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The Senior Adviser
Superannuation Unit
Financial System Division
The Treasury
Langton Crescent
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Via email: **strongersuper@treasury.gov.au**

1 November 2012

Subject: Superannuation Legislation Amendment (Further Measures) Bill 2012

Dear Sir/Madam

Thank you for the opportunity to comment on the exposure draft of the Superannuation Legislation Amendment (Further Measures) Bill 2012.

Our primary concerns relate to items which are not included in the Bill rather than what has been included. We believe there are various unintended flaws in the various Bills making up the Stronger Super package which need to be amended or at least clarified:

1. New barriers to fund rationalisation through mergers

The various MySuper Bills will make it much more difficult for the effective merger of superannuation funds in future. Even where the merger is in the best interests of members, it would appear trustees will need to obtain the consent of all members transferring from a fund which is winding up.

To enable mergers to be carried out efficiently, changes are necessary to:
- the definition of accrued default amounts; and
- the provisions restricting the transfer of members from one MySuper to another without member consent

2. The transfer of crystallised defined benefits to MySuper

A drafting flaw requires lump sum defined benefits which crystallise after 1 July 2017 to be transferred to a MySuper several years before they actually crystallise. Yet, in applying for a MySuper approval, trustees will need to elect to comply with this task. Further, transferring

crystallised defined benefits to MySuper is unlikely to be in interests of members, at least in the short term with benefits becoming subject to the fluctuations of investment markets, and withdrawal fees which would generally not be incurred otherwise. These problems could be solved by excluding crystallised defined benefits from the definition of accrued default amounts and/or providing a more reasonable period to enable a member to make alternative arrangements before a transfer to a MySuper is implemented.

3. Insurance issues

Amendments or clarification is required:

- To allow disability insurance definitions for which premiums are currently tax deductible to continue being provided
- To clarify the intent of Section 29TC(1)(b)
- To enable income protection insurance to be offered to some groups of MySuper members but not all
- To include specific provisions so that trustees offering income protection insurance can do so subject to reasonable conditions.

4. Tax treatment of allocations from an Operational Risk Financial Reserve

Amendments are necessary to the Income Tax Assessment Act (1997) to prevent allocations from such reserves to rectify an operational risk event from being treated as concessional contributions and potentially subject to excess concessional contribution tax.

5. Disclosure

The proposed requirements to disclose all assets on a fund's website need to be restricted so that only assets in excess of a materiality threshold need to be disclosed.

6. Defined benefit member with an additional MySuper account

Greater clarification is required in relation to the insurance requirements for defined benefit members with an optional MySuper account and the impact of Section 29TC(1)(b) for such members.

7. Member protection

The member protection requirements need to be removed irrespective of any changes to lost member requirements. Otherwise funds will be unable to comply with the MySuper fee rules.

8. Transfers from overseas funds

Either proposed Section 29TC(1)(f) needs to be amended to remove the requirement to accept amounts from overseas funds or the Government needs to clearly announce an intention to introduce regulations which will exempt funds from having to accept amounts from overseas funds.

We have included more detail on the above issues in Appendix 1.

Recommendation to delay implementation of MySuper
There are still a number of issues which need to be resolved before funds can fully understand the proposed requirements. In view of the delays in obtaining such clarification and the passing of relevant legislation, and the lack of regulations providing more detail on issues such as insurance, we strongly recommend the implementation of MySuper be delayed by at least six months.

We also highlight a recommendation we made to the Joint Parliamentary Committee in relation to the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 which would significantly increase the efficiency of transferring members to the new MySuper arrangements and, we expect, would result in a faster transition of accrued default amounts to a MySuper product.

This recommendation was to allow RSE licensees to continue allocating contributions to an existing investment option for existing members (as at 1 January 2014) until 30 June 2014. This would provide more time for the allocation of future contributions to be co-ordinated with the transfer of accrued default amounts. Contributions for new members would be immediately allocated to a MySuper unless directed otherwise by the member.

If you have any queries on this submission, please contact John Ward on 03 9623 5552 or john.ward@mercer.com

Yours sincerely

for
John Ward
Manager, Research & Information

APPENDIX 1

1. New barriers to fund rationalisation and mergers

The proposed legislation creates two major barriers to future rationalisation of funds through mergers.

a. Definition of accrued default amount – Choice members

Consider the following example where Fund A is merging with Fund B. It is proposed to transfer members from Fund A to Fund B using the successor fund transfer provisions.

