
TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL
2020: ADDRESSING UNDERPERFORMANCE IN SUPERANNUATION

EXPOSURE DRAFT EXPLANATORY MATERIALS

Table of contents

Glossary 1

Chapter 1 Addressing underperformance in
 superannuation.....3

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
Financial Services Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SMSF	Self managed super fund

Chapter 1

Addressing underperformance in superannuation

Outline of chapter

1.1 Schedule 1 amends the SIS Act to require APRA to conduct an annual performance test for MySuper products and other products to be specified in regulations (such as ‘trustee-directed products’ where the trustee has control over the design and implementation of the investment strategy). A trustee providing such products will be required to give notice to its beneficiaries who hold a product that has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in the regulations are satisfied.

1.2 Consistent with the recommendations of the Productivity Commission review into superannuation, the intent of these changes is to subject all APRA-regulated superannuation funds to annual performance tests for their MySuper and other products specified in the regulations (recommendation 4). The amendments seek to ensure that superannuation products have their performance assessed against an objective, consistently-applied benchmark, giving greater transparency to beneficiaries and protecting beneficiaries from underperforming products. These amendments also include measures to strengthen APRA’s powers to manage underperforming products.

Context of amendments

1.3 Superannuation is a unique system. It currently manages around \$3 trillion of retirement savings of Australians and its compulsory nature means that the Government has a heightened responsibility in holding funds to account and protecting member outcomes. Several reviews, including the Productivity Commission’s inquiry into superannuation, have found that persistently underperforming funds are a flaw of the system. These amendments build on the existing law to strengthen the protections against underperformance in the industry.

Existing law

Section 52 covenants

1.4 The operation of registrable superannuation entities are subject to a range of regulatory requirements to protect beneficiaries. These include obligations on trustees of registrable superannuation entities to comply with covenants under the SIS Act.

1.5 Section 52 of the SIS Act sets out a number of covenants that are taken to be included in the governing rules of registrable superannuation entities.

1.6 A trustee that contravenes a section 52 covenant is subject to a civil penalty order (see sections 54B and 193 of the SIS Act). Where the contravention involves dishonesty or an intention to deceive or defraud, a criminal offence applies. Trustees may be liable for fines up to 2,400 penalty units, and for serious breaches, imprisonment for not longer than five years (see sections 196 and 202 of the SIS Act).

1.7 APRA has general administration of the section 52 covenants, to the extent that administration is not conferred on ASIC under paragraph 6(1)(b) of the SIS Act. ASIC's current role is limited to matters of disclosure and record keeping. For example, ASIC has general administration of the section 52 covenants, but only to the extent that they relate to disclosure and record keeping obligations of trustees.

APRA's powers to establish prudential standards

1.8 Under the current law, APRA is granted a rule making power to establish prudential standards, and other components of the prudential framework. This is aimed at maintaining the financial soundness of RSE licensees and their registrable superannuation entities, ensuring that RSE licensees protect the interests, and meet the reasonable expectations, of beneficiaries of registrable superannuation entities, and other prudential matters.

1.9 For the banking, insurance and superannuation industries, APRA has developed a comprehensive framework of prudential standards and prudential practice guides. APRA's standards set out minimum financial, governance, operational and risk management requirements. The prudential practice guides set out APRA's expectations on the implementation of its standard and set out APRA's view as to what amounts to best practice.

1.10 Under Part 3A of the SIS Act, APRA has the power to establish prudential standards relating to prudential matters (see section 34C of the SIS Act). Currently, APRA does not have an explicit power to establish

prudential standards for resolution planning as this is not a prudential matter as defined by the SIS Act.

Productivity Commission review into superannuation

1.11 The Productivity Commission review into superannuation found that entrenched underperforming superannuation products are a structural flaw in the superannuation system. In order, to address persistent underperformance and increase beneficiaries' retirement savings, the Productivity Commission recommended requiring all APRA-regulated superannuation funds to be subject to annual outcomes tests for their MySuper and other offerings, with direct consequences for failing the test.

Summary of new law

1.12 Schedule 1 amends the SIS Act to require APRA to conduct an annual performance test for MySuper products and other products to be specified in regulations (such as trustee-directed products). A trustee providing such products will be required to give notice to its beneficiaries where their product has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee will be prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in the regulations are satisfied.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
APRA must conduct an annual performance test for MySuper products and other products specified in regulations.	No equivalent.
Trustees of superannuation products who fail an annual performance test must notify beneficiaries who hold the product, that the product has failed the performance test. The notice must meet any requirements prescribed by regulations.	No equivalent.
Trustees of superannuation products who fail the performance test in two consecutive years are prohibited from accepting new beneficiaries into those underperforming products.	No equivalent.

APRA may lift the prohibition if circumstances specified in the regulations are satisfied.	
APRA has a resolution planning prudential standard making power.	No equivalent.

