REGULATION IMPACT STATEMENT

Stronger Super implementation

September 2011

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BACKGROUND

This regulation impact statement (RIS) analyses the regulatory impact of the key implementation options following consultations on Stronger Super - the Government's response to the Super System Review (SSR).

OBJECTIVES OF STRONGER SUPER

The Government recognises that for many Australians their superannuation savings will form a significant part of their retirement income. Therefore, it is vital for members of the community to have complete confidence that the framework surrounding superannuation is robust and that superannuation funds are managed prudently in a way that delivers a comfortable and secure retirement for members.

Accordingly, in 2009 the Government commissioned Mr Jeremy Cooper and a panel of experts to undertake a review into the governance, efficiency, structure and operation of Australia's superannuation system (the Super System Review, or SSR). The Government released the SSR final report on 5 July 2010.

The SSR examined measures to reduce unnecessary costs and better safeguard the retirement savings of all Australians. The SSR undertook substantial consultation, with more than 450 formal submissions received. The key findings of the final report were:

- fees in superannuation are too high, as 'choice of fund'[1] in superannuation has failed to deliver a competitive market that reduces costs for members;
- the 'back office' of superannuation needs to be brought into the 21st century through the increased use of technology, e-commerce, uniform data standards, and use of the tax file number as the key member identifier; and
- the obligations and duties of superannuation fund trustees should be heightened to better ensure superannuation assets are managed prudently and in the best interests of all members of the fund.

On 16 December 2010, the Government announced 'Stronger Super' - a comprehensive package of reforms in response to the recommendations of the SSR. The Government supported, or supported in principle, 139 of the SSR's 177 recommendations. The Government's Stronger Super reforms will make Australia's superannuation system stronger and more efficient, and will help to maximise the retirement incomes of superannuation members.

The Stronger Super reforms include:

- creating a new simple, low cost default superannuation product called '**MySuper**';
- making the processing of everyday superannuation transactions easier, cheaper and faster, through the '**SuperStream**' package of measures; and

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[1] Since 1 July 2005, most employees have had the right to choose the superannuation fund that would receive their employer superannuation contributions.

- strengthening the governance, integrity and regulatory settings of the superannuation system for both APRA-regulated superannuation funds (the '**Governance**' reforms) and self-managed superannuation funds (the '**Self-managed superannuation fund (SMSF)**' reforms).

The Stronger Super reforms are expected to deliver significant fee savings for members, estimated at $1.55 billion per year in the short term, rising to $2.7 billion per year over the longer term. For a 30 year old worker earning average full-time wages, this would result in an extra $40,000 or seven per cent in retirement account balance.

STRONGER SUPER CONSULTATION

Following the 16 December 2010 announcement, the Government established a Stronger Super Peak Consultative Group to provide advice on how to best implement the Stronger Super reforms.

The Peak Consultative Group was chaired by Mr Paul Costello and comprised representatives of peak industry, employer, employee and consumer groups.

The Peak Consultative Group was supported by four working groups, which covered the four main streams of reforms: MySuper, Governance, Self-managed superannuation funds and SuperStream. The working groups allowed for more detailed discussions with relevant private and public sector experts on the practical and technical design and implementation issues.

Interested stakeholders were also able to provide input into the design and implementation of the reforms through the Stronger Super website at strongersuper.treasury.gov.au. Issues papers were posted on the website to facilitate consideration of relevant issues by interested stakeholders. Around 30 submissions were received in response to these papers.

The Peak Consultative Group and supporting working groups provided their views to Treasury and the Government on how to implement Stronger Super.

This document assesses the regulatory impact of options for implementing the Stronger Super package of reforms. For many recommendations, for which additional specific details are provided in the Appendix to this RIS, there will be little or no regulatory impact beyond that attributable to the Stronger Super announcement. For other recommendations, where the Stronger Super announcement was not definitive or implementation may result in an additional regulatory impact, this document assesses alternative options for their implementation.

MySuper

1. Background

The SSR found that many consumers do not have the interest, information or expertise required to make informed choices about their superannuation. Of almost 12 million Australians who currently hold a superannuation account, approximately 80 per cent have their compulsory superannuation contributions paid into a 'default' superannuation fund (ie, funds to which employers make compulsory superannuation contributions on behalf of employees who do not choose a fund to receive those contributions). Given the majority of Australians are invested in default superannuation funds, it is critical that these funds manage superannuation savings efficiently and in the interests of default members.

Currently, some superannuation funds offer hundreds of different options in terms of investment strategy, insurance cover and other product features. While this additional choice may be beneficial to some members, the added complexity and cost of these options is unnecessary for members who do not make active choices regarding their superannuation. These members will generally have similar needs that could be met with a simple superannuation product that focuses on providing retirement incomes, not unnecessary product features. Consequently, the Government committed to introducing MySuper, a new low cost and simple superannuation product, to replace existing default funds.[2]

MySuper will build on the existing system of privately provided default superannuation products (that is, it will not be provided by Government) and impose heightened duties and requirements on trustees in offering a default product, rather than prescribing a specific product that trustees must offer.

As announced as part of Stronger Super, key features of MySuper will include:

- new duties for trustees, including a specific duty to act in the best financial interests of members as reflected in long-term net returns, and to actively consider whether the fund has sufficient scale to continue to meet the trustee's duty to act in the best financial interests of members;
- a single diversified investment strategy[3];
- comparable data on long-term net returns published by APRA;
- restrictions on unnecessary or excessive fees, including:
  - a ban on commissions in relation to retail investment products[4] and group insurance;

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[2] On 1 August 2010, the Government announced its election commitment to introduce a low-cost, simple superannuation product called MySuper, which all APRA-regulated superannuation funds would be allowed to offer from 1 July 2013. The Government reaffirmed this commitment as part of Stronger Super.

[3] This refers to the strategy by which superannuation members' savings are invested in order to generate retirement incomes. It refers to the strategy of allocating these savings into particular assets (shares, property, fixed interest etc.) in order to balance the generation of returns on these savings with an appropriate level of risk and liquidity for the fund.

[4] As part of the Government's Future of Financial Advice reforms, there will be a prospective ban on conflicted remuneration structures including commissions and volume based payments, in relation to the distribution and advice of retail investment products including managed investments, superannuation and margin loans.

  - new standards for the payment of performance fees to fund managers;
  - a ban on entry fees charged to new members;
  - exit fees limited to cost recovery; and
  - switching fees not payable to the trustee in their personal capacity;
- a fair and reasonable allocation of costs between MySuper and other products;
- standardised reporting requirements written in plain English;
- a requirement to accept all types of contributions (eg, SG contributions, salary sacrifice contributions and after-tax contributions); and
- life, and total and permanent disability (TPD) insurance (where available, depending on occupational and demographic factors) offered on an opt-out basis.

With these key features, MySuper will be a relatively homogenous product, enabling members and employers to compare funds more easily based on a few key differences – cost, investment performance and level of insurance coverage.

Each registrable superannuation entity (RSE)[5] will be able to offer a single MySuper product with a single, diversified investment strategy. Limiting each RSE to a single MySuper product will focus the trustee's efforts with respect to MySuper members and drive economies of scale benefits through the consolidation of default products. MySuper products will be licensed by the Australian Prudential Regulation Authority (APRA) and required to comply with minimum operating standards imposed through licence conditions.

MySuper will improve outcomes for the majority of members who do not wish to be actively involved in choosing their superannuation arrangements, while maintaining freedom of choice for those members who do wish to choose. Members wishing to make active choices with their superannuation will still be able to opt for an alternative product, or manage their own superannuation affairs through an SMSF.

The emphasis of MySuper is on delivering value for money for members. By focussing the trustee's obligations on net returns, MySuper is expected to put downward pressure on fees and deliver higher retirement incomes for members. MySuper is estimated to reduce the total fees paid by superannuation fund members by around $550 million per year in the short term, rising to around $1.7 billion per year over the longer term. For a 30 year old worker on average weekly earnings, MySuper, in conjunction with SuperStream, could result in an extra $40,000, or seven per cent, in retirement savings (with around 80 per cent of this attributable to MySuper).

Employers will benefit from the increased simplicity, transparency and comparability of MySuper products. MySuper will lower the costs for employers in selecting a default fund, as they will have better information to assist with their choice, and the confidence that any MySuper product will meet minimum standards and offer a cost-effective superannuation plan for their employees.

The Government has also decided to ban up-front and trailing commissions and like payments for both individual and group risk within superannuation from 1 July 2013.

[5] Under the *Superannuation Industry (Supervision) Act 1993*, an RSE is defined as a regulated superannuation fund, an approved deposit fund, or a pooled superannuation trust but not a self managed superannuation fund. For simplicity of understanding, where it is referenced in this RIS an RSE can broadly be thought of as a superannuation fund.

Implementation details of the above requirements and additional aspects of MySuper have been subject to consultation with key stakeholders. A key objective in considering implementations details is to minimise disruption and unnecessary costs to all key stakeholders that may otherwise reduce the benefits of MySuper. Options for several additional aspects of MySuper, and the impact of these options, are considered below. These aspects are:

- Pricing of the MySuper product;
- Transferring existing superannuation account balances to the MySuper product;
- Cases of conglomerate groups with multiple 'brands';
- Whether the single investment strategy can vary on the basis of age; and
- The types of insurance offered.

2. MYSUPER PRICING POINTS

2.1. Issue / Problem / Objectives

The SSR recommended, and the Government announced, that each RSE will be able to offer a single MySuper product with a single, diversified investment strategy (recommendation 1.7(c)). While the SSR acknowledged that a single MySuper product might be able to be offered at different prices or fees to members of different employers, there was no specific recommendation on this point.

Currently, industry superannuation funds generally charge the same price to all members of their default products, while retail superannuation funds often differentiate fees on the basis of employment. ChantWest estimates the corporate superannuation sector providing default plans for employers to consist of around 3.7 million members and over $102 billion in funds under management (FUM).

Consequently, a key implementation detail to be determined is whether the single MySuper product for a fund should be required to be offered at the same price to all members of the product or alternatively, whether funds should be allowed the flexibility to charge different (lower) prices to employers commensurate with the administrative costs of servicing the employees of those employers.

A single price per MySuper product would be broadly consistent with the objectives of simplicity and transparency, and therefore potentially drive greater downward pressure of fees. It would also directly address the practice of 'flipping' whereby, on a change of employment, members are involuntarily moved from a low-fee employer-based superannuation plan to a higher-fee personal superannuation plan. Particularly in a market where labour mobility is high (according to ABS data, 56 per cent of employees have been in their current job less than five years), default members may be benefitting from a discounted employer plan for a short time then penalised in the 'personal' product for far longer.

A single price would also address the potential for cross-subsidisation of lower fee plans for larger employers by higher fee plans for small to medium employers.

However, a requirement for MySuper products to be offered at a single price may result in employees of certain employers paying higher fees. This could occur if a funds single MySuper price was higher than that paid under an employer plan. ChantWest argues that around 750,000 employees of large

employers could be paying higher fees under MySuper by not having access to a negotiated employer plan.

2.2. Options

Option A: A single MySuper product per RSE with the same price for all members irrespective of employer

Under option A, trustees would be licensed to offer a single MySuper product at a single price, or set of fees, for all members. The single price would apply to all members regardless of their employer.

Once MySuper is fully implemented, employer-specific plans would either be:

- converted to a MySuper product open to all members irrespective of employer;
- offered as a MySuper product under a separate RSE and open only to employees of a particular employer; or
- offered as a Choice product[6], where the employer plan could no longer accept default contributions.

Option B: A single MySuper product per RSE with flexibility on administration fees limited to large employers

Under option B, trustees offer a single MySuper product at a standard price generally available to all employers and members. However, trustees would be able to provide discounts on the administration fee charged to large employers, either by negotiating with individual employers or publishing discounts in a product disclosure statement (PDS). Large employers could be defined by reference to the number of employees. Any discounted prices would need to be reported to APRA and would be published.

Option C: A single MySuper product per RSE with flexibility on administration fees for all employers

Under option C, trustees would be able to offer their single MySuper product at a separate pricing point for any employer. However, variability on the price offered could only be reflected in discounts to the administration fee by either negotiating with individual employers or publishing discounts in a product disclosure statement (PDS) that may relate to the discount available based on the size of the employer.

All members that do not make a choice of investment option would be placed in the single, diversified investment strategy of the MySuper product and would have access to the same product features. All members would be charged the same fees except for any discount that they were entitled on the administration fee.

As with options A and B, where a trustee offers employer-specific pricing for a MySuper product, any employee that leaves the sponsoring employer must remain in the MySuper product and be charged the price applicable to the non-employer linked members.

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[6] A 'Choice' product refers to any product other than MySuper offered by an APRA-regulated superannuation fund. Choice products will not be able to accept default contributions on behalf of default members, but employees will be able to make an active choice to have their SG contributions paid to a Choice product.

2.3. Impact Analysis

Option A: A single MySuper product per RSE with the same price for all members irrespective of employer

Impact on members

With a single price applicable to all members of the MySuper product, option A maximises simplicity, transparency and comparability for members. Limiting MySuper to a single price makes it easy for members to understand what fees they are paying and how this compares to other products. Greater comparability would encourage competition thereby lowering fees for all members. While a lack of active choices in respect of superannuation is partly explained by member disinterest, greater simplicity and comparability will facilitate choices by members that would like to take an interest in their superannuation but who find the existing system too complicated. A single pricing point also ensures funds cannot flip members to a higher fee pricing point or product on cessation of employment.

However, while competition under a single price may lead to all members paying lower fees at some point in the future, it is possible that some members will be worse off in the short term under this option. Employees of medium to large employers who currently benefit from fee discounts under an employer-specific plan could be worse off, with ChantWest arguing that around 750,000 members could be paying higher fees under MySuper.

Impact on superannuation funds / trustees

Option A will reduce the ability of all trustees to offer different prices to employees of different employers. As current practice sees some industry sectors use employer-based tailoring and discounts more than others, some sectors will be affected more than others.

Retail funds will be most affected under a single pricing point. The current business model of these funds is to negotiate with employers (of all sizes) and tailor a default superannuation plan with different product features and fees for that employer. Under option A, retail funds will not have flexibility to negotiate employer-specific plans because trustees will be required to place default members in the MySuper product. While employers will be able to negotiate on the establishment of an employer-specific Choice product, this product would be unable to accept default contributions. While retail funds would be expected to adapt and offer single price MySuper products for all members (most have similar, non-employer based products already), there may be greater adjustment costs for retail funds (relative to industry funds) in moving to a single default product.

Industry funds will not be greatly affected by a single pricing point requirement, as the majority of industry funds already offer their default products at the same price to all members irrespective of employment.

Corporate standalone funds (that is, funds that operate on behalf of a single employer) do not offer plans for multiple employers (and consequently will not be affected in this respect). However, they will be affected by the limitations on 'flipping'. As these funds typically restrict membership to the employer-sponsored product, if this product becomes a MySuper product, they would have to decide what to do with employees who cease employment that may have one-off transitional costs for these funds.

Option A will not reduce the ability of funds to recoup costs, as the single price will be adjusted to reflect the average cost of acting on behalf of members. That is, superannuation funds will not be worse off under a single pricing point except if they lose market share.

Cameo

Price-per-plan Super is a superannuation fund that currently offers default superannuation plans for five individual employers. Price-per-plan Super currently charges fees of 1.20, 1.10, 1.00, 0.90 and 0.80 per cent of

assets per annum for the five individual employers respectively, reflecting the differing cost of managing the plan on behalf of these employers.

Under Option A, Price-per-plan Super could only offer a single MySuper product with a single price for all members irrespective of employer. If the MySuper product continues to be the default superannuation plan for these five employers, Price-per-plan Super would need to adjust its single fee to reflect the cost of managing the MySuper product on behalf of all members collectively (for example, setting a single price of 1.00 per cent of assets).

Impact on employers

Under option A, nominating a default fund will be simpler and easier for employers. Option A ensures all members receive the same superannuation experience regardless of employer maximising the benefits from improved fund scale. For these employers, there will be a reduced expectation that they negotiate a default superannuation plan with a superannuation fund and hence potentially lower compliance costs with choice of fund as there will be less need for engaged employees to opt out of the default fund.

Some employers may currently negotiate employer plans for their employees to make them an employer of choice. It is appropriate that the trustee makes a selection of investment strategy and services as they are required to meet their duties to members. However, employers will be able to subsidise the payment of fees and the provision of services provided to their employees in a non-employer specific MySuper product, or alternatively, pay directly for the cost of additional services provided (that is, the employer pays for the services rather than the cost being deducted from member accounts).

Some large employers may be negatively affected in the short-term, as their employees may be unhappy paying higher fees (for the potential short-term losers noted above). To avoid employees paying higher fees, some employers may decide it is necessary to set up a separate RSE specific to them. This would increase costs for those employers – as a guide, APRA estimates that the costs of setting up a separate RSE for a $50 million fund would be at least $37,000 under current arrangements, or 0.074 per cent of FUM.

Option B: A single MySuper product per RSE with flexibility on pricing for large employers

Impact on members

Providing flexibility on pricing for large employers would ensure that members in existing employer plans of this size continue to benefit from negotiated discounts that reflect administrative efficiencies of dealing with one large employer. Members who are employees of large employers would pay close to the same fees they do now (subject to the impact of MySuper on compliance costs, transparency, competition, etc), as administrative differences make up the majority of the difference between fees paid by members in employer sub-plans.

However, there may be employees of employers of non-large employers that would be paying higher fees under option B, if they are currently able to negotiate lower fees. However, it is not possible from available data to predict with any level of certainty the impact on individual employers.

As the same product features (other than price) will apply to all members of the MySuper product, option B will increase simplicity, transparency and comparability for members. As MySuper will be a simple, relatively homogeneous product, members will be better able to understand their superannuation and assess the relative performance of their fund.

Simplicity and comparability will be lower than under option A, as different members of the product will be subject to different prices. However, the different prices applying to different members will be

reported to APRA and published. This will ensure that prices offered to specific employers are made more transparent, ensuring greater comparability and competition in the market for default fund selection.

Allowing different pricing points based on employment retains the possibility of some cross-subsidisation and 'flipping' to a higher fee pricing point on cessation of employment. When a member ceases employment with the large employer, they could be moved to the higher pricing point applying to personal (or individual) members. However, ensuring the general pricing point is published by APRA and applies to the majority of members should ensure it is competitive.

Impact on superannuation funds / trustees

Option B will allow trustees to continue to offer different prices based on administrative efficiencies for large employers. Relative to Option A, this will reduce the impact on retail funds in particular, allowing them to continue to offer price discounts to large employers. However, as flexibility would be limited to the administration fee imposed on members, retail funds would no longer be able to tailor plans based on other product features, such as investment option, and service.

The impact of option B on most industry funds, corporate funds and public-sector funds is broadly the same as for option A.

Option B will not reduce the ability of funds to recoup costs, as prices will be adjusted to reflect the average cost of acting on behalf of members. That is, superannuation funds will not be worse off under a single pricing point except where they lose market share.

Cameo

Continuing the example provided under option A, one of the employers serviced by Price-per-plan Super is large enough to meet the threshold at which it can be offered an individual pricing point. Price-per-plan Super can decide whether to offer this employer an individual pricing point or to offer a single pricing point as outlined under option A. Price-per plan Super decides to offer this employer an individual price of 0.80 per cent of assets (its existing price), while offering the other four employers a single price (of 1.05 per cent, for example).

Price-per-plan Super is still able to recoup the costs of managing on behalf of all employers, however, it can only allocate the costs individually to qualifying large employers and collectively to the remainder of employers.

Impact on employers

Some small to medium sized employers may lose the ability to negotiate a specific superannuation plan to make them an employer of choice. However, employers will be able to subsidise the payment of fees and the provision of services provided to their employees in a non-employer specific MySuper product, or alternatively, pay directly for the cost of additional services provided (that is, the employer pays for the services rather than the cost being deducted from member accounts).

Large employers will retain flexibility to seek price discounts. However, they would no longer be able to negotiate for different services and options. This may result in a reduction of services for these particular employees, unless the employer chooses to pay for these services. This outcome is consistent with the objectives of MySuper which seek to ensure default members are not paying for product features they do not need or use. In addition, a reduction in services available should correspond in a reduction in the fees paid by members.

Option C: A single MySuper product per RSE with flexibility on administration fees for all employers

Impact on members

The impact of this option on members is expected to be lower relative to Options A and B. The fees charged by a MySuper product will be able to be differentiated by individual employers, as is currently the case for employer plans.

Providing flexibility on pricing would ensure that all members in existing employer plans of this size continue to benefit from negotiated discounts that reflect administrative efficiencies. Members in these plans would pay close to the same fees they do now (subject to the impact of MySuper on compliance costs, transparency, competition, etc).

Similarly to option B, option C will increase simplicity, transparency and comparability for members. However, comparability will be lower than under option B to the extent that it results in a greater number of prices applying to members of different employers.

As with option B, allowing different pricing points based on employment retains the possibility of some cross-subsidisation and 'flipping' to a higher fee pricing point on cessation of employment.