A member has directed the trustee of Fund A to allocate contributions to a Choice option in Fund A. Under a successor fund transfer, the member's account would normally be transferred to a similar investment option in Fund B.

However, once transferred to Fund B, the member's account would become an accrued default amount because the member has not directed the trustee of Fund B to allocate amounts to that option. It would therefore be necessary to transfer the member's account to Fund B's MySuper account. This may result in a significantly different investment strategy than had been chosen by the member in Fund A.

The creation of an accrued default amount following a successor fund transfer also results in difficulties similar to those raised in more detail in respect of defined benefits below. These accrued default amounts would generally need to be transferred to a MySuper years before they actually arose which will not be possible.

Recommendation: Amend the definition of accrued default amount to exclude accounts where the member has provided a direction to the trustee of a previous fund and the account is now invested in a similar investment option.

b. Inability to transfer from one MySuper to another

Following last minute amendments to Sections 29TC(1) (g) and (h) of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 it will not be possible to transfer the MySuper members of Fund A to Fund B's MySuper without the member's consent unless the transfer is permitted or required by legislation.

Under the SIS regulations, a transfer of a member to another fund is not prohibited if it is to a successor fund - that is, to a fund that provides "equivalent rights" in respect of benefits transferred to it. This successor fund standard is a high standard that protects the interests of members who are transferred.

Successor fund transfers are the most important mechanism for moving employees of employers from poor performing funds to high performing funds.

Unfortunately, the expression of section 29TC(1)(h) creates significant uncertainty around whether it remains possible to transfer members without their consent to another MySuper product that would be a successor fund.

The uncertainty arises because a successor fund transfer is not "permitted ..... under a law of the Commonwealth" it is permitted under the trust deed of that fund and not prohibited by the law of a Commonwealth.

Recommendation:

- ***amend proposed Section 29TC(1)(h) to expressly enable a transfer of members to another MySuper product that is a successor fund by replacing (h) with:***

  *"(h) a beneficial interest of that class in the fund (the **old interest**) cannot be replaced with a beneficial interest (the **new interest**) in another superannuation entity unless:*

  (i) the replacement is as a result of a transfer to a successor fund under Regulation 6.29 (1)(c) of the Superannuation Industry (Supervision) Regulations, or is permitted or required, under a law of the Commonwealth; or

  (ii) the person who holds the old interest consents in writing to the replacement with the new interest no more than 30 days before it occurs; and "

- ***if the first recommendation is not possible, to include a note to section 29TC(1)(h) as follows:***

  "Note: replacements with new beneficial interests that are "permitted" under a law of the Commonwealth would include new beneficial interests in a successor fund in accordance with regulation 6.29 (1)(c) of the Superannuation Industry (Supervision) Regulations"

2. Transfer of accrued default amounts in defined benefit funds

The requirements relating to the transfer of accrued default amounts in item 7 of Schedule 6 of the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (Section 29SAA) are flawed and in some cases, from 2017 onwards, it will be impossible for some RSE licensees to comply.

The concern relates to new accrued default amounts which arise after 1 July 2017 in a defined benefit fund which has offered a MySuper product for some time.

In a defined benefit fund, accrued default amounts can arise at any time when a member's lump sum defined benefit is crystallised (generally resulting from the member leaving the employer's service). This is because, at this point, the member ceases to be a defined benefit member and the crystallised defined benefit will (unless the member has given already given the trustee instructions as to how the amount is to be invested) become a default amount attributed to a member who is not a defined benefit member and so fall into the definition of accrued default amount. Existing rules in many defined benefit funds currently result in the automatic allocation of these crystallised benefits to the fund's cash option (or a very conservative option) as it is generally considered unreasonable for a member's defined benefit to suddenly become subject to investment fluctuations on leaving employment. The member would then be advised of the details of their crystallised benefit and be given the opportunity to either transfer their benefit to another fund or change the investment option. Any automatic or compulsory transfer which exposes the member to potential investment losses on the crystallised benefit may not be in the member's best interests.