Detailed explanation of new law

1.13 Schedule 1 inserts a new Part 6A into the SIS Act, which provides that:

- APRA must conduct an annual performance test, each financial year, on MySuper products and other classes of beneficial interest in a regulated superannuation fund that are specified in the regulations (such as trustee-directed products);
- APRA must notify the trustee of the superannuation products of the results of the annual performance test;
- Trustees of superannuation products that fail the annual performance test must notify beneficiaries who hold the product, that their product has failed the annual performance test; and
- Trustees of superannuation products that fail the annual performance test in two consecutive years are prohibited from accepting new beneficiaries into the superannuation product, unless APRA lifts the prohibition (if circumstances specified in the regulations are satisfied)

1.14 It will be considered a contravention of a covenant (see sections 54B and 193 of the SIS Act) for a trustee to fail to comply with the notification requirements or prohibition on accepting beneficiaries.

1.15 The amendments also provide APRA with a resolution planning prudential standard making power. They also allow regulations to specify formulas that will form the basis for APRA to rank superannuation products according to specified metrics including fee levels and investment returns which will support information on the YourSuper website announced by the Government as part of the Your Future, Your Super reforms.

Annual performance test conducted by APRA

1.16 Schedule 1 amends the SIS Act to require APRA to conduct an annual performance test for MySuper products and other classes of

beneficial interest in a regulated superannuation fund to be specified in regulations (such as trustee-directed products). A trustee providing such products will be required to give notice to its beneficiaries where their product has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product.

1.17 The annual performance test applies in relation to regulated superannuation funds (other than a regulated superannuation fund with fewer than 5 members). This ensures that the annual performance test will not apply in relation to other registrable superannuation entities or SMSF. *[Schedule 1, item 7, subsection 60B(1) of the SIS Act]*

1.18 The annual performance test will apply to MySuper products. In addition, the amendments allow regulations to specify other classes of beneficial interest in a regulated superannuation fund (such as trustee-directed products) that are subject to the annual performance test. *[Schedule 1, item 7, subsection 60B(5) of the SIS Act]*

1.19 APRA must conduct the annual performance test for each financial year and notify superannuation trustees in writing of APRA's determination of the test results by a deadline to be worked out under the regulations. It is expected that APRA will publish the test results. *[Schedule 1, item 7, subsections 60B(2), (3) and (4) of the SIS Act]*

1.20 APRA's determination of the results of the annual performance test will not be a 'reviewable decision' within the meaning of the SIS Act. This is because the test results are based on product performance compared to relevant benchmarks over the assessment period. The methodology to calculate a product's performance and benchmark will be clearly specified in regulations.

1.21 The requirements for the annual performance test will be set out in regulations. *[Schedule 1, item 7, subsection 60C(1) of the SIS Act]*

1.22 It is expected that the regulations will be made for this purpose that include, but are not limited to the following matters:

- specifying requirements in respect of investment returns (net of fees); and
- specifying requirements that depend on the exercise of a discretion by APRA; and
- specifying matters that APRA may, must, or must not take into account in exercising such a discretion; and
- allowing APRA to make specified assumptions in exercising such a discretion.

[Schedule 1, item 7, subsections 60C(2) and (3) of the SIS Act]

Regulations may allow different performance requirements for different products and provide APRA with flexibility in applying the test

1.23 This regulation making power operates broadly to allow circumstances to be specified where the annual performance test applies or does not apply for particular classes of products. This means that different requirements may be specified for different products (such as trustee-directed products). It also allows regulations to prescribe circumstances where APRA has discretion on these matters.

1.24 The annual performance test is generally intended to assess long term investment performance of a product. As such, the regulations could ensure the performance test generally only applies for products with a minimum number of years of performance. However, discretion could be provided to APRA to depart from this general rule to ensure trustees cannot create ‘new’ products to deliberately avoid being subjected to the new performance test.

1.25 For example, the regulations could provide that a product that has less than a few years of performance history need not meet any performance benchmarks unless APRA has exercised discretion to require the product to meet a benchmark. The regulations could further provide that APRA consider particular matters in exercising this discretion.

Regulations may allow the performance of 2 products to be assessed together

1.26 For the purposes of new Part 6A of the SIS Act, the regulations may specify circumstances in which two or more products (including a product that has ceased to exist) may be treated as being one product (the combined product). The regulations may specify circumstances where anything happening in relation to one of the products is to be treated as having happened in relation to the combined product. *[Schedule 1, item 7, paragraphs 60F(1)(a) and (b) of the SIS Act]*

1.27 This will allow regulations to be made to ensure that the annual performance test can be appropriately applied in a range of situations. For example, where a trustee transfers beneficiaries from a product that is close to failing (or has previously failed) the annual performance test into a new but similar product. This could be done to bypass the consequences of failing one or more annual performance tests.

