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The Treasury
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Email: intrafundconsolidation@treasury.gov.au

16 August 2012

Subject: Intra fund auto consolidation

Dear Sir/Madam

Thank you for the opportunity to comment on the exposure draft of the proposed legislation.

Given the considerable pressures RSE licensees are currently facing with the implementation of various Stronger Super measures, significant concerns with the exposure draft and the uncertainty as to when any legislation will be finalised, we recommend intra fund consolidation be deferred for twelve months during which time more appropriate requirements could be developed.

Further, we recommend mandatory consolidation be restricted to small inactive interests (other than pensions). Small interests would initially be those up to $1,000. Mandatory consolidation for small accounts should not occur without the member having the opportunity to opt-out unless there is no change to overall entitlements. For larger accounts, an opt-in approach would generally be more appropriate.

Our more detailed comments are set out in the following pages.

If you have any queries on our submission, please contact the writer on 03 9623 5552 or by email at john.ward@mercer.com.

Yours sincerely,

JDWard

John Ward
Manager, Research and Information

Executive summary

The Government's desire is to minimise the number of unnecessary accounts. The draft legislation and draft explanatory memorandum (EM) requires major changes to make it workable.

Our concerns include:

- The obligations placed on trustees to establish what is in each member's best interests is impracticable and should be removed
- The automatic consolidation of interests without a member's positive consent is unreasonable and any consolidation should be on an opt-in basis only (except for very small interests – say under $1,000 or where there is no overall impact on member entitlements)
- Pension interests should be excluded from the requirements due to the impracticability of merging such interests
- The exemption for defined benefit interests needs to be clarified
- The EM should provide examples of where merging interests would be considered to be impracticable
- The draft EM implies the requirements of the draft Bill can be complied with by maintaining separate interests under one account with one account fee and a single insurance policy. However, this is inconsistent with the draft Bill and in any case may result in breaches of proposed fee cross subsidisation requirements
- A number of examples in the draft EM provide confusion rather than assistance and need to be addressed
- The lack of protection for RSE licensees from action by members who are aggrieved by decisions to merge or not merge their interests. It is critical trustees are provided with protection where they have acted reasonably and in compliance with the legislation
- The apparent requirement to annually consider merging a member's interests where the member has previously indicated separate interests be maintained
- Apparent conflicts with requirements to transfer accrued default amounts to MySuper by 30 June 2017
- The requirement to have a consolidation policy in place by 1 January 2013 is impractical bearing in mind the current status of this legislation and the short time frame between passage of legislation and 1 January 2013. Licensees need at least six months from Royal Assent to put a policy in place
- The requirement for the first annual consolidation to occur by 30 June 2013 when the MySuper requirements will result in further new accounts shortly after that date. The first consolidation should not be required until at least twelve months after the requirements for employers to contribute to a fund offering a MySuper product are introduced
- The considerable costs RSE licensees will incur in complying with these requirements which will generally need to be passed on to all members of the fund as higher fees
- The short consultation period (less than one week) bearing in mind the substantial differences between the exposure draft and the previous version.

Overall recommendations

1. The obligations to be placed on trustees

The exposure draft is based on the theory trustees will be able to determine whether a merger of interests is in the member's best interests. This theory is basically flawed.

No change to investment and insurance after consolidation

Whilst it may initially appear to be in a member's best interests to combine two accounts where the investment options and overall insurance will not change after merger with a reduction in fees being the only difference, this is not necessarily the case. The following examples highlight some situations where this is not the case:

- Where the member is deliberately maintaining separate interests for death benefit purposes (e.g. binding death benefit nominations may be in place – with potentially different beneficiaries)
- Where the member is deliberately maintaining separate interests for tax or preservation purposes (for example, the member intends using one interest for the purposes of commencing a pension in due course and another interest which will be taken as a lump sum).

Change in investment options

Trustees will be required to consider whether the reduction in fees is likely to be greater than the additional investment income that might be expected from maintaining the separate accounts. It is unclear how a trustee could determine a reduction in fees is likely to offset potentially higher returns from a different investment option. Examples 1.2 and 1.3 of the draft EM further confuse the requirements. It might be assumed any member who has a Choice interest (that was not originally a default interest) is an engaged member because at least one of the interests has been specifically chosen by the member. Based on the logic of example 1.3 of the draft EM, the RSE licensee should not merge the interests. However, example 1.2 gives a contradictory outcome for a member with smaller account balances. The size of the member's account balance should have no bearing on the RSE licensee's decision. If a member has chosen a particular option, then the trustee should not be required to override the member's choice.

We also note standard industry practice in relation to investment choice would result in different investment options being included in the one superannuation interest with a single administration fee (investment management fees would vary depending on the investment options chosen.) Paragraph 1.13 therefore adds confusion as the only difference in fee would generally be a difference in investment management fees reflecting the greater complexity or costs involved with each investment option. RSE licensees should not need to consider such fee differences in these cases.