Impact on superannuation funds / trustees

Similarly to options A and B, superannuation funds will be required to develop and implement a single MySuper product that will be the default option for their fund. However, trustees will have the flexibility to price that product differently at an individual employer level or at predetermined prices for employers of a given size.

This greater flexibility will reduce the impact of MySuper on retail funds. However, it is expected that allowing price flexibility will not change the impact on industry superannuation funds or public sector funds that generally already provide a single default investment option priced at the same rate for all members, regardless of their employer.

The impact on corporate standalone funds is also unlikely to be different under any of the options as they tend to only to be open to employees of one employer.

Option C will allow the fund to ensure that it recovers the full costs of servicing the employees of each employer. Therefore, superannuation funds should not be worse off relative to the current situation.

Cameo

The arrangements for Price-per-plan Super would be similar as in option B, however, it could set different administration fees for all employers. Price-per-plan Super currently charges fees to members of five employers of 1.20, 1.10, 1.00, 0.90 and 0.80 per cent of assets per annum respectively. Under option C, Price-per-plan Super offers their new MySuper product to these employers at fees of 1.10, 1.00, 0.90, 0.80 and 0.70 per cent of assets per annum respectively reflecting the lower costs of the MySuper product compared to the existing employer plans.

Impact on employers

The impact of option C is the same as for option B, except small and medium sized employers will have additional flexibility to negotiate on price.

2.4. Consultation

This issue was discussed several times by the Peak Consultative Group and MySuper working group. There was no consensus on a preferred model.

The Industry Super Network (ISN), the Australian Institute of Super Trustees (AIST), the Australian Council of Trade Unions (ACTU) and CHOICE support requiring MySuper to be offered at a single price (option A).

The Financial Services Council (FSC), the Association of Superannuation Funds of Australia (ASFA) and Mercer argue trustees should be allowed some flexibility to tailor different MySuper offerings to individual employers at different fees. FSC noted during consultations that the lower cost of administrative processing accounts for around 80 per cent of the fee differential between employer plans.

The Australian Chamber of Commerce and Industry (ACCI) indicated that a significant number of employers value the ability to obtain a default superannuation plan that is tailored for their workplace, but acknowledged many small businesses would benefit from the simplicity offered by a single price, generic default product as envisaged by MySuper.

2.5. Conclusion and recommended option

On balance, it is recommended that all employers be allowed to negotiate with funds to obtain a discounted administration fee for their employees (option C). This would enable trustees to offer a single discounted administration fee for all members that are employees of an individual employer. All other members would be subject to the single price of a trustee's MySuper product.

Requiring funds to offer the same MySuper product with a single-priced investment strategy applying to all members will drive additional economies of scale and lower fees, while employer negotiation on administration fees will ensure employees of existing employer plans continue to benefit from negotiated discounts.

The implementation of the SuperStream reforms will increase the overall efficiency of superannuation fund administration, which is expected to reduce differences in administration fees over time, facilitating market-driven convergence of prices.

3. TRANSFER OF ACCRUED DEFAULT BALANCES

3.1. Issue /Problem / Objectives

The requirement that employers have to make default contributions to funds offering a MySuper product from 1 July 2014, in order to meet their superannuation guarantee obligations, will ensure the benefits of MySuper apply prospectively. That is, default members will benefit from the new MySuper arrangements in respect of ***new*** employer contributions.

However, an issue also arises with respect to default members' existing (accrued) default superannuation balances. To enable default members to obtain the maximum benefit from the MySuper reforms for their accrued default balances, it is important to facilitate the movement of these default balances into a MySuper product. If accrued default balances are not moved to MySuper

products, a default member's accrued default balance could be exposed to higher fees and commissions, and not benefit from the heightened MySuper trustee duties.

3.2. Options

Option A: Transfer of accrued default balances by the end of a transitional period

- Under this option, accrued balances of default members would generally be required to be moved into a MySuper product by 1 July 2017.

For trustees who choose to apply for approval to offer a MySuper product, this requirement would be included as a condition of their MySuper licence. The requirement would cover both members of the fund in which the trustee will offer a MySuper product, and members of any fund for which the trustee is trustee. Trustees may be able to do this by converting existing default arrangements to MySuper products, or by transferring the accrued default balances of members to a MySuper product under existing provisions. In the unlikely event a trustee does not wish to offer a MySuper product, the trustee would be required by legislation to take steps to move the accrued default balances of default members to a fund which does offer a MySuper product.

As an additional safeguard where members' balances are being transferred to a MySuper product, trustees would be required to write to affected members, setting out the benefits of MySuper and the member's existing product (consistent with section 947D of the Corporations Act), and advising that their accrued default balance would be transferred to the MySuper product unless the member advised they did not wish this to occur (that is, an opt-out approach).

All trustees would be required to prepare a transition plan that outlines, in a reasonable level of detail, the trustee's plan for moving accrued default balances to its or another new MySuper product, regardless of whether they intend to apply for a MySuper licence condition. Among other things, the transition plan would outline how the trustee intends to make sure it complies with requirements to transfer all accrued default balances by 1 July 2017.

Option B: Status quo

An alternative to the framework proposed above would be to have no legislative requirement to transfer accrued default balances. That is, only future superannuation guarantee contributions would be required to be made to a MySuper product.

Over time some proportion of balances would migrate to MySuper products as members change jobs, consolidate their accounts, or employers re-tender their default superannuation arrangements.

- Consultations have been undertaken with industry on account consolidation issues, including proposals involving automatically consolidating small inactive accounts to an employee's most recent active account on an opt–out basis, and facilitating broader account consolidation when an employee changes jobs. If implemented, these proposals would result in accrued default balances of some accounts being moved to MySuper products more rapidly.
- Members could also be encouraged to move their accrued balances to MySuper, including through a targeted communication campaign. A key consideration, however, is that these members are generally not actively engaged with their superannuation, and take-up may not be high.

- Employers may re-tender their default superannuation arrangements. It is understood many employers currently tender on a three yearly cycle. Employers will be likely to select funds offering MySuper products, as only contributions to these funds (or a defined benefit product or EPSSS) will satisfy superannuation guarantee requirements. However, this may not have an impact on accrued default balances, and is unlikely to benefit members who have been 'flipped', who are most disadvantaged by the existing arrangements.

Hence, it may take many years for a significant proportion of accrued default balances to be fully transferred under this approach.

3.3. Impact Analysis

Option A: Transfer of accrued default balances

Impact on superannuation funds/trustees

Trustees of superannuation funds will face compliance costs in moving the accrued default balances of default members to new MySuper products. The cost impact faced by trustees will depend on whether the trustee decides to offer a MySuper product, and if so, the approach adopted to providing that product.

It is expected most trustees will offer a MySuper product so they are able to accept default contributions from 1 July 2014.

Where a trustee elects to convert an existing default investment option into a MySuper product, they will face minimal transaction costs, as accrued default balances will effectively be incorporated into the MySuper product. This is most likely to occur in the industry fund sector. If it is agreed that trustees could continue to offer discounted administration fees to individual employers (see option C of the MySuper Pricing Points section above), there may also be minimal costs to retail funds converting existing default employer plans. There will be a cost involved in informing all affected members of the changed arrangements, but this cost will vary depending on the number of members involved and ease with which they can be contacted.

Where a trustee creates a new MySuper product and elects to transfer accrued default balances to that product under existing provisions (for example, under the trustees fiduciary obligation to act in the best interests of members, or under a successor fund transfer), transaction costs would be incurred. In similar cases, such as previous successor fund transfers, the transaction costs have been bundled in with product fees and passed on to members, so there is no available data on which to estimate these costs.

In addition, as noted above, there would be costs incurred in informing members of the proposed movement of their accrued balance. These costs would include the work required to give members sufficient information to compare the benefits, insurance and other services offered by their existing product and the relevant MySuper product.

In the unlikely event a trustee decides not to offer a MySuper product, the trustee would be expected to devote resources to searching the Australian Taxation Office's online facility to identify whether a member has an active account with another fund, and if not, to identifying funds offering appropriate MySuper products for its current default members. In addition, the trustee would incur transaction costs in transferring accrued default balances to another fund under existing provisions (as aforementioned), and in informing members of the proposed movement of their accrued balance.

The trustee could potentially be exposed to a legal risk if the selected fund turns out to be inappropriate for the default members who are transferred, and may require protection from existing law in these circumstances.

A full quantification of the impacts is subject to the requirements that APRA will impose through a prudential standard, for which it will prepare a RIS. APRA proposes to introduce a prudential standard to provide requirements for all RSE licensees during the transition period from 1 July 2013 to 1 July 2017, when all accrued default balances must be in a MySuper product. This standard is likely to include requirements:

- to identify default members and accrued default balances;
- for those registrable superannuation entities with default members and accrued default balances, to have a transition plan that, among other things, articulates where and when accrued default balances will move; and
- to articulate a communication plan to members and employers about the MySuper transition plan.

APRA also expects to introduce reporting requirements to assist the transition to MySuper. These requirements are likely to cover data items related to the movement of default member contributions and accrued balances and will be consulted on as part of the reporting standards and forms.

The transition plan requirements encompass activities that the RSE licensee would need to do to ensure compliance with their legislative obligations. As such, the impact of APRA's requirement is that RSE licensees may be required to provide this information to APRA sooner than they would have otherwise done for internal purposes. This will be considered by APRA when in prepares a RIS for its prudential standard.

Impact on members

In general, default members with accrued default balances would benefit from the timely movement of these balances to the new MySuper products, through the expected lower fees (net of any of the aforementioned costs being passed on by the trustee) and ban on commissions that MySuper will provide. It is estimated that up to 60 per cent of employees do not choose their superannuation fund or investment option.

Some members of particular classes or sub-plans may enjoy the benefit of additional services, such as designated call centres or workplace seminars. Members of these classes or sub-plans could potentially be worse off if their accrued default balances are moved to the fund's MySuper product. However, where additional services are currently fully paid for by members, any reduction in these services in the MySuper product should be fully offset by a commensurate reduction in the fees charged. Consequently, members should be no worse off, and to the extent they do not utilise the available services (as 'disengaged' members), may be better off.

The intention is for MySuper assets to be *accounted* for separately, not held separately for the benefit of MySuper members. This should minimise the need for funds to buy and sell assets to give effect to the transfer of balances into MySuper. To the extent such asset sales are required, this could give rise to capitals gains tax or stamp duty consequences which might flow on to members as lower returns. The Government will consider submissions from industry on whether there is a case for capital gains tax relief in these circumstances.

In the unusual situation that a contract with a third party provides that the trustee is liable to pay an amount to the third party even after members have been transferred (including for example, to a non-commission MySuper product), the trustee would remain liable for that amount. Depending on

the circumstances, the trustee may have a right to retain an amount in the fund by way of indemnity in respect of the expected liability, prior to calculating the balances of transferring members. While in these circumstances there would be an initial reduction in the member's accrued balance, the balance in the MySuper product would no longer be subject to ongoing commission payments.

Impact on employers

The movement of accrued default balances to MySuper products has no impact on employers.

Impact on other stakeholders

The movement of accrued default balances may have an impact on third parties depending on the services provided, the parties involved, and the term of any relevant contracts.

The group most likely to be impacted are financial advisers who are receiving trailing commissions on the accrued default balances of default members. Trustees of MySuper products will not be able to pay trailing commissions in respect of advice or other products or services provided to MySuper members. Consequently, where trailing commissions are currently being paid on accrued default balances, those payments must cease to be deducted from those balances (that is, from the member's accounts) after they are moved (or converted) to a MySuper product.

The outcome following the moving of the member's balance to a MySuper product (or the conversion of the member's fund, sub-fund or product into a MySuper product) will depend on the terms of the contract with the third party and the general circumstances. One possibility, where balances are moved or transferred, is that the trustee may cease to be under any obligation to the third party in respect of the relevant members. Alternatively, where a service contract exists between the trustee and a financial adviser, the trustee may seek to renegotiate the contract when it expires to exclude, for example, trailing commissions. At this point, the financial adviser would negotiate commercial terms for any new arrangements. The trustee would need to have regard to the best interests of beneficiaries in doing so. Where the agreement is ongoing, the financial adviser may have ongoing rights to payment. As noted above, in this situation, the trustee may, depending on the circumstances, have a right retain an amount in the fund by way of indemnity in respect of potential liability, prior to calculating the balances of transferring members.

Option B: Status quo

Impact on superannuation funds/trustees

The movement of accrued default balances to MySuper products over time would impose no additional compliance costs on trustees of superannuation funds. Costs associated with the movement of members, either under existing portability mechanisms or the proposed account consolidation arrangements, would be attributable to the normal functions undertaken in running the fund. There would be no additional reporting to members required.

Impact on members

Without a specific requirement, it is likely to take many years before the accrued default balances of some default members are moved into MySuper products. This is at least in part because many default members do not make active decisions in relation to their superannuation, and will not actively consolidate their accrued balance with their new MySuper account.

A significant delay in the flow through of MySuper benefits to some members will have a consequent impact on the level of their superannuation savings at retirement. For example, members who have been compulsorily moved to the personal division in a corporate superannuation plan could remain subjected to fees of around 2.37 per cent per annum (1.93 per cent excluding commissions) for some time. These fees are higher than those currently applying in corporate divisions, around 2.12 per cent

(with commission) for members of medium sized corporate plans, and around 1.73 per cent (with commission) for members of larger corporate plans.

Treasury modelling for the Super System Review estimated the average fee on assets in the default investment option of default funds at 0.97 per cent, and the average fee on assets in the accumulation phase in the choice sector at 1.28 per cent – a differential of 31 basis points. The modelling assumed funds would, on average, price MySuper products in the short run at around 0.85 per cent (for an account balance of $25,000) – a differential of 43 basis points.

Impact on employers

The movement of accrued default balances to MySuper products over time (through existing mechanisms or via account consolidation) has little or no impact on employers.

Impact on other stakeholders

The movement of accrued default balances to MySuper products over time would have no additional regulatory impact on other stakeholders. The movement of members, either under existing portability mechanisms or the proposed account consolidation arrangements, would be part of the normal business environment.

3.4. Consultation

Consultations on a mandatory approach to moving accrued default balances identified some cases where trustees may require an extended time period to convert existing default options:

- To allow insurance contracts to lapse and be renegotiated, particularly as some contracts link the level of premiums charged to the level of take-up in the workplace.
- To allow for the amendment of trust deeds that may have prohibitive conditions on amendments. In these cases, legislative amendments may be required to override the terms of trust deeds.

It was noted in consultations that under current legislative requirements, fund to fund mergers or transfers must comply with successor fund transfer rules and ensure equivalency of rights. An intra-fund transfer requires the trustee to act in the best interests of all members (both those being moved and those remaining), and in practice would require similar benefits as would be required under the successor fund transfer rules. The existing test of equivalency was considered to be well-understood and likely to facilitate mergers and transfers when compared to a test of overall disadvantage, and consequently should not be altered.

Concerns were expressed that a transfer of accrued balances may impinge on existing contractual arrangements between the trustee and third parties (including advisers), the trustee and employer, and possibly, the member and financial advisers. One view was that this constituted retrospectivity for the reforms because it would affect existing fees flowing to financial advisers who would be disadvantaged by the movement of members to a MySuper product. It is noted that where a member unilaterally chooses to leave a fund they are not currently limited by any contractual arrangements.

3.5. Conclusion and recommended option

On balance, the proposed framework for transferring accrued default balances set out in option A is recommended. This framework includes an additional period (one year beyond the end of the transitional period) which is considered appropriate as some MySuper products may not be licensed

until close to 1 July 2014. Trustees of superannuation funds will be required to transfer the existing balances of their default members to a MySuper product by 1 July 2017. These arrangements will ensure default members obtain the full benefits of MySuper, while allowing almost six years for industry to prepare for and manage the transition.

This framework is recommended as it provides:

- for the timely movement into MySuper products of the accrued default balances for the majority of default members;
- an opportunity for default members to retain their accrued balance in their current fund if they wish to; and
- A reasonable transitional period for trustees to make the necessary arrangements to comply with the requirements.

4. Multiple Brands

4.1. Issue / Problem / Objectives

As noted above, the Government announced that each RSE will be limited to offering one MySuper product, but it would consider whether separate 'brands' within an RSE can offer separate MySuper products.

Separate branding within a single fund (RSE) can arise from a number of different scenarios, however, the key scenarios considered are where:

- RSE licensees are merged or taken over as part of a larger consolidation of conglomerate groups within the financial sector;
- Corporate entities outside the financial sector merge or are acquired, and these corporate entities operate corporate superannuation funds;
- Two or more standalone superannuation entities merge; or
- Consolidation of two or more RSEs under a single RSE licensee.

Merging of corporate entities (financial or non-financial) does not necessarily entail the merger of RSE licensees within those corporate entities or the merger of RSEs of each RSE licensee. Several corporate groups currently operate multiple RSE licensees each with multiple RSEs. When two superannuation entities merge it is possible that the fund chooses to maintain the separate branding of the corporate entities on the different products offered by separate RSEs.

Where a fund operates several RSEs for each brand they own, the introduction of MySuper should be no different than for other RSEs, with each RSE able to offer a single MySuper product. However, there are costs associated with maintaining separate RSE's which add to the costs that ultimately flow through to members of the fund.

- RSE licensees' that operate several RSEs each with distinct brands often consider consolidating RSEs when tax conditions are favourable or when implementing systems upgrades. Under the

requirement that a fund is only able to operate a single MySuper product per RSE, then it will mean that RSE licensees' would also have to consider whether the benefits of consolidation would outweigh the value of existing brands that could not continue used for a separate MySuper product. Currently, there is no limit to operating multiple brands within a single RSE.

Where mergers have resulted in multiple brands representing distinct superannuation products currently operating within an RSE, the requirement to have a single MySuper product within an RSE would require either the rationalisation of these default options (and their brands) or separation of the brands into distinct RSEs. Differences in administrative systems and distribution channels make integration a costly process for the fund, and will usually be a staged process necessarily undertaken over a long time frame. In these circumstances, RSE licensees may wish to obtain the benefits of rationalising the number of RSEs that they operate, potentially leading to lower fees for members.

Also, it may be possible that the value of existing brands outweigh the costs of operating separate RSEs. In these circumstances, the requirement that a fund is only able to operate a single MySuper product per RSE would necessitate the additional costs of operating separate RSEs. Allowing the distinct brands to be operated within the single RSE may potentially reduce costs leading to lower fees for members.

4.2. Options

Option A: Exception to single MySuper product per RSE for distinct products acquired as a result of a merger or takeover

While most trustees would be limited to offering a single MySuper product per RSE, a trustee could apply to APRA for approval to operate one MySuper product per brand within a single RSE. In considering whether to grant an approval, APRA would have regard to relevant factors, including whether the separately branded products has been in existence prior to a merger or acquisition, and whether granting an approval would unreasonably compromise the broader objective of limiting each fund to one MySuper product.

Option B: No exception for multiple brands – single MySuper product per RSE

All trustees would be limited to offering one MySuper product per RSE. To comply with the introduction of MySuper, existing RSE licensees (that have resulted from a merger or takeover) wanting to offer a distinct MySuper product under each business entity would be required to either:

- operate separate RSEs for each business entity; or
- consolidate all existing default products into one MySuper product.

4.3. Impact Analysis

Option A: Exception to single MySuper product per RSE for distinct products acquired as a result of a merger or takeover

Impact on superannuation funds / trustees

Option A would provide APRA with the flexibility to determine, on a case-by-case basis, whether it is appropriate for a trustee to operate one MySuper product per brand within a single RSE.

Funds could make the case to APRA in circumstances where there may be significant costs to setting up or maintaining separate RSEs. These costs may include:

- statutory reporting obligations, such as quarterly and annual statistics lodgements and preparing audited accounts for each RSE (although the introduction of MySuper may require product-level reporting, so these costs may apply under a single RSE. This is subject to further consideration by APRA in developing prudential standards on fund reporting, for which it will develop a RIS);
  - In 2006, ASFA estimated the cost of complying with superannuation regulation to be around 10 per cent of administration costs. Option A is intended to avoid duplication of compliance costs.
- additional administration costs arising from requirements to maintain separate records and providing customised websites;
  - Additional administration costs are likely to have a minimal impact as entities would likely be able to transfer existing systems to the new RSE.
- possibly increased APRA supervisory levies by virtue of the creation of new RSEs; and
  - The levy has a small fixed component that is capped for funds with more than around $2.1 billion in assets and a FUM-based component. The increase in levies resulting from splitting a single RSE into multiple RSEs will depend on the size of the original RSEs and the number of new RSEs created. If the original RSE has less than $2.1 billion in FUM, levies will be unaffected; if the original RSE is larger than this amount, splitting into multiple RSEs will result in increased levies.
- Potential tax implications of operating under multiple RSEs (such as moving assets between RSEs triggering capital gains tax events that would not occur under a single RSE).

Funds could also seek an exception from APRA in limited cases where there is significant cost and complexity in consolidating multiple default products from multiple business entities in either transitioning to MySuper or undertaking a future merger or takeover.

