MySuper consultation working group

Issues paper on defined benefit funds

April/May 2011

PROPOSED REFORMS AND OBJECTIVES

As part of the Stronger Super package of reforms, the Government announced it will introduce a new low cost and simple superannuation product called MySuper that will replace the existing default investment options available to members. The design of MySuper is premised on MySuper being an accumulation product. Features of the MySuper product are intended to protect members from excessive fees and to have those members in a properly designed investment strategy where the trustee has established an appropriate asset allocation taking into account risk and return.

Government's response (Stronger Super) supports the recommendation that defined benefit (DB) funds will automatically qualify as a default fund for *Superannuation Guarantee (Administration) Act 1992* (SG Act) purposes, and hence be able to continue to receive contributions (recommendation 6.13).

For hybrid funds, the MySuper criteria must be met for accumulation members in order for the hybrid fund to be accepted as a default fund under the SG Act (recommendation 6.14). For the instance whereby a member has both defined benefits and accumulation benefits, and the fund's DB component satisfies the SG Act obligations of each employer making the contributions, the MySuper criteria do not have to be met in respect of those members (recommendation 6.15).

The rationale for allowing DB funds to qualify as a default product is that members of DB funds are not exposed to the same risks in respect of costs and investment performance as accumulation fund members as employers bear the risk. However, as DB funds do not need to meet the standards for a MySuper product, it is proposed that these default products will not be able to label themselves as MySuper products.

Since a member's account balance in a DB fund is not determined by investment performance of the fund or the costs of the fund, the proposed higher trustee duties and standards applying to a MySuper product are irrelevant for DB funds. For example, trustees of DB funds will not have to formulate and give effect to a single diversified investment strategy (aimed at optimising MySuper members' best financial interests as reflected in long-term net returns) as net return is irrelevant for DB fund members since the benefit is not determined by the investment strategy. Similarly, banning commissions and entry fees is also not a factor for DB funds as the employer, not the employees, pays the costs of the fund.

Issue 1 – Resignation benefits

A resignation benefit equal to the benefit accrued is payable to an employee of a DB fund in the event of a resignation. This benefit is an accumulation contribution, raising the question as to whether it should stay in the DB fund once the member has resigned.

The advantage of allowing the resignation benefit to remain in the DB fund is the reduction of portability issues. Vesting may be restricted and this can result in losses when the employee changes jobs and are required to switch to their new employer's scheme. Additionally, the employee may decide to return to the same employer in the future and leaving the benefits in the DB fund would make sense in this situation. One option is for the fund to become a hybrid fund that offers both DB benefits and accumulation benefits.

On the other hand, leaving the accumulation contribution in the DB fund could result in members not being protected with heightened trustee duties and restriction on fees associated with MySuper.

Question 1.1 Should a resignation benefit be allowed to stay in a DB fund?

Question 1.2 Are there any other types of payments in a DB fund that may be affected?

Issue 2 – Employer costs and actuarial services

The Government has announced that the cost of advice provided to employers will no longer be borne by members of MySuper products or other products in the choice architecture model. This would include DB schemes. Currently, actuarial services are provided to employers and employees of DB funds, but are paid for by the fund. It is unclear whether this arrangement would be allowed to continue under the Stronger Super reforms.

As the employer bears the full risk of a DB fund, it ultimately pays the costs of the actuarial services. Further, the payment of actuarial services from the fund will not impact on member benefits as they are defined benefits.

Question 2.1 Should there be an exemption for DB funds under this arrangement? If so, why?

Issue 3 – Other MySuper issues affecting Defined Benefit funds

Question 3.1 Are there any other issues relating to MySuper that affect DB funds?