For the most part, members are not sophisticated investors and presenting 8000 lines of holdings (some as small as 0.0001% of a fund or less) adds little to no value.

Example: Consider the “average member” with a $50,000 investment.

- A fund holding 8000 investments in equal proportions (which is not a likely scenario) would have $6.25 in each investment for the member.
- A fund holding 8000 investments displaying their top 20 investments (anything greater than 5% of holdings) would generally satisfy the member with regard to how and where their money is invested.

Recommendation: A 5% materiality threshold should be applied to portfolio holdings as per the ASFA/FSC model.

A BETTER APPROACH TO REGULATION

The FSC welcomes the Government's clear commitment to deregulating the financial services industry to boost the industry's competitiveness and improve outcomes for consumers and shareholders.

In this context, the FSC outlines a number of recommendations that would refine the recent Stronger Super reform process by reducing unnecessary and often distortionary regulation. Under these recommended changes more Australians will access cheaper super which meets varying needs and the costs arising for industry from the new regime will be lower.

REMOVAL OF 500 EMPLOYEE THRESHOLD FOR A TAILORED MYSUPER

Section 29TB of the SIS Act prevents a superannuation fund with a MySuper authorisation from customising the investment option and pricing for a particular workplace. That is, the SIS Act requires that a MySuper provider use the same investment option (aside from a lifecycle exemption) for every workplace with less than 500 employees. Only workplaces with more than 500 staff may access different asset allocations.

Australian workplaces with less than 500 employees are not homogenous and should be entitled to access customised asset allocation for their default fund. Workplace demography differs based on occupation, age, location, cultural beliefs or other preferences.

Recommendation: All Australian workplaces should be permitted to access customised investment options (asset allocation) by removing the 500 employee threshold requirement.

CHARACTERISATION OF A MYSUPER PRODUCT

Detailed requirements for a MySuper product are prescribed by section 29TC of the SIS Act. These prescriptive requirements go beyond the member's interest in the fund to indirectly related and incidental matters, such as educational seminars and subsidisation of fees by employers.

Section 29TC requires that all members who hold a MySuper product must be entitled to access the same options, benefits and facilities except to the extent that a benefit is provided by taking out risk insurance. The phrase "options, benefits and facilities" extends beyond the superannuation interest in the fund (eg. account balance, investments, earnings) to matters such as education and member seminars. As a result, section 29TC effectively operates to prohibit workplace seminars (except for large employers) because they exclude members from other workplaces. This serves against the interests of members.

Recommendation: Education and seminars be excluded from the requirement to offer the same options, benefits and facilities.

FEE DEREGULATION AND DISCOUNTED FEES

Section 29VB of the SIS Act permits RSE licensees to reduce administration fees for MySuper products. This is designed to permit a discount only where the employer demonstrates their administrative efficiency or where a fee cap exists. This effectively means that a trustee of a MySuper product may not discount / lower an administration or investment fee for any member or workplace.

We believe that this level of prescriptive fee regulation is unnecessary as workplaces and individual members are being prevented from accessing discounted fees where the RSE licensee considers fees should be cheaper than the highest possible fee in the Product Disclosure Statement (PDS).

Further, there are ways in which to permit discounted administration fees (via the exemption or caps) but not discounted investment fees. All individual members and workplaces should be permitted to access both discounted administration and investment MySuper fees.

This would recognise that MySuper is corporate superannuation and is often used by employers as part of a legitimate staff attraction and retention policy.

Recommendation: The Government amend section 29VB of the SIS Act to allow investment fee and administration fee discounts to be accessible to all Australians – through workplaces or as individual members. Such amendments should not allow RSE licensees to increase MySuper fees, but would allow RSE licensees to reduce fees through caps or discounts for individual members and workplaces.

REMOVAL OF MULTIPLE AUTHORISATION DUPLICATION

Section 29T of the SIS Act requires an RSE licensee with a generic MySuper authorisation to apply to APRA prior to providing superannuation services to each large employer.

We believe this unnecessary duplication of regulation and process is cumbersome, time consuming, unnecessary and costly for superannuation funds and the Government. We believe one licence to operate a business in any industry is sufficient.

The FSC is also concerned this additional authorisation process would move APRA away from its proper and very important role as prudential regulator focused on risk and governance into areas of commercial interest between funds and large employers which have nothing to do with its regulatory role.

Recommendation: Superannuation funds with a MySuper authorisation for a generic MySuper product be required to report the existence of an arrangement with an employer to APRA, rather than apply to APRA prior to establishment.

This process would address the public policy concern that the existence and number of employer plans are unclear to APRA. It would also require regular reporting without undermining the efficiency, competitiveness and commerciality of tender processes.

TRANSFERRING MEMBERS BETWEEN MYSUPER PRODUCTS

The legislation prevents an RSE licensee from unilaterally moving a member from a MySuper product without the member's prior consent given no more than 30 days before the transfer (section 29TC). This prohibition applies to the movement from any MySuper product, including a large employer MySuper product, and even prohibits transfers between MySuper products.

As a result, an RSE licensee is prevented from transferring an employee member from a large employer MySuper product to (say) the generic MySuper product when the member ceases employment with the large employer. The legislation thereby requires an RSE licensee to continue providing the member with the MySuper fee discounts negotiated by his or her former employer even though the member is no longer employed by the employer.

The FSC points out that the prohibition on transferring a member from a MySuper product without consent is inconsistent with the Super System Review's findings. At recommendation 1.16 of the Final Report, the Panel stated "*Members should only be able to be moved involuntarily out of a MySuper product if they are ...(b) flipped from a MySuper product in a master trust to another MySuper product in another division of that trust.*". In describing this recommendation, the Panel reiterated that it would be "a matter for the trustee where a MySuper corporate master trust product engages in such flipping; the trustee could decide to retain the member and accumulated balance in the original MySuper corporate master fund product."

There are justifiable and feasible reasons for differentiated 'tailored MySuper' products for larger workplaces or those that can deliver efficiencies in engagement and administration. In many cases, the savings are explicitly linked to employer capacity. Being forced to retain ex-employees (who may direct another employer to contribute to the tailored arrangement) fundamentally alters that capacity and it should be at the discretion of the fund to determine whether or not to transfer a member between MySuper products.

Another concern with the prohibition on transferring members from a MySuper product is the situation of a member of a generic MySuper product who is entitled to join a large employer MySuper product.

In this situation, employer contributions would be allocated to the large employer MySuper product. However, Section 29TC would prevent an RSE licensee from transferring the member's account balance to the large employer MySuper product without the member's consent. This results in the member having two MySuper accounts and, accordingly, paying two sets of fees.

The legislation accordingly prescribes inconsistent and distortionary treatment for MySuper members depending on whether they are in a generic or large employer MySuper product.

