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LAWYERS

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Our Ref AQM/BRH

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Dear Sir/Madam

**Exposure Draft – Tax Laws Amendment (2012 Measures No. 5) Bill 2012: Merging
superannuation funds**

Henry Davis York is grateful for the opportunity to comment on the Exposure Draft. Our submission is set out in the attachment to this letter.

We would be happy to elaborate on our comments if that would be of further assistance.

Yours faithfully
Henry Davis York

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Exposure Draft – Tax Laws Amendment (2012 Measures No. 5) Bill 2012: Merging superannuation funds

Submission on Exposure Draft

Background

The very large increase in superannuation fund mergers that previous regulatory initiatives in the superannuation industry have produced has not been the result of an express policy, set out in legislation. It arose simply as the economic consequence of a significant expansion in compliance costs. The latest round of changes, under the umbrella of Stronger Super¹ are different. They are explicitly designed to promote economies of scale. The new regulatory regime will demand that trustee boards consider scale as part of their strategic focus.

The central legal provision in this regime will be s 29VN(1)(b) of the SIS Act.² This provision requires that the trustee board determine on an annual basis whether holders of their basic product (the commoditised "MySuper" product, into which most employees will be required to be placed) are disadvantaged compared to such product holders in other funds. The board's assessment of disadvantage must consider:

- Whether the number of the fund's MySuper beneficiaries is insufficient.³
- Whether the number of the fund's beneficiaries as a whole is insufficient.⁴
- Whether the pool of assets in which the assets underlying the MySuper product are mixed is insufficient.⁵

The role of APRA in enforcing the requirements will obviously be critical. In this regard, the following additional elements of the Stronger Super regime are very significant:

- The gathering of fee, cost and net return information from funds in relation to their MySuper products by APRA, and the publication of this information quarterly.⁶
- The intention of APRA to review the sufficiency of scale requirement as part of its prudential supervision.⁷

¹ Stronger Super - Government response to the Super System Review issued on 16 December 2010 by the Hon Bill Shorten MP and Stronger Super Information Pack - Government decision on the key design aspects of the Stronger Super reforms issued on 21 September 2011 by the Hon Bill Shorten MP.

² See Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (**Trustee Obligations Bill**).

³ Proposed s 29VN(1)(b)(i) of the SIS Act (see Trustee Obligations Bill).

⁴ Proposed s 29VN(1)(b)(ii) of the SIS Act.

⁵ Providing the assets of the fund that are attributed to the MySuper product are to be pooled with other assets of the fund, or assets of another entity or other entities: proposed s 29VN(1)(b)(iii). If not, the assets supporting the MySuper product must be considered in isolation.

⁶ Proposed s 13(4A) of the Financial Sector (Collection of Data) Act 2001 and s 348A of the SIS Act (see Exposure Draft Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012).

The justification for the components of the scale determination emerge fairly clearly from the different cost and fee structures faced by trustees.⁸ What remains somewhat unclear is what the comparator "other funds" will mean in the board's determination of scale.

For funds in the cohort of the largest superannuation funds the relative inferiority of performance attributable to insufficiency of scale will be much less significant.⁹ For these funds it will be easier to conclude that the disadvantage is not attributable to scale. Even if a determination is made that insufficiency of scale is a cause of relatively poorer performance, a board could reasonably conclude that the interests of beneficiaries would be promoted merely by competing harder to gain scale from other competitors.

For smaller superannuation funds the situation will be quite different. The research finds that the average not-for-profit fund in the smallest quintile has risk-adjusted net returns that are lower by 28 basis points per quarter (or 112 basis points per annum) compared to the average not-for-profit fund in the largest size quintile.¹⁰ It will be very hard for the smallest funds to avoid the conclusion that their inferior performance is attributable to scale, and the making of such a determination is likely to have quite different consequences.

The obvious implication will be that such funds should merge with another fund to gain scale. There are of course a number of considerations to bear in mind in taking this course, including successor fund transfer requirements and the associated risks of transition. Alternatively, it is possible that a collaborative strategy might allow smaller superannuation funds to compete in the area of scale economies in a way that allows them to succeed. However, planning for these ventures would need to be advanced fairly quickly in order for them to be operational in the time frame required. It is already a requirement of the MySuper authorisation application that the trustee attach the policies and procedures by which it will make its scale determination.¹¹

The Exposure Draft

Against this background, the legislative changes proposed in the Exposure Draft will further strengthen the Stronger Super policy position, by removing an obstacle to superannuation fund mergers. As stated in the draft Explanatory Memorandum:

"the Government's Stronger Super reforms will put pressure on superannuation funds to improve their competitiveness or reassess their viability in the absence of merging with another entity.... Tax considerations are a major impediment to mergers..."

We agree that the extension of the Income Tax Assessment Act 1997 Division 310 relief through to 30 June 2017, proposed in the Exposure Draft, is appropriate, given the Government's policy to place consideration of the benefits of scale at the centre of trustee boards' concerns.

⁷ Note APRA's September 2011 Discussion Paper *Prudential standards for superannuation*, at p 14. The Explanatory Memorandum to the Trustee Obligations Bill notes that APRA will also provide prudential guidance (at paragraph 1.27).

⁸ APRA Working Paper "Effect of fund size on the performance of Australian superannuation funds" March 2012 by Dr James Richard Cummings.

⁹ Cummings, above note 8.

¹⁰ Cummings, above note 8, at p 22.

¹¹ APRA Application Form *Authority to offer a MySuper product* issued 3 May 2012.

Conclusion

We are grateful for the opportunity to respond to the Exposure Draft and would be happy to answer any questions on this submission.

Henry Davis York
24 August 2012

This submission has been prepared by Anne MacNamara and Braydon Heape, members of the Financial Services Group at Henry Davis York. Their contact details, together with details of other partners in the Financial Services Group, are set out below:

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