Impact on members

Option A would reduce the possibility of situations where trustees would have to split RSEs and pass additional costs on to members. As administration, regulation and compliance costs are generally passed on to members in full (not-for-profit funds, for example, have no other source of funds), it is reasonable to assume any additional costs will be passed on to members.

Under option A, greater consolidation of RSEs would be expected to deliver economies of scale benefits, resulting in lower fees for members. In particular, where the trustee would otherwise have operated the distinct brands under separate RSEs (as many do already), there may be a net benefit to members of allowing multiple branded products to save costs by operating under a single RSE.

Impact on employers

Under current legislation and under MySuper with a single product per RSE at a single price, employers are required to nominate a fund for members that do not exercise choice of fund. Under this option, where there could be multiple MySuper products, the employer would have to nominate the particular product within the fund in order to meet its obligations. This would require greater understanding of the chosen fund but only minor additional paperwork.

Impact on other stakeholders

Large conglomerate groups would be most likely to make applications under this exception. Conglomerate groups considering future mergers or takeovers will not face an impediment from having to consolidate multiple MySuper products, however the structure of superannuation business within financial conglomerates is not seen as an impediment to mergers, as many currently choose to continue multiple RSEs following a merger. Large conglomerate groups transitioning to MySuper may benefit from an exception from APRA in unanticipated circumstances where the process is exceptionally difficult.

Option B: No exception – single MySuper product per RSE

Impact on superannuation funds / trustees

As noted under option A, superannuation trustees that currently operate multiple brands within a single product (no known cases exist) would face additional costs from either:

- operating under separate RSEs – additional administration, regulation, levy and management costs and potential tax consequences; or
- consolidating the brands into a single product.

The competitiveness of some entities may be reduced by a reduction in brand value.

Impact on members

The potential benefit of limiting RSE licensees to a single product per RSE is that it may drive greater consolidation of products, resulting in economies of scale benefits for members.

As noted under option A, the costs to members of limiting RSE licensees to a single product per RSE are:

- trustees passing on additional administration, regulation and compliance costs from any change to existing arrangements, whether that is operating under separate RSEs or consolidating into a single MySuper product, resulting in potentially higher fees for members; and
- loss of established relationship with existing brand if the brands are consolidated into a single MySuper product.

Impact on employers

There would be no additional impact (relative to what the Government has already announced) on employers from option B.

Impact on other stakeholders

Transitioning to MySuper may be difficult and costly for conglomerate groups that have multiple existing brands as a result of a merger or takeover. However, APRA is only aware of one conglomerate group that has suggested that limitations on multiple brands would cause transition issues. No other superannuation entity has mentioned concerns at this stage.

Large conglomerate groups often have complicated legal and administrative structures that provide significant impediments to consolidation. At present, it appears that no financial services conglomerate operates distinct brands from within a single RSE, although one has canvassed an intention to do so in the medium term. As the cost of consolidation may be prohibitive for large conglomerate groups, it is more likely that they would continue to choose to operate multiple RSEs, which would mean no impact on these groups.

Conglomerate groups considering future mergers or takeovers would face an impediment from having to consolidate multiple MySuper products if the purpose of the merger was to operate multiple MySuper products in one RSE. However, the combination of RSEs is most often not a central consideration in a merger as there is no impediment to an RSE licensee continuing to operate multiple RSEs.

4.4. Consultation

As mergers and acquisitions may result in multiple brands within a conglomerate group, the superannuation industry broadly supports an exception aimed at avoiding the need for these groups to maintain separate RSEs, which may have precluded efficiencies gained from having one RSE. The industry generally believes that the exception would have to be tightly defined to maintain the intent of a single MySuper product per RSE.

4.5. Conclusion and recommended option

While most trustees should be limited to offering a single MySuper product per RSE, it would be prudent to have a mechanism that accommodates exceptional circumstances by allowing trustees to seek APRA's approval to operate one MySuper product per brand within a single RSE (option A). This option is recommended because it provides a mechanism for handling potentially costly exceptional circumstances and genuine impediments to fund mergers / takeovers while not compromising the objectives and benefits of one MySuper per RSE.

5. LIFECYCLE INVESTMENT OPTIONS

5.1. Issue / Problem / Objectives

In introducing MySuper, which will have a single diversified investment strategy, consideration also needs to be given to whether trustees can automatically alter the single investment strategy to reflect members' interests at different ages (often referred to as a 'lifecycle investment option').

In general, younger members (perhaps decades away from retirement) may benefit from a higher risk, higher growth investment strategy, whereas older members (seeking to maintain their savings for impending retirement) may need a more conservative investment strategy to preserve their accumulated benefits. Some trustees believe that it is in the best interests of default members to automatically vary the default investment strategy for members as they get older. If lifecycle investment options are not allowed, the existing default investment strategies of some trustees would effectively be prohibited.

However, MySuper is designed to be a relatively homogeneous product with a simple set of product features, including a single diversified investment strategy. Allowing lifecycle investment options may reduce the simplicity and comparability of MySuper for members.

5.2. Options

Option A: Allow trustee to determine if its single investment strategy is a lifecycle investment option

MySuper trustees would be allowed to offer a lifecycle investment option as the single investment strategy for their MySuper product. That is, trustees would be permitted to automatically alter the default strategy to reflect members' interests at different ages, if they consider this to be in the best financial interests of members collectively.

The trustee will have capacity to determine the precise nature of the investment strategy underpinning the lifecycle investment option, but will be permitted only to adjust the strategy on the basis of member age (that is, two people of the same age in a MySuper product will have the same investment strategy).

Trustees that currently operate default lifecycle investment options could convert this into a MySuper product.

Lifecycle investment options will not be a compulsory feature of MySuper - trustees that do not consider a lifecycle investment option to be in the best financial interests of members will not be required to offer one.

Option B: Prohibit lifecycle investment options

Trustees would not be allowed to offer a lifecycle investment option as a MySuper product. A single diversified investment strategy would apply to all members irrespective of their age.

Trustees that currently operate default lifecycle investment options could only continue to offer this strategy as a Choice product, meaning all existing default members would have to make an active choice for contributions to continue to be paid to this type of product.

5.3. Impact Analysis

Option A: Allow trustee to determine if its single investment strategy is a lifecycle investment option

Impact on superannuation funds / trustees

Trustees would have additional flexibility develop an investment strategy that reflects members' interests at different ages, rather than being limited to offering a MySuper product that meets the average needs of all members.

Trustees that currently offer a lifecycle investment option as their default investment strategy will benefit from an easier transition to MySuper, as they would not have to undertake a complicated process of converting a lifecycle product into a product for all ages, which may involve difficult trade-offs between the competing interests of these members. However, there is expected be additional requirements for these trustees to provide APRA with necessary information to publish comparable data on investment performance (differentiating between strategies for different members).

There is no data regarding the prevalence of lifecycle investment options, however, anecdotal evidence suggests there are a small number of lifecycle options operating as the default investment option, with the majority of members consequently in these products. While lifecycle investment options are not common, restricting their use as the investment strategy of MySuper products could

have a significant impact on the competitiveness of funds that currently offer these products (as they would no longer be able to accept contributions on behalf of members that do not make a choice).

There would be no additional regulatory impact (beyond introducing MySuper) for trustees that choose not to offer a lifecycle investment option.

Impact on members

Trustees that choose to offer a lifecycle investment option would have to demonstrate that it is in the best financial interests of members collectively, so allowing trustees to offer these options must increase member benefits.

As a member's risk profile generally changes with age, lifecycle investment strategies could provide a product suitable to the needs of many default members. Such members could benefit from their trustee automatically adjusting the risk profile of their investments as their interests change. Existing members of lifecycle investment options could continue to invest in such a product while being afforded the additional protections under MySuper (for example, heightened trustee duties with regard to fees).

Allowing lifecycle investment options to be offered may reduce the comparability of MySuper products. MySuper is intended to be a relatively homogeneous product with simple product features, facilitating greater comparison of products and greater competition on key features such as cost, investment performance and level of insurance coverage. Lifecycle investment strategies may reduce this simplicity by treating members of different ages differently and making it more difficult for a member to understand the fees and performance outcomes that apply specifically to them. Lifecycle investment options will have different outcomes for members depending on their age, and the average performance of the MySuper product that offers a lifecycle investment strategy will not be representative of any individual member. The extent to which comparability is reduced will depend on development of data publication standards by APRA. APRA will be consulting with industry in developing the standards.

Impact on employers

Allowing lifecycle investment options will not have a significant impact on employers. Under MySuper, employers will be required to choose a fund that offers a MySuper product knowing that MySuper provides at least a minimum standard product for default members; irrespective of whether the investment strategy is a lifecycle investment option or not.

Employers that take an active interest in choosing a MySuper product for their employees may benefit from having an option that caters to employees of different ages, particularly large employers with a diverse workforce. However, it may also increase complexity for employers choosing the optimal MySuper product for their employees.

Option B: Prohibit lifecycle investment options

Impact on superannuation funds / trustees

For the majority of trustees, there will be no impact from prohibiting lifecycle investment options in MySuper. However, some trustees would be prohibited from offering their current default lifecycle investment option under MySuper. These trustees would have to choose whether to offer it as a Choice product (and have to seek agreement from all members, as it could not accept default contributions) or convert all members to a standard MySuper product.

Impact on members

As referred to above, prohibiting lifecycle investment options in MySuper is unlikely to initially impact many members (as only a few funds currently offer a lifecycle investment option). Members that wish to invest in a lifecycle investment strategy would have to do so as a Choice product, without the additional protections of MySuper. Default members in existing products that have lifecycle investment strategies may have their investment strategy changed significantly. However, they will have the opportunity to move to a Choice product (see section on transition period).

Members would benefit from the additional comparability under MySuper without it being reduced by lifecycle investment options.

Some members could be worse off if trustees are unable to automatically alter the risk profile of their single investment strategy with age.

Impact on employers

Prohibiting lifecycle investment options is unlikely to have a significant impact on employers, as not many of these products are currently available. Some employers that currently choose a lifecycle investment option as their default fund would have to reassess their default fund, however all employers will be required to do this on the introduction of MySuper. Employers that strongly believe in the benefits of lifecycle options could convince their employees to sign up to a Choice product with this option.

5.4. Consultation

The superannuation industry broadly supports allowing trustees to determine if their single investment strategy is a lifecycle investment option.

Opinions differ on the merits of lifecycle investment options in achieving members' best financial interests over the long term. Some stakeholders argued that it provides trustees with the flexibility necessary to optimise outcomes whereas others argued that lifecycle investing leads to lower retirement incomes from too conservatively investing just prior to retirement.

While lifecycle investment options are not universally supported, a key conclusion of consultations was that it is reasonable for members' investment strategies to vary on the basis of their age if the trustee believes it is in their best financial interests.

5.5. Conclusion and recommended option

Trustees are best placed to decide whether a lifecycle investment option is best suited to their members. Therefore, it is recommended that trustees be allowed to use a lifecycle investment strategy as the single investment strategy for their MySuper product (option A).

This option would also:

- provide greater flexibility for trustees to determine appropriate age-based investment allocations;
- ensure the investment strategy chosen by the trustee must still be in the best financial interests of members;
- have no regulatory impact for those that do not choose to adopt such a strategy.

6. TYPES OF INSURANCE OFFERED THROUGH SUPERANNUATION

6.1. Issue / Problem / Objectives

New arrangements for the selection and management of the external insurance cover procured by trustees, and for the default insurance offered to members, have been announced as part of the Government's Stronger Super package of reforms.

The new arrangements will require trustees to offer default opt-out life and TPD insurance to all members in MySuper and choice products (with limited exceptions) (response to recommendations 5.1 and 5.6). In addition, income protection insurance (sometimes known as income continuance or temporary disability insurance) will be allowed to be offered by a trustee (response to recommendation 5.9) – see the insurance part of the Appendix for further details.

Other types of insurance do not support the objectives of superannuation and will not be permitted to be offered by any superannuation entity and trustees will have to phase out these types of insurance for existing members (response to recommendation 5.10).

To implement the reforms that will simplify insurance offered through superannuation by limiting it to life, TPD and income protection cover, it is necessary to define these types of insurance to ensure that insurance available in the concessional tax environment of superannuation is consistent with the retirement income objectives of the superannuation system. The insurance policies of superannuation funds vary considerably in the definitions used (and therefore coverage), particularly for TPD insurance. Some definitions used are not always consistent with other aspects of superannuation legislation.

Insurance is currently allowed to be offered to members of superannuation funds if it is consistent with providing benefits as defined in the sole purpose test at section 62 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). However, the current wording of section 62 has allowed funds to offer insurance that is not consistent with the purpose of superannuation (that is, to provide retirement income). In particular TPD insurance policies that provide payments in the event a member is unable to work in their 'own' occupation and / or for the loss of limbs or eyesight, as these policies do not directly relate to the member being permanently unable to work due to injury or ill-health.

Payments made under these policies cannot be released to a member if they do not satisfy a condition of release contained in Schedule 1 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations). Specifically, benefits can only be released under the 'permanent incapacity' condition of release where the trustee is reasonably satisfied that the member is unlikely, because of ill-health, to engage in gainful employment for which the member is reasonably qualified by education, training or experience.

As a result of inconsistent definitions, some members are unable to receive a payout until they meet another condition of release, which for many could be retirement (that is, the benefit is currently paid into the member's account until another condition of release is met, such as preservation age). These members are unable to access their insurance benefits until they meet a condition for release.

The cost of TPD insurance provided through superannuation is deductible to the extent the policies provide cover which is consistent with the definition of 'disability superannuation benefit' in the *Income Tax Assessment Act 1997*. This definition mirrors the definition of 'permanent incapacity' in the SIS Regulations. Where broader insurance cover is provided, superannuation funds are only allowed a partial deduction for the cost of the premium (to the extent it meets the definition).

Aligning the types of insurance available within superannuation with those policies for which a trustee can receive a full tax deduction for premiums and any benefits can be released to members would ensure that insurance provided through superannuation is for the purpose of providing benefits in retirement or where a member cannot work as a result of injury or ill-health.

6.2. Options

Option A: Proposed insurance arrangements

Align the types of insurance available within superannuation with those policies for which a trustee can receive a full tax deduction for premiums and any benefits can be released to members.

Under this option, the types of insurance that could be offered in superannuation would be made consistent with the conditions of release at Schedule 1 of the SIS Regulations.

Section 62 of the SIS Act would be clarified so that it only provides for benefits for circumstances that are covered by the following examples:

- Life insurance offered through superannuation must only provide coverage for the death of a member or the member having met requirements to certify that they have a terminal medical condition.

- TPD insurance offered through superannuation must only provide coverage for when the member, because of ill-health (whether physical or mental), is unlikely to engage in gainful employment for which the member is reasonably qualified by education, training or experience.

- Income protection insurance must only provide coverage for when a member has ceased to be gainfully employed (including a member who has ceased temporarily to receive any gain or reward under a continuing arrangement for the member to be gainfully employed), because of ill-health (whether physical or mental) that caused the member to cease to be gainfully employed but does not constitute permanent incapacity.

Where a trustee is unable to amend a trust deed for a fund to phase out benefits not consistent with these three types of insurance, those terms of the trust deed would be overridden by legislation and replaced by benefits that are consistent.

A transitional period would be provided for funds to adjust their insurance arrangements to ensure that the benefits they offer members are consistent with the types of insurance that can be provided through superannuation.

Contracts between trustees and insurers are generally for a period three years. Therefore, a three year period from the commencement of other Stronger Super reforms on 1 July 2013, should allow trustees sufficient time to renegotiate their contracts. This will also allow time for trustees to amend trust deeds. However, where a trustee is unable to amend the trust deed for a fund then, after the end of the transitional period, those terms of the trust deed will be overridden by legislation and replaced with benefits that are consistent.

Option B: No change to insurance arrangements

Under option B, there will be no change to the existing arrangements that define the types of insurance that superannuation funds can offer.

6.3. Impact analysis

Option A: Proposed insurance arrangements

Impact on members

Some members will no longer be paying premiums for insurance cover for which they would be unable to receive benefits until they meet a condition of release rather than when an insurance payment is made for them. . These members may benefit from a reduction in premiums resulting from alignment of the definition with tax deductibility.

Some members may no longer be able to continue to obtain insurance cover through superannuation that falls outside the new definitions. Their cover will be adjusted so that it is consistent with the new definitions. As a result, these members are likely to pay lower premiums through their superannuation (reflecting the cost of providing narrower coverage). However, these members will be able to seek additional coverage outside of superannuation.

Members will benefit from greater simplicity and comparability of insurance cover. For members who use superannuation as their primary means of insurance cover, standard definitions for these types of insurance (provided through superannuation) will make it easier to compare the costs and benefits of particular cover. Members will be better able to compare the amount of cover and the premiums they would pay.

The proposed transition period for phasing out existing contracts should accommodate existing arrangements that currently do not comply with the proposed definitions. The new definitions will also ensure that the cover provided to members is consistent with commonly held understanding of these types of insurance.

APRA does not collect information on insurance definitions at the product level, so there is no data available on how many members will be affected by the proposed arrangements.

Impact on superannuation funds / trustees

Trustees will benefit from greater certainty surrounding the types of insurance that can be offered by superannuation funds consistent with conditions of release. In purchasing insurance cover to offer to members, trustees acting in the best interests of members want benefits to be paid when they are needed (which is normally as soon as possible).

Some trustees will have to renegotiate their insurance policies to ensure they comply with the new requirements. However, the proposed transition period will ensure the renegotiation occurs as part of the normal course of business unless trustees choose to do it sooner. As a result, there should be no additional cost for funds in moving to and then complying with standard definitions.

APRA does not collect information on insurance definitions at the product level, so there is no data available on how many trustees will be affected by the proposed arrangements. Anecdotal evidence from consultations suggests that cases of inconsistent definitions are rare.

Impact on life insurers

Following the transition period, there may be some reduction in business for life insurers reflecting that superannuation funds are no longer allowed to offer any other types of insurance (beyond life, TPD and income protection). The impact is likely to be small however, as anecdotal evidence suggests that other types of insurance are not widely taken up by members through superannuation. However, there is no data available to estimate the percentage of business affected.

It is expected that TPD insurance policies that are not currently consistent with tax deductibility or conditions of release will be renegotiated to ensure that they are. This is likely to reduce any potential impact on the business of insurers.

APRA does not collect information on insurance definitions at the product level, so there is no data available on how many insurers will be affected by the proposed arrangements. Anecdotal evidence from consultations suggests that cases of inconsistent definitions are rare.

Option B: No change to insurance arrangements

Impact on members

Members will continue to pay premiums for insurance that may not be consistent with the primary purpose of superannuation, which is to generate retirement incomes. These members are likely to have lower retirement incomes as a result.

There will continue to be cases where an insurance benefit is paid to a member's account but does not meet a condition of release, meaning the member cannot access it until they do.

Impact on superannuation funds / trustees

There will be continued uncertainty for trustees in attempting to provide insurance cover in the best interests of members.

Impact on insurers

This option maintains the status quo, so there will be no impact on insurers.

6.4. Consultation

The superannuation industry broadly supports aligning the insurance that can be offered in superannuation with tax deductibility and conditions of release. However, FSC and some insurers have suggested that broader definitions for TPD policies should be allowed to continue so as not to reduce the existing benefits of members. Others argued that changes to tax deductibility of premiums for TPD insurance will result in broader definitions being phased out.

6.5. Conclusion and recommended option

It is recommended that life, TPD and income protection insurance will be the only permissible types of insurance to be paid for by members through their superannuation and that legislation be clarified to ensure that trustees can only offer insurance cover to members where, under existing rules, the benefits can be released to the member when an insurance payment is made for them. Trustees should have until 30 June 2016 to phase out existing policies that are not consistent with the definitions of life, TPD and income protection insurance to be incorporated in the legislation.

This option better aligns insurance offered in superannuation with broader superannuation objectives and will have minimal impact on key stakeholders in transitioning to the new arrangements.

GOVERNANCE OF SUPERANNUATION

1. BACKGROUND

Australia has adopted a trust structure for governance of superannuation funds. A trustee has fiduciary and statutory obligations to manage the assets of the trust on behalf of its beneficiaries, and in the beneficiaries' best interests.

To ensure a consistently high standard of governance across the superannuation industry, it is important that trustees' duties are clearly understood and are sufficiently robust to accommodate developments in the size, structure and practices of the superannuation industry.

Trustee duties can be established through trust law (as equitable duties), set out in trust deeds, or specified as statutory duties in legislation. The specific covenants set out in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) are automatically taken to be incorporated into the governing rules of all superannuation funds.

While some of the superannuation fund trustees are individuals, most trustees of Australian Prudential Regulation Authority (APRA) regulated funds are corporate trustees and it is the board of directors that are responsible for the trustee's decisions and actions.

Given Australian superannuation funds hold assets roughly equal to Australia's GDP (around $1.3 trillion), it is vitally important that trustee and investment governance structures are robust.

While the review found no evidence of systemic failure of trustee governance in the superannuation system, it did identify shortcomings in the governance model that need to be addressed and improvements that can be made.

The review suggested there were difficulties for trustees and directors of corporate trustees in understanding what is expected of them and that, as the industry consolidates, conflicts of interest and conflicts of duty arise regularly.