Recommendation: Superannuation funds be permitted to transfer a member between MySuper products without the consent of the member.

DISCOUNTED FEES FOR FORMER EMPLOYEES AND OTHERS

Within a generic MySuper product, trustees should also be permitted to discount fees for former employees, associates and family members.

Where an employer has successfully negotiated a discount on the administration fees for its employees, the legislation prohibits an RSE licensee from continuing to provide the administration fee discount when the member is no longer employed by the employer, in fact it requires them to transfer the former employee/member to the 'generic' MySuper which may have higher administration (and overall) fee where there are not the same efficiencies or savings that can be delivered. However, it may be the case that for the trustee continuing these arrangements is efficient even when the employment nexus is broken.

As a result, flexibility in approach is important.

An amendment of the type sought by the FSC would recognise that discounted MySuper can often be used by employers as part of a legitimate staff attraction and retention policy.

Recommendation: Trustees should be permitted to continue to provide an administration fee discount, when the member is no longer employed by the employer (a former employee).

CONSISTENCY OF CALCULATIONS (S29QC)

Under s29QC of the SIS Act, where an RSE licensee provides information calculated in a particular way to APRA under a reporting standard and the RSE licensee gives the same or equivalent information to another person, including on a website, then the RSE licensee must ensure that this information is calculated in the same way as the information given to APRA.

Logically, the industry anticipated that this would mean dashboard data reported to APRA in SRF 700.0 would need to be mirrored in dashboard data on the website. However, s29QC of the SIS Act is potentially far broader.

A breach of s29QC of the SIS Act by an RSE licensee is a strict liability offence (50 penalty points). In light of the potential for criminal liability, the industry has a number of concerns and recommendations in relation to this section.

These concerns are exacerbated in light of the significant expansion in the APRA reporting standards; they cover 35 new forms, 23 old forms and approximately 1000 numerical items that are, mostly, at some point "calculated" somewhere. Given the breadth and audience of trustee reporting, ensuring all website pages and documents are completely up to date with what has just been submitted to APRA will be impossible.

Recommendation: Limit the scope and penalties of s29QC to the key information reported to APRA that must be consistent (Product Dashboards).

Recommendation: allow a timeframe for updating documents and disclosures (within 45 days) of reporting data to APRA if the calculation method is changed.

Recommendation: Allow RSE licensees to report data with an "as at" date and when done so, s29QC of the SIS Act and its penalties do not apply (e.g. even if information is out of date, it will be clear it is out of date and penalties do not apply).

Recommendation: Allow RSE licensees to publish returns on websites, member specific areas of websites, in statements and in promotional material provided they comply with FSC standards 6 and 10 and ASIC Regulatory Guide 53.

Recommendation: Allow RSE licensees to publish in a member's statement a member specific rate of return (which may not match the formula for the APRA form but is more accurate).

Recommendation: Expressly exclude old APRA forms from s29QC of the SIS Act.

Information Sheet 167 from ASIC expanded the potential scope of s29QC of the SIS Act by adding "If APRA requires you to report data about asset allocation (including defining 'cash' or any other asset class), you will need to consider whether changes should be made to your disclosure to align with these definitions."

Thus, ASIC have adopted an expansive view of s29QC and applies it beyond what is "calculated" for APRA to include definitional considerations. It is the FSC's position that this view is not supported by s29QC. It also skews the financial services industry by re-writing how only the superannuation part of the financial services industry should operate asset class reporting to clients without taking into account the investment (non-superannuation) half of the industry.

Recommendation: Asset class reporting and other matters not directly related to calculations should not be caught by s29QC of the SIS Act.

The FSC is also aware that accounting bodies are concerned with differences between what is reported to APRA and what they report under standard accounting principles (AASB).

Recommendation: Accounting reports should not be caught by s29QC of the SIS Act.

EXECUTIVE REMUNERATION

The Super System Review recommended that executive remuneration in the superannuation industry be disclosed by adopting a similar model to that applied to listed companies in s300A of the *Corporations Act* 2003.

While the type of remuneration information that must be disclosed for superannuation is similar to that required by s300A, there are some marked differences which results in a significantly more onerous regime applying to superannuation.

Disclosure of Executive Remuneration on Super fund websites - scope

The obligation to disclose executive remuneration in superannuation is set out in section 29QB of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Section 29QB requires the remuneration of executive officers to be disclosed.

We are concerned with the use of "executive officers" in this context. Section 29QB relies on an existing definition in the SIS Act, which previously was used for limited purposes (e.g. rules in relation to disqualified persons).

The term is defined in section 10 of the SIS Act as:

> executive officer, in relation to a body corporate, means a person, by whatever name called and whether or not a director of the body, who is concerned, or takes part, in the management of the body

However, section 300A of the Corporations Act 2001 requires disclosure of the remuneration arrangements for key management personnel. The term "key management personnel"(KMP) is defined under section 9 to have the same meaning as the accounting standards.

Australian Accounting Standard AASB 124 defines "key management personnel" as 'persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.'

The concept of executive officer under SIS is much broader than the concept of key management personnel in the accounting standards. The breadth of the definition means that it could potentially extend beyond senior management and executives to apply to line managers. Indeed, ASIC have interpreted this broadly to mean any person who is a 'senior manager' for the purposes of APRA Prudential Standard SPS 520 *Fit and Proper.*

This is particularly concerning to some of our members whose initial list of persons covered by SPS 520 was rejected by APRA as part of their application for a MySuper product. These members were required by APRA to expand their list beyond what they reasonably considered should be caught.

This seems an unusual consequence given the intention expressed in the relevant Explanatory Memorandum and Explanatory Statement was to model the requirements of executive remuneration disclosure for RSE licensees on the standards prescribed by section 300A of the Corporations Act (and regulation 2M3.03 of the Corporations Regulations).

We recommend that the definition of "executive officer" be reconsidered to avoid persons not in a position of requisite authority being required to publicly disclose their remuneration.

The Explanatory Statement to the regulations is somewhat confusing in that it refers to “monies attributable to directors”. Our concern with current drafting is that there may be some doubt about the scope and it being greater than directors and creates further uncertainty given that potentially the term is subject to “relevant regulators providing clarity as to who is intended to be captured as an “executive officer” for example, all responsible persons in relation to the RSE…”

Recommendation: The requirement to disclose remuneration of executive officers be changed to require disclosure the remuneration of "key management personnel" as defined in the accounting standards.

