MySuper consultation sub-group

Issues paper on eligible rollover funds and member protection rules

April/May 2011

PROPOSED REFORM

The Government's Stronger Super package of reforms includes separate licensing for trustees of eligible rollover funds (ERFs) and additional duties for trustees of ERFs (recommendation 10.15). In addition, to assist members to locate and consolidate their lost superannuation, the new arrangements will require trustees of ERFs to cross match accounts in their ERF with any active fund which seeks access to match its accounts (recommendation 10.16). Separately, all funds will be required to cross match their new members with ERFs.

Due to the added protection that will be provided to members of ERFs, and the assistance to help members consolidate lost accounts, the Government supports abolishing the member protection rules (recommendation 10.14).

OBJECTIVE

Lost accounts can materially impact on the adequacy of many individuals' retirement incomes, particularly where accounts remain unclaimed at retirement, are eroded by unnecessary fees or charges, or receive poorer investment returns than other retirement savings.

The reforms aim to ensure that disengaged members who lose connection with their superannuation accounts receive a level of protection comparable to members in MySuper products, by requiring ERF trustees to be licensed and by applying to ERF trustees a number of the duties that will apply to MySuper trustees.

With the introduction of these reforms, it is proposed that the member protection rules be abolished, thereby improving the efficiency of the superannuation system and helping to reduce costs.

ISSUES

Issue 1 – Licensing and trustee duties

ERFs are intended to be a temporary repository for the benefits of members who have lost connection with their superannuation accounts. Superannuation funds typically transfer benefits to an ERF where the member becomes a lost member; holds a small balance; does not nominate where they want their superannuation benefit transferred to within a specified timeframe; or is a non-member spouse, in circumstances connected with the division of superannuation following marriage breakdown. ERFs were envisioned as developing the necessary expertise to reunite members with their lost superannuation, while administering low balances at very low cost.

An ERF must treat all members, regardless of their account balance, as a 'protected' member (discussed in Issue 3). Transferring lost and low account members to ERFs was intended to prevent the costs of servicing these members from reducing the returns of other fund members.

Superannuation trustees owe a fiduciary duty to members, including members who are lost by the fund. Therefore, a superannuation fund is obligated to ensure that the ERF to which lost members are transferred operates in the interests of these lost members. However, currently the ERF sector, in general, is not performing its intended role because:

- not all superannuation funds send small inactive accounts to ERFs;
- there is a lack of incentives for ERF trustees to re-connect members with their 'lost' superannuation resulting in a large number of lost accounts; and
- there are very different investment strategies which result in a wide range of returns, some of which do not effectively preserve the balance of lost members.

The number of accounts in ERFs is likely to be reduced over time as lost accounts with less than $200 and accounts that have been inactive for more than 5 years, with insufficient details to identify the owner, are automatically paid to the Australian Taxation Office. In addition, new funds are unlikely to flow into ERFs if member protection is abolished and the Government's tax file number reforms are implemented. Therefore, the importance of the ERF sector is likely to diminish over time.

The Government supports separate licensing of ERFs and additional duties for trustees of ERFs (recommendation 10.15). The reforms aim to ensure that disengaged members who lose connection with their superannuation accounts receive protection comparable to those members in MySuper products, by requiring ERF trustees to be licensed and by applying a number of the same duties to ERF trustees as will apply to MySuper trustees. These duties include:

- the trustee must provide members with a single diversified investment strategy with an overall cost aimed at optimising their best financial interests;
- the trustee must form the view on an annual basis, that its ERF has sufficient scale on its own (with respect to both assets and number of members) to provide optimal retirement savings for its members;
- no entry fees charged for an ERF, including on rollovers; and
- exit fees only charged on a cost recovery basis.

Consultation questions

Question 1.1 Are there any duties which should apply to ERF trustees that are not included in the list of proposed duties above?

Question 1.2 What are the benefits of requiring ERF trustees to undertake an investment strategy which seeks to preserve the balances of lost members?

Question 1.3 Given the likely reduced role of ERFs in the future, should ERF trustees be licensed or should MySuper trustees be required to cross match their accounts with those accounts in ERFs? What other options are available?

Issue 2 – Cross matching of superannuation accounts

Some ERF trustees make little effort to re-connect members with their superannuation. This reflects the fact that there is little incentive to reunite members with their money because:

- matching lost members with unclaimed accounts is costly;
- ERFs are able to collect ongoing fees on these accounts; and
- there is no unique member identifier to assist in re-uniting members with their lost accounts.

As part of the Stronger Super reforms, the Government will permit the use of tax file numbers as a primary search key from 1 July 2011. For new, and some existing, accounts this will overcome the problem of the lack of a unique member identifier.

The Government supports cross matching of accounts in ERFs to assist members to locate and consolidate lost superannuation (recommendation 10.16).

Consultation questions

Question 2.1 Are there any impediments to ERF trustees cross matching accounts in ERFs with active accounts where a fund seeks access to this service?

Question 2.2 How often should an ERF trustee be required to respond to requests from a fund to cross match its ERF accounts with the fund's active accounts?

Question 2.3 Should all funds be required to cross match with ERFs for a new member?

Issue 3 – Abolishing member protection rules

Members are only 'protected' if they satisfy conditions in SIS Regulation 1.03B, primarily if their account balance is less than $1,000, and contains mandated employer contributions. SIS Regulation 10.06 further provides that the trustee of an ERF must treat every member of that ERF (including those with balances greater than $1,000), as a protected member at all times.

Broadly, the current member protection rules mean that administrative costs cannot exceed the investment returns credited to the member's account in a given reporting period. That is, these rules prevent a reduction in account balances through the imposition of administrative fees.

However, these costs do not include the costs of providing insurance, certain grandfathered exit fees, or taxation. Nor does member protection extend to administration costs levied proportionally against the assets of the fund as a whole. These costs are levied before the earnings of the fund are allocated to the member. These exceptions diminish the effectiveness of the member protection rules.

Further, for funds other than ERFs, member protection involves members with larger accounts subsidising the accounts of members with protected balances.

Abolishing member protection rules will improve the efficiency of the superannuation system and help reduce costs. Therefore, the Government supports, in principle, abolishing member protection rules (recommendation 10.14).

Consultation question

Question 3.1 Is there any information on the demographics of members likely to be affected (especially those members likely to be disadvantaged) by the abolition of member protection rules?

Question 3.2 What efficiency and cost gains will there be for funds if the member protection rules are abolished?

Question 3.3 To what degree will the proposed changes to ERFs impact, in terms of licensing and trustee duties and cross matching of accounts, on the need to apply member protection rules?