2. OFFICE OF 'TRUSTEE-DIRECTOR'

2.1. Issue / Problem / Objectives

The review found that trustee governance structures have not kept up with developments in the industry. It suggested there were difficulties for trustees and directors of corporate trustees in understanding what is expected of them.

The review noted that currently:

- trustees are subject to the duties imposed by subsection 52(2) of the SIS Act and a variety of RSE licensing requirements; and
- directors of corporate trustees are currently subject to:
  - the 'fit and proper' requirements for an RSE licensee;

- subsection 52(8) of the SIS Act which imposes the covenants set out in subsection 52(2) on the directors of corporate trustees as though they were trustees personally; and
- those parts of the *Corporations Act 2001* that apply to company directors.

The review expressed concern that the present system creates ambiguity and confusion for some directors of corporate trustees as to whom their duty of loyalty is primarily owed: to the members of the fund or to the for-profit trustee company (and hence its owners and associated parties).

Given the superannuation industry is consolidating, the review expressed concern that conflicts of interest and conflicts of duty will arise more regularly.

To address these concerns the review recommended creating a new statutory office of 'trustee-director'. The duties, powers and standards required of this office would be clearly set out in a single piece of legislation, the SIS Act.

The review envisaged that these duties would enhance, expand and clarify the duties set out in subsection 52(2) of the SIS Act as well as appropriately adapting the duties of directors in chapter 2D of the Corporations Act.

The review also saw a need to formulate two additional duties for trustees who are also directors. The first is that directors of corporate trustees should be required to act solely for the benefit of members, including and in particular, to give priority to the duty to members when that duty conflicts with the director's duty to the trustee company, its shareholders or any other person.

The second additional duty the review recommended was for directors of corporate trustees to exercise the degree of care, skill and diligence as an ordinary prudent person of business would exercise in dealing with the property of another for whom the person felt morally bound to provide.

The objectives of the changes in relation to trustee governance are to ensure a consistently high standard of governance across the superannuation industry, and thus deliver the public policy goal of enhancing the retirement income of superannuation fund members.

2.2. Options

Option A: Create a distinct new office of trustee-director

Create a distinct new office of 'trustee-director' for the directors of corporate trustees. The duties, powers and standards required of this office will be consolidated in a single place, the SIS Act. They will expand and clarify the duties set out in subsection 52(2) of the SIS Act and adapt the chapter 2D directors duties from the Corporations Act.

Potential conflicts will be addressed through 'conflict' duties including that a director of a corporate trustee put member interests above the interests of shareholders, and avoid potential conflicts with other superannuation funds or service providers; and a requirement to act with the care, skill and diligence of a 'person of business'.

This option was recommended by the review (recommendation 2.1).

Option B: No new office of trustee-director but heightened trustee duties

Do not create the distinct office of 'trustee-director' but implement reforms that address the particular problems identified by the review:

- introduce a duty for each trustee (including individual trustees and corporate trustees) to give priority to the interests of members when that duty conflicts with other duties;
- increase the standard of care, skill and diligence required of each trustee to that of a prudent person of business.

In addition, clarify the duties of directors of corporate trustees in section 52 of the SIS Act by requiring them to:

  - act honestly;
  - exercise independent judgment.
  - exercise the same degree of care, skill and diligence as that of a prudent person of business;
  - take reasonable steps to avoid putting themselves in a position where their interests conflict with members' interests;
  - give priority to the interests of members when that duty conflicts with other duties;
  - take reasonable steps to avoid putting themselves in a position where their duty to any other person (such as another superannuation fund or a service provider) conflicts with their duty to members;
  - take reasonable steps to avoid putting themselves in a position where their duty to any other person (other than members) conflicts with their duty to the trustee company;
  - not obtain any unauthorised benefit from the position of trustee or trustee-director; and
  - not enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers.

Option C: No change to trustee governance arrangements

Maintain the status quo.

2.3. Impact analysis

APRA intends to issue prudential standards around conflicts management and requirements for trustees to be fit and proper persons that will supplement the legislative obligations, and will be subject to a separate RIS process.

Option A: Create a distinct new office of trustee-director

During consultation, a number of concerns were raised in submissions and by the Governance working group and the Peak Group with the Super System Review's proposal to move certain directors' duties from the Corporations Act to the SIS Act to create a new office of trustee director.

The benefit gained from moving to a 'trustee-director' model would be likely to be significantly outweighed by the costs required to achieve a move from the Corporations Act to the SIS Act without resulting in any unintended divergence between the standards imposed by the different duties.

Impact on members

Heightening the obligations of superannuation fund trustees to manage superannuation assets prudently and in the best interests of all members of the fund should lead to enhanced retirement income of superannuation fund members.

Impact on superannuation funds / trustees (including directors)

In the Corporations Act, directors' duties are three pronged: general duties under Part 2D.1; a duty not to trade while insolvent under section 588G; and a duty to keep books and records. Replicating the Corporations Act directors' duties in the SIS Act would consolidate applicable duties for the directors of corporate trustees in one location, and may therefore be considered to be more transparent.

During consultation, it was noted that moving requirements for directors of corporate trustees into the SIS Act while leaving requirements for other directors in the Corporations Act has potential for confusion as to the roles and responsibilities of the two regulators, APRA and ASIC, under the SIS Act. For example, would APRA enforce breaches of duty by the corporate trustee, and ASIC enforce breaches by directors of the corporate trustee?

Consolidation may create consistency problems between the duties in the respective Acts and, over time, result in unintended regulatory divergence. This may create uncertainty for people who are both a director of a corporate trustee and a director of another corporation, as to the differences in the requirements of directors' duties that are applicable to their respective roles. In this way, it may create an undue regulatory burden on directors.

The working group noted that obligations placed on trustees and directors of corporate trustees exist in a number of areas in addition to the SIS Act and Corporations Act, including the *Taxation Administration Act 1953* and the common law, and concerns about the feasibility of including all directors' obligations in one piece of legislation were raised.

The change would require updating of educational and training material that trustees prepare for 'trustee-directors' and compliance with additional regulatory attention.

A better clarified and articulated set of trustee duties will give trustees greater certainty and confidence in respect of decisions which they make for the benefit of their members. There will be less scope for court judgments to be made in favour of a member plaintiff where trustees are able to show fulfilment of obligations which are easily identifiable and clear.

The change would require updating of educational and training material for directors of corporate trustees and compliance with additional regulatory attention.

Impact on other stakeholders

Other stakeholders affected include the regulators, APRA and ASIC.

The review identified the consequences of creating a new office and moving provisions into the SIS Act would include cost and disruption.

During consultation, concerns about the feasibility of including all directors' obligations in one piece of legislation were raised.

Issues regarding the jurisdiction of the relevant regulators could also arise, along with the risk of misalignment of the provisions (in the SIS Act that covered trustee-directors compared with those in the Corporations Act that covered other directors) as time went on.

Option B: No new office of trustee-director but heightened trustee duties

During consultation it was thought that a new role of trustee-director did not necessarily need to be created to achieve the intent of the review's recommendation and, rather than creating a new office, it was agreed that reforms should focus on addressing the particular problems identified by the review, and clarifying in the SIS Act those duties that appropriately apply to individual directors, rather than to the corporate trustee (including acting honestly and exercising independent judgement).

APRA intends to issue prudential standards around conflicts management and fit and proper that will supplement the legislative obligations and be subject to a separate RIS.

Impact on members

Better trustee and investment governance will:

- lead to increased confidence and thus engagement from members;
- help ensure that the appropriately qualified people are running the fund and that they are aware of their duties toward members;
- help ensure conflicts are better managed so that members can be confident that all trustee-directors are acting solely for the benefits of members;
- improve accountability to members;
- assist in better investment returns;

Impact on superannuation funds / trustees (including directors)

The changes would help ensure that the appropriately qualified people are involved in the management of the superannuation fund and that they are aware of their duties toward members.

During consultation concerns were raised that applying duties to individual directors could expose directors to increased liability. In response it was noted that the proposed duties would essentially be a clarification of obligations under the existing law, and that any risks would be able to be managed. Under existing legislation individual directors are already liable individually (subsection 52(8) of the SIS Act and sections 180-184 of the Corporations Act), and members have the ability to sue directors (subsection 55(3) of the SIS Act). In its final report, the Peak Group suggested that careful drafting of should address this issue.

Requiring trustee-directors to exercise the care, skill and diligence as an ordinary 'prudent person of business' instead of 'an ordinary prudent person' may result in some people (particularly in not-for-profit sector) declining to nominate. However, running a superannuation fund is akin to running a business and the proposed obligation is appropriate. In practice, directors of corporate trustees already operate at the prudent person of business level as this is already the requirement for remunerated directors (for example, under paragraph 14A(2)(a) of the NSW *Trustee Act 1925*).

A better clarified and articulated set of trustee duties will give trustees greater certainty and confidence in respect of decisions which they make for the benefit of their members. There will be less scope for court judgments to be made in favour of a member plaintiff where trustees are able to show fulfilment of obligations which are easily identifiable and clear.

The change would require updating of educational and training material for directors of corporate trustees and compliance with additional regulatory attention, however costs should be minimal.

Not proceeding with the office of 'trustee-director' avoids: the potential for confusion for individuals who are both directors of superannuation corporate trustees and other boards; uncertainty regarding the jurisdiction of ASIC and APRA; and the risk of misalignment of provisions over time.

Impact on other stakeholders

Other stakeholders affected include the regulators, APRA and ASIC.

The changes should result in an improved regulatory regime for the superannuation industry.

Option C: No change to trustee governance arrangements

This option would preserve the status quo. Therefore, there would be no substantive compliance burden on industry and no additional cost to the regulators.

Impact on members

Preserving the status quo would not enhance the duties of superannuation trustees towards their members and conflicts of interest and conflicts of duty will continue, which is likely to impact negatively on members' retirement incomes.

Members would not face additional costs that could arise from increased compliance costs from new duties.

Impact on superannuation funds / trustees (including directors)

No heightening of trustee duties, thus:

- difficulties for trustees and directors of corporate trustees in understanding what is expected of them will continue and as the industry consolidates, conflicts of interest and conflicts of duty will arise more regularly;

- ambiguity and confusion for some directors of corporate trustees as to whom their duty of loyalty is primarily owed (to the members of the fund or to the for-profit trustee company) will continue;

- no updating of educational and training material for directors of corporate trustees would be required and

- no additional regulatory attention.

Impact on other stakeholders

No change from the existing position, thus the improvements to ensure there is a more accountable and efficient trustee governance regime will not occur.

2.4. Consultation

During consultation concerns were raised with the Super System Review's proposal to move certain directors' duties from the Corporations Act to the SIS Act to create a new office of 'trustee-director' in submissions and by the Governance working group and the Peak Group.

These concerns included: the potential for confusion for individuals who were both directors of superannuation corporate trustees and other boards; concerns about the feasibility of including all directors' obligations in one piece of legislation; the risk of misalignment of provisions over time; and issues regarding jurisdiction of the relevant regulators.

2.5. Conclusion and recommended option

It is recommended that trustee governance be improved without introducing a new office of trustee director (option B). This achieves the outcome of heightening trustee governance across the superannuation industry, without creating a new office and moving all the provisions into a single piece of legislation, which would have the potential for: confusion for individuals who are directors of superannuation corporate trustees and other boards; provision in the SIS Act and Corporations Act becoming misaligned over time; and issues regarding the jurisdiction of ASIC and APRA.

SuperStream

1. Background

'SuperStream' is the name given by the SSR to the package of measures designed to enhance the 'back office' of superannuation, improve the productivity of the superannuation system and make the system easier to use.

The Review identified significant cost imposed by existing administrative processes. These include the excessive costs and complexity arising from manual processing of both money transfers and data, the lack of standardised formats, and poor and incomplete data. Ernst & Young has estimated the SuperStream proposals could save up to $1 billion per year in fees and costs.

2. Data and e-commerce standards

2.1. Issue / Problem / Objectives

As at 30 June 2010, the superannuation system comprises over $1.23 trillion in assets. It is estimated that the Australian superannuation system processes more than 100 million transactions annually, at a cost of over $3.5 billion annually to process. These include member support (e.g. call centre) activities ($1 billion), contribution management ($1.25 billion), reporting ($250 million), and benefit payment services ($1 billion).

Several aspects of the current system are inefficient.

- There are no mandated data or transmission requirements for transactions within the superannuation system.
  - Different funds have different data requirements and funds have adopted their own IT platform and data transmission formats for processing data and payments.
  - Data quality is often poor, leading to members being incorrectly enrolled in funds with a resultant risk of multiple accounts being created.
  - Contributions often do not contain the minimum data requirements to identify the member meaning the funds cannot be correctly allocated, resulting in money being put in suspense accounts and either returned to the employer or transferred to the ATO as unclaimed monies.
- Widespread use of manual payment and data transfer methods have contributed to poor data quality which has resulted in processing delays, duplicated and lost accounts and has added costs in the system through the need to collect incomplete data.
  - High-cost cheque and paper transactions between employers and funds account for between 50 and 80 per cent of transaction flows. Similarly, rollover transactions between funds, of which there are upwards of 2 million annually, are also almost exclusively paper based.

The industry has been aware of the impacts of poor data quality caused by paper based transaction for some time. The SSR noted the industry failed in adopting the swimEC initiative due to its voluntary nature. SwimEC is the superannuation, wealth and investment management electronic commerce program developed jointly by the superannuation and managed funds industries.
SuperStream includes proposals to address inefficiencies in back office processing by:

- improving the quality of data in the system;
- allowing the use of tax file numbers (TFNs) as the primary locater of member accounts;
- encouraging the use of technology to improve processing efficiency; and
- improving the way fund-to-fund rollovers are processed and the way contributions are made.

The success of SuperStream will be measured through:

- improved data quality across all superannuation transactions
- a reduction in the number of multiple, inactive or lost member accounts following improved quality of member data and through account consolidation measures;
- a reduction in processing timeframes for contribution and rollover transactions.
- improvements in the member and employer experience (for contributions and rollovers); and
- collaboration and continuous improvement of back office processing across the super industry.

2.2. Options

Option A: Mandate the use of data and e-commerce standards based on the Standard Business Reporting (SBR) framework

Data and e-commerce standards will be developed and implemented to across all superannuation transactions, including member registration; contributions; rollovers and reporting to Government.

The data standard will be based on the Standard Business Reporting (SBR) framework for defining terms and relationships.

The use of SBR simplifies business-to-government reporting by:

- removing unnecessary or duplicated information from government forms;
- adopting a common reporting language, based on international standards and best practice;
- providing an electronic interface to agencies directly from accounting software which will also provide validation and confirm receipt of reports; and
- making financial reporting a by-product of natural business processes.

Basing the data standard on the SBR framework will ensure consistency with the harmonised set of definitions, or taxonomy, developed for reporting by businesses as part of the SBR project. Many of the data terms needed to support the superannuation transactions are already contained in the SBR definitional taxonomy. This common reporting language and ability for re-use of terms means that terms already used in reporting from business-to-government can be extended for superannuation

purposes. For example, APRA has adopted SBR for its reporting framework and APRA-regulated superannuation entities have an option to provide reports via the SBR framework.

The data and e-commerce standards will use the same framework as SBR for the formatting of the transaction message. This uses the eXtensible Business Reporting Language (XBRL), an international standard for financial reporting.

As a component of the mandated standard, superannuation payments (such as contributions from employers and rollovers from one fund to another) will be required to be made electronically. Employers and funds will be able to utilise existing electronic payment solutions to remit payments (that is Electronic Funds Transfer, BPay), so long as the system used complies with standards set by the Australian Payments Clearing Associations. Every payment will have a unique identifier that will be part of the data reported, to ensure that the payment and associated member information are linked.

Use of the data and e-commerce standards will be mandatory for employers, funds and service providers involved in the processing of superannuation transactions. Funds (or their agents) will be expected to provide form processing services for employers, thus shielding them from having to deal with multiple funds for every contribution run.

As noted earlier, the uptake of the voluntary industry SwimEC standard was not successful due primarily to the lack of a 'first mover' advantage. The benefits of standardised data and electronic payment processes can only be fully realised if the use of the standards is mandatory.

The adoption of data standards will allow participants to communicate by using standardised business terms, while electronic transmission will allow for a more automated and timely processing of transactions with fewer errors. This will result in improved efficiency, an easier system for employers to use, fewer lost accounts and more timely flow of money to member accounts.

The introduction of mandatory data and e-commerce standards will result in a significant change in systems and behaviour across the funds and employers. To mitigate risk and recognise the amount of change that will be required to adopt the data and e-commerce standards, it is proposed that a phased implementation occur. This approach will provide funds, employers and service providers with certainty in terms of investment decisions and planning lead times.

The proposed implementation for data and e-commerce standards is as follows:

2012 – Data standards published and available for use (voluntary uptake and on-boarding period).

2013 – Data standards and use of e-commerce becomes mandatory for processing rollovers and accepting any contributions by APRA-regulated funds and SMSFs.

2014 – Data standards become mandatory for employers with 20 or more employees making contributions.

2015 – Proposed application of data standards and use of e-commerce to small employers with less than 20 employees subject to further consideration of impacts.

The Government is mindful of the implementation issues this raises for small employers in particular and will continue to consult with employer groups on the best and most practical ways to achieve these objectives.

The data and e-commerce standards will be supported by a graduated series of sanctions for non-compliance. The severity of the sanction in any given situation will depend on the type of

non-compliance, culpability of actor and individual circumstances. The enforcement regime will follow existing compliance models and patterns, such as the superannuation choice obligations, where appropriate.

Option B: Voluntary adoption of data and e-commerce standards

As noted earlier, while the industry recognises the significant cost savings that can be generated over the long term, there has been general inertia to adopt the swimEC standards. The SSR suggested that this is because of:

- the voluntary nature of the standards;
- the costs involved in implementing the standards;
- the perceived lack of advantage in early adoption, as the system depends on mutuality to generate cost savings (that is, the benefits from large up-front investment are not realised until a sizeable number of other funds adopt the standards); and
- the swimEC standards incorporating the needs of many participants, resulting in many data fields only being relevant to a minority.

Past industry experience with SwimEC suggests that take up rates for voluntary standards are likely to be very low. Most parties would have little incentive to deviate from current practices and the complexity of employer-to-fund relationships would continue. As a consequence, data quality and processing time issues are likely to persist in the absence of a mandatory standard.

As a result, the voluntary adoption of data and e-commerce standards across all superannuation transactions was not viewed as a viable option to achieve the sought policy outcomes.

2.3. Impact analysis

Option A: Mandate the use of data and e-commerce standards

Impact on members

Members will benefit from the establishment of a mandatory set of data and e-commerce standards as there will be a requirement for all contributions to be submitted to funds electronically, in a pre-determined format and in a more timely manner.

This will result in an improvement in member information as there will be a minimum data requirement imposed when transmitting the contribution message. Enhanced data quality will reduce the likelihood of members becoming lost due to incomplete or incorrect information being provided to funds.

The receipt of accurate data by funds will improve the ability of funds to allocate funds to member accounts in a timely manner and remove the potential for funds to be allocated to suspense accounts (where member information received is incomplete). Electronic payments also allow for quicker allocation to member accounts than payments currently made by cheque.

Improvements to member information received will also improve the current proof of identity procedures (provision of authenticated paper copies of identity documents) undertaken by funds when a request is received for a rollover or payment of a benefit. For example, enhanced data quality for member information will enable the introduction of a streamlined process for confirming member

identity for rollovers between APRA-regulated funds by use of an automated member verification service.

Mandatory electronic payments will result in a reduction in the time taken to process contributions and rollovers and for payments to be allocated to a member account. For example, funds currently have 30 days from the receipt of information in which to process the rollover request.

It was agreed by the SuperStream working group that a measure of success for the new standards would be the ability for rollovers to be processed (from account to account) within six days of the request being made.

The removal of inefficiencies in current administrative practices will reduce transaction costs and provide funds with the scope to reduce fees charged to members. The potential gains to the system through improved efficiency in contribution management are demonstrated by the estimate that 'straight-through' electronic processing of correctly provided member and financial data is approximately five cents per transaction , compared to a cost of in excess of $1 for processing a transaction using paper.

In their submission to the Cooper review, Ernst and Young estimated that superannuation funds and their agents receive in excess of 100 million contributions per annum. As at 30 June 2010, APRA statistics indicated that there were in excess of 2.5 million rollovers of superannuation.

Impact on superannuation funds / trustees

The mandated use of data and e-commerce standards for all superannuation transactions will impact all superannuation funds to varying degrees depending on their existing use of technology.

As at 30 June 2010, there were 589 APRA funds, 3,869 Small APRA funds and 428,198 self managed superannuation funds.

All funds and administrators will need to upgrade existing systems in order to transmit and receive messages consistent with the data and e-commerce standards. This is likely to impose the greatest cost on those funds and administrators with a wide range of legacy systems that will need to interact with the new data standards or who have recently made significant systems expenditure inconsistent with the new standards. This is a 'transitional cost' which over time is expected to be recouped by ongoing operational savings.