We note transferring crystallised defined benefits to a MySuper can also result in an increase in withdrawal fees incurred by the member. Currently withdrawal fees for defined benefit members are almost always met from employer contributions rather than reducing the member's benefit. If a crystallised defined benefit is transferred to a MySuper product, a withdrawal fee (assuming one applies in the MySuper product, as is generally expected to be the case) would become payable by the member on subsequent withdrawal from the MySuper. This likely consequence is another reason why the transfer may not be in the member's best interests, particularly where the member wishes to cash their benefit, purchase a pension or rollover to another fund in the short term.

As currently written, the Bill requires the RSE licensee to elect to transfer accrued default amounts arising after 1 July 2017 to the fund's MySuper within 30 days of the fund receiving approval to offer a MySuper (which could be from 1 July 2013). As a crystallised defined benefit arising after 1 July 2017 would be a default amount attributed to a member who is not a defined benefit member, it would become an accrued default amount. It will be impossible to achieve such a transfer in the required time frame as the time for transfer (within 30 days of the fund receiving approval to offer a MySuper) would have ended well before the accrued default amount arose.

A similar problem arises where a defined benefit is crystallised shortly before 1 July 2017 although in this case, the transfer must occur by 1 July 2017 (assuming the fund received approval to offer a MySuper more than 30 days before 1 July 2017). In such cases it may not be possible to comply with APRA's proposed requirements of providing members with three months notice of such transfers.

For an accumulation fund, it is unlikely new accrued default amounts will arise in a fund which has offered a MySuper for some time (an exception is through a fund merger and this is covered further in the previous section.)

Recommendation:
Either

- ***Amend the definition of accrued default amounts to exclude crystallised defined benefits; and/or***
- ***Amend the transfer requirements to allow trustees a period in which the transfer of a crystallised defined benefit to a MySuper can be arranged (this should be at least four months after the accrued default amount arose to enable the trustee to provide three months notice and a further month in which to make the transfer if the member does not respond)***

3. Insurance issues

The industry is still confused in relation to the insurance requirements. Confusion relates to two particular areas:

a) Definitions

The definitions of permanent incapacity and whether definitions such as loss of limbs, inability to perform home duties or activities of daily living (i.e. definitions which are currently fully tax deductible) will be able to continue. We understand this will be clarified in regulations and reiterate the concerns raised in our earlier submissions that any prohibition of such definitions will not be in members' best interests.

b) 29TC(1)(b)

Proposed section 29TC(1)(b) requires all MySuper members to be provided with the same benefits, options and facilities. On the other hand, the EM to Tranche 3 indicates trustees can provide different levels of death and permanent incapacity benefit to different employer groups and different levels of employee within employer groups. Whilst we support the approach in the EM, it is unclear how this satisfies the requirements of Section 29TC(1)(b).

We also understand Treasury interprets the legislation as requiring a fund to offer (at least on an opt-in basis) income protection benefits to all MySuper members where such benefits are provided or offered to members who are employees of a particular employer. Again it is unclear how this interpretation complies with Section 29TC(1)(b) as it means some members can have income protection on an opt-in basis with others potentially having it on an opt-out basis.

We also consider it inappropriate for income protection to be offered to all MySuper members. Allowing members to opt-in to such insurance will not always be in their best interests as they may already have adequate sick leave or non-superannuation income protection insurance. In any case, we note there is no specific provision which would enable trustees to apply reasonable underwriting conditions. We note the Bill includes a provision which explicitly

allows reasonable underwriting conditions to be applied to the provision of death and permanent incapacity insurance. The omission of a corresponding provision for income protection insurance raises significant doubts as to whether such conditions are allowed for income protection insurance.

Recommendations:

- ***Disability insurance definitions which are currently tax deductible should continue to be allowed***
- ***Section 29TC(1)(b) needs to be reconsidered so its intent is clearer***
- ***It should be possible to offer income protection insurance to some groups of MySuper members but not all***
- ***Specific provisions need to be included so that trustees offering income protection insurance can do so subject to reasonable conditions***

4. Impact of excess concessional contributions tax on allocations from Operational Risk Financial Reserve

Funds will be required to satisfy the new Operational Risk Financial Requirements. In many cases this will be achieved by setting up an Operational Risk Financial Reserve.

