Coalition Members and Senators Dissenting Report

Coalition Members and Senators agree that the default superannuation industry needs reform to enhance competition, transparency and comparability in the system.

We recognise that the regulatory environment in the compulsory savings regime is critical in achieving the policy goal, which is to maximise Australia's retirement savings through publicly mandated, privately managed superannuation.

The two MySuper Bills before this Committee will change the way in which the private sector is allowed to operate in this market.

In the Coalition's view, these Bills will not increase competition but they will contribute to better transparency and comparability.

The genesis of these Bills was the Super System (Cooper) Review of 2009-10.

Since endorsing the MySuper recommendations in August 2010, the Government has approached delivery of the reform in a very piecemeal manner.

There are two Bills before this Committee now and there is another MySuper Bill (the third) which is yet to be exposed for consultation.

In addition, competition matters will be examined by the Productivity Commission, which is presently undertaking a review into default superannuation under modern awards.

The final incarnation of MySuper in these Bills is vastly different from where the government started.

The government's original approach would have resulted in a highly rigid "one size fits all" default superannuation market, which would have been unable to accommodate different demographic profiles in Australian workplaces.

The Coalition welcomes the moves away from a rigid "one size fits all" approach as it had the potential to disadvantage many Australians.

Despite our in-principle support for the policy, the Coalition has considerable reservations about the proposed regulatory design features of both Bills.

We believe these reservations are significant enough to oppose passage of the legislation. Principally these are around the authorisation process, the licensing regime, a proposed "scale test" and the lack of clarity surrounding the provision of intra fund advice.

Further, the Coalition does not support the proposition that the Parliament should consider voting on these Bills without the outcome of the Productivity Commission inquiry and any legislative changes resulting from this inquiry.

Competition in the default superannuation market

The Coalition has long argued in favour of genuine choice and competition in the default superannuation market.

Only with genuine competition in an efficient and transparent default superannuation market will fund returns and retirement savings for Australians in default super funds be maximised.

Current arrangements where default funds under modern awards are selected by Fair Work Australia are not transparent, not competitive and inappropriately favour union dominated industry super funds.

The continuation of those current closed shop anti-competitive arrangements for the selection of default superannuation funds is a national disgrace.

In the lead-up to the last election the government was shamed into promising a Productivity Commission inquiry to address the anticompetitive aspects of its decision to hand to Fair Work Australia the power to approve default funds. Having recognised the deep flaws in the current process before the last election it was disappointing that the government has been so slow to act on that commitment.

It took the government more than eighteen months to commission this inquiry which we are now told will take the best part of this year.

It is clear that the Minister for Workplace Relations and Superannuation has been intent on protecting the best interests of his friends in the union movement for as long as possible.

It is the view of Coalition members of the Committee that this has been at the expense of working families across Australia who have been missing out on the benefits of genuine choice and competition for far too long

We have welcomed the fact that the government has finally asked the Productivity Commission to recommend a more open, transparent and competitive process for the selection of default funds under modern awards.

However we consider that even before the Productivity Commission has reported, the Parliament should amend this legislation to force the government to ensure Australians in default superannuation can benefit from enhanced competition in that market.

Specifically, we point to recommendation 1.2 of the Cooper Review in relation to MySuper and modern awards which said: "*The SG Act should be amended so only a MySuper product is eligible to be a 'default' fund nominated by an employer*."

In recommending, universal eligibility of default funds for industrial purposes, recommendation 1.3 stated:*" ...all MySuper products are able to be nominated, for 'default fund' purposes in awards approved by Fair Work Australia."*

Coalition members of the Committee are of the view that in creating this new default superannuation product, all MySuper funds should be allowed to be an eligible default fund for any workplace and be able to compete freely. To not allow MySuper funds to compete on a level playing field fails to address the existing competition issues in the default super industry and undermines the MySuper reforms.

Under the proposed reforms every product must be assessed by APRA as meeting a minimum set of standards or requirements before it is registered as a MySuper product. This process will ensure that all MySuper products offer appropriate levels of consumer protection and are therefore suitable to be utilised as default superannuation funds.

Once compliance with this set of criteria is established and a MySuper product is registered the Coalition members of the Committee are of the strong view that there is no need for any other process to further determine which eligible and suitable default funds should be included into individual awards.

To embark on such a separate process would create duplication and additional costs for no additional consumer benefit or protection.

Once assessed as meeting the relevant standards and being eligible to be used as a default superannuation product, every MySuper fund should be able to freely compete in the marketplace and to offer itself as a default fund with no further barrier or restriction.

Coalition members of the Committee are concerned that instead of acting in the public interest, the government's continued delays in implementing reforms to ensure genuine competition in the default superannuation market are driven by its desire to protect the vested interests of union dominated industry super funds.

We consider it imperative that action to address the current highly undesirable lack of competition in the default super market should be taken now in conjunction with any other changes to default super rather than be delayed further.

Recommendation 1:
That the legislation be amended to allow any authorised MySuper product to become a default fund under any industrial arrangement.

General concerns on Authorisation requirements

A number of submitters to the Committee expressed concerns about the impact of APRA authorisation requirements.

The Industry Super Network (ISN) argued that given the time lag between an application by an RSE and a determination by APRA:

> ...the sooner APRA provides pro-forma forms and guidance regarding the application process as outlined in section 29S, the more orderly the transition to MySuper will be. To avoid any confusion and uncertainty, information on the MySuper transition process should be made available as soon as is possible.[1]

The Australian Institute of Superannuation Trustees' (AIST) noted:

> ...the key date where a fund makes a MySuper application for a large employer MySuper prior to 1 July 2013 will be 27 December 2013. Within this time frame, funds will be able to accept default contributions into their existing default fund while their MySuper application is being decided. Effectively, this means funds (other than in relation to large employer MySuper products) will have to make an application for MySuper authorisation within the six month window between January and June 2013.
>
> Funds are likely to want to apply as early as possible in this period and ideally prior to 1 April 2013, so that they can advise employers of their MySuper status, and ensure that they will be MySuper compliant if APRA require the full 180 days, as well as for other marketing purposes.[2]

The AIST explained that:

> ...we think that there should be an absolute requirement on APRA to process all applications within that time frame because the consequences of not getting MySuper authorisation from a fund is dire. It is not like not getting a public offer licence. You will not be able to accept superannuation guarantee contributions after 1 October, which effectively means for a live fund that you will not be able to operate in the marketplace.
>
> ...if employers are proceeding quite happily to make contributions to a particular fund and then on 1 October they can no longer make SG contributions to the fund how do they actually fulfil their obligations under the SG requirements?[3]

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1 Industry Super Network, *Submission 7*, p. 1.