Change in insurance

In merging accounts it may not be possible to consolidate the insurance cover. The insurance provided under the ongoing account may not have the flexibility to add on any insurance transferred from the account being merged. In some cases, even the insurer would be different. Where this is not possible, it is difficult to envisage a trustee being able to consider such a merger would be in the member's best interests. As above, there are also issues relating to different potential beneficiaries under the different interests which would make it virtually impossible for any trustee to decide to merge interests without member consent unless the combined cover results in no change in potential beneficiary.

Recommendation: *The member interest test is unworkable in many situations and it is inappropriate for RSE licensees to be required to make decisions about a member's best interests where there is significant room for doubt. We consider mandatory auto-consolidation is flawed unless it is restricted to very small account balances. Consolidation of larger accounts should only occur with the positive consent of the member unless it is clear there is no change in overall entitlements.*

2. Pension interests

There is no specific reference to pension interests in the exposure draft explanatory memorandum. We note contributions cannot be added to a pension account once a pension has commenced. Neither can an amount be rolled over to a pension product. If pension products are to be merged or combined, it would appear both pensions would need to be commuted, combined whilst in non-pension mode and the combined amount used to purchase a new pension. Such a process will impact on:

- Social Security treatment – we note the trustee will not be aware of the impact on specific pensioners
- Tax – merging two pension interests with differing percentages of relevant tax components could have a significant adverse impact on some pensioners – we note the trustee will not be aware of the pensioner's intentions regarding partial commutations and draw down amounts. Separate pensions could have been established deliberately to minimise future tax payable. We also note the ATO has not yet finalised draft Tax Ruling TR 2011/D3. Depending on the outcome of this Ruling, merging two pension interests by commuting both and recommencing a new pension could have significant adverse tax consequences for the pensioner as well as creating serious practical difficulties for the fund
- Minimum draw down limits – commuting existing pensions and recommencing a single pension could result in an increased level of minimum drawdown in the year of commutation/recommencement

It will generally be impossible for any RSE licensee to determine whether combining pension accounts is in the best interests of the member.

As written, the draft Bill would also seem to require the RSE licensee to merge a pension interest with a member's active accumulation interest in the growth phase. We consider this to be impracticable due to the different tax treatment of the different accounts as well as relevant tax legislation which requires pensions to be maintained as separate interests. Hence such situations should be exempt from the merger requirements.

Recommendation: *Pension accounts need to be specifically excluded from the merger/consolidation requirements*

3. Defined benefit interests

Defined benefit interests are specifically excluded from the merger requirements. We note a defined benefit interest may include a defined benefit component and an accumulation component. By excluding defined benefit interests, it would not be possible for an RSE licensee to merge, say, an inactive accumulation account with the accumulation component of the defined benefit interest.

However, the fourth dot point under paragraph 1.13 of the draft EM implies that it would be possible to merge with a defined benefit interest where the defined benefit is able to accommodate an accumulation component.

Recommendation: *The Bill and the EM should be consistent. If the intention is to require mergers with an accumulation component of a defined benefit interest, this should be specifically set out in the Bill.*

4. Multiple employers

Some members may have more than one employer and as such are active members of more than one superannuation plan. In some cases, the members may be active in two or more employer based plans in the same corporate master fund. Insurance cover may vary from employer plan to employer plan (potentially with different insurers) and it would generally not be possible to merge insurance cover.

Recommendation: *The EM should indicate mergers of interests in different employer plans in the same fund may not be practicable.*

5. Exemption where merger is not practicable

We note the EM is silent in relation to the meaning of what is not practicable. If this Bill is to proceed, we consider the EM should include examples of situations where a merger is not, or may not be practicable.

Such examples should include:

- The merger of two pension interests
- The merger of a pension interest with a non-pension interest

- The merger of two accounts which will result in a decrease in insurance cover
- The merger of two interests where the potential death benefit beneficiaries are different
- The merger of a Choice interest where the member has positively chosen the interest (or a similar interest in a predecessor fund)
- The merger of two active interests for members with more than one employer (unless the member consents)

Recommendation: *The EM should provide examples of situations where it would (or may) not be practicable to merge interests.*

6. Maintaining separate interests but under one account

Paragraph 1.12 of the draft EM adds further confusion by its statement:
"The term 'merge' covers two kinds of case. In the first, trustees can choose to retain separate interests, but bring them under a single 'account' with a single set of membership fees and charges, and a single insurance policy."

This is inconsistent with the draft Bill which only refers to the merger of superannuation interests. If the Bill is amended to accommodate this interpretation, it would conflict with other proposed legislation.

For example, if a pension interest and a MySuper interest were consolidated under one "account" with one fee, this would result in a breach of proposed Section 99E of the Superannuation Industry (Supervision) Act (to be introduced by the exposure draft of Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012) as it would result in a cross subsidy between a MySuper class and a pension class of members.