To mitigate costs associated with the adoption of the data and e-commerce standards, superannuation funds and trustees have the opportunity to determine to what extent they integrate required changes (in particular the XBRL format) into their administrative systems. Funds will have options ranging from the implementation of a low cost XBRL translation layer (enabling them to send and receive XBRL messages) through to a high cost option of fully integrating XBRL components across all systems (including legacy systems) at a database level. Additionally, the use of third party providers (such as administrators or clearing houses) provides an option to outsource the requirement to send and receive messages in the new format.

The introduction of data and e-commerce standards will deliver a significant, benefit for APRA funds by improving the quality of member information received from employers and the ability to link payments to contributions. This will result in decreased processing costs and the removal of complexity for funds and / or their service providers when processing member information that is incomplete.

The introduction of a superannuation definitional and reporting taxonomy will enable funds to have maximum reuse of existing data and consistency when reporting to government. This will also enable the simplification of information collected across existing reports.

Funds will be required to process contributions and rollovers in the new format from 1 July 2013.

Impact on employers

The mandated use of data and e-commerce standards for all superannuation transactions will impact employers to varying degrees depending on their existing use of technology, the number of employees, the degree to which they wish to outsource the function and the avenue they choose to adopt the data and e-commerce standards. All employers will need to have the capability to remit contributions (message and payment) electronically and as such will be required to upgrade their systems or software packages, or alternatively, work with a business partner who can provide this service on their behalf. Employers will be able to choose from a variety of options including:

- the Medicare Small business Clearing House (free to small business);
- other commercial clearing houses;
- an accountant, book-keeper or bureaux service;
- a software service ('cloud') provider; or
- a sponsoring fund portal offering.

To mitigate the impact on employers, the Government intends to apply a phased implementation approach.

- 2014 – Data standards become mandatory for employers with 20 or more employees making contributions.
- 2015 – Proposed application of data standards and use of e-commerce to small employers with less than 20 employees subject to further consideration of impacts.

This proposal aims to ensure that funds are fully compliant with the new data and e-commerce standards and able to receive contributions. Additionally by providing a 12 month period for business to adopt the standards after introduction to funds there is an opportunity for funds to assist in rolling out the new standards to employers that they have an existing relationship with.

Small business is provided a further 12 months before they are required to make contributions using the data standards. This is to recognise the difficulties in communicating the requirements across the 800,000 small businesses and ensure readiness across the sector. The Government is mindful of the implementation issues this raises for small employers in particular and will continue to consult with employer groups on the best and most practical ways to achieve these objectives.

Smaller employers who currently rely on cheques and paper forms to meet their superannuation obligations will be able to utilise the free clearing house offered by the Medicare Small Business Superannuation Clearing House. This optional service is currently available to small businesses with less than 20 employees and is designed to reduce the compliance cost associated with meeting their superannuation guarantee obligations. Employers who choose this service will be able to satisfy their obligations by passing the necessary information and funds to the clearing house for further processing.

Option B: Voluntary adoption of data and e-commerce standards

Impact on members

As a voluntary system of data and e-commerce standards would not be expected to have a substantial adoption rate, there would be very limited cost reduction and efficiency savings. As a result, there would be very little, if any, benefits to be passed on to members under this option.

Impact on superannuation funds / trustees

Under a voluntary system, superannuation funds and their service providers would not be required to upgrade existing systems. There would be a first-mover disadvantage, as early adopters of the standards would not receive substantial benefits until such time as others also became compliant.

Although this option would reduce the need for potentially costly systems upgrades in the short term, there will be no corresponding efficiency savings from streamlined processing of contributions and rollovers transactions.

Impact on employers

Employers would not be required to upgrade systems to ensure contributions sent comply with the new standards. There would be no incentive to adopt a voluntary standard especially when there was not a uniform approach across funds in how data was to be received.

Current inefficiencies experienced by employers (such as rework to provide information on incomplete member data) would remain.

2.4 Consultation

The Peak Consultative Group and SuperStream Working Group recognised the importance of data and e-commerce standards to streamlining back-office processes and achieving efficiency savings. There was strong support in the working group for mandating the data standards in order to bring about the desired behavioural change and outcomes.

The Working Group agreed to the following recommendations relating to the data and e-commerce standards:

<u>In relation to the definitional taxonomy</u>

a) Adopt the definitional taxonomy framework in SBR as mandatory for defining SuperStream terms and relationships.
b) Ensure that any terms unique to SuperStream are approved by, and subject to change control by the new SuperStream Governance body, in consultation with impacted stakeholders.
c) The form of this standard and the timing of its adoption should be reflected in an appropriate statutory framework.

<u>In relation to the message format & structure</u>

a) Subject to satisfactory resolution of large file and processing efficiency issues, adopt the message format and structure used in SBR as mandatory for defining transaction and reporting messages used to support SuperStream.
b) Ensure that any changes to SuperStream messaging are approved by, and subject to change control by the new SuperStream Governance body, in consultation with impacted stakeholders.

c) Adopt a mandatory transaction identifier based on an improved SPIN identifier and unique account or transaction code (for inclusion in all data and payment messages).
d) The form of this standard and the timing of its adoption should be reflected in an appropriate statutory framework.

<u>In relation to the payment standard</u>

a) Adopt the BECS standard as the basis for SuperStream electronic payments.
b) Empower the new SuperStream governance body, in consultation with APCA and other relevant stakeholders, to endorse electronic payment methods based on this standard, including the adoption of any new standard based on ISO 20022.
c) As for (c) above: Adopt a mandatory transaction identifier based on an improved SPIN identifier and unique account or transaction code (for inclusion in all data and payment messages).
d) The form of this standard and the timing of its adoption should be reflected in an appropriate statutory framework.

Option A is consistent with these recommendations.

2.5 Conclusion and recommended option

It is recommended that the data and e-commerce standards be mandated as per option A in order to maximise the efficiencies and provide a level playing field for participants.

Although option B (voluntary adoption) would result in less expenditure on system upgrades, it would be unlikely to achieve the objective and provide savings to members, who are the ultimate beneficiaries of the superannuation system.

3. CONSOLIDATION OF SUPERANNUATION ACCOUNTS

3.1. Issue / Problem / Objectives

Lost and unnecessary superannuation accounts can have significant impact on the retirement savings of individuals concerned and also add to fund administration costs. As at June 2010, there were around 33 million superannuation accounts in Australia, being three accounts for every worker.

As at 30 June 2011, there were an estimated 5 million accounts recorded on the lost member register. Of these accounts, approximately 2.6 million had a balance less than $1,000.

Currently, processes for individuals wishing to consolidate accounts can be cumbersome and time consuming. Trends towards casual and short-term employment, particularly for young workers, also add to the growth in multiple and lost accounts.

It is not mandatory for an individual to provide their TFN to a superannuation fund. If a TFN is not provided, the individual is taxed at the highest rate for any contributions received and funds are left with additional processing work as they do not have a genuine identifier to link payments received to.

The ability to use TFNs within the superannuation is a key requirement to further efficiency with the superannuation system and a key leverage point for consolidation of accounts. The use of TFNs to facilitate this outcome with the superannuation sector has not previously been possible as no legislation existed enabling funds to use the TFN as a primary identifier.

Action has now been taken by the Government to expand the use of tax file numbers for superannuation purposes. From 1 July 2011, superannuation fund trustees and retirement savings account providers have been able to use TFNs as a primary locator of member accounts, rather than having to use other methods first and to facilitate account consolidation.

From 1 January 2012, superannuation fund trustees and RSA providers will be able to use TFNs for the purposes of intra-fund account consolidation (with member consent).

The Government aims to increase retirement incomes by facilitating a steady reduction in the number of unnecessary and lost superannuation accounts while minimising risks of unintended consolidations. The wider use of TFNs and the availability of electronic processes and tools aim to make it easier for members and trustees to voluntarily consolidate accounts.

3.2. Options

Option A

- The ATO would upgrade its online services to allow members (and funds on their behalf) to better search for multiple accounts, through the use of TFNs and other identifying information.
- Where a member has multiple accounts within a fund, the fund would be required to be required to consolidate these accounts, where possible.
- From December 2013 lost and inactive accounts with a balance under $1,000 would be subject to automatic consolidation unless the member opted out of the process.
- The consolidation process would operate by the ATO using the TFN to identify multiple accounts and advising the active fund who would then arrange the consolidation on behalf of the member (unless the member has opted out).
- From July 2014 a new enrolment process is to be implemented for new employees to encourage employees to actively consider and arrange account consolidation at this time.
- The success of the new processes would be reviewed at the end of 2014 to determine their success and whether a review of the threshold is necessary for the ongoing auto-consolidation of inactive accounts.

Option B

- As above but no consolidation of accounts below $1,000 would occur unless the member opted in to the consolidation process. The consolidation process would operate by the ATO identifying multiple accounts and advising the member and the ATO arranging the consolidation on behalf of the member.

3.3. Impact analysis

Individuals / Members

The options identified above rely on the use of TFN to link member accounts and thereby consolidation.

The quotation of a TFN is not mandatory and as such individuals will continue to have the option of not providing a TFN for superannuation purposes. Where an individual elects not to have their TFN quoted for superannuation purposes this will result in the account being transferred to the ATO as unclaimed money (see section 3.6 below).

Members may benefit from consolidation by avoiding multiple fees, including unnecessary insurance premiums on multiple accounts. Ultimately they can be expected to have higher retirement benefits. For example, a 22 year old paying three insurance premiums in three separate accounts could have a retirement benefit nearly $80,000 lower than if they had just one account.

These benefits are more likely to accrue if Option A is adopted and accounts below $1,000 are automatically consolidated (with an opt out option) as many members are disengaged and may not actively consolidate their accounts if they are required to opt in to the process.

Some members may wish to deliberately maintain multiple accounts. They will have the ability to opt out of consolidation if desired under Option A. By setting the automatic consolidation amount at below $1,000 the risks of inadvertent consolidation will be limited.

Superannuation funds / trustees

Under Option A, funds will be required to arrange the consolidation on behalf of members once advised by the ATO of multiple accounts.

To facilitate this process funds will be required to report all active / inactive accounts that they hold to the ATO. To ensure more accurate data is obtained reporting will occur on a six monthly basis.

Upon receipt of reports, the ATO will match all accounts to known TFNs and advise the nominated / active fund that the member has multiple accounts that they may wish to be considered for consolidation.

As the gaining fund, the nominated / active fund will be required to contact the member and seek their consent to consolidate any other accounts.

This will facilitate the consolidation process by ensuring the gaining fund is in control of the process rather than having the ATO as an additional third party in the process.

3.4. Consultation

The members of the working group agreed that consolidation of member accounts is an important issue and that the implementation of the data standards in conjunction with the phased consolidation approach outlined below will help curb the proliferation of multiple accounts. It also agreed that the phased approach will triggers members to think about consolidation.

The consultative group did not resolve the question of who arranges consolidation, and some of the representatives of the funds would have preferred that the ATO do the work. Since the receiving fund stands to benefit, the Government proposes that the receiving fund should do the work, once notified by the ATO.

The SuperStream group sketched out a phased process for consolidating accounts. The main steps are:

July 2011:	Funds can use TFNs as primary locater to find accounts within a fund.

January 2012: Funds can use TFNs to search SuperSeeker, the ATO's website for searching for lost accounts — but only with member consent.

July 2012: Where a member has multiple accounts within a fund, funds would be required to consolidate these accounts, where possible.

July 2012: The ATO will provide a new online facility for members to view their active (but not their inactive) superannuation accounts that are currently reported to the ATO, in addition to their lost accounts and other superannuation moneys held by the ATO (for example, unclaimed money). Funds will be able to search the account information with member consent.

October 2013: Funds reporting inactive accounts, lost accounts as well as active accounts to ATO.

December 2013: Commencement of auto-consolidation of lost and inactive (2 years without contributions or rollover) accounts under $1,000 and accounts in ERFs. Process to be initiated by the ATO and conducted annually. The ATO would identify relevant accounts and advise the current fund. This fund would be legally responsible for arranging consolidation unless:

- the member accepts the option provided by the current fund to opt out of the process,
- the account balance was now above $1,000 or
- the account had received contributions or a rollover within the last 24 months.

In addition, members and funds (with member consent) can use the new ATO online facility at any time to search for all accounts, including inactive accounts. They will be able to lodge an electronic claim form for any ATO held super monies through this online facility.

July 2014: Enrolment processes for new employees will be modified to encourage employees to actively consider and arrange account consolidation at this time.

If the new employee does not make an election to consolidate, the default option would be to create a new account with lost / inactive accounts (with balances less than $1,000) transferred into the new account through auto-consolidation process previously.

July 2015: Review the success of these processes and whether further enhancements are warranted.

3.5. Conclusion and recommended option

It is recommended that the phased approach and the broad framework as proposed by the SuperStream working group and outlined in option A be adopted.

The phased approach will facilitate a steady reduction in the number of unnecessary and lost superannuation accounts while minimising risks of unintended consolidations with the opportunity to review the success of the measures at the end of 2014, including whether the cap for auto-consolidation of lost and inactive accounts should be increased to $10,000.

The wider use of TFNs and the availability of electronic processes and tools will make it easier for members and trustees to voluntarily consolidate accounts.

The automatic consolidation of low balance accounts will further reduce the number of existing lost accounts in circumstances where members are unlikely to initiate a consolidation. A new enrolment process will stem the growth of unnecessary accounts in the absence of a member making an active choice to retain an existing low balance account on the commencement of employment.

3.6. Contributions where member identity cannot be established

3.6.1. Issue / Problem / Objectives

The No-TFN contribution measure aims to increase the number of superannuation accounts with TFNs attached to them in order to streamline the account consolidation process.

TFN quotation is essential for the effective administration of the superannuation system by the ATO and superannuation funds. However, TFN quotation remains voluntary, to accommodate privacy concerns. However, there are a number of consequences where individuals do not quote their TFN: the individual will incur No-TFN contribution tax, and also, individuals cannot make post-tax contributions.

Under existing law, individuals are not required to supply their TFN to their superannuation fund. However, where employer contributions are not accompanied by a TFN, funds are subject to a no-TFN tax of 31.5 per cent, in addition to the standard 15 per cent tax on contributions. This does not apply to accounts opened before 1 July 2007, if contributions are less than $1,000. A fund can claim an offset to recover the no-TFN tax if the member quotes their TFN within three years of the tax being imposed.

As at July 2009, the ATO estimated that seven per cent of all member accounts reported (approximately 15 million active accounts) did not have a TFN.

The Government made a number of recommendations to expand the use of TFNs to improve superannuation fund efficiency and assist with account consolidation.

The use of TFN has been identified as crucial to the success of the broader policy objectives of account consolidation and enhanced system efficiency through improved member data. To this extent the ATO will develop verification services to simplify the existing processes for confirming whether a TFN can be confirmed against known identity information.

It is intended that employers will utilise this validation service to verify the TFN for an employee at the time of completing the TFN declaration process (and before making a superannuation contribution).

The options explored below would be triggered as a result of a 'No' response upon using the validation service.

Two options are being considered to deal with No-TFN contributions, that is, where an employee fails to provide a TFN.

3.6.2. Options

Option A: Employer forwards money to the ATO

Under this option, the employer would send contributions directly to the ATO, along with identifying details that it has – as recommended by the SSR (recommendation 9.2).

This approach is more efficient and provides an incentive for the employee to provide their TFN, as money sent the ATO will not bear interest, unlike if the money were sent to a fund.

Option B: Employer forwards money to the fund

Under this option, the employer could forward the superannuation contribution to their default fund, which would then have until the next unclaimed money reporting cycle (ie 30 April or 31 October) to obtain a TFN and other identifying details.

If the fund was unable to obtain sufficient personal details to enable a TFN match to occur, it would send the money to the ATO, which would treat it as unclaimed money. Ordinary fund rules relating to suspense accounts would apply.

3.6.3. Impact Analysis

Option A would require employers and the ATO to develop a new process for dealing with no TFN contributions. In contrast Option B leverages off the existing process funds follow for unclaimed money.

Implementation of Option A would mean that the member would not receive the benefit of insurance or interest.

Option B ensures members continue to receive insurance and interest on their contributions while the fund is endeavouring to obtain a TFN for the member. Where the TFN was obtained within the timeframe allowed, this would enable continuity of insurance and interest on contributions for the member.

Option B is therefore optimal for members and requires no new change of practice for employers – any No TFN contributions would be sent to their default fund. Under Option B funds would only need to pay amounts to the ATO if they are unable to obtain the TFN and any payments required to the ATO would leverage off existing unclaimed money processes.

Both options would impose initial compliance cost on employers as they validate the employee's TFN. However, once this validation is complete and the data is matched correctly, further validation of the employee's TFN would not be necessary. The initial validation process will reduce the need to further rework by the employer. The existing No TFN tax paid on contributions where No TFN is provided will be removed under both options.

3.6.4. Consultation

The consultation working group supported Option B as being more efficient for employers and maximising the opportunity for the member's TFN to be identified and the member to gain interest and insurance coverage.

Option A was not supported, as it would require employers and the ATO to use a new process, and the member would not gain interest or the benefit of insurance.

3.6.5. Conclusion and recommendation

It is recommended that option B where the employer continues to forward contributions to the default fund be adopted and to have contributions without reference to a TFN be subject to the unclaimed money process after a specified period of time.

This has a number of advantages, as it would leverage off existing unclaimed money processes, not require a new system to be introduced for employers and the ATO, provide an incentive for funds to seek TFNs and ensure that if a member does subsequently quote a TFN that they have not been disadvantaged by potential loss of interest and insurance cover, which is what would occur if the contributions were provided directly to the ATO.

4. PAYSLIP REPORTING

4.1. Issue / Problem / Objectives

The Fair Work legislation currently requires employers to report *entitlements* to superannuation, accrued during the pay period, on payslips. However, employers are not actually required to make SG contributions until after the end of the quarter and some employers do not make their superannuation guarantee (SG) contributions in full and on time. The problem is compounded where employees do not know that their employer has failed to make the contribution and therefore cannot ask the ATO to intervene.

In its 2009-10 *Annual Report*, the ATO records that during 2009-10 it:

- investigated 18,134 employee complaints;
- raised superannuation guarantee entitlements for around 311,000 employees;
- raised $507 million in superannuation guarantee charge; and
- collected $262 million in superannuation guarantee charge, and $135 million in penalties.

While the number of complaints received by the ATO relate only to about 1 per cent of the employer population, and only to about 0.2 per cent of employees, there is nonetheless a significant problem for many thousands of workers.

Currently, employees do not receive information on their contributions in time to take action. Funds only notify their members about contributions in their annual statement, which can be issued up to eighteen months after the pay period in which superannuation was not paid. Similarly, funds provide only limited information to the ATO, on member contribution statements, again on an annual basis and in arrears. The time lag in receipt of information poses as a barrier for employees to have current information to follow up on the account.

During the 2010 election campaign, the Government announced the *Protecting Workers' Entitlements* package. Under the package, the Government announced that employees would receive:

- Information on their payslips about the amount of superannuation actually paid to their account; and
- Quarterly notification from their superannuation fund if regular payments cease.

The objective of the package is to improve employer compliance and ensure that superannuation entitlements are paid in a timely manner. Additionally, by giving employees more information about their superannuation payments we expect that the measure will reduce the time it takes to identify unpaid contributions.

More broadly, the objectives are to improve member awareness and engagement, and to tell members when they can check with their fund that their contributions have been made.

4.2. Options

Option A: Payslip reporting of both accrued entitlements and actual contributions.

Under option A, employers would be required to report superannuation contributions, on payslips, when they are actually made during the pay period. This would be in addition to the current requirement for them to report accrued entitlements for the pay period concerned.

Option B: A single 'expected payment on or before date', on payslips.

Under option B, employers would be required to report a single 'expected payment on or before' date on payslips. This would in many cases be the SG due date (or a due date under a workplace agreement or award). In some cases, however, employers would remit contributions sooner, and could choose to disclose an earlier date.

Option B modifies the Government proposal for separate reporting of actual payments and accrued entitlements. It ensures employees are aware of when their contributions are due to be paid so they can check on the payment at that time.

Option C: Combine options A and B, so that payslips report accrued entitlements and actual contributions for the pay period (option A) as well as an expected payment date (option B).

As a variant on option C, payslips could also report a cumulative total for unpaid contributions (for instance, during the quarter to date).

4.3. Impact analysis

Option A: Implement the original Government proposal (reporting both accrued entitlements and actual contributions).

Under option A, employees would receive additional information on their payslips on actual contributions made. This may assist some employees who are actively involved in monitoring their superannuation. However it may also confuse employees because the accrued and actual payments will often vary significantly, for example, where the entitlement is accrued fortnightly and paid quarterly.

This option would be the most costly for employers. Software providers have advised through consultation that it is an expensive option to add actual payments to payslips. Costs have not been quantified at this time.

Firms with their own proprietary software needing upgrading would face much larger costs, since their costs would not be shared with other businesses. There may be additional on-going expenses for employers in dealing with employees confused as to why their payslips contain two separate figures, which often will not align.