Website Disclosure under s29QB

The requirements of the website disclosure regulations (s29QB) include the obligation to make documents and information publically available that relate to a registrable superannuation entity (RSE). According to s29QB:

> (1) An RSE licensee of a registrable superannuation entity must ensure that the following is made publicly available, and kept up to date, at all times on the registrable superannuation entity's website:
>
> (a) details of the remuneration of:
>
> (i) if the RSE licensee is a body corporate—each executive officer in relation to the RSE licensee; and
>
> (ii) if the RSE licensee is a group of individual trustees—each trustee of the registrable superannuation entity;
>
> being details of a kind prescribed by the regulations;
>
> (b) any other document or information prescribed by the regulations”

We note in the Superannuation Industry (Supervision) Act 1993 (SIS) within section 6 “General administration of Act”:

Subject to subsections (3) and (4):

> (a) APRA has the general administration of the following provisions, to the extent that administration of the provisions is not conferred on ASIC by paragraph (da) or the Commissioner of Taxation by paragraph (e), (ea), (fa), or (g):
>
> (i) Parts 2A, 2B and 2C (other than subsection 29SAA(3) and sections 29QB and 29QC);
>
> …
>
> (c) ASIC has the general administration of:
>
> (ia) subsection 29SAA(3) and sections 29QB and 29QC; and
>
> …

(3) The Minister may give APRA or ASIC directions about the performance or exercise of its functions or powers under this Act.

The FSC has raised many issues with s29QB in our 29 July 2013 submission to Treasury. Largely these have not been actioned due to the focus on Class Order Relief applications. The FSC and its membership believe that there are a number of policy and technical issues with the Regulations which result in their application being unworkable, overly onerous or having unintended negative consequences for RSE licensees, members or sponsoring employers within a corporate superannuation context.

ASIC recently issued Consultation Paper 219 (CP219) “Keeping superannuation websites up to date” per s29QB. However the focus of that paper was largely on the triggers and subsequent publication timeframes for a potential “safe harbour” via Class Order determination. However there are a number of fundamental issues with s29QB for which we seek changes to the regulations.

The confidentiality of material to be published

The FSC is particularly concerned with the requirement to publish confidential material including actuarial reports for defined benefit funds and details of arrangements in corporate superannuation funds:

Actuarial reports:

- Often contain commercially sensitive material (e.g. future corporate developments such as redundancy programs).
- The reports often contain member information (or information from which someone can derive specific member details). For example:
    - The reports contain details of salary ranges for Defined Benefit members for some very small funds or small benefit categories within funds
    - The report also covers insurance and claims information (expressed as multiples of member’s salary).
- The reports contain information regarding funding levels (and indexes) which are not public knowledge. This is particularly of concern for plans which are temporarily in an unsatisfactory financial position and which are in the process of rectifying the issue. Members of these funds have been made aware of their fund’s status through the annual update process and therefore it is of no concern to general members of the public who are not part of the fund and cannot join the fund.
- Where outsourced, external Plan Actuaries insert disclaimers preventing making these reports available to 3rd parties without their permission.
- The funds are (in almost all cases) closed to new members, therefore there is no benefit to the general public in publishing this information (no new member can elect to join the fund).

Corporate superannuation details

- Commercial reality is that employers can negotiate special fees and services including for generic or large employer MySuper and for choice products. Making the commercial terms public will only drive the wrong behaviours (diminution of services and reduced competition). Further, in no other area of private sector commerce is this level of detailed fee disclosure required (except where the private sector tenders for public works).
- Corporate and tailored plans are not available to the general public. Customers can only become a member of a particular plan if they work for that employer / organisation in a particular capacity. For corporate plans, where it is not “public offer” there is no reason for public disclosure of member-privileged pricing and services. Providing information on fees that may not be generally available, and are dependent on scale of the employer plan would be misleading to members not entitled to such discounted fees.

- Many of the corporate superannuation offers are tailored to fit the needs of different organisations or employers or even classes of employees within an employer. We note that within a company, some classes of staff have different superannuation and insurance arrangements compared to other classes of staff. Publication of this information therefore breaches member's privacy and is a breach of the RSE's confidentiality with the Corporate plan sponsors.
- Significant event notices are often specific to individual employer sponsored superannuation plans and/or members and publishing these documents for the general public raises privacy, confidentiality and commercial sensitivity issues. It could also give rise to complaints where members misunderstand whether a SEN does or does not apply to their specific individual employer or class of employment.
- Confidentiality and commercial sensitivity issues are recognised under s1017c of the Corporations Act and s29QB should not override this.
- The FSC maintains that there is no mandate under s348A of the SIS Act for APRA to require the publishing of commercially negotiated, customised fees, insurance or asset allocations beyond the generic MySuper product for a fund. As announced by Treasury in 2011:
  - To maintain transparency of these arrangements, the details of all separately tailored MySuper products and discounted administration fees will be required to be reported to APRA and will also need to be separately published by trustees
  - Provided the trustees publish the data relating to a sponsoring employer transparently (and "separately") to the members concerned, the FSC believes the intent of the regulations have been met.

It is therefore clear that, as written, Section 29QB is unnecessarily vague about sensitive materials (commercial arrangements, actuarial reports etc) and publication would not serve the best interests of members.

We note here that in the recent APRA Discussion Paper (Publication of superannuation statistics and confidentiality of superannuation data) certain data was deemed by APRA to be non-confidential because, under section 29QB, it is required to be published on the RSE Licensee's website. FSC indicated in its response to the APRA paper that it would be making submissions to Treasury for changes to clarify the confidentiality of certain data within s29QB.

Accordingly, the FSC proposes that s29QB of the law be qualified.

Recommendation:

1) s29QB be amended to include qualifications that specifically prohibit APRA and/or ASIC to require RSE licensees to publish documents where the content breaches The Privacy Act, or where commercial interests are jeopardised.
2) s29QB should also be amended to allow for publication of summary documents (e.g. summary of actuarial report) where the full document might breach The Privacy Act, or where commercial interests are jeopardised.
3) s29QB should also recognise that, for documents associated with employer sponsored plans, RSEs should be allowed to publish information on employer intranets or secure RSE member websites, in lieu of the RSEs public website.

Timing requirements are unnecessarily onerous

The requirement to "keep up to date at all times" has necessitated CP219 to help clarify the intent of the legislation. We submit that while ASIC has the power to either issue safe harbour via Class Order or to give guidance on the matter, it would be clearer if s29QB was amended.

The information being published is generally not time-sensitive, and where it might be considered time-sensitive (eg PDSs and FSGs), the law already has other controls in place (eg the requirement not to accept money against a defective PDS).

Some documents require board or trustee approval before publication:

- Remuneration reports need to incorporate both Long and Short Term Incentive payments. Most corporate entities base incentive payments giving due consideration to the financial performance over the corporate financial year, and it takes time to compute, audit and approve performance outcomes, including approval requirements mandated under Prudential Standard SPS 510. Also, Section 300A of the Corporations Act has a framework that requires board approval before these can be made available for publication on the websites.
- Actuarial reports may have several drafts presented to the trustee. The trigger should occur once the documents are approved by the trustee.

