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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

9 July 2018

Subject: **Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018**

Thank you for the opportunity to comment on the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 (the Bill).

Mercer understands and supports the motives behind the proposed changes and agrees that they would have some valuable benefits, particularly in reducing the number of unwanted multiple accounts and unwanted insurance.

Main concerns

Our main concerns are:

- In our view a start date of 1 July 2019 is not feasible for some of these changes
- On our reading, where a member account is invested in more than one investment option, the amendments in the Bill will be inconsistent with the policy intent, be either unworkable or very costly to administer, be complex to communicate and result in manifestly inappropriate outcomes. These comments apply to the fee cap provisions, the transfer of inactive accounts to the ATO and aspects of the insurance measures and results from the amendments being drafted to apply at product (investment option) level when they should apply at the total member account level.
  - For example, if a member account has a total balance of $100,000 but this is split across a number of investment options and one of those (Option X) has a balance of less than $6,000, then:
    - The fund may be required to transfer the Option X balance to the ATO if that investment option receives no contributions for 13 months (e.g. where contributions have been directed to another option/s in that period)
    - The fund would be required to apply the 3% cap to the fees on the Option X balance
    - The fund would be required to work out whether any opt-out cover related to the Option X balance and cancel any such cover (we are unsure how the fund would make such an assessment, as our understanding is that in most default funds, insurance arrangements for Choice and MySuper (or both) members are the same and cover relates to the overall member account, not to an investment option e.g. a member could move from the MySuper

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investment option to a Choice option to a mix of options without any impact on their insurance cover)

- All these outcomes would be totally at odds with the policy intent of protecting small accounts and practically impossible for funds to administer
- We have not yet had the opportunity to raise and discuss these concerns with the Treasury and therefore hope our reading of these provisions is incorrect. However if it is not, it is essential that appropriate amendments be made.

- A number of other refinements to the 3% fee cap provisions are needed to reduce the implementation costs and inappropriate outcomes.

Summary of Recommendations

Fee caps

1. We recommend that the changes be deferred 12 months i.e. a start date of 1 July 2020 rather than 1 July 2019. If this recommendation is not accepted, we recommend the cap not apply to accounts (or products, if applicable) closed before 1 July 2020 i.e. the cap would apply with effect from 1 July 2019 but only to accounts with non-zero balances at close of business 30 June 2020 or later.

2. We strongly recommend that s99G be amended to provide for application of the cap at account level rather than at product level. Application of the cap at product (investment option) level would add very substantially to the complexity of this measure and be inconsistent with the policy intent as announced and described in the Explanatory Memorandum i.e. the intent of the cap is to protect low balance accounts, not low investment option balances within an account that has a total balance of more than $6,000.

3. We recommend the proposed amendments to s29TC be modified to allow trustees to adopt practical approaches to complying with the cap e.g. permit variation from the standard fees basis “to the extent … **considered necessary or practicable by the trustee** …to comply with section 99G (fee cap on low balances)”.

4. To mitigate the potential for gaming and anomalous outcomes, we recommend the cap not apply to any account from which there has been a partial withdrawal during the year. If our recommendation 2 above is not accepted, we recommend the cap not apply to any product from which there has been a partial withdrawal during the year.

5. We also recommend that the minimum balance in SIS reg 6.35 be increased from ‘less than $5,000’ to at least $6,000 to align with the 3% fee cap balance limit. (Currently SIS reg 6.35 allows a trustee to refuse a partial withdrawal benefit request if the remaining balance would be less than $5,000 after the withdrawal.)

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Transfer of inactive accounts to the ATO and pro-active ATO consolidation

6. We strongly recommend that the provisions of the Bill be amended to provide for the inactive account tests (both the activity test and the balance test) to apply at account level rather than at product level.

7. These measures will require updates to the SuperStream superannuation data and transaction network. Any such changes require suitable lead-in periods and the meshing of the timetable with other SuperStream enhancements can significantly reduce the implementation costs and avoid unnecessary disruption. Other SuperStream enhancements proposed or under discussion include processing of rollovers to and from SMSFs (late 2019) and taking the opportunity to include the 2016 Budget initiatives regarding death benefit income stream rollovers and ATO commutation authorities, as well as adding ATO Release Authorities and the 2017 First Home Super Saver Scheme release authority requirements into the SuperStream rollover message.. A 1 July 2019 implementation date for the proposed measure may not be achievable or cost-effective. We recommend that the ATO be provided with a 12 month window to implement the measure from 1 July 2019 or as soon as practicable within the following 12 months.