Maintaining two separate pension interests under one account with one fee would also result in fee cross subsidisation where members with one (or no) pension interest would be forced to subsidise those with more than one interest.

Recommendation: *If the Bill is amended to require one account fee for multiple interests, it would be necessary to exempt pension interests*

7. Lack of protection for trustees

We expect there will be numerous instances of members complaining to RSE licensees about their interests being mandatorily consolidated under the requirements of this legislation. In some cases, members will consider the consolidation was not in their interests, either potentially or because they have already been detrimentally affected. In some cases, it may be possible for the consolidation to be reversed however, in other cases, it will be impossible to do so or only possible if rectification is made, presumably at a cost to the RSE licensee's insurer, the fund's Operational Risk reserves or an increase in fees to all members.

We suspect a high proportion of such cases will end up in the Superannuation Complaints Tribunal.

Recommendation: *The Bill needs to provide protection for trustees against claims by members for any actions taken by the trustee to merge a member's interests or any decisions not to merge a member's interest where such actions or decisions were in accordance with the law and the RSE licensee's policy on intra-fund consolidation.*

8. Repeat merger requirements

RSE licensees are expected to perform a matching and consolidation process at least annually. Where a member has opted out (or potentially declined to opt-in) of merging multiple accounts, the draft Bill would require the RSE licensee to undergo the same process for the same member year after year. At the very least, the RSE licensee would need to consider whether an earlier refusal to consolidate by the member is now a valid reason not to consolidate (on the grounds of member's best interest).

Recommendation: *Where a member has either opted out or declined to agree to merging accounts, the RSE licensee should not be required to instigate a merger of those accounts in subsequent years.*

9. Implementation timing

The timing of implementation is a serious concern.

Firstly, the draft Bill requires each RSE licensee to have a policy on intra-fund consolidation in place by 1 January 2013. The draft Bill is different in scope to the earlier draft Bill on intra fund consolidation issued in April 2012 and it is unclear when any Bill will be tabled in Parliament, when it will be passed and whether it will be amended before being passed. It is unreasonable to expect RSE licensees to develop a policy in the period until 1 January 2013, particularly when it is unclear what rules will apply. Many RSE licensees already appear to have expended significant time and resources working towards implementing the previous version of this draft legislation.

Secondly, the draft Bill requires the first merger of interests to occur by 30 June 2013. This is before the implementation of MySuper which is likely to create further new interests for many members resulting in further consolidation work for RSE licensees. It would be more logical for RSE licensees to be able to consider merging interests after the implementation of MySuper rather than before so that appropriate mergers of current interests can occur once rather than the exercise having to be repeated after MySuper is introduced.

Recommendation: *RSE licensees should be given at least six months after Royal Assent of relevant legislation to prepare a policy and should have at least six months after 1 October 2013 (or such later date by which employers must contribute default contributions to a fund offering a MySuper product) in which to first implement those policies.*

10. Conflict with other draft legislation and APRA Prudential Standard SPS 410
The timing requirements of this draft Bill appear to conflict with the timing requirements for account consolidation under the Exposure Draft of Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 and the draft APRA Prudential Standard SPS410 on MySuper Transition which require various existing accrued default amounts to be transferred to MySuper by 30 June 2017.

Recommendation: *A clear explanation of the how this draft Bill and the draft Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 and SPS410 interact should be provided*

11. Cost
The process of annually checking whether a member has more than one interest is likely to be considerable.

RSE licensees will need to:

- Attempt to match accounts
- Where a match (using Tax File Number) has been found, names and addresses may be different requiring the trustee to follow up to ensure the accounts are held by the same person. The member will need to provide proof of change of name etc.
- Write to relevant members advising that their interests have been or are about to be merged. Such correspondence will need to be detailed to highlight the changes. Many such advices will be individual in nature and hence will need to be specifically prepared on an individual basis
- Where merging is on an opt-out or opt-in basis, keep records of member responses and activate/deactivate merger processes appropriately (we note recordkeeping of opt-outs will become very complex and confusing as there will also be the need to keep records of opt-outs from inter-fund consolidations and insurance
- Issue termination and rollover statements

As the RSE licensee cannot charge the relevant member a fee for this service, costs will need to be recovered by increasing fees across the board.

12. Consultation period
We note our concern with the very short period for consultation on this significant piece of legislation. Bearing in mind the substantial differences to the earlier exposure draft on this issue a longer consultation period should have been provided to enable appropriate time for the industry to consider the implications of the proposals.

Appendix

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 institutional clients worldwide. Mercer consultants help employers design and manage health, retirement and other benefits, and optimise human capital.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). Mercer's outsourcing business has $55 billion in funds under administration locally, provides services to over 1.3 million super members and 15,000 private clients and is part of a global consulting, outsourcing and investments firm which operates in 42 countries.

We provide our own master trust the Mercer Super Trust in Australia which has approximately 260 participating employers, 240,000 members and more than $15 billion in assets under management. Mercer’s investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.