Option B: a single 'expected payment on or before date'

Under option B, employers would report a single 'expected payment on or before' date. This addresses concerns that employees currently mistake the accrued entitlements shown on payslips for actual payments. Employees will be better informed, and able to follow up with their fund to confirm that payments have been made by the due date – meeting the underlying policy objectives. This would be complimented by a new requirement for funds to have internet portals where members could check their contributions have been made – see section 5.

This option would be less costly to implement for employers. Software providers advise it would be a relatively straightforward modification of the existing software, requiring only the addition of a field for the expected payment date.

Funds will be required to have portals, so that members can check their contributions on the web (see section 5 below). While some funds do not already have them, others either do have portals of their own or use the services of a superannuation administrator which offers web-based access. The three major administrators, Australian Administration Services, Superpartners and Pillar Administration, administer in about 12 million accounts between them, around one third of the total number of accounts, and process nearly half of all contributions to APRA-regulated superannuation funds.

Option C: combine options A and B

This option would combine the expenses of both options.

4.4. Consultation

The sub-group had mixed views on whether the original proposal for payslip reporting of actual contributions (option A) would improve member engagement with their superannuation, or encourage employer compliance. Some believed that a better long-term goal would be to increase the frequency of contributions to reduce the gap between the payslip date and the contribution remittance. Other members of the sub-group recommended the alternative approach (option B). However, some members still believed that payslips should receipt actual contributions, and that if this is mandatory, then software providers would modify accounting and payslip software packages accordingly if sufficient time was provided. They noted that MYOB already has this capability, though it would need further development.

4.5. Conclusion and recommended option

We recommend that initially employers should report on payslips a single 'expected payment on or before' date on as outlined in option B. This would be comparatively easy and quick to implement while still meeting the underlying objectives of better informed employees and greater understanding of the information that is reported on payslips.

Given the complexity associated with reporting 'actual' payments on the payslip, we recommend that further consultation is conducted with industry and payroll providers to determine whether the reporting of 'actual' payments is practical and cost effective. From 1 July 2013, subject to there being no significant payroll system costs, payslip reporting of actual contributions will commence.

4.6. Should payslip reporting be phased in?

The Office of Best Practice Regulation suggested that consideration be given to whether payslip reporting should be phased in, with smaller employers being given more time to comply. However, the sub-committee recommended option B (reporting of an 'expected payment on or before' date) as it was of the view that this option provided sufficient time for employers and their software providers to make the required changes to their payroll systems and did not disadvantage any employees across different business sectors.

In addition, very small employers present the highest risk of not paying superannuation on time and in full. If their reporting is deferred, more employees will not receive their superannuation entitlements. Additionally, very small employers do not always use software. They may fill in their payslips by hand, in which case they will have no difficulty in providing the new information.

The Government is, however, considering phasing in the reporting of actual contributions from 1 July 2013, subject to there being no significant payroll system costs.

5. QUARTERLY FUND NOTIFICATION

In addition to payslip reporting, the second limb to improved access to information was for funds to notify employees and employers electronically if regular (quarterly) contributions cease.

5.1. Options

The working group considered two options:

Option A: Quarterly notification where regular payments cease.

Funds would notify employees, employers and possibly the ATO, quarterly, if regular superannuation contributions cease. Self managed superannuation funds would not be included.

Option B: Funds report whether they have 'received' contributions

Funds would report quarterly to members on whether they had 'received' or 'not received' superannuation contributions for that quarter.

- This communication would generally be by way of email or SMS only. It would be sent to members only and not generally to employers or the ATO.
- It would cover all superannuation contributions, including salary sacrifice and other employer mediated contributions (including after-tax contributions by employees).

The communication would then invite members to log in to a member portal and view a quarterly transaction statement. This would not be a complete financial statement, but would cover transactions only.

- The quarterly transaction statement would also be mailed-out to members on request.
- Members would then be able to compare their payslip information with the quarterly transaction statement.

Under both options, funds would generally report electronically, via email or SMS. Funds would acquire these addresses when enrolling new members, and would encourage existing members to provide electronic contact details. Members could request paper based notification.

Option C: Employer reporting to the ATO

Though it did not form part of the election commitment, the consultation group also considered whether funds should report contributions, in aggregate, to the ATO. They had mixed views on whether this would be worthwhile given that the ATO is unlikely to have the resources to monitor such data. The group noted that the Business Activity Statement could be expanded to require reporting of SG contributions paid by the employer, in aggregate, for a given quarter.

- This would include a compliance declaration from employers.
- This would not allow the ATO to monitor contributions closely, but would serve as a red flag indicator: it would indicate at a macro-level whether an employer is broadly complying.

5.2. Impact analysis

Option A: Quarterly notification where regular payments cease

This option could impose a significant cost on funds as it could require funds to monitor each account each quarter and determine what contributions are 'regular'. As contributions can change for various valid reasons (change of job, leave) this is likely to lead to numerous notifications which may add to confusion for employees and cause additional workloads for funds and employers.

Option B: Funds report whether they have 'received' contributions

This would be significantly less costly as funds would simply report whether contributions have been received or not – rather than tracking and monitoring different types of contributions. Individuals could then contact the fund to determine if contributions they expected to be made have not been made.

Option C: Employer reporting to the ATO

While the impact of this option on employers is not quantified although it is expected that any requirement to have the employer provide additional reporting on the BAS will result in a significant administrative burden.

The ATO would use its existing BAS process to receive the data, and would need to modify its software to allow tax officers to interrogate the data in high risk cases. It is estimated that this process modification might cost the ATO $25 million. It is the ATO's view that reporting of the total amount of superannuation guarantee paid by an employer for all employees in a particular quarter on the BAS would not significantly improve the detection of SG compliance as reporting would be at the aggregate level only, rather than for each individual employee.

5.3. Consultation

The consultation group discussed the difficulty of determining what constitutes 'regular contributions' and noted that contribution patterns can vary significantly for individual members. For example, casual or seasonal workers may change their working hours. Salary sacrifice arrangements may also impact workers' entitlements. Additionally, the lack of a strong employer-fund relationship (particularly in a choice environment) may prevent funds from finding out if contributions have ceased for a legitimate reason (for instance because of end of employment, change of fund, maternity leave, etc). In some cases employers may remit contributions to up to 400 different funds. Expanding the contribution data set for monitoring purposes would be very cumbersome, and would be unlikely to capture all circumstances.

The sub-group believed that it was only feasible for funds to report when contributions had ceased altogether, and not where there were changes in patterns of regular contributions.

- It noted that in these circumstances there would still be a large number of false positive notifications and that considerable reverse work flow could be created for both employers and funds. Additionally, reputation risks may exist if funds send out ceased-payment notices where employers have in fact met their obligations. And these notifications would not capture cases of underpayment, only cases where payment has ceased altogether.

- For similar reasons, the sub-group were not generally in favour of funds notifying employers.

- The sub-group also doubted whether it is useful for funds to notify the ATO, given the potential volume of false positive notifications. The sub-group believed that it would be better instead to rely on employees following up any legitimate concerns with their employer, and then potentially notifying the ATO.

For the reasons outlined above, the sub-group put up an alternative proposal under which funds would merely notify employees that they have 'received' or 'not received' contributions (option B below).

The consultative group endorsed option B, since it would provide employees with more useful information than option A. Unlike option A, where employees are not notified unless contributions cease altogether, option B would prompt the employee to check on the precise level of their contributions. It would improve employee engagement with superannuation.

The group recommended that funds should use email in the first instance, since SMS contact is less preferable given the limited text space and security concerns in providing a link to personal information. They noted that postal contact is expensive and inefficient.

5.4. Conclusion and recommended option

It is recommended that funds report to members on whether they have received contributions as outlined in option B. This achieves the objective of improved information flow without adding unnecessary costs and potential confusion. Quarterly notification where regular payments cease as in option A is likely to add significant administrative costs and lead to added confusion among members and employers, given that there are numerous reasons why contribution levels could change between quarters.

It is not clear that reporting to the ATO would significantly improve SG compliance as reporting would be at the aggregate level only, rather than for each individual employee and add additional costs.

SELF MANAGED SUPERANNUATION FUNDS

1. BACKGROUND

Self managed superannuation funds (SMSFs) are one of the five main fund types in the Australian superannuation system. An SMSF is a superannuation entity that has less than five members, all of whom are generally trustees or directors of the corporate trustee. This means that SMSFs are unique in that the members manage their own superannuation savings and are responsible for meeting all legal obligations as trustee of their fund. This gives all members the ability to be involved in the decision making process and exercise some control over the management of the fund.

The closely-held nature of SMSFs requires a different regulatory approach to that for other superannuation funds. Most superannuation funds are subject to prudential regulation by the Australian Prudential Regulation Authority (APRA) to ensure that trustees act in the best interest of members. SMSFs, on the other hand, are regulated by the Australian Taxation Office (ATO) using a compliance-based approach. The ATO has been regulating SMSFs since 1999 and works to promote high level of voluntary compliance with regulatory and taxation requirements by SMSFs. ATO regulation includes assisting trustees to establish and manage their funds, checking that SMSFs are complying with the superannuation laws, taking enforcement action (if necessary) when breaches of the law are detected and checking that approved auditors perform their duties to the required standard.

The rules and regulations covering the duties of trustees and the operation of SMSFs come from several sources. They include: trust law; the trust deed of the superannuation fund; the Superannuation Industry (Supervision) (SIS) Act 1993; the Corporations Act 2001; and the Income Tax Assessment Acts (1936 and 1997). An SMSF may tailor their trust deed to meet their particular circumstances and objectives, however the SMSF remains subject to relevant superannuation legislation.

At 30 June 2010, there were almost 430,000 SMSFs, representing 99 per cent of all superannuation funds. SMSFs hold over $390 billion or 32.5 per cent of total superannuation assets ($1.2 trillion). The sector has about 815,000 members, which comprises about 7 per cent of the roughly 11.6 million members in Australian superannuation.[7]

In terms of total numbers of members involved, the SMSF sector is small when compared to the industry as a whole. However, the SMSF sector is the largest superannuation sector by number of funds and asset size.

The SMSF sector is also the fastest growing superannuation sector. The average asset balance of an SMSF has grown from around $476,000 in June 2004 to $835,000 in June 2009. In June 2004, 41.9 per cent of SMSFs had an asset value of less than $200,000 compared to only 25.5 per cent of all SMSFs in June 2009.[8]

The Stronger Super announcement included the Government's response to the 29 SMSF recommendations of the Super System Review. The Government supported 22 of the recommendations and supported in-principle one recommendation. The objective of the

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[7] ATO SMSF Statistical Report June 2010, APRA Quarterly Superannuation Bulleting June 2010, SMSF Statistical Summary Report, p. 2, 10 December 2009

[8] ATO SMSF Statistical Report June 2010, p. 11

Government's Stronger Super SMSF reforms is to improve the operation and efficiency of the SMSF sector by:

- implementing more appropriately targeted penalties that can be applied in the case of breaches and giving the ATO more power to enforce the requirements of the SIS legislation;
- improving the knowledge and competency of SMSF service providers, including financial advisers, accountants and auditors;
- ensuring that investments made by SMSFs are genuinely made for retirement income purposes rather than current day benefit;
- improving the level of data and information available on the sector;
- reducing unnecessary administrative burdens on SMSF trustees; and
- preventing fraud and illegal release through improvements to the SMSF registration process and increased penalties.

The Government's announcement also included that it would consult with stakeholders on the implementation of the SMSF reforms.

2. AUDITOR INDEPENDENCE

2.1. Issue / Problem / Objectives

SMSFs are subject to less onerous supervision than other superannuation entities, on the basis that all members of such funds are the trustees or directors of the corporate trustee and are, therefore, in a position to protect their own interests.

Given the size of the SMSF sector, it is not possible for the ATO to audit every SMSF each year. Consequently, SMSFs are required under the SIS Act to appoint an approved auditor to conduct an annual financial and compliance audit. Approved auditors fulfil an important role in providing assurance to the Government and general public that SMSFs are compliant with the law and are using the superannuation tax concessions for genuine retirement income purposes. As such, it is vital that auditors have the competency and independence to conduct an audit that provides this assurance.

There are approximately 11,500 SMSF approved auditors. Currently, under the SIS Regulations an approved auditor is:

- a registered company auditor;
- a member or fellow of one of five specified accounting professional bodies (CPA Australia, the Institute of Chartered Accountants in Australia (ICAA), the National Institute of Accountants, the Association of Taxation and Management Accountants and the National Tax and Accountants Association);
- a SMSF specialist auditor of the SMSF Professionals Association of Australia; or
- the Auditor-General of the Commonwealth, a state or a territory.

There are no legal requirements for the independence standards of approved auditors in relation to SMSFs. Some auditors are subject to independence standards placed on them by their professional association. The Joint Accounting Bodies (JAB) has introduced independence standards for their members that conduct SMSF audits. The JAB is comprised of CPA Australia, ICAA and the Institute of Public Accountants (IPA) (formerly the National Institute of Accountants). However, some approved auditors may not be subject to independence standards. Consequently, there is not a level playing field in relation to SMSF auditor independence.

In addition to the financial audit, SMSF auditors are required to detect and report any contraventions of the SIS legislation by SMSF trustees. Auditor independence issues reduce the confidence that the Government can place in the audit and undermine the compliance-based regulation of the sector. The ATO has identified the following issues with a number of SMSF auditors:

- little or no evidence that an audit was performed;
- failing to adequately deal with independence obligations; and
- lack of knowledge in relation to the SIS legislation and professional obligations.

In 2009-10, the ATO's review of high-risk auditors identified that 17 per cent had inappropriate or no safeguards for audit independence risks. In addition, they identified that 29 per cent of SMSF auditors were also the SMSF's accountant and had prepared a material part of its financial statements, and 28 per cent of auditors exhibited evidence of a relationship or conflict of interest that might impact the auditor's ability to be independent.

The Government announced that it supports the recommendation to implement independence standards for SMSF approved auditors and would consider existing auditor independence standards that could be imposed, developing new standards if necessary.

The Government's aim is to improve the reliability of the SMSF audit by ensuring that SMSF auditors are independent from SMSF trustees.

2.2 Options

Option A: APES 110

Members of the JAB are subject to independence standards developed by the Accounting Professional and Ethical Standards Board (APESB). These standards are set out in 'APES 110 – Code of Ethics for Professional Accountants'.

Option A would legislate that SMSF auditors must comply with APES 110 as a condition on their registration. In addition, the APESB would be requested to produce guidance for SMSF auditors on how to apply the APES 110 independence requirements in the SMSF context.

APES 110 adopts a conceptual framework that requires the identification and evaluation of threats to independence and the application of safeguards to reduce any threats created to an acceptable level. It requires that auditors are independent in mind and in appearance. Independence in mind is defined as 'the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism'. Independence in appearance is defined as 'the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a

Firm's, or a member of the Assurance Team's, integrity, objectivity or professional scepticism had been compromised'.

APES 110 does not prohibit auditors or audit firms from having any economic, financial or other relationship to the audit client. Rather, it requires that the significance of the relationship is evaluated in light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

APES 110 identifies the following examples of threats to independence:

- self-interest threat – when an audit firm or auditor benefit from a financial interest in, or other conflict of interest with, an audit client;
- self-review threat – when an auditor is reviewing decisions or judgments made by themselves or someone in their firm;
- advocacy threat – when an audit firm or auditor may be perceived to promote an audit client's position or opinion to the point that objectivity may, or may be perceived to be, compromised;
- familiarity threat – when an audit firm or an auditor becomes too sympathetic to the audit client's interests as a result of close relationship with the client; and
- intimidation threat – when an auditor may be deterred from acting objectively or exercising professional judgment by threats, actual or perceived, from the audit client.

In addition, APES 110 identifies the following examples of safeguards that may be applied depending on the nature of the threat:

- safeguards created by the profession, legislation or regulation, such as education and external review processes;
- safeguards within the audit client, such as an independent audit committee that provides oversight of the audit engagement; and
- safeguards within the audit firm's own systems and procedures.

Option B: Full audit independence

Option B would legislate that SMSF auditors must have full audit independence as a condition on their registration. The Super System Review panel indicated that its preference was for full audit independence.

Full audit independence requires that both the auditor and audit firm cannot provide non-audit services to the SMSF. The auditor and audit firm also cannot provide advice or services to the individual member/trustees or their family business. Non-audit services include, but are not limited to, bookkeeping, valuation services, secondments, human resources services, tax services, legal services, management functions, actuarial services and financial advice.

Full audit independence is a prescriptive approach to auditor independence, unlike APES 110 which is a conceptual approach.

2.3. Impact analysis

Option A: APES 110

The conceptual approach of APES 110 provides a flexible framework for assessing auditor independence. Prescriptive standards cannot address all situations and can lose relevance over time as services evolve. APES 110 allows the individual circumstances of an audit engagement to be taken into account and a decision to be made based on professional judgment.

APES 110 not only addresses issues of independence based on the facts of the services provided, but also addresses issues of independence in appearance. Although an auditor may be independent in fact, if they appear to not be independent then the confidence that can be placed in the audit is diminished. Prescriptive standards cannot address issues of the appearance of independence.

Applying APES 110 to SMSF auditors would be consistent with Australian and international professional standards. The International Federation of Accountants, through its International Ethics Standards Board for Accountants (IESBA), sets international ethical and independence standards. The independence requirements in APES 110 are largely the same as those set out in the IESBA's Code of Ethics.

Legislating SMSF auditor compliance with APES 110 should involve no costs for SMSF auditors. Most SMSF auditors are already required to comply with APES 110 through their professional membership. This approach would give legislative force to the standards and allow greater enforcement. Those auditors complying with their professional obligations will not incur any costs. Rather, they will benefit from enforcement of the standards on non-compliant auditors because there will be a more level-playing field. Greater enforcement may also increase demand for their services by preventing other auditors from conducting audits where they are not independent.

The drawback of using a conceptual approach is that it can result in uncertainty and inconsistent application. Conceptual standards are subjective and open to interpretation, and so there can be uncertainty about what is and isn't allowed. Some auditors may apply the standards more strictly than others or more strictly than is necessary if they are unsure of how they will be enforced. The development of guidelines for SMSF auditors will assist them to understand how the standards should be applied.

Option B: Full audit independence

The prescriptive approach of full audit independence provides greater certainty for auditors because it clearly articulates when an audit should not be conducted. However, it is also an inflexible framework and could lead to avoidance. As outlined above, prescriptive standards cannot address all situations and cannot address the appearance of independence. An auditing firm may provide no other services to an SMSF and yet still not be independent. For example, an auditor's independence may be compromised by having developed a relationship with the client over time but a prohibition on non-audit services would not deal with this situation.

Internationally, some jurisdictions place restrictions on non-audit services. The United States has the most wide-ranging prohibition on the provision of non-audit services. The Sarbanes-Oxley Act 2002 (SOX) prohibits eight specific categories of non-audit services, including accounting and bookkeeping services, and requires that any other non-audits services must be preapproved by the audit client's audit committee. SOX applies to listed entities.

However, no jurisdiction, including the United States, prohibits auditing firms from providing all categories of non-audit services to an audit client. Consequently, a prohibition on all non-audit services would be inconsistent with international practice.

This approach would also be inconsistent with independence standards applied to other auditors in Australia. Company auditor independence standards are set out in the *Corporations Act 2001*, with a general requirement that the auditor should not perform an audit if they are not capable of exercising objective and impartial judgment in relation to the conduct of the audit or a reasonable person, with full knowledge of all of the relevant facts and circumstances, would conclude that the auditor is not capable of exercising such judgment. The Corporations Act also contains specific auditor independence requirements. These requirements only address financial, business and employment relationships with entities being audited and do not address non-audit services. Company auditors are also required to comply with APES 110.

Full audit independence would result in a loss of income to firms that provide multiple services to an SMSF, despite that in some circumstances it may be reasonable for the firm to provide both audit and non-audit services to the SMSF. However, only large firms would be affected and the loss of income would not be significant, given that the average fee for an SMSF audit is $644[9]. Small firms would not have the division of staff and responsibilities to provide both audit and non-audit services to an SMSF under a conceptual framework.

2.4. Consultation

The SMSF working group considered this measure. In addition, separate meetings were held with the JAB, SPAA and the APESB. Two public submissions were received.

The view of the SMSF working group, which was also supported by the Peak Consultative Group, was that the auditor independence standards set out in APES 110 are appropriate for SMSF auditors. They explained that independence relates to more than services performed. A move to prescriptive rules for auditor independence would result in avoidance and would not address auditors that are not independent in principle. They argued that the principles-based approach in APES 110 is therefore more appropriate.

The SMSF working group also expressed concern that full audit independence would be inconsistent with international auditing standards. Consequently, they preferred the approach of APES 110, which is almost identical to the IESBA's Code of Ethics.

The SMSF working group also expressed the view that while the APES 110 requirements are appropriate, there are issues with SMSF auditors' understanding of the requirements and with enforcement. They suggested that APESB could produce guidelines on the application of APES 110 for SMSF auditors.

The APESB agreed with the SMSF working group's view that prescriptive independence standards are inconsistent with international best practice and would not adequately address SMSF auditor independence issues. They indicated that they would be willing to consider issuing guidelines specific to SMSF auditors if requested.