2 Australian Institute of Superannuation Trustees, *Submission 9*, p. 10.

3 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. 49.

The AIST told the committee:

> we would strongly urge...the parliament to expedite the carriage of all elements of the Stronger Super legislation through Parliament so that there can be some greater clarity so that in the second half of this year, funds are in the position that they can do everything that is needed to get their application into APRA for their MySuper product.[4]

The AIST also recommended that where APRA does not make a decision within the required period, it should be required to give reasons.[5]

Mercer was unclear as to what APRA will request from trustees as part of the authorization process:

> At this stage it is unknown as to the level of detail that will be sought by APRA as part of the application process. For example, it is not known whether APRA will expect trustees to have developed appropriate policies based on the proposed prudential standards before submitting an application.[6]

APRA told the committee that it would be seeking to make public its draft application authorisation forms and standards in May–June 2012, with a view to finalising these before the end of 2012. It noted that it has already started 'dialogue with trustees about the sorts of things we expect to see'.

APRA told the committee that:

> The biggest danger is that there might be some trustees who are laggards in the process and come in quite late in the piece...In terms of the queuing process, we aren't going to date, stamp and number each form when it comes in...But we have 260 frontline supervisors and probably 120 or 130 will have some involvement in this process.
>
> If we got 100 different applications on one day, they are likely to go to 50 different supervisors...The queuing issue might be less of a problem than what people were suggesting...We're encouraging draft applications in the second half of 2012 and that's again to facilitate the process.[7]

APRA explained to the committee that this legislation gives APRA the job of approving specific products (as opposed to product providers) for the first time in its history:

> ...this is the first time in any of our legislation that we have a product authorisation role. Equally, this is the first time that our legislation is actually a prescribed product, because we do not have prescribed bank accounts or insurance policies and so on. So from that perspective it is new.

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4 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 2 March 2012, p. #.

5 Australian Institute of Superannuation Trustees, *Submission 9*, p. 11.

6 Mercer, *Submission 13*, p. 6.

7 Keith Chapman, APRA, *Proof Committee Hansard*, 2 March 2012, p. 55.

> I do not think the process needs to be different; I think the level of detail and the level of analysis that we undertake need to be different. That is what we have been looking to try to do.
>
> We will have challenges to get people out of the mindset of, 'I'm looking at everything this trustee does and how they operate,' to, 'I'm looking at this product.' That is why we are talking about a MySuper authorisation form and authorisation process as opposed to an RSE MySuper offerer authorisation process. While it is different, I see that it is much more of a check on the product's specific characteristics rather than on trustee behaviour. Having said that, we have been public in some of our seminars, which I referred to earlier, with comments that we will obviously be looking more askance at the trustees who apply to offer MySuper products where we have a long history of fringe behaviour, for want of better terminology. There is an official word but I cannot remember what it is. We have said that, but those numbers are not huge. It is not 50 per cent of the population but it is probably somewhere around five per cent to 10 per cent. That does not mean that it is trustees where we have a legitimate disagreement. We have had legitimate disagreements with many people over time. But it is the ones where it might just be taking an awfully long time to get rectification that we thought was fundamental.

The Coalition members consider that it is imperative given the complexity of the task ahead that APRA provide appropriate guidance to the industry about the standards and forms required for the authorisation process at least 12 months prior to the commencement of the MySuper legislation.

Recommendation 2:

That APRA provides full details of the standards and forms required for the authorisation process at least 12 months prior to the commencement of the MySuper legislation.

The process to obtain a tailored large employer MySuper plan

A provision in the Core Provisions Bill requires prior authorisation of each tailored large MySuper employer plan rather than simply providing a reporting mechanism.

Five organisations—BT, Mercer, the Corporate Superannuation Specialist Alliance (CSSA), the Association of Superannuation Funds of Australia (ASFA) and the Financial Services Council (FSC)—all argued that the Bill's authorisation process for tailored MySuper products for large employers is unnecessary.

BT Financial Group argued:

> According to the legislation APRA may take up to 180 days to approve a tailored MySuper offering. We believe the requirement for APRA approval will result in:
>
> Significant delays to how quickly members can benefit from the new arrangement, by delaying how quickly the members can transition to the new fund.

> Uncertainty for employers who have commercially negotiated a beneficial arrangement for their employees. Employers must wait for approval from APRA and then take further action if not approved.
>
> Reduced competition within the superannuation industry as employers become less likely to negotiate a tailored arrangement or conduct a competitive tender due to the considerable length of time it would take.
>
> BTFG believes that the proposed level of APRA involvement in commercial arrangements entered into by superannuation funds with employers is unnecessary and inefficient. APRA's role should be to monitor compliance with MySuper legislation through annual reporting and ongoing supervisory activities, as envisaged in the Stronger Super Information Pack.[2]

BT recommended that:

> ...the Bill be amended so that APRA is only required to licence the ability of an RSE to offer MySuper products.
>
> Superannuation funds that enter into a commercial relationship with an employer and in doing so create a tailored MySuper product, would then only have an annual reporting obligation to APRA. The information collected could be used by APRA, along with its other prudential activities, to monitor the tailoring of MySuper products and ensure that they are consistent with legislation.