We note Section 292-25 of the Income Tax Assessment Act (1997) and Section 292-25.01(4) of the Income Tax Assessment Regulations require certain allocations from reserves to be treated as concessional contributions.

On our reading, these regulations would require an allocation from an Operational Risk Financial Reserve to a member's account to be treated as a concessional contribution. This is unreasonable in relation to allocations designed to compensate for an operational risk event by restoring a member's position to where it would have been if that operational risk event had not occurred.

Recommendation: Section 292-25 of ITAA(1997) needs to be amended to avoid allocations from operational risk reserves being treated as concessional contributions.

5. Disclosure

Proposed Section 1017BB of the Corporations Act requires RSE licensees to show details of all investments on their web-site. Most funds have a very large number of investments and the provision of details regarding all of these is likely to result in too much material which members are unlikely to be able to properly digest.

We note the Bill provides the ability for the Government to specify materiality criteria in regulations although it is unclear whether such regulations will be issued. We consider such criteria are essential to protect members from an overload of minor information.

We also consider the cost of providing the detailed information specified by APRA in its current discussion paper on data collection will far exceed any likely benefit. We will be raising our concerns directly with APRA.

Recommendation: Regulations enabling licensees to restrict details of investments to material investments should be made.

6. Defined benefit member with an additional MySuper account

We understand it is not necessary for any contributions for a defined benefit member to be allocated to a MySuper account. However there will be occasions where a defined benefit member elects a MySuper account (and will therefore be subject to the MySuper fee requirements).

On the other hand, Schedule 2, Item 6 (section 68AA) indicates the MySuper insurance requirements do not apply to a defined benefit member. In other words, it appears it would not be necessary to provide a defined benefit member who also has a MySuper account with opt-out MySuper insurance.

Whilst we support this interpretation, we are concerned with the requirements of proposed Section 29TC(1)(b) which requires all MySuper members to be provided with the same benefits, options and facilities. We assume the express provisions of section 68AA would override the provisions of 29TC(1)(b), however, this is not entirely clear.

Another concern relating to Section 29TC(1)(b) relates to whether the provision of a defined benefit to one or more defined benefit members who are also MySuper members would require all MySuper members to be offered defined benefits. This would clearly be impractical with employers unwilling to provide such benefits.

Recommendation: Greater clarification is required in relation to:

- ***the insurance requirements for defined benefit members with an optional MySuper account***
- ***the impact of Section 29TC(1)(b) for such members***

7. Member protection

It would appear to be impossible for RSE licensees to comply with the MySuper fee requirements and also satisfy the member protection requirements in Section 6 of the SIS regulations.

We note the Minister for Financial Services and Superannuation's statement on 22 October indicating member protection will be removed from 1 July 2013 as part of a package of changes to the lost member requirements.

Recommendation: The member protection requirements need to be removed irrespective of any changes to lost member requirements. Otherwise funds which charge dollar-based MySuper administration fees will be unable to comply with both the MySuper fee rule requiring them to charge the same dollar fee to every MySuper member and the member protection requirement to limit fees on small accounts.

8. Transfers from overseas funds

Currently, Section 29TC(1)(f) requires a MySuper to accept all types of contributions. On the other hand, the provisions of the Superannuation Legislation Amendment (New Zealand Arrangement) Bill 2012 enabling the transfers between Australian funds and New Zealand KiwiSaver funds has been introduced on a voluntary basis (i.e. funds do not have to accept transfers from New Zealand).

Further, funds can currently accept contributions from UK pension funds subject to satisfying various UK registration and reporting requirements. It is unreasonable to expect all MySuper funds to satisfy conditions imposed by another country.

Unless properly addressed, funds could end up having to satisfy many different requirements relating to the acceptance of transfers from a significant number of different countries.

Recommendation: Either:

- ***Proposed Section 29TC(1)(f) needs to be amended to remove the requirement to accept amounts from overseas funds; or***
- ***The Government needs to clearly announce an intention to introduce regulations which will exempt funds from having to accept amounts from overseas funds***

APPENDIX 2

Who is Mercer?

Mercer is a leading global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people.

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). We have $55 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust, the Mercer Super Trust, has approximately 260 participating employers, 240,000 members and more than $15 billion in assets under management.

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