Same day publishing of some documents is problematic.

- Given the compressed timeframe for account preparation and auditing (4 months down to 3 months), it is possible a financial report may only be approved by the board on the day of lodgement to APRA. Therefore, annual financial statements could be challenging to publish on the same day.
- While every effort is made to have documents uploaded on websites quickly, some technology teams do require a short lead time for publication.
- Where a website has inadvertently come down, the trustee could be in breach of any "same day" publishing requirement.

Updating website information can be problematic at the two peak holiday times (Christmas / New Year and Easter / ANZAC Day).

With regard to Significant Event Notifications (SENs), for most large funds, member mailings are often staggered to make volumes acceptable for mail houses and Australia Post. Trustees should avoid a situation where a SEN or material change notice appears on a website 2-3 weeks before it is mailed to a member. The FSC submits that it would not be appropriate for a member of the general public to become aware of a SEN before all impacted members of the fund have been notified. This will give rise to confused members and a larger amount of calls and complaints. The FSC suggests a non-immediate timeframe is reasonable to allow mailing houses time to complete full mailings and for Australia Post to deliver the letters to affected members.

It is therefore clear that, as written, section 29QB is unnecessarily onerous and publication could revert to annually at no detriment to the original policy intent of public disclosure of information. Accordingly, the FSC proposes that the law be reviewed.

Recommendation: Amend s29QB of the SIS Act so that the reference "and kept up to date, at all times" is replaced with "and reviewed annually".

ACCRUED DEFAULT AMOUNTS

The FSC asks that the Government revisit the definition of "accrued default amount" (ADA) in s20B of the SIS Act.

FSC members were appreciative of the important changes made to the original definition via the Superannuation Legislation Amendment (Further MySuper and Transparency Measures)

Act 2012. However, the operation of this provision still leads to some anomalous outcomes for some members of superannuation funds. Specifically, we request that s20B(3) be amended to provide a further exception in relation to members who have provided a direction to a trustee to invest in the current default option of a fund that is not a standard employer-sponsored fund (Choice Fund) as defined in the SIS Act.

The Super System Review Panel acknowledged that recognition of choice was an important factor in differentiating between those members who would be afforded the protections of MySuper and those members who should remain in a choice product. Indeed it was only ever envisaged that standard employer-sponsored members with benefits in the default investment option of their employer-sponsored arrangements would be the subject of MySuper. As currently drafted, the ADA definition captures a significant number of choice members who have selected a Choice Fund and have nominated the current default as their investment option.

The FSC disagrees with the presumption that an explicit direction to invest in a default option of a Choice Fund is a delegation of that member's investment decision to the trustee. The nature of a Choice Fund generally means that a member not only selects the superannuation product but at the time of application, also directly or impliedly selects the investment option to which contributions should be directed. This is clearly contrary to a standard employer-sponsored arrangement where the employer completes the application form on behalf of the member meaning that the fund and the investment option are initially selected for the member rather than it being their choice.

Where a member has chosen an investment option that is also the current default for standard-employer sponsored members and that option has become the MySuper option, the FSC accepts that it is not necessary to differentiate in this circumstance. In effect, the choice member's chosen option is not fundamentally changed.

In contrast, where an ADA relates to a balance in a Choice Fund, the transfer of that balance to a MySuper product is likely to abrogate a member's exercised right to choice of investment and fund. This transfer may have adverse consequences for the member including:

- loss of existing insurance benefits (the MySuper product may have inferior insurance arrangements and be subject to underwriting restrictions);
- change in asset allocation inconsistent with the member's existing direction;
- potential loss of investment returns based on the member's own investment selection and self-assessment of their risk appetite; and
- loss of access to a range of product features and services that may not be replicated in the MySuper product.

The members who lose these rights and benefits will predominantly be members who are satisfied with their current arrangements. Whilst the proposed solution to this problem is to give members the ability to opt-out, the experience of FSC members is that superannuation members have a low response rate to such campaigns, and do not always respond in a timely manner, even when it is in their interests to do so.

As at 31 December 2013, one personal superannuation fund (without a MySuper product) believes it has up to 33,000 members who have provided clear direction to invest in the default option of various products within that fund. The total ADA balance for these members is approximately $500 million. These members generally have significantly higher average balances than a genuine default member (i.e. a standard employer-sponsored member who has not provided a direction to the trustee) and are satisfied with their choice of fund and current investment arrangements.

While one option would be to require members of Choice Funds to opt-in to the transfer of the ADA to MySuper rather than the current process of requiring the member to opt-out; the preferred method is to amend the legislation for an additional exception to the ADA definition.

This approach protects members who have made an investment direction into a current default against detriment arising from a failure to respond to the ADA communication in a timely manner. In addition to the matters raised above, this detriment may include an inability to re-enter their fund of choice where the fund is closed to new members.

Recommendation: That s20B(3) be amended by including an additional exception as follows:
'Such an amount is not an accrued default amount:
…
(e) if the trustee of a fund that is not a standard employer-sponsored fund is satisfied on reasonable grounds that the member has given the trustee, or trustees, a direction in relation to an investment option (including the option which under the current governing rules of the fund would be the investment option for a new member if no investment direction were given) under which the asset (or assets) of the member are invested or to be invested in the fund.'

The effective commencement date should be 1 January 2013.

We believe the proposed amendment set out above will not compel a trustee to undertake further analysis of its members to confirm that an investment direction has been provided if it is not practical for them to do so. We also believe the proposed approach will not interfere with any existing identification and transfer processes undertaken by the industry to date.

OPERATION OF S29WA OF THE SIS ACT

Direction of contributions and recognition of Successor Fund Transfers

The issue of a receiving trustee being able to rely on a direction given to the transferring trustee in the context of a successor fund transfer (SFT) has only been clearly addressed in relation to accrued default amounts (see section 20B(3A)). However, this provision (i.e. 20B(3A)) was not replicated in the Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013 amendments to section 29WA of the SIS Act. Instead, the Government has taken a different approach of saying recognition of a previous direction will be dealt with under separate Regulations (see section 29WA(5)).

Furthermore, the Supplementary Explanatory Memorandum to Tranche 4 directly deals with this issue as it states (para 1.8 and 1.9):

Recognising Previous Directions

1.8 New subsections 29WA(5) and 29WB(5) will provide regulation making powers to prescribe the circumstances in which a direction, relating to the investment of contributions, given to the trustee of one regulated superannuation fund is to be taken to be a direction given to the trustee of another regulated superannuation fund for the purposes of the relevant sections. [Amendment 4, subsection 29WA(5), and Amendment 7, subsection 29WB(5)]

1.9 It is intended that the regulations to be made under these subsections will address the circumstances where a member has been moved from one fund to another under a successor fund transfer.