The CSSA told the committee:

> Tailored MySuper funds should not require individual approval from APRA, as a blanket approval could be provided RSE licenses. This would reduce the time taken for approval and reduce administration, and therefore costs.[8]
>
> At the end of the day, the main difference between a tailored MySuper and the standard MySuper, to use a better term, is that the investment strategy can be chosen differently. There is no other difference between the two of them. If, as FSC requested, you go for a MySuper approval and you get it and do not have to come back with each tailored fund, it sort of takes away the need to have any number or any restriction around it, in my opinion. Investment strategy is the only difference, at the end of the day.[9]

The Association of Superannuation Funds of Australia (ASFA) put a similar argument:

> To compel the trustee to make a series of separate applications to APRA would prove an extremely inefficient process, consuming considerable resources and creating significant delays for little or no benefit. As a

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8 Mr Gareth Hall, Treasurer, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 19.

9 Mr Douglas Latto, President, Corporate Super Specialist Alliance, *Proof Committee Hansard*, 2 March 2012, p. 20.

> prudential regulator APRA has the power to assess large employer offerings as part of their regular reviews of funds.[10]

Mercer argued the case for not requiring a tailored MySuper product authorisation process as follows:

> The fund that Mercer runs is a good example. We mentioned earlier the master trust with 260 corporate subplans. We have something like 50 employers, or more than that, that have more than 500 employees. They might want to look at having a tailored MySuper vehicle. It seems very strange to us that the trustee of the fund—there is one trustee running the whole fund for all of the subplans—would potentially have to make 50 separate applications to APRA. Most of the content of the applications would be identical. There will be variations with fees and some minor variations with insurance and possibly investments, but we are talking about the same trustees having met the trustee obligations in similar ways. We think it would be better to have a single application per trustee and some sort of provision for APRA to review and disallowed—:
>
> ...in order to offer a tailored MySuper product, the trustee must already have convinced APRA that it is competent to operate a MySuper product. It therefore seems unnecessary that trustees have to obtain separate approval to operate a tailored MySuper, particularly where the proposed arrangement already has the requisite number of employee members to qualify. The requirements will add to inefficiency, make transition to MySuper more difficult and create further inefficiencies and time delays in relation to future fund mergers.[11]

Mercer argued in its submission:

> We do not consider that it should be necessary for separate approval be sought from APRA in relation to Tailored MySupers. In order to offer a Tailored MySuper, the trustee must already have convinced APRA that it is competent to operate a MySuper product. It therefore seems unnecessary that trustees have to obtain separate approval to operate a tailored MySuper, particularly where the proposed arrangement already has the requisite number of employee members to qualify. The requirements will add to inefficiency, make transition to MySuper more difficult and create further inefficiencies and time delays in relation to future fund mergers.
>
> Recommendation :
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> The requirement for APRA approval of tailored MySupers should be removed (at least for cases where the 500 employee limit has been exceeded).[12]

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10 Association of Superannuation Funds of Australia, *Submission 12*, p. 5.

11 Mercer, *Submission 13*, p. 25.

12 Mercer, *Submission 13*, p. 25.

The Financial Services Council (FSC) proposed an alternative authorisation process for tailored plans:

> MySuper tailored plans must be reported to APRA on an annual basis – APRA can disallow a tailored plan where the tailored plan is not compliant with the licence conditions within 30 days. At which time, tailored plan closure arrangements commence.[13]

The FSC proposal of a reporting system for tailored large employer MySuper products was put to APRA for its comment. It responded:

> From our perspective, we are generally in favour of entry control because it does give us the ability to evaluate the application that is coming in and we can do a pretest of those issues. Having said that, all our normal supervision work is like an exit control because once we have somebody in we then continually supervise them and, over the years, we learn more about what they are doing.[14]

> From our perspective we see the introduction of MySuper as a major change. There are different specific responsibilities for trustees, different legislative obligations and we would have a definite preference for an entry control. Having said that, when you tease it through the AIST representatives, who have just finished, there is a lot of work involved in that process, and we are conscious of that. We will work within the timeframe to do as thorough job as we can on entry so that there will still be some degree of post-entry review and potential exiting of trustees who we do not believe are doing the right thing. We worked for a long time to get the trustee licensing back in 2005-06 because we saw that as a significant means of increasing the standard of the trustee directors and trustees within the industry. We see this one the same way. [15]

Coalition members of the Committee agree with those submitters who have stated that this process would be cumbersome, time consuming, unnecessary and costly.

We endorse the FSC recommendation of converting this cumbersome process with an annual reporting process that would still allow APRA to disallow a non-complying fund. We believe that such a process would address the public policy concern that the existence and number of employer plans are unclear to APRA. It would require reporting without undermining the efficiency, competitiveness and commerciality of tender processes.

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13 Financial Services Council, *Submission 3*, p. 6.

14 APRA, Proof Committee Hansard, 2 March 2012, p.

15 APRA, Proof Committee Hansard, 2 March 2012, p.

Further, the Coalition does not believe this is the proper role for the prudential regulator, which should be focused on risk and governance, not on commercial matters which affect neither factor.

Recommendation 3:

That the requirement for MySuper trustees to apply to APRA when issuing a tailored employer plan be replaced with an annual reporting obligation.

The large employer threshold

There was significant concern expressed to the Committee about the benchmark above which large employers can tailor funds for their employees. The provisions of the Bill allow for such tailoring where an employer contributes to a fund on behalf of 500 or more members.

The Corporate Super Specialist Alliance (CSSA) argued that tailoring of MySuper funds should be allowed for all employers:

> The proposed legislation allows for plans of large employers and their associates to be tailored if they contribute on behalf of 500 or more members. We believe this is inconsistent with the current superannuation environment which allows tailoring of superannuation plans at any level that is commercially viable, and we question why 500 members was chosen as a benchmark for a large employer. A 50 member fund of executives could conceivably have greater assets than a 500 member fund made up of blue collar workers, with a lot less administration required, so why should members of that fund be prohibited from negotiating a distinct product to suit the particular needs of their workplace? Different workplaces will have very different requirements.[16]

The Association of Financial Advisers also proposed a limit of 50 employees:

> Further to our point above about prescriptive detail, the AFA does not support the requirement that tailored plans can only be offered for employers with 500 employees. This seriously limits the number of eligible employers and would mean that many employees missed out on the potential benefits of a tailored plan. If the government feels the need to be prescriptive in this area, a number of 50 employees would be more appropriate.[17]

The Australian Institute of Superannuation Trustees (AIST) argued for:

> ...an arbitrary requirement, such as 500 members for whom an SG contribution has been received from the employer in the past 12 months, and who have not terminated their employment with the employer.[18]

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16 CSSA, Submission 2, p. 4.