Insurance changes

8. We strongly recommend that the provisions of the Bill be amended to provide for the inactive account test and the low balance test to apply at account level rather than at product level.

9. The commencement of the insurance changes needs to be at least two years from the date the legislation and associated regulations are finalised. We recommend that the timeframe be amended to allow funds to implement the changes in an orderly manner having regard to when their insurance contract is next renewed (by 30 June 2021 at the latest), in line with the Insurance in Superannuation Code. The will allow sufficient time for funds across the industry to renegotiate their insurance contracts, with competitive testing of the terms and rates offered, as well as for the major changes required to fund administration systems and processes to be completed. If there is not enough time to allow for competitive pressure to be created, then funds are likely to be forced to accept higher premium rates and/or poorer terms and conditions than they would otherwise obtain, with members the losers.

Please refer to the Attachment for further comments. Note that the Attachment does not include commentary on Recommendations 6, 7 and 8. For background comments on Recommendations 6 and 8, please refer to our comments above on issues associated with a member account invested in more than one investment option (Main concerns, page 1).

Who is Mercer?

Mercer is one of the world's leading firms for superannuation, investments, health and human resources consulting and products. Across the Pacific, leading organisations look to Mercer for global insights, thought leadership and product innovation to help transform and grow their businesses. Supported by our global team of 22,000, we help our clients challenge conventional thinking to create solutions that drive business results and make a difference in the lives of millions of people every day.

Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over $150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 239,000 members and more than $22 billion in assets under management.

Please contact me on [redacted] or by email if you would like to discuss this submission.

Yours sincerely

[redacted]

Dr David Knox
Senior Partner

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ATTACHMENT – DETAILED COMMENTS

1. 3% fee cap on accounts with balances of less than $6,000

1.1 Outline of Proposal

Schedule 1 to the Bill prevents trustees of superannuation funds from charging certain fees or costs exceeding 3 per cent of the balance of an account annually if the balance is less than $6,000.

1.2 Introductory Comments

Mercer supports the intent of this measure. In terms of ease of implementation and administration, the provisions in the Bill are a substantial improvement on the exposure draft legislation. However we consider further changes are needed to avoid unnecessary complexity and unintended outcomes.

1.3 Cap should apply to account not product

Most of the Explanatory Memorandum (EM) talks about the cap as applying to an account e.g. paragraph 2.17:

> *2.17 It is the balance of an account that determines whether administration fees, investment fees and prescribed costs are capped and, if so, the maximum amount of these fees and costs that is charged.*

Paragraph 2.18 then explains that, for a member who has more than one account in a fund, the cap would apply for each account that has an end balance of less than $6,000.

We have no problem with this. However section 99G as set out in the Bill refers to 'a choice or MySuper product', with the cap applying based on the balance of the **product**. In this context we would read a 'product' as meaning an investment option – if this is the intended meaning, we are very concerned that this would result in much more complex administration requirements and inappropriate outcomes.

In particular, we are concerned about how s99G is intended to apply where a member has a <u>single account</u> with a MySuper product AND one or more Choice products, or a single account with a number of Choice products? Or a single account where a member switches 100% of their balance from one investment option (product) to another during the year?

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Note that dollar-based administration fees (e.g. $2 per week) apply at account level, not for each investment option. If the cap was to apply at product level how would these be split between investment options?

> *EXAMPLE 1: Jose has an account with a year-end balance of $50,000 spread between two investment options ($47,000 in the MySuper option and $3,000 in the International Shares Investment Option). His fees for the year are $104 of dollar-based weekly administration fees related to his account-keeping, plus asset-based fees & costs of $400 on his MySuper balance and $30 on his International Shares balance. Does s99G mean that the fund has to apply the cap to the fees on the International Shares balance because it is below $6,000? We submit this would be inappropriate given the size of his total account balance. If it is required, please confirm the trustee would be able to apportion the $104 of dollar-based fees in any way it considers reasonable.*

> *EXAMPLE 2: Building on Example 1, at the following 1 August Jose switches the whole balance he has invested in the International Shares Option ($3,100) into the Australian Shares Option. Does s99G mean that, effective 1 August (and within 3 months of this date if the cap is administered via a rebate), the fund has to apply the cap to the one month of fees on his International Shares balance (and some portion of the dollar-based fees) because he is exiting from this product and the closing balance is below $6,000? Assuming he makes no further investment change before year-end, does the fund need to apply the cap separately to his balance in the MySuper option and his balance in the Australian Shares Investment Option, allowing for the latter test to be on a pro-rata basis for 11 months?*

As announced and stated in the EM, the intent of the cap is to protect low balance accounts, not low investment option balances within an account that has a total balance of more than $6,000.