Two public submissions were received on SMSF auditor independence. One submission agreed with the SMSF working group's view that APES 110 is appropriate for SMSF audit independence. The

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other submission, however, expressed the view that the issues identified with SMSF auditor independence justify imposing stricter standards on SMSF auditors than other auditors.

2.5. Conclusion and recommended option

Auditor independence is crucial to the reliability of the SMSF audit. Currently, no legislative independence standards apply to SMSF trustees.

The application of APES 110 to SMSF auditors would better achieve the objective of improving the reliability of SMSF audits than the prescriptive approach of full audit independence. The conceptual approach would provide a framework for exercising professional judgment rather than setting out rules that lead to avoidance. This approach would be consistent with international and Australian standards and ensure that SMSF auditors are treated consistently with other auditors. It would ensure that assessments of independence take into account all circumstances of an audit engagement and would be flexible to deal with changes in industry practices.

SMSF auditors would not incur any costs under this approach because they should be complying with APES 110 under the professional obligations. The development of guidelines will assist SMSF auditors to understand and apply the standards.

3. IN-SPECIE TRANSFERS

3.1. Issue / Problem / Objectives

The Government supported in-principle the Super System Review recommendation that legislation relating to acquisitions and disposals between SMSFs and related parties should be amended so that either:

a) where an underlying market exists, all acquisitions and disposals of assets between SMSFs and related parties must be conducted through that market; or

b) where an underlying market does not exist, acquisitions and disposals of assets between SMSFs and related parties must be supported by a valuation from a suitably qualified independent valuer.

SMSF trustees are permitted to dispose of assets to related parties. They are prohibited from acquiring assets from related parties, but there are exceptions for listed securities and business real property. Broadly, related parties are members, standard employer-sponsors, relatives, and related trusts or companies. Related party transactions lack transparency and are open to abuse because the buyer and seller are often the same person, or are otherwise closely related. This is particularly the case where the transaction is conducted outside a formal market. The most common example of this is in-specie transfers of listed securities.

There is a risk that off-market transfers between related parties may involve transaction date or asset value manipulation to illegally benefit the SMSF or related party (depending on the transaction). In-specie transfers involve the SMSF trustee keeping and registering documentation that specifies the date and value at which the transfer occurred. An SMSF trustee could manipulate the transaction date or asset value in order to stay under the superannuation contributions caps or to avoid Capital Gains Tax (CGT) implications.

The ATO conducted a pilot compliance program in 2010 and identified funds that received in-specie contributions in 2008 financial year where:

- the contribution potentially exceeded the contributions caps;
- the contribution may have been deliberately undervalued (that is not market value) so the contributions caps were not exceeded; or
- the contributed asset was prohibited from being acquired under subsection 66(1) of the SIS Act.

A total of 40 cases were selected for review to test the degree of risk associated with valuation, timing and asset class of in-specie contributions. Of these 40 cases, a total of 19 had used valuation methods that raised concerns about the accuracy of the amount of the contribution reported.

Two of these 19 funds were required to return excess contributions to members due to breaches of the contributions caps. In both cases it was found that the dates used for the share valuations were not accurate, with the acceptable valuation dates being later when the shares had a higher unit price. With the correct values attributed to the shares, the contributions caps were breached.

Although there were some concerns with the remaining funds about valuation methods used, there was no impact on contributions caps. The focus in these cases was on providing education and advice to trustees about dates of transfer and valuation methods for any future contributions.

3.2. Options

Option A: Prohibit off-market transfers where a market exists

Under Option A, the Government would support the Super System Review's recommendation to prohibit off-market transfers between SMSFs and related parties where an underlying market exists. Transfers of assets between SMSFs and related parties would be required to be made through an underlying market, or be accompanied by an independent valuation if no market exists.

The requirement to transfer assets through an underlying market would generally apply to listed securities. Other assets would need to be transferred at a price determined by an independent valuation. The transfer of listed securities through the market would divide the transaction into two separate transactions. The related party would sell the listed securities to the market and the SMSF would then purchase them from the market, or vice versa.

In response to another Super System Review recommendation, the ATO will be publishing valuation guidelines. This will provide guidance to SMSF trustees on what is considered to be an independent valuation and how it can be obtained. The guidelines will also address situations where valuations are difficult to obtain, for example in the case of unlisted shares.

Option B: New rules for in-specie transfers

Option B would place new rules on in-specie transfers involving SMSFs in order to reduce the risk of asset value and transaction date manipulation. SMSF trustees would be required to evidence that a transaction has occurred by lodging documents with the relevant registry within 28 days. Legal ownership would be taken to have transferred when the SMSF is registered as the legal owner. Beneficial ownership may be transferred sooner and would be taken to have transferred when the documents are lodged with the registry. SMSF auditors would be required to verify the date and price of any off-market transfers and to ensure that the lodgement period has been adhered to.

As with Option A, SMSF trustees would be required to transfer assets at a price determined by an independent valuer if no underlying market exists.

3.3. Impact analysis

Under both options, SMSF trustees would be required to obtain a valuation when acquiring an asset from or disposing of an asset to a related party where no market exists. Obtaining a valuation will involve costs for SMSF trustees. The cost of obtaining a valuation will depend on the type and value of the asset.

Option A: Prohibit off-market transfers where a market exists

A prohibition on off-market transfers where a market exists would increase the transparency of related party transactions by providing an independent price for the transaction and eliminating doubt in relation to the transaction date. This would eliminate the potential for abuse and ensure that SMSF trustees are not using in-specie transfers to circumvent the contributions caps or CGT.

This measure would mostly affect listed securities and would involve costs for SMSF trustees. Trustees would need to engage a broker in order to process the transaction. However, the brokerage costs would be minor, at approximately $30 per transaction. Also, following changes to ASX Listing Rule 8.14 in January 2011, share registries are now able to charge fees for registering off-market transfers. The fees charged by share registries range between approximately $30 and $65. Consequently, SMSF trustees may incur no additional costs from an on-market transfer, and may actually save money.

SMSF trustees may incur a cost from the potential delay between the sale and re-purchase of the asset, during which time the price could fluctuate. However, the time out of the market would be insignificant in most cases. The ASX Market Rules allow brokers to be both the buyer and seller in one transaction, so in many cases the sale and re-purchase could take place simultaneously (ASX Market Rule 17.2.7).

SMSF trustees may have difficulty selling listed securities through the market. For example, there may be a trading halt or suspension on a listed security. The trustees would be prevented from buying and selling the security, which could delay the winding-up of the fund or prevent them from meeting their liabilities.

Although there are some costs associated with on-market transfers, few SMSF trustees would be affected. In 2008-09, four per cent of SMSFs that had lodged their annual return (approximately 16,000) reported an in-specie contribution. In 2009-10, this fell to 3.5 per cent (approximately 15,000).

Option B: New rules for in-specie transfers

Imposing a time limit on the lodgement of documents associated with an in-specie transfer would reduce the risk of asset value and transaction date manipulation. The requirement to lodge the documents with the registry within 28 days would reduce the scope for trustees to choose a false transaction date on which the price was lower in order to avoid breaching the contributions caps. However, this requirement would not eliminate the risk. There would still be some scope for trustees to manipulate the asset value or transaction date.

This approach would ensure consistency between SMSFs and APRA-regulated funds, which can make in-specie transfers. In particular, Small APRA Funds (SAFs) have the capacity to make in-specie

contributions. SAFs are similar to SMSFs in that they have less than five members and the members have a large degree of control over the management of their retirement savings.

However, the majority of APRA-regulated fund members are not permitted by their fund to make in-specie contributions. At June 2010 there were only 5,000 SAF members, compared to the approximately 31 million members of other APRA-regulated funds.[10] In addition, there are key differences between SAFs and SMSFs that minimise the risk of manipulation of in-specie transfers. SAFs have an independent trustee and are prudentially regulated by APRA. Consequently, members do not have direct control over the choice of transaction date or asset value.

3.4. Consultation

The SMSF working group considered this measure. One public submission was also received.

The SMSF working group did not reach a consensus on this issue. Some working group members disagreed with part (a) of the Super System Review recommendation, which would require all transactions between SMSFs and related parties to be conducted through an underlying market where one exists. The public submission also expressed this view. The working group members gave the following reasons for their objection to part (a):

- evidence of asset value and transaction date manipulation is only anecdotal;
- delays between transaction date and registration of the transfer may not be the fault of the SMSF trustees but could result from delays at the registry;
- on-market transactions could result in losses due to market fluctuations during time out of the market;
- on-market transactions would impose brokerage costs on SMSF trustees;
- difficulties can arise with on-market transfers, such as being unable to sell low-value shares to the market;
- requiring on-market transfers would impose unreasonable burdens on SMSF trustees in cases of divorce, business or fund restructures where assets are transferred between SMSFs; and
- APRA-regulated funds, and other investors, are permitted to make in-specie transfers.

These working group members suggested that instead of prohibiting off-market transfers, there should be rules relating to the time in which documents must be lodged with the share registry. Back-dating of transfer forms could be prevented by requiring that SMSF trustees must lodge the documentation with the registry within 28 days of the transaction. The members argued that 28 days is appropriate because in some States stamp duty is payable on off-market transfers and the duty must be paid prior to lodgement of the documents with the share registry. Also, it would provide SMSF trustees time to gather all information and obtain, complete and submit the forms. The members also suggested that guidance could be provided to SMSF auditors about the evidence that they should look for when auditing in-specie transfers.

Other SMSF working group members disagreed with the above views and supported implementation of part (a) of the Super System Review's recommendation. Their view was that:

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[10] APRA Annual Superannuation Bulletin, pg 24

- off-market transfers between SMSFs and related parties can and do result in manipulation. Despite that there is little quantitative evidence of abuse, abuse can occur and this justifies prohibiting such transactions;

- the risk associated with time out of the market is not significant because the ASX Market Rules allow the same market participant to be both the buyer and seller, with the price being the midpoint of the bid and offer quotes (ASX Market Rule 17.2.7). The risk may be an issue in a minority of cases, but in most cases the time out of the market would be one day at the most;

- the costs of undertaking transactions though the market are minor; and

- although APRA-regulated funds are permitted to make in-specie transfers, most fund members are not able to make in-specie contributions.

The Peak Consultative Group also supported the implementation of part (a) of the Super System Review's recommendation because of the potential for abuse of off-market transfers. If in-specie transfers were permitted, the peak group stated that the timeframe within which documentation should be registered should be approximately three days.

All stakeholders supported part (b) of the Super System Review recommendation to require transfers of assets between SMSFs and related parties where there is no underlying market to be accompanied by an independent valuation.

3.5. Conclusion and recommended option

Option A is recommended, which would introduce a requirement for asset transfers between SMSFs and related parties to be conducted through an underlying market. The objective of this is to eliminate the risk of asset value and transaction date manipulation. Cases have been indentified where SMSF trustees have manipulated the asset value or transaction date in order to circumvent the superannuation contributions caps or their CGT obligations.

This requirement would involve some costs for SMSF trustees. These costs include brokerage fees and possible time out of the market resulting in asset value fluctuations. However, brokerage fees are minor and, in most cases, time out of the market is likely to be insignificant. In addition, brokerage fees could in some cases be less than the cost of registering an off-market transfer.

Given the risk of abuse, through which SMSF trustees can gain significant advantage over other superannuation fund members by making excess contributions and avoiding tax liabilities, it reasonable that off-market transfers should be prohibited. Only approximately four per cent of SMSFs make in-specie contributions and so few SMSF trustees are expected to be affected.

IMPLEMENTATION AND REVIEW

The implementation of the Stronger Super reforms will be progressed as follows:

- MySuper and Governance reforms – legislation will be developed in stages, including consultation with industry, over the course of 2011 and early 2012. The reforms are expected to commence from 1 July 2013.

- Self-managed superannuation funds – draft legislation will be developed, including consultation with industry prior to the end of 2011. The reforms will generally be in place by 1 July 2012.

- SuperStream – due to the complexity and longevity the SuperStream program of reforms, the SuperStream Working Group will continue to meet regularly until the end of 2011. The working group will continue to work on the data and e-commerce standards with a view to having contributions and rollovers data and e-commerce standards published by January 2012. The account consolidation measures commenced on 1 July 2011 with the use of TFN as the primary locater of member accounts within a fund. This will be followed by a phased approach with the complete account consolidation model in place by 1 July 2014.

Prior to the commencement of the MySuper and Governance reforms, APRA will develop prudential standards in consultation with industry.

Ongoing monitoring of these reforms will be undertaken by the Treasury, APRA, ATO and ASIC to ensure that the reforms are achieving their objective and whether any further reforms are necessary. Some elements of Stronger Super are expected to be subject to a post-implementation review within two years of commencement.

APPENDIX - OTHER ELEMENTS OF STRONGER SUPER CLARIFIED FOLLOWING CONSULTATIONS

1. MYSUPER

1.1. APRA licensing

The Government announced that superannuation fund trustees will have to be licensed by APRA to operate a MySuper fund. APRA can then enforce the new provisions that will apply to MySuper product trustees, including a requirement to act in the best financial interests of members.

Following consultations on this issue, the simplest and most efficient approach for licensing trustees of MySuper products is to apply for a variation of their RSE licence to hold a MySuper licence class issued by APRA. This approach is therefore recommended.

The superannuation industry supports this approach, as it was designed to be simple, build upon existing processes, avoid duplication and ensure APRA is given sufficient power to regulate MySuper.

1.2. Transitional period

The Government announced that superannuation funds will be allowed to offer MySuper products from 1 July 2013. The Government's response also advised that MySuper products will replace existing default funds after an appropriate transitional period. At the end of this transitional period employers would only be able to meet their superannuation guarantee obligations by making contributions to a fund that offers a MySuper product. The response noted the Government would consult with relevant stakeholders on the transitional period and other transitional issues.

It is expected most fund trustees will apply to be able to offer a MySuper product from 1 July 2013. Subject to the passage of legislation, APRA could accept applications some months ahead of 1 July 2013 so that funds wishing to offer a MySuper product from 1 July 2013 are able to do so. However, there may be certain trustees that require a longer period in order to be licensed to offer a MySuper product. For these trustees a transitional period of two years (to 1 July 2015) would provide sufficient time for funds to be licensed to offer a MySuper product.

Following consultations with key stakeholders, it was determined that a two year transitional period would provide sufficient time for trustees to be licensed to offer a MySuper product and allow employers to comply with the new requirement. A two year transitional period would also permit the development of an easily accessible register of complying MySuper providers to assist business, as well as providing sufficient time for the Australian Taxation Office to effectively disseminate information to business on the subtle change to the superannuation guarantee requirements.

2. INSURANCE

2.1. Trustee duty to manage insurance for the benefit of members

It is proposed that trustees of MySuper products and APRA-regulated superannuation funds that offer insurance will have a separate statutory duty to manage their insurance offerings in the best interests of members, including:

- selecting insurance cover with regard to the cost and value for money for members;
- negotiating the terms of the insurance contract, including adequacy of the level of default cover; and
- pursuing claims that the insurer has denied in part or total where there is a reasonable expectation of success and it is cost-effective to do so (response to recommendation 5.3).

This will build upon the minimum default opt-out life and TPD insurance that trustees of superannuation funds will be required to offer. In requiring trustees to manage insurance in the best interests of members and negotiating the terms of the contract, members will be more likely to experience optimal outcomes (in terms of quality of insurance and cost effectiveness). In requiring trustees to pursue claims with insurers, members will be more likely to receive the appropriate benefits as specified in their insurance policy.

Overall, sound management of insurance by trustees is likely to help boost members' retirement savings. However, trustees may need to devote more resources in order to comply with the increased oversight requirements.

It is expected that this measure will be implemented via a change to the SIS Act. This will maintain consistency with other duties imposed on trustees and investment managers of superannuation funds.

2.2. Requirement on trustees to devise and implement an insurance strategy

It is proposed that the duty on trustees of MySuper products will be supported by a new requirement for trustees to devise and implement an insurance strategy covering the insurance that it will provide to its members (response to recommendation 5.4).

This will place insurance requirements on trustees on a similar level to investment requirements on trustees. It builds upon the minimum default opt-out life and TPD insurance that trustees of superannuation funds will be required to offer, as well as the duty imposed on trustees to manage insurance for the benefit of members. It will benefit members through an expected improvement in trustees' management of insurance, which in turn is expected to boost overall retirement savings. Trustees may need to devote further resources in order to comply with the new arrangements.

It is intended that this will be implemented through the addition of a new covenant in subsection 52(2) of the SIS Act. However, only a high-level requirement to devise an implement an insurance strategy will be contained in law. APRA will develop a prudential standard (for which APRA will prepare a RIS) that provides minimum requirements that the strategy must comply with, as well as factors to be taken into account in the development and implementation of the strategy. These implementation arrangements will maintain consistency with other covenants superannuation funds must include in their governing rules, for example the requirement on trustees to devise and implement an investment strategy.

During consultation, it was agreed that there will be a need for legislation to be amended to enable members to request a copy of the insurance strategy (to the extent that only non-commercially sensitive information would be provided). This will ensure consistency with disclosure requirements for other prescribed documents.

2.3. Default opt-out insurance for MySuper and Choice products

The Government announced that all APRA-regulated funds will be required to offer life and TPD cover (where available, depending on occupational and demographic factors) on an opt-out basis.

An important principle of this is that all APRA-regulated superannuation funds should permit members to opt-out of insurance. This is because members may decide they do not require cover, or they may have cover outside of superannuation. However, to ensure that implementation of this requirement is workable for trustees, who typically agree premium rates in advance for the next 12 months, it is practical for members to be able to opt-out at certain times rather than whenever they want. It is proposed that members be provided the opportunity to opt-out at a minimum of within 90 days that a member joins a fund or on each anniversary of joining the fund.

As alluded to in the announcement, there may be some situations where funds find it hard or impossible to get insurance at a reasonable cost if opt-out is allowed, such as where group insurers will only cover high-risk occupations if insurance cover is compulsory. Therefore, trustees unable to obtain opt-out cover at a reasonable cost will either offer compulsory insurance or no insurance. .

Members that have a defined benefit interest may already hold insurance. For these members, there would be a risk that they would be over-insured if they also had opt-out insurance cover on an accumulation interest they held in the fund. Therefore, trustees will have the discretion to not offer opt-out insurance to members in a MySuper product that also hold a defined benefit interest in that fund which has life and TPD insurance.

These issues and the implementation approaches were developed with members of the consultation groups, who unanimously support the approaches outlined.

2.4. Tailored and additional insurance for MySuper products

Another implementation consideration of the Government's announcement that trustees of MySuper products will be required to offer default life and TPD insurance cover on an opt-out basis is whether additional insurance can be obtained within the MySuper product.

Individuals face different circumstances, for example, some members may have no financial dependents compared to other members with several financial dependents. While most members of MySuper are not expected to make active choices, MySuper will include members that do wish to alter their insurance arrangements without having to leave the protections afforded by MySuper. Restricting such members from altering their insurance cover could encourage them to leave MySuper or to have an additional account (a Choice product) solely for insurance. This would undermine the key objective of MySuper to introduce heightened duties around investment and insurance on behalf of default members. Therefore, members should have the flexibility to increase or decrease their insurance cover (if this is offered by the trustee) without having to leave the MySuper product.

Related to this, employers may be aware of factors at the workplace level that influence the appropriate level of insurance for their employees. In addition, some employers decide to subsidise the cost of insurance on behalf of their employees. So while MySuper products must have a standard level of life and TPD insurance (the default insurance strategy), the standard cover will be able to be

replaced by a default insurance strategy (including the benefit structure) tailored by the employer for their employees.

The superannuation industry generally agrees that there should be a standard default level of life and TPD insurance in MySuper, but that the default cover could be replaced by a default insurance strategy (including the benefit structure) tailored for particular employers.

2.5. Income protection insurance

As part of Stronger Super, the Government announced that income protection insurance be offered on an opt-out basis to members of all APRA-regulated funds.

However, there are characteristics of income protection cover that mean it is not universally beneficial. Where members are covered by Workcover, have sufficient leave, or hold insurance outside of superannuation which offsets any policy within superannuation, it is unlikely that income protection insurance will be beneficial. In the interests of maximising retirement incomes for members, mandatory opt-out income protection insurance is not optimal.

Income protection insurance is also much less commonly provided in superannuation than life and TPD insurance. While 96 and 67 per cent of members have life and TPD insurance respectively, only 24 per cent of people have income protection insurance through their superannuation fund. As superannuation funds are not currently required to offer income protection insurance, introducing this requirement would create an impost on many funds to start providing cover.

As part of consultations, it was noted that while funds are increasingly offering income protection insurance, it may not be suited to all members as a default (offered on an opt-out basis). The consultative groups broadly agreed that, while income protection insurance should be permitted, it should be left up to the trustee to decide whether to offer this type of insurance and whether it is opt-in or opt-out.

Therefore, it is proposed that a trustee determine whether income protection insurance should be offered on an opt-out or opt-in basis or at all. This will retain the existing arrangements for income protection insurance.