17 Association of Financial Advisers, *Submission 15*, p. 3.

18 Australian Institute of Superannuation Trustees, *Submission 9*, p. 11.

The Financial Services Council (FSC) proposed amending subsection 29TB(2):

> *(2) An employer is a large employer in relation to a regulated superannuation fund:*
>
> *(a) where the employer is the only standard employer-sponsor in relation to the class of beneficial interest referred to in subsection (1), the employer has at least 500 employees at the time a beneficial interest in that class is first issued and at the end of each annual reporting period and where there is more than one standard employer in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that employer and each other standard employer is 500 employees or can reasonably be expected to grow to 500 employees during the reporting period; or*
>
> *(b) where there is more than one standard employer-sponsor in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that employer and each other standard employer sponsor totals at least 500 employees at the time a beneficial interest in that class is first issued and at the end of each annual reporting period and where there is more than one standard employer in relation to the class of beneficial interest referred to in subsection (1), the number of employees of that employer and each other standard employer is 500 employees or can reasonably be expected to grow to 500 employees during the reporting period;*
>
> *(c) A person is not counted as an employee for the purposes of subsection (2) if the person's salary or wages are not to be taken into account for the purpose of making a calculation under section 19 of the Superannuation (Guarantee) Administration Act 1992.*[19]

Mercer told the committee:

> Our main concerns about that area are the complexity of the test in the way it is written into the bill. We think it should be replaced with a much simpler test. Various submissions have suggested it should be based on the number of employees of the employer, or it should be based on the number of members in the employer's fund if we are talking about a corporate master trust, for example. We could live with either of those definitions as long as it is something that is simple and easily measurable by the employer if it was number of employees of the fund if it was number of fund members.[20]

Mercer recommended amending the 29TB threshold so that it is based on either the number of employees of the large employer and its associates or the number of members in the employer's plan.[21]

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19 Financial Services Council, *Submission 3*, p. 11; See also Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 2 March 2012, p. 4.

20 Mercer, *Proof Committee Hansard*, 2 March 2012, p. 40.

21 Mercer, *Submission 13*, p. 28.

The Association of Superannuation Funds of Australia (ASFA) argued in its submission that:

> If a numerical measure of 500 is to be employed we suggest that the measure be aligned with the prescribed class in regulation 3.01 of the Superannuation Industry (Supervision) Regulations 1994 ("SIS regs"), which is the class of members, other than standard employer members, which non public offer funds are allowed to have without having to become public offer. This includes former employees, or relatives and dependants (generally spouses) of employees and former employees, of the employer - and its associates.
>
> Further, with respect to the requirement that "any" employee may become a member - there may be instances where, owing to the industrial relations circumstances of the employer, it may not be possible for this to be the case.
>
> Finally, it is unclear whether the trustee must make a separate application with respect to each large employer MySuper offering or can simply make one application with respect to being able to offer one or more large employer MySuper offerings. If it is the former then it is unclear as to why this should be the case, given that the only additional criteria are relatively narrow and capable of being determined "objectively" as a question of fact.[22]

In evidence to the committee, APRA indicated that it did not understand the implications of the 500 fund member threshold in proposed subsection 29TB:

> What about the issue that there are some provisions here that appear to give you very little discretion? I am thinking particularly of the 500 employee test or, as drafted presently, the 500 members of the fund test. It is the case, isn't it, that if the number of members drops below that then you essentially have to press the button to say that this fund has to cease operating?
>
> Mr Chapman: We will obviously treat that with some discretion. If it is down to 499 today—
>
> Mr FLETCHER: I just want to understand that because, unless I am misreading the bill, I am not quite sure on what basis you would have that discretion.
>
> Mr Chapman: I have been corrected by my expert, Dr Ellis. I have unfortunately said the wrong thing. One of the ways we want to address that is that when we get the trustees applying for those sorts of funds—which is in the draft application we are working on at the moment—we want to come up with a contingency plan for if employee numbers drop. We have said publicly that we do not think the trustees should be coming to us with a 29T(b) request for 500 employees. We think it needs to be more than that. The trustee has to be reasonably satisfied—and again we have those words 'reasonably satisfied'—that the 500 are going to be there. There is a little bit of a scale argument as well—

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22 Association of Superannuation Funds of Australia, *Submission 12*, p. 5.

> Mr FLETCHER: Can I just make sure I understand that? What you are saying to me, in practical terms, if I am understanding correctly, is that there is no discretion for you as drafted if it falls below 500 members and therefore the only means to mitigate against the risk of a fund having to come to a screaming halt with all the attendant inconvenience for members, employers and so on is that the employer and the trustees must make sure that there is in fact substantially more than 500 members? Is that a fair assessment?
>
> Mr Chapman: Yes.
>
> Mr FLETCHER: That tends to make a bit of a nonsense of the 500 member test to start with, doesn't it?
>
> Mr Chapman: I am not going to comment on your conclusion there. Whenever you have any numerical test of any sort, there is always going to be an issue about what happens when you fall below it.
>
> Mr FLETCHER: Can I put the question to you another way. Would it give APRA additional administrative flexibility if the provision were amended so it did not refer to a hard test of 500 members?
>
> Mr Chapman: Clearly the answer to that is yes. It would give us an additional measure of flexibility. I know I have harped on this quite a bit this afternoon, but the test we would have would still be the same. Whether we are triggering that test at 550 or 450, it does not really matter. It still comes down to the fact that the onus has to be put back on the trustee to satisfy us that either they are going to stay above whatever the limit or they have a plan to do something once they fall below the limit. So even if there were flexibility in the legislation that said, 'If they fall below 500, APRA has discretion on whether to close the fund or not,' we would be unlikely to keep the fund open as it went from 500 to 400 to 300 to 200 to 100. We would still be putting the onus back on the trustee to have a contingency plan in place as they get down towards 500, which is what we propose at the moment. At the moment we are proposing with the legislation as it is now that any trustee who comes to us with a MySuper product between 500 and, say, 1,000 (a) has to make an assessment that they believe they are going to be over that and (b) has a plan which obviously would ramp up in terms of intensity and detail as you get closer to the bottom about what they will do when those numbers drop. The strict answer to your question is that clearly having that would give us more administrative flexibility, but the process we would go through would still be very similar. It is just that it would be returned from a hard number to some 'reasonable' number in APRA's view, which might be 450 or whatever.[23]

The Coalition members accept the strong submissions made by so many participants in the superannuation industry that the threshold in its current form is complex, unworkable and may have a number of unintended consequences.