Crucially, an early announcement that this issue will be addressed is warranted. Members in funds that have been transferred through past Superannuation Fund Transfers (SFTs) and who have been 'mapped' to an equivalent choice option potentially must have their current contributions made to a MySuper account. In progress SFTs are made more complex whilst this anomaly in intent and law remains complicating communications and adding to costs.

Equally, the announcement should clarify that trustees who are currently applying contributions to a MySuper account despite past SFT's should also not be affected by any subsequent changes to the operation of s29WA.

Recommendation: The Regulations referred to in 29WA(5) should be made as soon as possible. At the very least, a clear announcement of the intent to pursue the approach indicated in the Explanatory Memorandum would assist.

Application of s29WA to funds that do not offer a MySuper product

The application of section 29WA of the SIS Act to trustees that do not offer a MySuper product remains unclear.

More specifically, section 29WA(2) provides that a trustee must treat any contribution to the fund in relation to which no election has been made as a contribution to be paid into a "MySuper product in the fund". This suggests that the provision only applies to those trustees that have obtained an authorisation to offer a MySuper product in the fund for which they received the contribution. This view is arguably supported by APRA's FAQ 28. However, APRA's FAQ 66 suggests otherwise. Under this FAQ, APRA requires that a trustee treat contributions in relation to which the member has not given any direction as a contribution to be paid into a MySuper product from 1 January 2014.

Based on the current drafting of section 29WA, it is not clear that the trustee has been provided with the power to pay the contribution to a MySuper product outside the fund. Paying a member's contributions to another fund could result in member complaints and potential liability for the trustee (for example, if a member's insurance policy lapses because of the redirection of contributions). Importantly, a failure to comply with the provision is a strict liability offence.

We recommend that the intended operation of section 29WA in relation to funds without a MySuper product be clarified.

Assuming that the provision is intended to apply to all trustees (and not just those which offer a MySuper product in the relevant fund), section 29WA(2) should be amended so that it requires the contribution to be paid into a MySuper product of the fund or a MySuper product of a fund nominated by the trustee. If this approach was to be adopted, an appropriate transition period would be required.

Alternatively, if the provision is intended to apply only in respect of contributions received by a trustee of a fund that offers a MySuper product, we recommend that clarification is provided through a further FAQ.

Grandfathering as at 31 March 2013

When originally enacted, s29WA contained no exceptions for contributions made to capital guaranteed arrangements, risk only superannuation, endowment policies and cash investment options.

This created a distortion because the amounts held in these arrangements were expressly excluded from being accrued default amounts. As a result, new contributions could not be made into these superannuation arrangements without a member direction but the amount held in the arrangements was not accrued default amounts.

This distortion was partially addressed by the subsequent inclusion of exceptions to s29WA in relation to these types of arrangements. However, the exceptions were limited to those who were members of the arrangements as at 31 March 2013.

One of the most egregious consequences of the partial exception arises when an employer provides disability benefits to its employees through making contributions above 9.25% (ie additional voluntary employer contributions) to a risk only superannuation arrangement. Section 29WA operates to permit the employer to continue to make the additional contributions for a person who was an employee on 31 March 2013. However, it effectively prevents the employer from making the additional contributions for an employee who started work on 1 April 2013. As a result, the superannuation legislation operates as a barrier and interferes with the private remuneration arrangements in place between an employer and its employees

Recommendation: Amend s29WA to enable the exceptions to apply to all employees regardless of whether they started work before or after 31 March 2013.

Requirement for a written direction

The base-line conditions before a member can exercise investment choice are set out in regulation 4.02A of the Superannuation Industry (Supervision) Regulations 1994. Section 29WA effectively applies additional rules for member investment choice without reference to regulation 4.02A.

In particular, s29WA(4) will not recognise a direction for the purposes of that section if the direction is given after 31 March 2013 and:

(a) the direction was not given in writing; or
(b) a copy of the direction is not held by or on behalf of the trustee, or the trustees, of the fund.

The requirement for a direction to be in writing ensures that the member investment choice rules are <u>not</u> technologically neutral. For example, it may prevent the current practice of a trustee from accepting switches over the telephone. Further, interpretation of the word "writing" is required in order to enable electronic switches (say, through the member's private section of the fund's website).

Recommendation: Amend s29WA to use technology neutral language.

<u>FEE DISCLOSURE CONSULTATION, AMENDMENTS AND DEFERRAL</u>

Disclosure of fees and costs in PDSs

The disclosure of fees and costs in PDSs was significantly re-vamped by the *Superannuation Legislation Amendment (MySuper Measures) Regulation 2013*. Unfortunately, these changes were implemented without proper industry consultation which has led to significant disclosure issues.

One of the most problematic changes is the modification of the concept of indirect cost ratio and how they are to be disclosed in PDSs. The issues relating to this change are discussed in the following section.

However, there are a variety of other issues arising from the PDS disclosure. In our view, these changes are detrimental to consumers. They will make fee disclosure less clear and make product comparisons more confusing and difficult because:

1. The regulations permit inconsistent disclosure of similar fees and costs: While the new regulations attempt to standardise terminology, many common types of fees are able to be disclosed in a number of inconsistent yet still compliant ways. Consumers will not be able to easily compare fees and costs where different issuers choose different approaches – even where the two products are identical.
2. The regulations adopt terminology that is not true to label: In a number of cases, the terminology and definitions required by the new regulations will confuse and may even mislead consumers.
3. The disclosure of fees and costs is dependent on product structures: The way in which fees will be disclosed will depends on product structure – fees and costs that are identical from a client's point of view would be disclosed differently if the product structures are technically different.
4. The regulations apply different definitions to the same terminology: The new requirements have different definitions for the same terminology in different contexts. For example, ICR is defined and calculated differently for managed investment schemes versus superannuation funds. This is especially problematic for superannuation platforms that give customers access to a menu of underlying managed investments.
5. The regulations do not cater for existing disclosure rules that streamline the disclosure of platform investment options: The new requirements do not allow platforms to rely on disclosure from underlying product issuers.
6. Implementation of the regulations will be costly with little benefit: The new requirements will be very costly for industry to implement, with no apparent benefit to consumers. These costs will eventually be passed on to consumers through higher fees and charges.

FSC recommendation on addressing fee disclosure issues

Our concerns can be divided into issues for the fee disclosure in the 8 page PDS and issues for the fee disclosure in incorporated material

The main issue arising from fee disclosure in the 8 page PDS is that the fee table in the 8 page PDS is intended to provide a summary of the fees for a particular investment option. However, the changes require all fees information for that option to be set out, even though this information is also set out in the fee table contained in the incorporated material.

Recommendation: That only a summary fee table be set out in the 8 page PDS. For example:

- by deleting the disclosure of incidental activity-based fees from the table – that is, advice fees, and other fees and costs; and
- by deleting the 'How and when paid' column which did not appear in the previous version of this table.