1.28 For example, in circumstances specified in the regulations (such as where APRA considers it appropriate that the performance of the products be considered together), the performance history of the underperforming product could be attributed to the new similar product.

1.29 The amendments clarify that regulations made for this purpose may include but are not limited to the following matters:

- specifying requirements that depend on the exercise of a discretion by APRA; and
- specifying matters that APRA may, must, or must not take into account in exercising such a discretion; and
- allowing APRA to make specified assumptions in exercising such a discretion. *[Schedule 1, items 7, subsections 60F(2) and(3) of the SIS Act]*

Notification of underperformance by trustees to beneficiaries

1.30 The Schedule amends the SIS Act to require a trustee of a superannuation product to give notice to its beneficiaries who hold the product, within 28 days of APRA giving notice of the test results, where the product has failed the performance test. A trustee will be required to notify beneficiaries for each year that a product fails the performance test. The amendments allow regulations to be made to specify the requirements for the notification, including the form and content of the notification. *[Schedule 1, item 7, subsections 60D(1), (2) and (3) of the SIS Act]*

1.31 This ensures that beneficiaries are made aware that their superannuation product is underperforming.

1.32 As the obligations are part of the section 52 covenants, a contravention is subject to a civil penalty (see sections 54B and 193 of the SIS Act). Where the contravention involves dishonesty or an intention to deceive or defraud, a criminal offence applies (see section 202 of the SIS Act).

1.33 The notification to beneficiaries must be consistent with any requirements about the notification prescribed by regulations. This could mean that a superannuation product's underperformance must be explained prominently, clearly and concisely to beneficiaries. The requirement to be consistent with requirements prescribed by regulations also ensures that there will be a consistent approach taken to how information about underperformance is presented by all trustees who must comply with the new obligation.

1.34 The regulations may specify that information relating to the ranking of products according to relative fee levels, investment returns or other metrics be included in the notification. This could be satisfied by the notification incorporating by reference material from a website maintained by the Australian Taxation Office, as in force or existing from time to time. *[Schedule 1, item 7, paragraph 60D(3)(b) and subsection 60D(4) of the SIS Act]*

1.35 This ensures that the regulations could require the notification to include a link to the YourSuper comparison tool, announced by the Government as part of the Your Future, Your Super reforms, to empower

beneficiaries to compare and select a superannuation product that meets their needs.

1.36 Incorporating material into the notification as it exists from time to time will ensure that the most up-to-date comparison information is provided by trustees to beneficiaries. The material to be incorporated by reference will be publicly and freely accessible.

Prohibition against accepting beneficiaries into underperforming superannuation products

General operation of the new prohibition

1.37 Schedule 1 also amends the SIS Act to prohibit superannuation trustees from accepting new beneficiaries into products that have failed the annual performance test in two consecutive years. *[Schedule 1, item 7, subsections 60E(1) and (2) of the SIS Act]*.

1.38 As compliance with the prohibition is part of the section 52 covenants, the maximum penalty for accepting new beneficiaries into underperforming superannuation products is the same penalty that applies if a trustee contravenes a section 52 covenant (see sections 54B and 193 of the SIS Act). *[Schedule 1, item 6, subsection 52(14) of the SIS Act]*

1.39 The prohibition prevents individuals from entering persistently underperforming superannuation products. That is, existing beneficiaries of the entity who do not hold the product will not be permitted to switch into the product and individual beneficiaries will not be able to acquire the product.

1.40 Beneficiaries who hold an interest in a product at the time the product becomes subject to a prohibition may continue to hold the product. Such beneficiaries are also not precluded from continuing to make contributions to that product.

1.41 Generally, trustees are still be able to accept a beneficiary into another product offered by the trustee where that other product is not subject to a prohibition. That is, the prohibition operates at the product level, rather than the superannuation entity level.

Operation of the prohibition in special cases involving 2 different products failing the annual performance test in consecutive years

1.42 However despite the prohibition generally operating at the product level, the amendments allow regulations to specify the circumstances where two products offered by the same trustee that fail the annual performance test in two separate but consecutive years may both be subject to the prohibition.

1.43 This is achieved by the amendments providing that for the purposes of new Part 6A of the SIS Act, the regulations may specify circumstances in which two or more products (including a product that has ceased to exist) may be treated as being one product (the combined product). The regulations may also specify circumstances where holding a product should be considered holding the combined product. *[Schedule 1, item 7, paragraphs 60F(1)(a) and (c) of the SIS Act]*

1.44 This will allow regulations to deal with a situation where the trustee has begun offering or transferred beneficiaries to a new but substantially similar product. For example, this could be done in an effort to avoid being subject to the prohibition. In such a case, no singular product has failed the annual performance test in two consecutive years, but it may nonetheless be appropriate for a prohibition to be imposed on both products for the protection of beneficiaries given the similarity of the two products.