23 *Proof Committee Hansard*, 2 March 2012, p. 59.

We therefore recommend a simple and effective test that the threshold be amended to define a large employer as any employer that has 500 or more employees at the relevant time.

Recommendation 4:

That the large employer threshold be amended to define a large employer as any employer that has 500 or more employees at the relevant time.

The 'scale test'

The Committee also received evidence about strong concerns relating to the proposed scale test contained in the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.

The Financial Services Council expressed its concerns at the hearing as follows:

> Mr Bragg: We are comfortable with the idea that the trustee should consider scale. You recall that, during the review, the chairman of the review was very keen to canvass the issue of the Canadian Pension Fund coming to Australia and trying to buy Transurban and I think he mused at the time that it would be good if Australian pension funds or super funds could do the same thing. That is fair enough. Our view is that a scale test should not be in law. Not only is it a barrier to entry but the test, as suggested in the current drafting, is very subjective, very open. We are not sure how one would be required to perform the scale test. I am not sure what sort of data you would be asked to use. Presumably, it is a comparative test. So I am not sure how you test scale. Another issue about scale is that the ACCC has made it very clear that, in certain parts of the wealth industry, mergers are not permitted. So even if you find you do not have enough scale, I am not sure whether you would be able to get anymore scale.
>
> Senator CORMANN: Obviously, the way the scale test has currently been drafted into the legislation there is obviously the implication in there that biggest is best. Is the evidence in the marketplace that biggest is necessarily best when it comes to fees or performance?
>
> Mr Bragg: It can be.
>
> Senator CORMANN: Is it always the case?
>
> Mr Bragg: No. There are some very well-performing smaller industry and retail funds. There are some very inexpensive, from a fee perspective, large corporate retail and industry super funds. I think it is a mixed bag.
>
> Senator CORMANN: Scale should be a consideration, but should it be a test that drives decision making towards effectively aiming for bigger scale, no matter what?
>
> Mr Bragg: Not in isolation to member value.[24]

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[24] Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 2 March 2012, p. 5.

The Industry Super Network agreed that such a test would be problematic in practice and accepted that there was no automatic correlation between scale and fund returns to members:

> Senator CORMANN: There are a lot of smaller funds that argue they are cheaper and better performing than most of the other larger funds. The data seems to support that proposition. Looking at the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill, how would trustees make judgments when they have to apply the scale test the way it is currently proposed in the legislation? It is going to be rather subjective isn't it? Who is going to ultimately make a judgment as to whether they have properly discharged their duty to apply the scale test?
>
> Mr Watts: We agree that is problematic. There is not an automatic correlation to the scale with providing a financial interest to members. But there is a sufficient link between scale and returns to members for that to be appropriately considered. It is a proper duty that a fund consider whether it has sufficient scale to operate in the financial interests of its members. How it does that is going to be a problematic exercise because, no doubt, a smaller fund may be of sufficient scale to perform well.
>
> Senator CORMANN: How can a trustee satisfy themselves that they have discharged a duty? How are regulators ultimately going to make a judgment on whether or not they have?
>
> Mr Watts: Ultimately I think it is going to be on the returns they are providing to their beneficiaries.
>
> Senator CORMANN: Does it create a significant level of uncertainty though in making judgments? You are nodding.
>
> Mr Watts: Absolutely, there will be a level of uncertainty. In our opening statement we raised it as an issue that would require some guidance as to how trustees are going to meet that duty.[25]

The Corporate Super Association expressed its concerns about the subjectivity of the proposed test and the potential for ongoing disputation between APRA and various funds over the interpretation of the test:

> Senator CORMANN: Do you have any views about the scale test?
>
> Mrs Goddard: Yes. It is very difficult to know how a trustee will form a view and it is very difficult to determine whether APRA will agree with their view. So there is subjectivity in the requirement on the trustee and we submit that there will be a degree of opinion from APRA as to whether the trustee's judgment is appropriate. So we think the scale test is going to be a difficult one.[26]

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25 Mr Richard Watts, External Relations Manager & Legal Counsel, Industry Super Network, *Committee Hansard*, 2 March 2012, pp 14–15.

26 Mrs Elizabeth Goddard, Research Officer, Corporate Super Association, *Committee Hansard*, 2 March 2012, p. 29.

The Association of Superannuation Funds of Australia described the wording of the test as problematic, expressed concerns that the test may produce 'wrong results' and strongly argued that the scale test should be removed from the legislation:

> Ms Vamos: We believe the current wording of the scale test is problematic. On speaking to Treasury, we believe that guidance will be provided by APRA. In terms of being able to provide for fund members, size of portfolio and number of members are certainly two factors, but there are other factors as well. In our view, fund trustees, as part of their best interest duties, have to look each year at whether or not they are able to provide services in the best interests of their members. So our initial view is very much that the—and certainly part of the consultation process—whole scale test may produce the wrong results.
>
> Senator CORMANN: So what you are implying is that, as the current scale test definition goes, biggest is necessarily best and that is wrong. Is that what you are saying?
>
> Ms Vamos: That there were many examples where big is not necessarily better. Fund trustees and superannuation funds must be accountable on their long-term performance. They must be accountable on what they provide to members in terms of retirement outcomes. We want to ensure that this is the focus of any trustee obligations and any regulation around the superannuation industry.
>
> Senator CORMANN: You said that the way the current scale test is defined is problematic. How would it need to be changed or improved? Or do you think we should do away with the scale test all together?
>
> Ms Vamos: I think there are other ways to get the outcome that the scale test is trying to achieve. I think it could be removed. The discussion between the industry and the regulator in terms of how you measure the long-term performance of a superannuation fund in relation to the retirement outcomes they are providing their members is where the discussion should be had. The measures should be part of that. It is part of the contemplation of the governance requirements.
>
> Senator CORMANN: Sure. We would agree with all of that. There is no case, really, to introduce the scale test into the trustee obligations, is there?
>
> Ms Vamos: We think there is the case to introduce performance testing, but we are uncertain as to whether the scale test will get the right outcomes in the end.
>
> Senator CORMANN: Beyond what is already in place now and beyond what is proposed, how would you improve duties around performance testing?
>
> Ms Vamos: It is not so much how to improve duties. When you are measuring the long-term performance of a superannuation fund there are a number of measures that need to be looked at. A lot of those measures could even be what a number of analysts look at in listed organisations as well. What those factors should be and what those measures should be are currently being determined. The minimum is what is the net return to members, sustainability of a fund in the long-term, being able to continue to

> provide services, efficiency of services, quality of communication, ability to provide choice, ability to provide post-retirement, and whole-of-life investing. They are all factors that need to be taken into account.
>
> Senator CORMANN: Sure. Would your recommendation to us be that it would be preferable not to proceed with the scale test as is proposed in the legislation?
>
> Ms Vamos: Our preference would be to see the scale test removed, yes.[27]

Mercer also stated at the Committee hearings that in its opinion the scale test was problematic and should be removed from the legislation:

> Dr Knox: … There are two areas in the second bill that we would want to address—and, again, some of them were raised this morning. We think the scale tests are problematic and may not end up with the best outcomes. They are very prescriptive and they do not necessarily deliver what may be in the members' best interests.[28]
>
> Senator CORMANN: Did I hear you say that the current scale test is problematic?
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> Dr Knox: Problematic.
>
> Senator CORMANN: Do you think the scale test should be removed?
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> Dr Knox: Whilst I can understand where Jeremy Cooper was coming from in wanting larger funds and so forth, I think with the current direction of scale the scale test is not needed if the trustees have that responsibility to act in the member's best interest.
>
> Senator CORMANN: I think that that is a very good point. In a general sense the trustees have to make judgements on a whole series of things, so the question really is: why would the legislation seek to prescribe something that is quite vague really but seems to have this implication that bigger is best? Is that a fair suggestion?
>
> Dr Knox: Yes, that is fair. There is evidence around the world from studies that, certainly on the admin side, as funds get bigger, generally admin fees come down. As you get more funds you get economies of scale for administration. As funds get bigger you get slightly different investment opportunities. I think the problem with the prescriptive scale test as it is at the moment is that it cannot possibly consider every situation. There will be some small funds operating in a niche market that do a very good job. If you follow the logic that the scale tests suggest—as you have suggested: bigger is best—then we would not have credit unions; we would only have the big four banks. I am not sure that that logic holds. I think we do need that tension.
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> It is somewhat interesting that in Australia we have some very big funds—we also have the self-managed super fund sector, which is at the other

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27 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 2 March 2012, pp 32–33.

28 Dr David Knox, Senior Partner, Mercer, *Committee Hansard*, 2 March 2012, p. 38.

> end—but I think there is an opportunity, as long as that fund is operating well, is
>
> well-governed and is delivering good outcomes to members, where bigger is not always best and particular niche fund may well do well.
>
> Senator CORMANN: To go back to my original question, then, it would be better to leave these sorts of judgments to trustees on the basis of having to act in the best interests of members, rather than to introduce a scale test.
>
> Dr Knox: Because the scale test is prescriptive and cannot possibly cover in legislation—
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> Senator CORMANN: I am just trying to get you to say whether you think it would be better if we remove the scale test.
>
> Dr Knox: Let's get rid of the scale test.
>
> Senator CORMANN: Thank you. That is what I was looking for.
>
> Mr Partridge: In the end, the marketplace will weed out those funds that are not going to survive because they do not have the scale necessary in some form or other.[29]

The Australian Institute of Superannuation Trustees also called for the removal of the scale test and made the point that it did not believe there was any direct correlation between fund size and fund performance:

> Mr Haynes: It is not necessarily our preference, but we would not shed any tears over the removal of the scale test. In an earlier iteration of the legislation, there were two separate scale tests—one for investments and one for number of members. Clearly, the number of members, to our mind, has no relationship whatsoever to the ability of a fund to perform.

Coalition members of the Committee find that the submissions made by the industry about the scale test are compelling and do not consider that it is an appropriate test to apply to default superannuation arrangements.

Although there can often be benefits that accrue to consumers from investing in large pooled investments, a scale test for super funds would have a number of negative consequences including the following:

- It introduces a barrier to entry in the marketplace and therefore lessens competition;
- It is a wide, subjective test with no guidance of how to undertake it;
- How would scale measured in relation to net returns of members and what would happen where a large fund has a poor return but a small fund produces a good return? It assumes that big is best and that is not always the case;
- No official data is to be provided to make the comparison; and

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29 Dr David Knox, Senior Partner, Mercer, *Committee Hansard*, 2 March 2012, pp 42–43.

- In many cases, mergers are not possible due to taxation matters, Australian Competition and Consumer Commission resolutions etc.

The Coalition understands the aspiration that big funds are good for Australia and that there can be significant benefits in achieving greater benefits from scale. However, we do not agree with legislatively imposing a duty upon trustees to have regard to the inherently vague and imprecise notion of 'scale'. We don't believe that the scale test would be workable in the context of a properly functioning default superannuation system.

Recommendation 5:

That the 'scale test' be removed from the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.*

Intra Fund Advice

Intra fund advice is the provision of financial advice by superannuation funds to their members.

Currently, the term 'intra fund advice' and the advice provided by various superannuation funds ranges widely from very general advice, product specific advice, advice on retirement options or even more specific or individualised 'holistic' financial advice.