The following issues arise in relation to fee disclosure in the material incorporated by reference into a PDS:

- New fees and costs are required to be included in the fees and costs table, such as buy-sell spread. However, it is not clear how this row is to be completed. For example, there are no legislative rules regarding what should be included in the buy-sell spread row for a superannuation product which has a large number of investment options each with a different buy-sell spread. On the one hand, it would not be possible to include the buy-sell spreads for all investment options in the table. On the other hand, the legislation does not permit a summary of the buy-sell spreads to be included in the table and for full information to be set out elsewhere.

- The legislation now requires information on 'Other fees and costs' to be set out in the fees and costs table. Previously, this information could be included in other parts of the incorporated material. The inclusion of this row creates practical difficulties, particularly as on its face it includes all other fees and costs, such as activity fees, advice fees for personal advice and insurance fees – although a footnote to the table also covers these fees. It is also not possible to set out the amount of insurance costs in the table.
- A prescriptive and legalistic set of fee definitions must be set out in the incorporated material, even if those fees are not applicable to the product. However, the drafting of the definitions is not clear, concise and effective and arguably is of little benefit to members.
- There is no ability in a PDS for a large employer MySuper product to set out a statutory fee example for that MySuper product.
- Mandatory changes require the consumer advisory warning to refer to the ability of an employer to negotiate lower administration fees, even if the PDS is for a personal super product or a for pension product and does not have employer-sponsored arrangements.

Current and prior member disclosures and Trust Deeds will often use such terms as management fee and management costs. As these terms no longer form part of the mandated definitions, in order to comply with the newly defined fee types, changes would be required for annual statements, annual reports, investment reporting and potentially trust deeds and investment policies. The cost of the I.T. rebuild for the periodic statements alone would be significant. Importantly, closed products will be significantly impacted by these changes. Whilst there is no requirement for the PDS to be updated with the new fee template, trustees are required to change the disclosure in periodic statements to reflect the new concept of indirect costs. This terminology will be meaningless to existing members of closed products resulting in confusion.

We recommend that products that are closed as at the commencement date for the new fee disclosure regime, be excluded from the operation of clause 301 of Schedule 10 (as amended) and that they continue to be able to disclose in accordance with the current requirements.

Recommendation: The Government commence consultation on a new fee disclosure regime for PDSs which provides information on fees in a clear, concise and effective manner and which can be applied regardless of the superannuation product.

Indirect Costs and Indirect Cost Ratio (ICR)

The fees and costs tables in both the PDS and incorporated material require disclosure of the indirect costs ratio. However, the definitions are uncertain and there is ambiguity in the definition of Indirect Costs and ICR. Schedule 10. Clause 101 of the *Corporations Regulations 2001* (Regulations) defines Indirect Costs as excluding amounts that are charged to members as a fee. It is unclear whether Indirect Costs include fees that are not charged directly to members but instead reduces the returns of an investment option.

The MySuper Regulations[24] amend Schedule 10, clause 104(1) of the Regulations which defines ICR and includes a footnote that a fee deducted directly from a member's account is not included in the ICR. This implies that a fee not deducted directly from a member's account (eg: one deducted from the returns of the investment option) should be included in the ICR. This uncertainty is further compounded by the footnote to the definition of ICR in clause 209A of Schedule 10 which makes reference to "a dollar-based fee" deducted directly from a member's account being excluded from the ICR.

Whichever approach is taken, we note that recent PDS disclosures from various providers have resulted in reduced clarity and comparability. Furthermore, the changes required are likely to lead to further material implementation costs being incurred across the industry to align periodic statements. In particular:

- If (as the footnote to the definition suggests) the ICR includes indirectly charged fees, the new fee template appears to double-count the indirect fees as they may be included in the administration and investment fees as well as in the ICR.If the ICR is intended to exclude directly and indirectly charged fees, then clauses 101 and 104(1) of Schedule 10 will need to explicitly state that the "total of the indirect costs for the MySuper product or investment option" is to also exclude indirectly charged fees. However, doing so will be in contravention of existing industry practice and also ASIC guidance. Indeed, existing ICRs will in many instances take into account investment fees, issuer fees and administration fees rather than explicit dollar based fees deducted from a member's account.

We believe that to change the meaning of a measure that has been in use by the entire industry for many years is very problematic. There will be significant ramifications if it is confirmed that the ICR now excludes fees that are indirectly charged as part of standard unit price calculations.

A change in methodology for calculating the ICR will significantly impact periodic statements. As previously mentioned, any change to periodic statements requires considerable lead time to implement due to the system implications. Periodic statements and PDSs will need to be consistent in the approach to disclosure and it is desirable for the timing for the commencement of both the PDS and periodic statements to align.

The current methodology for calculating ICRs provides investors with a reasonable and straight forward measure of all fees and costs that are not charged directly to a member's account. If it is intended to change the intent of the ICR so that it would exclude indirectly charged Investment and Administration fees, the following consequences need to be considered:

- It appears that Administration and Investment fees can be charged on the Net Asset Value (NAV) or Gross Asset Value (GAV) of a fund whereas the ICR must be calculated on NAV. This inconsistency will be difficult for members to understand and could lead to further confusion and reduced comparability between different providers. The current ICR methodology requires the total costs to be expressed as a percentage of NAV and therefore provides members with a uniform measure of costs.
- Historic documents will quote ICRs that have little comparison to ICRs currently quoted. The likelihood of investor confusion is high.

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[24] *Superannuation Legislation (MySuper Measures) Amendment Regulation 2013,* Schedule 1 item 33

- It may become subjective as each fund provider will describe and bundle their indirect fees and costs differently including investment management, administration and other recoveries.

The FSC notes that trustees who have already moved to the new regime have done so in an inconsistent manner resulting in less comparability across the industry rather than more. This will lead to confusion for members when attempting to compare fees across funds and when making investment decisions. This inconsistency is not only found in relation to the interpretation of the ICR requirements, but also in relation to the interpretation of the new fee requirements more generally. For example, there is variation amongst providers in the treatment of transactional costs. It appears that some providers are reflecting all transactional costs in the buy-sell spread, others are including these costs in their ICR whilst some are electing to disclose some or all of their transactional costs outside of the fee template. There is also uncertainty as to the extent to which other amounts such as one-off cost recovery charges can be disclosed outside of the fee template.

Recommendation: The Regulations be amended to confirm that the ICR includes any fees or costs not charged directly to members' accounts but deducted from the investment returns (i.e. calculated within the unit price or crediting rate) and that such fees or costs are to be included in the ICR but not double counted as Administration and Investment fees.