Lifting the prohibition

1.45 The amendments allow APRA to determine that the prohibition be lifted where the requirements to be specified in regulations have been met. This will allow the regulations to specify the criteria for when a superannuation product may re-open to new beneficiaries based on when the product's performance has improved. *[Schedule 1, item 7, subsection 60E(3) and (4) of the SIS Act]*

1.46 APRA's determination that the prohibition should be lifted comes into force on the day the determination is made or a later day specified in APRA's determination. *[Schedule 1, item 7, subsection 60E(5) of the SIS Act]*

1.47 APRA must give a copy of the determination to the entity as soon as practicable after making it. *[Schedule 1, item 7, subsection 60E(6) of the SIS Act]*

1.48 The amendments clarify that such a determination by APRA is not a legislative instrument within the meaning of section 8 of the *Legislation Act 2003*. This is included to assist readers of the legislation and is merely declaratory of the law. *[Schedule 1, item 7, subsection 60E(7) of the SIS Act]*

APRA resolution planning prudential standards power

1.49 Schedule 1 also amends the SIS Act to provide APRA with a resolution planning prudential standard making power that relates to the resolution of an RSE licensee, a registrable superannuation entity or a connected entity of an RSE licensee, in order to best protect the interests of beneficiaries. *[Schedule 1, item 4, paragraph 34C(4)(ea) of the SIS Act]*

1.50 The amendments amend the definition of a 'prudential matter', and insert the definition of 'resolution' into subsection 10(1) of the SIS

Act. The definition has the same meaning as it does in the other industry Acts (see *Banking Act 1959*, *Insurance Act 1973* and *Life Insurance Act 1995*). This means the reference to ‘obligations’ means financial obligations. [*Schedule 1, item 3, subsection 10(1) of the SIS Act*]

1.51 This ensures that APRA has clear powers to set appropriate prudential standards on resolution planning, and ensure that RSE licensees put in place measures to improve their preparedness for resolution. This allows APRA to ensure RSE licensees are prepared for a range of contingencies, including the possibility that the prohibition against accepting new beneficiaries into a product may lead to a material deterioration in the financial condition of the regulated superannuation fund.

1.52 Under the other industry Acts, the term ‘prudential matters’ is important in determining the scope of the prudential standard-making powers of APRA and the matters for which standards may be made. However, this term is currently defined differently in the SIS Act and other industry Acts, as the SIS Act does not currently contain any specific reference to resolution. That resolution planning is not included in the SIS Act as a prudential matter may lead to uncertainty regarding APRA’s ability to make prudential standards relating to the resolution of an RSE licensee and in some cases their connected entities.

1.53 The amendments harmonise the definition of ‘prudential matters’ across the industry Acts by incorporating a specific reference to resolution under the SIS Act. The amendments also clarify APRA’s ability to require RSE licensees and their connected entities to take actions to address potential barriers to orderly resolution.

Rankings of superannuation products by APRA

1.54 Schedule 1 also amends the SIS Act to allow the regulations to specify one or more formulas for the ranking of superannuation products by APRA. The formulas assist products to be ranked according to specified metrics including fee levels, investment returns or any other criterion. The formulas assist APRA to rank MySuper products or other classes of beneficial interest in a regulated superannuation fund specified in regulations (such as trustee-directed products).. The regulations also allow APRA to choose between two or more alternative formulas that relate to the same class of product. [*Schedule 1, item 8, section 348B of the SIS Act*]

1.55 This provides transparency and certainty about the basis by which superannuation products will be ranked by APRA with the results to be published on a website maintained by the ATO.

1.56 The website will be an interactive website designed to make it easy for beneficiaries to choose a superannuation product based on fees and performance information.

Consequential amendments

1.57 The amendments insert a definition of ‘resolution’ in the definitions section of the SIS Act. *[Schedule 1, item 3, subsection 10(1) of the SIS Act]*

Administration arrangements

1.58 The amendments provide that APRA has general administration of the new Part 6A introduced by these amendments to the extent that administration is not conferred on ASIC. *[Schedule 1, item 1, paragraph 6(1)(b) of the SIS Act]*

1.59 ASIC has general administration of new Part 6A to the extent it relates to the keeping of certain reports and certain disclosures of information. *[Schedule 1, item 2, paragraph 6(1)(d) of the SIS Act]*

Application and transitional provisions

1.60 The amendments relating to the new annual performance test apply in relation to MySuper products on and after 1 July 2021 and in relation to other classes of beneficial interest in a regulated superannuation fund specified in the regulations on and after 1 July 2022. *[Schedule 1, item 9]*

1.61 The amendments introducing a new resolution planning prudential standard making power for APRA apply on the day after Royal Assent. *[Schedule 1, item 9]*