Section 99G as currently worded does not reflect that intent. Furthermore, the administrative complexity of the cap would be much worse if the cap were to apply to each investment product holding within an account rather than to the account overall.

1.3.1 Recommendation

We strongly recommend that s99G be amended to provide for application of the cap at account level rather than at product level.

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1.4 Allow flexibility to charge less than the full cap

Say a fund's standard fees (including indirect costs) for its MySuper product are $2 per week plus 0.8% pa and the member's year end balance is $3,000.

The proposed cap on the fees for the year would therefore be 3% x $3,000 = $90.

As we read the Bill, the only way the fund can comply with the cap is to work out the standard fees (including indirect costs) for the year and rebate the difference. Calculation of the $2 per week is simple (52 x $2 = $104) but calculation of the asset-based fees and indirect costs is often not straightforward and an approximation will be required.

For clarity and administrative simplicity the fund may prefer to waive the $2 per week fees entirely for protected accounts i.e. only charge the asset-based fees and indirect costs of 0.8% pa. Clearly this would meet the intended requirement that fees of less than 3% be applied to protected accounts.

An alternative approach we believe should also be permitted is for the fund to estimate the asset-based fees and indirect costs for the year by applying the relevant cost percentage to the closing balance e.g. in this case 0.8% x $3,000 = $24. This would usually be expected to be an overestimate as the balance would normally increase over the year, so the approximation would normally be in favour of the member.

On our reading, the proposed amendments to s29TC would not allow either of these approaches, because they only permit modification from the standard fees basis "to the extent … necessary …to comply with section 99G (fee cap on low balances)".

1.4.1 Recommendation

We recommend the proposed amendments to s29TC be modified to allow trustees to adopt practical approaches to complying with the cap e.g. permit variation from the standard fees basis "to the extent … **considered necessary or expedient by the trustee** …to comply with section 99G (fee cap on low balances)".

1.5 Prevention of gaming

The cap is based on the closing balance at year end or on full withdrawal. This would appear to allow a member whose balance is much greater than $6,000 to benefit from the cap by withdrawing a sufficient part of their balance to access the cap at year end or on withdrawal of the residual balance prior to year-end.

EXAMPLE: Joe has $1,003,000 in Account A and $3,000 in Account B. On 15 June, he transfers $1m from Account A to Account B. The yearly fees on Account A are restricted to a cap of $90 even though its balance was around $1m for most of the year, requiring the fund to refund fees of $10,000 to this account. Next year in mid-June, Joe plans to transfer the excess over $3,000 in Account B back to Account A, avoiding a further $10,000 in fees. The fees subsidy to Joe will have to be met by charging higher fees to other members.

Inappropriate refunds could also apply to members who are not attempting to game the system. Gaming opportunities (and anomalies) would be greatly amplified if the fee cap was applied at investment option level (which we have strongly recommended against – see section 1.3 above).

1.5.1 Recommendations

We recommend the cap not apply to any account from which there has been a partial withdrawal during the year.

If our recommendation 1.3.1 is not accepted, we recommend the cap not apply to any product account from which there has been a partial withdrawal during the year.

We also recommend that the minimum balance in SIS reg 6.35 be increased from 'less than $5,000' to at least $6,000 to align with the 3% fee cap balance limit. (Currently SIS reg 6.35 allows a trustee to refuse a partial withdrawal benefit request if the remaining balance would be less than $5,000 after the withdrawal.)

1.6 Implementation Date

Given the complexity of the cap provisions and the expectation that different funds will take different approaches to how they implement the cap, we do not think the changes can be implemented across the whole industry by 1 July 2019.

1.6.1 Recommendation

We recommend that the changes be deferred 12 months i.e. a start date of 1 July 2020 rather than 1 July 2019.