ASIC Class Order Relief and Timing

On 16 December 2013 ASIC issued Class Order CO 13/1534 which defers the commencement of the following requirements:

- Extending the timeframe to comply with new fees and costs disclosure requirements for PDSs. The requirements will not apply to PDSs given before 1 July 2014.
- Extending the timeframe to comply with new fees and costs disclosure requirements for periodic statements. The requirements will not apply to reporting periods ending before 1 July 2014.

Timing - Exit Statements

The Class Order which deferred the commencement of the MySuper Measures Regulations for periodic statements to those with reporting periods ending before 1 July 2014 does not adequately consider exit statements (which are also classified as periodic statements). As the relief currently stands, exit statements in relation to members that leave a fund after 1 July 2014 will be required to meet the new requirements. This will mean that providers will need to have system developments completed in time to apply to exit statements from 1 July 2014. This is in contrast to half-yearly or annual statements for which providers will have additional time to meet the requirements.

This will effectively negate the apparent intent of the relief, as exit statements will have to comply with the new requirements despite the likelihood that Government will review these requirements on the basis that they are significantly flawed

Recommendation: We request that there is a deferral of the MySuper Measures requirements for all exit statement changes for periods ending before 1 July 2015 to provide a reasonable transition time for debate and rectification of the legislative issues and to ensure that statement templates are not required to be updated twice.

Timing - General

Whilst this relief is welcome and has prevented wide scale non-compliance across the industry, it does not address the interpretative concerns in relation to ICR disclosures. Until such time as these are addressed, we will continue to see variable disclosures across industry.

One FSC member's super and pension products generally undertake a PDS roll during May each year. Even with the benefit of class order relief, in February 2014 they will need to begin committing resources to meeting the new requirements.

It would add unnecessary cost for these products and their members if the requirement to include the required PDS changes by 30 June 2014 is maintained.

Given the lack of clarity in relation to some of the disclosures required by the Regulation, FSC members are grappling with how to comply with the required fee disclosures in this current roll of PDSs due to risk of re-work and potential member confusion. A timely response from government and regulators is of the utmost importance, if the 30 June 2014 timeframe remains in place.

It is not standard practice to require new disclosures to be built within a short implementation window. This is because the time taken to amend disclosures from receiving final requirements is generally 3-6 months. Statement changes are at the higher end of this spectrum (as against PDSs) due to requisite system and template amendments. Different product issuers will be operating to different cycles.

In the interests of good disclosure and best practice regulation, we believe a transitional window of greater than 6 months from the date of receiving completed regulations that have been adequately consulted upon is generally provided for such capital intensive disclosure amendments to allow industry to accommodate new requirements in a seamless fashion congruent with their standard operating procedures. Given the gamut of regulatory change required to be implemented by industry in a compressed timeframe, our belief is that appropriate transitional provisions are of the utmost importance, even more so than under general conditions when the level of change is less.

We suggest that given the numerous technical concerns raised by FSC with the operation of the new disclosures, as well as the need to consult with responsible entities (REs) in relation to managed investment scheme disclosures, that it is imperative more generous transitional arrangements are provided than those contained in ASIC CO 13/1534.

Essentially, this is required because the new regulations cannot be considered to be an appropriate set of final regulations as evidenced by the significant inconsistencies in application across industry by those who have attempted to implement them. Such inconsistency directly contradicts the policy intent of fee comparability.

Recommendation:
1) The various Government agencies jointly consult with industry to provide clarity in relation to the disclosure requirements and finalise the regime.
2) The commencement date, as amended by ASIC CO 13/1534, should be delayed so that the superannuation PDS disclosures are required to be made when the PDS next rolls on or after 30 June 2014 and no later than 30 June 2015. This will provide government with reasonable time to finalise the disclosure requirements and ensure consistent application across industry in line with the policy intent.

APRA reporting consequential impacts

The MySuper Measure Regulations also has a flow on effect to fee, cost and ICR data reporting in the new APRA Reporting forms (SRF 530.0 Fees, SRF 700.0 Dashboard, SRF 702.0 Investment Performance, SRF 330.0 Financial Performance).

The current Class Order relief for MySuper Measures Regulations does not cover the flow on impacts to such reporting. Therefore, from 1 July 2014, the APRA reporting will be also be impacted and RSEs risk being in breach of s29QC (consistency) as well as risk incorrect lodgement.

Recommendation: Any Class Order relief given for the MySuper Measures Regulations must therefore also consider relief for these APRA reporting forms.

APRA REPORTING REQUIREMENTS

The FSC is concerned with the

a) The publication of data reported to APRA
b) The volume of reporting requirements arising in relation to Choice investment products. Some providers are advising the FSC that they will be sending 2000 to 3000 reporting forms to APRA annually under the new reporting regime at enormous expense.

On the first point, the FSC has recently responded to the APRA consultation paper on publication of data it collects. The FSC has highlighted to APRA that their mandate under FSCOD and the APRA Act, and even elements of the Corporations Act should prevent the publication of much of the data they receive for prudential purposes.

APRA's initial premise is that all data will be classed as "not confidential" unless it is proven otherwise, and it is APRA's sole decision as to whether a sufficient argument has been mounted to classify data as "not non-confidential". We re-iterate our concerns about their approach and would be happy to provide Treasury with a full copy of our APRA submission. We request Treasury to tighten the regulations to reduce the publication of data submitted to APRA.

On the second point, in APRA's Response to Submissions regarding the Reporting Standards for Superannuation (SRS 700.0, SRS 702.0 and SRS 703.0) dated 6 September 2013, APRA noted the following in paragraph 4.6:

> "The Government has indicated that it will undertake further public consultation on the requirements for choice product dashboards, including whether the net return or net investment return is the more appropriate measure of performance for choice products.
>
> On that basis, APRA will defer finalising the requirements regarding investment performance reporting for select investment options until the Government's consultation has concluded. This will enable alignment between the final requirements in law regarding the product dashboard and APRA's reporting requirements.
>
> SRF 702.0, therefore, applies only to MySuper investment options (non-lifecycle MySuper products and lifecycle stages of lifecycle MySuper products).
>
> With regard to SRF 533.0, now that the baseline collection of the select investment options has been completed, APRA has a clearer emerging picture of the types of select investment options that will be reported to APRA from 1 July 2014. As a result, APRA intends to re-consult on the requirements of SRF 533.0 as they apply to select investment options as part of future consultation on reporting for such options in relation to the product dashboard and investment performance."

The FSC is of the view that it is necessary for the Government to broaden APRA's review of which Choice investment option reporting requirements are still required. It is also necessary to conduct an assessment of the additional cost that would arise if all the additional Choice investment option reporting requirements were implemented against the prudential regulatory benefits that would be achieved.