2.6. Time periods to lodge TPD complaints

The Government supported in principle the review recommendation to amend the *Superannuation (Resolution of Complaints) Act 1993* to allow the Superannuation Complaints Tribunal (SCT) to consider complaints in respect of TPD claims when the claim has been lodged with the trustee within six years of the member ceasing employment and the complaint has been made to the SCT within two years of the trustee's decision. The Government noted that time limits may affect claims.

During consultation, there was agreement in principle that the time limits for the SCT and the courts should be aligned as far as practicable. The SCT is the highly preferable mechanism for dispute resolution with respect to superannuation complaints, as this is far more efficient and cost effective than the courts. However, trustees and the SCT face considerable difficulties when dealing with TPD claims where the claimant has ceased working a long time ago.

Under general law, a claimant has the right to apply to a court to review a trustee's decision, usually within six years of a cause of action arising, which in the case of a TPD claim is usually the date of the trustee's decision.

There was agreement in principle that a better alignment of the time limits of the SCT and the courts could be achieved through extending only the time period for which a member could lodge a complaint with the SCT rather than the time period for lodging a claim with their trustee.

It is therefore proposed that the time limit for lodging a complaint with the SCT in respect of a trustee decision be extended to six years, unless the claim was lodged with the trustee within two years of ceasing employment, in which case the time limit would only be extended to four years. While these two time limits do not necessarily operate consecutively, in practice the total of the two time limits will more closely align the SCT time limits with those applicable to the courts.

Extending the SCT time limit would not add to the trustee's record keeping obligations, as the trustee is obliged to maintain those records in the event that a court action was lodged.

3. FEES IN SUPERANNUATION

3.1. Types of fees that can be charged in MySuper products

As noted in the background on MySuper above, the Government announced that a key feature of MySuper will be restrictions on unnecessary and excessive fees in superannuation. As part of implementing this, the Government also announced that it will determine the types of fees that can be charged by MySuper and Choice products.

3.1.1. Fees in MySuper products

Following consultations, it is proposed that MySuper products have six headline fees:

- Administration fee – which includes general costs of servicing members, such as account-keeping, call centre operation, general administration and processing of contributions and intra-fund advice costs (if offered);
- Investment fee – the general costs of investing members' money;
- Performance fee (if applicable) – which is the fee paid to investment managers for performance above a certain benchmark;
- Buy and sell spreads – funds generally charge more for new units issued to a member than they pay for units redeemed, which ensures that the approximate costs of entering, exiting and transacting in the underlying assets of the fund are borne by the transacting member, rather than other members who are not joining or leaving the fund;
- Exit fee – fee charged to recoup the administrative costs of a member leaving the fund; and
- Switching fee – fee charged to recoup the administrative costs when a member changes investment strategy within the fund.

In addition to these fees, additional fees can be charged if they could be demonstrably linked to choices of a particular member (for example, where an account has to be split as a result of a family law settlement). Individual members may also have funds deducted from their accounts for particular activities, such as the costs of accessing personal financial advice (not intra-fund advice) on their superannuation.

As announced as part of Stronger Super, entry fees would not be allowed in MySuper products but exit fees, switching fees and buy and sell spreads will be allowed in MySuper products but only on a

cost recovery basis (to enable trustees to recover administrative costs for the first two fees and the investment costs incurred on underlying investments through buy and sell spreads).

The six headline fees reflect the most common types of fees the superannuation funds currently charge. Rather than reducing the number of things funds can charge for, this consolidation of fee types simply groups similar fees together under umbrella titles such as 'administration' and 'investment' fees. Other than the announced limitations on entry, exit and switching fees (and restrictions on advice fees being progressed through the FOFA reforms), the standardisation of fees is not expected to limit the ability of funds to charge members for justifiable costs.

Limiting the number of fees will benefit members trying to understand what they are paying for and hoping to compare the performance of their MySuper product against other products. Member understanding will also benefit from greater standardisation of data on fees that will be collected and published by APRA (as announced in response to recommendation 10.3).

Consultation group members were involved in the development of standard fees to ensure the outcome would be achievable with minimal impost on industry. The outcome of this process was supported by the consultation groups.

3.1.2. Fees in Choice products

To prevent exit, switching fees and buy / sell spreads from being a barrier to portability (members switching products or funds), the Government announced that these fees will be limited to cost recovery for all APRA-regulated funds. In particular, limiting these fees to cost recovery will reduce the cost of Choice members moving back into a MySuper product.

Following consultations on fees in Choice product, no further limitations on fees are proposed. Choice products and members are fundamentally different to MySuper products and members, meaning there is less need for limitations on fee types.

3.3. Performance fees for MySuper products

The Government announced that it, in conjunction with APRA, will determine parameters under which trustees can pay performance fees to fund managers (recommendations 3.2 and 3.3).

Following consultations on this issue, it is proposed that trustees must include the following provisions in any performance fee arrangement with a fund manager in respect of assets of the MySuper product:

- a reduced base fee that reflects the potential gains the investment manager receives from performance fees taking into account any fee cap;
- measurement of performance on an after-tax (where possible) and after-costs basis;
- an appropriate benchmark and hurdle for the asset class reflecting the risks of the actual investments;
- an appropriate testing period; and
- provisions for the adjustment of the performance fee to recoup any prior or subsequent underperformance (for example, high water marks, clawbacks, vesting arrangements and rolling testing periods).

If a performance-based fee does not contain each of these provisions, a trustee must be able to justify that the arrangement is in the best financial interests of the members of the MySuper product. This is

to ensure that (in exceptional cases) trustees would be excluded from investing in certain investments overseas where a performance fee does not meet the parameters.

This would ensure that the payment of performance fees by trustees of MySuper products to fund managers is only for arrangements that reward genuine performance. Standards for performance fees are therefore expected to reduce fees paid by members where no actual benefit is received. These standards will place a heightened responsibility on trustees to ensure performance fees are in the best financial interests of members.

The provisions for performance fees were developed in consultation with industry stakeholders, who were particularly concerned to ensure the standards do not exclude trustees from certain investments or impose additional costs on funds. The consultation group members supported the standards and the framework for exceptional cases.

4. GOVERNANCE

It should be noted that to coincide with the introduction of legislation, APRA will be developing prudential standards in consultation with industry. It is envisaged that an investment governance prudential standard will provide further detail on many of the investment governance issues raised in this section.

4.1. Expected costs of investment strategies

The Government supported in principle the review recommendation to amend paragraph 52(2)(f) of the SIS Act to include 'the expected costs of the strategy, including those at different levels of any interposed legal structures and under a variety of market conditions', as one of the factors to which APRA fund trustees must 'have regard'.

This proposal will ensure that fund trustees provide further focus on the expected costs of an investment strategy, such as in areas identified by the review where there were significant costs in the implementation and execution of funds management and investment transactions. This proposal will help ensure that a fund's superannuation assets are managed prudently and in the best interests of all the members of the funds, and will also help improve trustee decisions, efficiency and effectiveness, and so help grow member superannuation entitlements.

During consultation support was expressed for this proposal, and it was noted that this is something that trustees already take into account. Support was expressed for adding this covenant into the investment governance covenants in paragraph 52(2)(f) of the SIS Act.

A high level requirement will exist in the legislation with further details to be contained in a prudential standard, to be developed by APRA and for which APRA will prepare a RIS.

4.2. Taxation consequences of investment strategies

The Government supported in principle the review recommendation that paragraph 52(2)(f) of the SIS Act be amended to include 'the taxation consequences of the strategy, in light of the circumstances of the fund', as one of the factors to which APRA fund trustees must 'have regard', and to ensure that trustees consider those taxation consequences when giving instructions in mandates to investment managers.

As mentioned under 'Expected costs of investment strategies', this proposal will help ensure that a fund's superannuation assets are managed prudently and in the best interests of all the members of the funds, and will also help improve trustee and fund decisions, efficiency and effectiveness, and so help grow member superannuation entitlements.

During consultation support was expressed for this proposal, noting that this would make explicit what trustees currently implicitly consider. Key stakeholders agreed that the proposed requirement should refer to 'expected' taxation consequences, as the actual consequences may not be certain at the time of the decision. Support was expressed for adding this covenant into the investment governance covenants in paragraph 52(2)(f) of the SIS Act.

A high level requirement will exist in the legislation with further details to be contained in a prudential standard, to be developed by APRA and for which APRA will prepare a RIS.

4.3. Timely and independent valuation information

The Government supported in principle the review recommendation that paragraph 52(2)(f) of the SIS Act be amended to include 'the availability of valuation information that is both timely and independent of the fund manager, product provider or security issuer', as one of the factors to which APRA fund trustees must 'have regard'.

During consultation support was expressed for this proposal.

However, it was noted that requiring the use of 'timely' and 'independent' valuation information might pose practical problems in dealing with infrastructure investments and the availability of independent valuations. Questions were raised as to whether the requirement would apply to all investments classes such as Australian equities, or only to direct investments. Therefore, it is recommended that a requirement for trustees to consider the availability valuation information be included in the legislation but for further detail (including issues around timely and independent) to be developed by APRA through an investment governance prudential standard.

This proposal will ensure better accuracy in unit prices, and better management of the valuation, liquidity and crediting of assets, particularly in respect of unlisted assets. As mentioned under 'Expected costs of investment strategies', this proposal will help ensure that a fund's superannuation assets are managed prudently and in the best interests of all the members of the funds, and will also help improve trustee and fund decisions, efficiency and effectiveness, and so help grow member superannuation entitlements.

Support was expressed for adding this covenant into the investment governance covenants in paragraph 52(2)(f) of the SIS Act.

4.4. Providing reasons for trustee decisions

The review identified that one of the weaknesses of trust law is that trust beneficiaries often cannot acquire information from trustees about decisions that are in the beneficiaries' interests.

The review recommended that section 101 of the SIS Act be amended to require a trustee to provide a member with reasons for its decision in relation to the member's formal complaint. The Government supported this recommendation in principle.

During consultation, support was given to limiting reasons for decisions to matters that affect the individual, with the need to allow interested third parties (such as a claimant to death benefits) to also

be able to obtain reasons for decisions. During consultation it was also noted that many trustees already provide reasons.

The Government will progress this proposal, which will make trustees more accountable and transparent to members and interested parties in relation to formal complaints.

4.5. Trustees to offer a range of investment options

The Government supported in principle the review recommendation that choice trustees be required to offer a range of options sufficient to allow members to obtain a diversified asset mix if they choose, but members can choose to be undiversified and the trustee would have no obligation to assess the appropriateness of the investment strategy chosen by the member.

It is proposed that trustees will be subject to new express duties in selecting and monitoring options. A high level requirement will exist in the legislation with further details to be contained in a prudential standard, to be developed by APRA and for which APRA will prepare a RIS.

This proposal allows trustees to provide investment options in a responsible and appropriate manner, and allows members to choose investments appropriate to their individual needs. As the review noted, for some members, maximisation of retirement income involves consideration of investments across their entire asset portfolio, rather than just across their superannuation assets alone.

No issues were raised during consultation about this proposal, given it reflects industry practice, and therefore is unlikely to have significant costs impacts.

4.6. Protection for trustees from civil liability

The Government supported in principle the review recommendation that a choice trustee that discharges its duties in selecting and monitoring investment options should not be exposed to civil liability in the event that a member suffers damage by reason of illiquidity or other circumstances affecting the investment option, including diminution in value or failure.

During consultation it was noted that the SIS Act did not deal adequately with trustee obligations in an environment where members are able to choose from a broad range of investment options offered by the fund.

Therefore, the law be clarified to ensure that choice trustees will have to offer investment options which, in respect of the members' aggregate benefits with the fund, allows the member to obtain a diversified asset mix if they choose.

During consultation, it was also suggested that subsection 55(5) should be amended to clarify that a trustee must not have contravened the covenants in paragraphs 52(2)(a) to (e), not just paragraph 52(2)(f), as a defence to an action for loss or damage. This proposal will be adopted as suggested, and is designed to ensure better compliance with the principles of investment governance.

4.7. Binding death benefit nominations

The review recommended that the SIS Act should be amended so that binding death benefit nominations would be invalidated when 'life events' occur in respect of the member. If this occurs, binding death benefit nominations should only have to be reconfirmed every five years. The review

noted that the current system used by States and Territories under which testamentary dispositions are invalidated could be used as guidance for creating a single national model.

The Government supported these recommendations in principle and noted the disparity of State and Territory approaches to the invalidity of testamentary dispositions.

In consultation it was noted that some funds do not accept binding death benefit nominations, and others have adjusted their governing rules to allow for non-lapsing binding death benefit nominations. This seems to be in conflict with the policy of requiring binding death benefit nominations to lapse after 3 years. In this context, there would be little practical effect in increasing the time for having to re-confirm a binding death benefit nomination from three to five years.

During consultation it was agreed that the operation of binding death benefit nominations was complex, involving a difficult balance between ease of administration for trustees and equitable distribution of benefits on the death of a member. Concerns with the potential complexity in legislating for binding death benefit nominations to lapse on various significant life events, such as marriage, death, divorce and birth were raised.

While there was no agreement on reforms for improving the current framework for binding death benefit nominations, it was agreed that there are broader policy issues involved (including whether superannuation should be treated separately to a person’s estate), and that further study is required before the recommendation could be supported.

It was also suggested that there would be little practical effect in increasing the time for having to re-confirm a binding death benefit nomination from three to five years.

It was noted that in the absence of trigger events, extending the time period meant there was a greater chance the nomination would be out of date.

Given the issues raised during consultation, it was concluded that no changes be made to the current framework for binding death benefit nominations. Approvals are being sought for the Government to consider a broader examination on the appropriateness of binding death benefit nominations in the context of superannuation becoming an increasingly significant part of a person’s estate.

4.8. Operational risk financial requirement

The Super System Review recommended that new capital requirements for superannuation fund trustees on a risk-weighted basis should be phased-in over time. In its Stronger Super announcement, the Government supported this recommendation in principle. The Government announced that the current capital requirements for superannuation fund trustees should be replaced with a risk-based system applying to all APRA-regulated funds for holding financial resources against operational risk. The Government also announced that any capital requirement arising from a trustee’s non-superannuation business should be in addition to any requirement imposed under the SIS Act, as recommended by the review.

Operational risk is the risk that a superannuation fund may suffer loss due to inadequate or failed internal processes, people and systems or from external events.

Currently, trustees of public offer funds must hold net tangible assets of at least $5 million, either directly, in combination with an approved guarantee, or through a custodian. In limited cases the capital requirement can be met when all fund assets are held in a prudentially regulated entity, such as a life insurance company. There are no capital requirements for the trustees of non-public offer superannuation funds. Trustees may also be required to hold an Australian Financial Services Licence

issued by the Australian Securities and Investments Commission, which also imposes capital requirements, but need only comply with the capital requirements under superannuation legislation.

The review found that these existing trustee capital requirements are not sufficient to protect fund members adequately from the impact of operational risk. In particular, the review found that the trustee capital requirements are too low relative to the operational risks faced by many superannuation funds, are not calibrated to reflect these risks, and do not take into account the fact that some trustees may manage several funds and may also manage non-superannuation managed investment schemes. The review was also concerned that the capital requirements only apply to public offer superannuation funds and found drawbacks to the guarantee and custody alternatives by which trustees can satisfy the capital requirements.

Accordingly, it is proposed to introduce a new risk-based operational risk financial requirement, which all RSE licensees must meet. RSE licensees are the bodies responsible for managing RSEs, such as superannuation fund trustees.

The new risk-based financial requirement for operational risk would replace the current trustee capital requirements contained in the SIS Act. Details of the new requirement would be contained in a prudential standard, to be developed by APRA. It is envisaged that the standard would permit the requirement to be met through an operational risk reserve (maintained within the RSE), RSE licensee capital (maintained outside the RSE), or some combination of the two.

In addition to the new operational risk financial requirement, it is proposed to amend the Corporations Act so that RSE licensees that also manage non-superannuation managed investment schemes are no longer exempt from the Corporations Act requirements to have available adequate financial resources.

The proposed changes would provide current RSE members with enhanced protection from losses due to operational risk. They may also promote members' confidence in the superannuation system and lead to an improved focus on risk management by RSE licensees.

Consultation on the proposed operational risk financial requirement was conducted through the work of the Government's Stronger Super Peak Consultative Group, as well as through the receipt of public submissions.

The imposition of a financial requirement as a means of managing operational risk was supported by the Peak Consultative Group. It was acknowledged that any financial requirement should be able to be met through the trustee's (RSE licensee's) capital or an operational risk reserve, or a combination of the two. There was general support for a risk-based and tailored approach to calculating the financial requirement, with APRA periodically monitoring and reviewing reserve levels as part of its ongoing prudential supervision activities.

A range of public submissions also supported a risk-based financial requirement for operational risk. Some submissions raised specific issues with how such a requirement should be implemented. These issues would be considered by APRA in developing its prudential standard for the operational risk financial requirement in consultation with industry and for which APRA will prepare a RIS.

5. SuperStream

5.1. Governance body

The Government agreed with the SSR recommendation that governance arrangements be introduced for SuperStream. The SuperStream Working Group supports the need for a governance body to oversight the implementation of the new data and e-commerce standards.

The appropriate ongoing governance arrangements could not be agreed to during consultation. Some favoured a standalone body with a broad mandate and representation with the ability to make enforceable decision regarding amendment to the data and e-commerce standards.

Others noted the inter-reliance of the proposed standards on the Standard Business Reporting (SBR) definitions and the difficulty the industry has had in self-regulating in this area. They favoured a structure where Government has a strong role (as it does with the current SBR process) but stakeholders have the ability to monitor SuperStream's implementation and recommend changes in the standards or processes involved.

The experience with swimEC suggests the significant cost savings likely from the introduction of industry wide standards and electronic processing will not be realised unless the Government provides the necessary leadership.

It is proposed that a SuperStream Advisory Council be set up to oversight the SuperStream measures as the design details are finalised and implementation commences when the working group winds up.

The Advisory Council members would be appointed by the Treasurer and meet regularly to monitor the implementation of SuperStream, identify improvements in the standards and protocols around them and make recommendations for changes to the Treasurer. The Council would also report to the Treasurer on what the agreed measures of success for SuperStream are showing.

One of the main advantages of the Advisory Council is that it leverages off the existing Government consultative arrangements akin to the Standard Business Reporting Business Advisory Forum. This is important as there will be commonalities with between the SuperStream and existing SBR taxonomy.

Industry participants, including APRA-regulated funds, SMSFs, administrators, clearing houses, employers and members would be represented through the select membership of the Advisory Council. It is envisaged that the Council would have 10 members who would be expected to link back to their sector when engaging in discussion and decision making.

5.2. Member protection

The Government announced that it would consult on the SSR recommendation that abolish the member protection rules (recommendation 10.14).

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.

Member protection rules were introduced when the contribution rate under the SG Act was only three per cent, and average wages were substantially lower than is the case today. In addition, there are direct costs to funds in terms where members have low balances. This is because every fund has to

provide for member protection in devising its administrative systems and procedures, adding complexity and costs.

Member protection also leads to cross-subsidisation of low balance accounts, raising broader equity considerations. It also provides a disincentive for members to consolidate smaller accounts.

To support the Government's efforts to consolidate multiple member accounts, it is proposed that the member protection rules be abolished, thereby improving the efficiency of the superannuation system and helping to reduce costs. It is proposed that this take place from December 2013.

There was general, but not unanimous, support among consultation group members for abolishing the member protection rules, timed to coincide with related account consolidation initiatives being considered as part of the SuperStream reforms (see the Consolidation of Superannuation Accounts section of SuperStream). Most consultation group members noted that member protection is a significant cost to the industry and provides little benefit as the current rules are not applied universally across the industry. However, FSC noted that it would harm the industry's reputation of treatment of younger members with small account balances.

6. SMSFs

6.1. Standard deeming provisions

The Government announced that it would introduce standard deeming provisions into the SIS Act to automatically deem anything permitted by the SIS Act or a tax act to be permitted by SMSF trust deeds and anything prohibited by the SIS Act or a tax act to be prohibited by SMSF trust deeds.

Although stakeholders agreed with the objective of reducing administrative costs for SMSF trustees, issues were raised in consultation about the practical benefit of this measure. The SIS and tax legislation are not the only legislation that apply to SMSFs. Consequently, updates to the SMSF trust deed would still be necessary when amendments to other legislation occur. Also, there may be unintended consequences from this measure. Standard deeming provisions could lead to complacency, with SMSF trustees not giving appropriate regard to their trust deed. The trust deed would also not be able to be read as a standalone document because without being updated it would not be an accurate reflection of the legislative requirements on SMSFs. It may also be possible that inconsistencies between trust deeds and legislation will not be wholly answered by the standard deeming provisions when applied to specific circumstances. This would result in uncertainty for SMSF trustees.

A provision that would deem anything prohibited by the SIS Act or a tax act to be prohibited by the trust deed would have no effect. The legislation would override the trust deed in the case of any inconsistencies and so the provision is unnecessary.

The cost of upgrading an SMSF trust deed is estimated to be between $100 and $200. Consequently, the benefit from the standard deeming provisions would be minimal; particularly considering it would not eliminate the need to update the trust deed. Therefore, no change to the status quo is recommended.