Today intra fund advice only exists by an ASIC Class Order exemption.

The Committee received evidence from a number of participants expressing strong concerns about how intra fund advice would interact with the MySuper legislation, particularly given that it is only briefly referred to in the explanatory memorandum of the Bill currently before the Committee.

These concerns included a risk that such intra fund advice would lack transparency, lead to some super fund members cross-subsidising others through the fees they pay and the risk of secret commissions.

The Financial Services Council was concerned about the risk that the legislation would allow for a cross subsidy from some members of a superannuation fund to other members who choose to access such intra fund advice:

> Mr Bragg: We would be uncomfortable if in the third tranche of this legislation, which is going to define the parameters of intrafund advice, which can be cross-subsidised amongst the membership of a fund, it includes the capacity for a fund to issue complex personal financial advice and then cross subsidise that amongst the membership. Our view would be that the existing parameters, as we discussed with the Chairman, should be maintained but not expanded.[30]

[30] Mr Andrew Bragg, FSC, *Proof Committee Hansard*, 2 March 2012, p. 2.

The Corporate Superannuation Specialist Alliance expressed its concerns to the Committee:

> We feel strongly that intrafund advice should be restricted to general advice. It should not include personal advice. Personal advice should not be cross-subsidised by members of funds and should be paid for individually. It is not practically possible to provide advice on complex matters such as transition to retirement without understanding the client's financial position. It is therefore necessary to follow the correct advice process of knowing your client. Allowing personal advice to be provided under the guise of intrafund advice will result in a reduction of consumer protection. This seems to completely contradict the desired outcomes of FoFA. We would recommend that where intrafund advice is provided, an explicit fee is charged rather than hiding the fee within the administration fee. This will make sure fund members are aware of what they are paying for and are therefore entitled to receive intrafund advice. If this fee is explicit and is negotiable it could be used to remunerate advice providers for the provision of general advice and education. Paragraph 4.12 of the MySuper explanatory memorandum further limits educational opportunities, as it suggests education must be made available to every member of a MySuper fund and cannot be, for example, workplace specific. This suggests that employees of any number of different employers must all be invited to each educational seminar regardless of their location in Australian and regardless of the fact that they may be industry competitors. This will make the provision of education in the workplace basically impossible. It will only serve to reduce education and therefore financial literacy. We suggest this is removed as it seems illogical.[31]

It added:

> The only way that we would be rewarded for adding services into the workplace would be through this intrafund fee, of which you are going to have no control over its value or level. We are hitting a MySuper world that sounds as though it is going to compete on cost. As soon as you start competing on cost, it is very tempting to cut back on various fees and minimise the advice-service component. That then means that we may not be renumerated sufficiently to be able to deliver the services that we do today—and we are not going to run them at a loss; we would be forced to withdraw the services. I cannot see how that is going to benefit when we are the one group out there that are being proactive rather than reactive in providing services to the workplace.[32]
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> ...
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> Frankly, we believe in transparency. We think that the intrafund fee is effectively going back to the 1980s where fees were all bundled together

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31 Mr Gareth Hall, CSSA, Proof Committee Hansard, 2 March 2012, p. 18.

32 Mr Douglas Latto, CSSA, *Proof Committee Hansard*, 2 March 2012, p. 23.

> and it was a secret commission. We do not understand why that is being proposed.[33]

The Association of Superannuation Funds of Australia (ASFA) told the committee that intra fund advice should be limited:

> Senator CORMANN: What is your view on intrafund advice? Do you think there should be any limitations placed on what intrafund advice can be provided?
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> Ms Vamos: Our view is that intrafund advice should be limited. It is at the very low end of the scale of personal advice. It is, if you like, an extension of general advice. Our position is very much that it should be principles based. We do not support a broad, nine-category approach as currently is being supported. Our view is that, as it does come out of administration fees, it should be a service that a member of a superannuation fund would believe they would be entitled to because they have that money in the fund. So if they have a question about their interest in the fund, the account balance of their fund, and simple scenarios that can be answered through the process of calculations and calculators, then we believe it should be part of the intrafund offering.
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> Senator CORMANN: So you are in favour of the proposition that the cost of providing intrafund advice is bundled into the overall administration fee—that is, it is not transparent—and that it can be charged across the whole membership, irrespective of whether individual members access advice?
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> Ms Vamos: Our view is that all fees should be transparent. The administration—
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> Senator CORMANN: So you are not in favour of bundling it into the admin fee?
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> Ms Vamos: No, we are definitely in favour of it being part of the administration fee. We would support the disclosure of, if you like, where the administration fee pie is, in terms of funds. We have done a lot of work in this area with Rice Warner. As to the operational costs and the operational fees charged, only a small amount of that overall fee actually applies to call centres and intrafund advice. We do support the transparency where administration fees are applied, as well as where investment fees are applied.
>
> Senator CORMANN: When people put evidence to us which says that intrafund advice, the way it is proposed, is completely opposite and counter the spirit by FoFA, that it is distorted, conflicted, with hidden fees and hidden payments, with no capacity to opt out, do you not agree with that characterisation?

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33 Mr Gareth Hall, CSSA, Proof Committee Hansard, 2 March 2012, p. 23.

> Ms Vamos: We do not agree. We believe that, when you look at the definitions of 'personal advice' and 'general advice', the definition of 'personal advice' is so broad that it captures the type of simple scenario advice that a member of a superannuation fund believes they are entitled to because they are a member of that fund.
>
> Senator CORMANN: But why should any member of a fund pay for the personal advice of other members of the fund that they do not access themselves?
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> Ms Vamos: The same argument can be applied in terms of website access, general advice access, call centre access. The majority advice provided by superannuation funds is general advice and factual information. Indeed, as members—
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> Senator CORMANN: I am not talking about the general advice. I am talking about the personal advice.
>
> Ms Vamos: Again, when you look at the concept of intrafund advice, and you look at general advice, we think the better view is that infrafund advice is general advice that has been extended. Our view is that you have to limit personal advice and frame it more in terms of holistic financial planning. But intrafund advice is very much about interest in the fund. Really, it is definitions of advice that have raised this issue.[34]