If this recommendation is not accepted, we recommend the cap not apply to accounts (or products, if applicable) closed before 1 July 2020 i.e. the cap would apply from 1 July 2019 but only to accounts with non-zero balances at close of business 30 June 2020 or later.

2. Restrictions on default insurance cover

Proposal

From 1 July 2019 superannuation funds will only be permitted to offer insurance on an opt-in basis for accounts:

- that have balances below $6,000; or
- for new members who are under 25 years old; or
- that have not received a contribution for 13 months or longer.

Implications

For most funds the proposed changes will have a major impact on both the terms and conditions of their group insurance policy and their insurance administration and underwriting processes.

The package would be expected to result in significant changes to the insured member base of most funds, as well as to how and when default cover is provided. Trustees will need to work with their insurers to re-negotiate the terms and conditions of their fund's group insurance policy. Increases in premium rates and changes to automatic acceptance terms are highly likely as a result of greater expected anti-selection (e.g. opt-in is more likely for members in poorer health), more underwriting costs and the spreading of fixed costs over a smaller premium base.

Other implementation challenges include the design and implementation of new insurance administration and underwriting processes, updating of disclosure material such as PDSs and communication of the changes to members – with much of this reliant on the revised terms and conditions of the fund's group insurance policy.

A start date of 1 July 2019 would require the group insurance terms and conditions to be reviewed for every large super fund by early 2019 at the latest. A one-size-fits-all approach is not possible as individual fund characteristics such as the proportion of new members under age 25 and the number of inactive accounts will vary significantly from fund to fund, as will their current terms and conditions. Doubts have already been raised about the capacity of the group insurers to conduct a thorough reassessment of risk for every fund within the necessary timeframe, as well as whether there is sufficient data available to allow accurate assessment of the impact of the changes on claim rates.

The changes in fact impact on most areas of fund operations and will require major changes to administration systems and procedures. To provide some indication of the size and breadth of the task, let us consider the Mercer Super Trust, which is a corporate master trust with around 230 employer sub-plans, many of which have a number of benefit classes with different insurance designs, resulting in more than 800 different insurance arrangements overall. For all these arrangements, the trustee will have to:

- work out what opt-in cover to offer to those
  - under age 25,
  - with an account balance of less than $6,000, or
  - with accounts where there has been no contribution for 13 months
- work out on what basis to offer opt-out insurance
  - when members who have or haven't opted in beforehand turn 25, or
  - their account balance hits $6,000, or
  - an inactive account above $6,000 receives a contribution
- consult with employers and policy committees
- renegotiate contracts with multiple insurers (noting that each of these insurers will also have to do this with multiple other trustees over the same tight timeframe, adding significant extra pressure to the process)
- rewrite insurance policies and governing rules
- update insurance rates, terms and conditions in Product Disclosure Statements
- communicate to existing members (some of them well in advance of the others as required by the legislation)
- re-design and re-configure administration systems and processes.

This is at least a two-year project, with the two years starting from when the legislation is passed and the associated regulations are made.

A start date of 1 July 2019 is not feasible. It would be much better to link in with the sensible timeframes in the Insurance in Superannuation Voluntary Code of Practice, which Mercer supports and has undertaken to comply with. The Code recognises that most funds have three year contracts with their insurer, with premium rates locked in for three years, and that forcing funds to renegotiate these early may disadvantage members.

If the timeframe is not pushed out sufficiently, the likely outcome is that members will bear substantial extra costs due to:

- premium rates being increased more than they otherwise would because trustees will not have time to conduct tenders and insurers will not have time to confidently assess the risk and hence will build in higher contingency margins

- extra implementation costs because of overtime and extra staff needed to work to the required deadline.

In simple terms, the more rushed the implementation timetable, potentially the worse the outcome for the majority of fund members who have insurance.

Shorter timeframes also increase the risks of miscommunication to members and other unintended consequences or errors.

Recommendation

We recommend the timeframe be amended to allow funds to implement the changes in an orderly manner having regard to when their insurance contract is next renewed (by 30 June 2021 at the latest), in line with the Insurance in Superannuation Voluntary Code of Practice. Otherwise, the changes should be deferred by at least 12 months, so that there is an implementation period of at least two years from when the legislation is passed and the associated regulations are made.