In addition, we believe Government should also consider raising with APRA the removal of SRF 711. We note SRF 711 is intended to collect data for the purpose of informing the assessment of public policy (SuperStream) and only for a limited period. Given the information is only required temporarily and is not for prudential supervision purposes, we believe the implementation of this particular reporting form imposes an unnecessary cost and regulatory burden on industry. Moreover, we understand many of the data fields under SRF711 will be very difficult to source, particularly given the infancy of the MySuper contribution regime.

The FSC is of the view that with the vastly enhanced data collection in relation to RSE Licensees, much of the reporting requirements for Choice investment options is redundant and simply creates additional costs for superannuation funds, consumers and indeed for the APRA to process.

Recommendation:
1) Government discuss with APRA not create a Reporting Form SRF 701.0 Product Dashboard (Choice Products) as doing so would create unnecessary regulatory cost for funds and members.
2) Government discuss with APRA on abolish SRF 330.1, 533.0, 702.0, 703.0 and 711.0.
3) Government review the FSC submission to APRA and to tighten various regulations to reduce the publication of data submitted to APRA.

Select Investment Options

APRA's reporting standards introduce the concept of a "Select investment option". The intent was to capture the most important investment options for a trustee and report them to APRA to allow for better prudential supervision. However, the concept is flawed.

As evidenced in many of the larger players, there can be between 200 to 400 Select investment options. Clearly, the definitions are too broad.

APRA reporting by Select investment option is planned to be completed quarterly. Where a provider has 300 Select investment options, for SRF 533.0 (Asset Allocations) there will be 300 x 4 quarters = 1200 reports submitted to APRA annually. If we just assumed there were six major providers, then APRA would receive 1200 x 6 = 7200 submissions per annum for just this one form.

Prudential supervision will not be enhanced by this over reporting. Government costs will necessarily increase to handle the phenomenal increase in data. Member costs will increase to handle the additional trustee reporting.

The planned APRA reporting by Select investment option requires full financial data to be reported that is not naturally captured at the investment option level. RSEs are struggling with this currently (required for 1 July 2014). While the data is theoretically desirable it is neither needed nor practical to collect.

APRA intends on publishing much of the data it collects (subject to the responses received from the recent APRA consultation paper on publication of statistical data). Where an RSE has a large number of Select investment options, this level of granular financial data clearly exposes confidential information of an RSE's operation.

Recommendation:
1) Treasury to work with ASIC to create Class Order relief for Select investment option reporting (SRF 533.0 and 330.1) whilst the Government consults with the industry on the issues raised in this paper.
2) The Government discuss with APRA to abolish reporting by Select investment option level.

Reducing the frequency of APRA reporting

APRA's reports require lodgement of data at both defined and ad-hoc times. In some cases, there are both quarterly and annual reporting of identical information. For example, investment performance information is required to be reported on a quarterly, annual and ad-hoc basis upon wind up of a fund.

This duplication, combined with the timeframe for preparation and lodgement of a variety of reports simultaneously drives up compliance costs and increases the risk that data provided will be of sub-standard quality and integrity. It is questionable whether such constantly changing data in significant volumes will allow APRA to usefully undertake timely prudential supervision activities in response, as is anticipated.

For defined benefit funds which are in run-off mode, data rarely changes, yet the frequency of reporting has now increased to quarterly. Trustees will provide the same data to APRA four times a year with little variation in content. This will certainly not aid APRA in its prudential supervision.

The industry has now had two quarters to understand the operational realities of the enhanced APRA reporting framework, albeit based on relatively low volumes of reports. A commonly reported reality is that there is a significant increase in resources dedicated towards preparation for lodgement of the reports. This is usually because data needs to be sourced from a number of locations/systems and converged into a central staging point for assembly, reconciliation, authorisation and lodgement.

From the second half of 2014 the number of forms lodged each quarter is scheduled to significantly increase (up to 10 times the report volumes currently being handled) with the introduction of APRA reporting in relation to Choice investment products. This will create a significant spike in the application of resources and costs.

We note that APRA has the authority to collect additional data for supervision, and providers are willing to do this where APRA has specific concerns with a specific provider. However, over reporting by the whole industry merely adds ongoing costs to every layer (members, trustees, regulators) for little benefit.

Recommendation: The Government consult with industry in relation to reducing the frequency of reporting requirements to APRA (e.g. in relation to Choice investment products, and defined benefit data) with a bias towards annual reporting unless there is a clear prudential regulatory reason for more frequent reporting.

Defences to APRA for reporting breaches

Under section 13 of the *Financial Sector (Collection of Data) Act 2001*, failure to provide the information required by an APRA reporting standard is a criminal offence of strict liability carrying a penalty of $8,500. Alternatively, APRA can issue an infringement notice under

Division 3 of Part 3 of the Financial Sector (Collection of Data) Act 2001 which has a penalty of $1,700 per breach.

There are no legislative defences to a breach of the APRA reporting standards. This is problematic given the marked and considerable increase in APRA's data requirements and the need for RSE licensees to rely on information provided to them by other investment vehicles under the new look-through rules, some of which will not be associated with the RSE licensee and will not have a direct relationship with the RSE licensee.

Due diligence / reasonable steps defences are provided to superannuation funds under the product dashboard and portfolio holdings rules in the Corporations Act. The APRA reporting defences could be modelled on these existing statutory defences.

Recommendation: The *Financial Sector (Collection of Data) Act 2001* be amended to grant trustees statutory due diligence / reasonable steps defences.

CONSUMER ADVISORY WARNING

A change to the Corporations Regulations driven by MySuper was clause 221 of Schedule 10.

There were several technical problems with the change, including:

- For the second paragraph, the term 'investment' is more generic than either the old term 'fund' or new term 'account' and is therefore more appropriate for a prescribed warning intended to cover all of MySuper, choice super and MIS product PDSs.
- In the fourth paragraph, incomplete terminology did not cover all of the various types of fees that may be negotiable for MySuper, choice super and MIS products.
- The current first sentence in the fourth paragraph (ie negotiation of administration fees by employers) is potentially relevant to corporate and MySuper products only.

Below is an amended clause which the FSC is of the view would address these concerns:

Division 7–Consumer Advisory Warning

221 Consumer advisory warning

DID YOU KNOW?

Small differences in both investment performance and fees and costs can have a substantial impact on your long term returns.

For example, total annual fees and costs of 2% of your investment balance rather than 1% could reduce your final return by up to 20% over a 30 year period (for example, reduce it from $100,000 to $80,000).

You should consider whether features such as superior investment performance or the provision of better member services justify higher fees and costs.

Some fees may be negotiable - ask your fund or, if applicable, your financial adviser.

TO FIND OUT MORE

If you would like to find out more, or see the impact of the fees based on your own circumstances, the Australian Securities and Investments Commission (ASIC) website (www.moneysmart.gov.au) has a *[superannuation or managed investment] fee* calculator to help you check out different fee options.

Recommendation: Adjust the Consumer Advisory warnings for PDS and statements as noted above.