Mercer supported the notion that some personal advice should be permitted in intra fund advice but highlighted that it was a real challenge to draw the line at how much advice should be permitted:

> Senator CORMANN: What is your view about intra-fund advice? Should there be limitations on it, or do you think that personal advice should be freely provided under the guise of intra-fund advice?
>
> Dr Knox: I think our view is that we should be able to go beyond general advice, but some personal advice is very personal and takes a lot of effort, and that should be paid for by the individual. The question is: where on the continuum between general advice and personal advice do you draw the line?
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> Senator CORMANN: But why would it be appropriate for the collective membership to pay for any individual personal advice at all? The objectives of FoFA are transparency around fees and removing conflicts. If you look at what we have been told, here you have hidden fees, a lack of transparency around fees and potential conflicts and you are charging the whole membership irrespective of whether members take advantage of the advice. They would seem to be in conflict with each other.
>
> Dr Knox: There are currently, I think, four elements of intra-fund advice that are permitted to be offered by super funds, with examples such as insurance and investment choices and learning about different types of contributions. Our concern is that, if you make every question, apart from general knowledge, if you like, or general information, subject to a fee,

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34 ASFA, *Proof Committee Hansard*, 2 March 2012, p. 32.

> many members actually will not ask the question. They will ring up the call centre and ask, 'Do you think I should make salary sacrifice or after-tax contributions,' and the operator at the other end will say, 'That's going to cost you $50 to $100,' to which the member will say, 'I won't pay.' We have a level of intra-fund advice at the moment and we would not reduce it.[35]

Treasury appeared to be uncertain about the way that intra-fund advice will be treated under the MySuper reforms. The following exchange reflects both uncertainty and confusion:

> Mr FLETCHER: Do you envisage that, under the intra-fund advice provisions, it will be possible to offer personal advice as opposed to general advice and have that considered to be intra-fund advice?
>
> Ms Vroombout: Minister Shorten put out a press release on 8 December which outlined the broad parameters of the definition of intra-fund advice. Yes, that contemplated that it would be both general and personal advice.
>
> Mr FLETCHER: What kind of personal advice? How detailed might it be? Does Treasury have a view on that?
>
> Ms Vroombout: We have not got to the detailed drafting yet. The press release indicates that it would have to be advice that was consistent with the sole-purpose test in the superannuant industry (supervision) legislation. Then it notes that, notwithstanding that the advice met that test, there would be certain sorts of advice that wouldbe excluded from the definition of intra-fund advice. More complex sorts of advice would be excluded from the definition. I do not have any more detail than was outlined in the press release of 8 December.
>
> Mr FLETCHER: Does that mean we can think of three classes of advice: general, personal not so complex and personal more complex—or personal below a complexity threshold and personal above a complexity threshold, where personal below a complexity threshold will be permitted as intra-fund advice?
>
> Ms Vroombout: That is correct.
>
> Mr FLETCHER: Are you able to enlighten us as to what the complexity threshold will be?
>
> Ms Vroombout: All I can say is that the press release of 8 December outlined, I think it was, four things that would be regarded as sufficiently complex not to form part of intra-fund advice.
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> Mr FLETCHER: On the issue of the allocation of the cost of intra-fund advice, it is the case that, essentially, a member who chooses not to take intra-fund advice is cross-subsidising those who do.

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35 Dr David Knox, Proof Committee Hansard, 2 March 2012, p.

> Ms Vroombout: The nature of intra-fund advice and, I guess, the purpose of its definition is that it is the sort of advice that can be collectively charged to the membership.[36]

Coalition members of the Committee consider that if intra fund advice is to continue to be provided in the future it should be provided under the same legislative and regulatory framework as all other financial advice.

Despite intra fund advice clearly being a type of financial advice there is no definition or scope of such advice provided in either the MySuper legislation or the government's Future of Financial Advice (FOFA) legislation.

There is no limitation placed on what may constitute intra fund advice and there are no provisions determining who should pay for such advice in any of the proposed legislation.

Coalition members of the Committee consider that the complete lack of consideration, definition or restriction of intra fund advice within both the MySuper and the FOFA legislation is a serious omission on the part of the government that exposes consumers to severe risks.

This is particularly the case because intra fund advice would not be subject to the best interests duty being introduced by the FOFA legislation and because many industry super funds currently fund such intra fund advice by levying fees for this advice on all fund members. This would not be permitted if FOFA applied, as FOFA essentially bans the provision of advice in circumstances where the cost of providing the advice is not met by a direct and transparent payment from the recipient of the advice. The policy rationale is that in these circumstances the provider of advice will be receiving its economic return from sources other than payment from the recipient (for example, an undisclosed commission from a product provider) and hence the provider of the advice will be motivated by factors which are not known to the recipient. Unfortunately, that principle appears to have been overlooked by the government when it comes to intra fund advice. It is hard to see any clear policy rationale for applying the principle in one context but ignoring it in another.

Given the reliance of many industry super funds on the provision of intra fund advice for marketing advantage and the attraction of new members, we are concerned that the government has avoided defining and limiting the scope of intra fund advice because it has bowed to the interests of the union-dominated industry super funds.

Coalition Committee members strongly recommend that intra fund advice should be defined in both the MySuper and the FOFA legislation, that there be express limitations included in the legislation to ensure that such advice is general in nature only (similar to the provisions relating to basic banking products) and that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty and be paid for by the person accessing this advice without any cross-subsidy from other fund members.

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36 Treasury, Proof Committee Hansard, 2 March 2012, pp. 62–63.

Recommendation 6

That the MySuper legislation be amended to:

1. **Provide a comprehensive definition of the term 'intra fund advice';**
2. **Ensure that 'intra fund advice' is general in nature only;**
3. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty contained in the proposed FOFA legislation;**
4. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be paid for by the person accessing this advice without any cross-subsidy from other fund members; and**
5. **Repeal the existing ASIC Class Order exemption as it would be superfluous once intra-advice is properly defined in legislation.**

Senator Sue Boyce **Senator Mathias Cormann**

Paul Fletcher MP **Tony Smith MP**