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9 February 2018

## **Consultation: Design & Distribution Obligations and Product Intervention Power – Draft Legislation**

Dear Sir/Madam

Thank you for the opportunity to comment on this draft legislation.

We will confine our comments to the issue of the application of the proposed Design and Distribution Obligations (DDO) to superannuation products.

We note that the draft material proposes that the DDO should not apply to MySuper products but should apply to all other superannuation products.

We submit that the exemption should apply to all superannuation products, for many reasons including the following:

- Superannuation products are already highly regulated and trustees have fiduciary obligations to their members (including the 'best interests' duty and other covenants under s52 of SIS)
- APRA intends to lift the bar even higher and is [consulting](#) on measures that include requiring trustees to make an annual assessment of whether all their products are delivering quality outcomes to members
- Many large super funds are designed to be suitable products for any investor and the concept of a target market is often not applicable
- Investment products offered via superannuation are subject to many constraints

- Nor can super funds offer exotic insurance products; they are legally restricted to offering cover for death, total & permanent disability and total & temporary disability; further, in most cases the insurance is obtained as part of the default MySuper product arrangements
- Superannuation funds generally offer the same insurance arrangements to non-MySuper members as those that apply to MySuper members
- The proposed exclusion of MySuper products means that the majority of new members for many of the largest super funds would not be subject to the DDO
- Even so there would be substantial costs associated with the implementation and ongoing administration of the DDO for super funds, which would ultimately be borne by members
- In our view the costs would be likely to far outweigh the benefits of applying the DDO to superannuation, which appear to be marginal at best.

The imposition on superannuation funds of a further layer of costly regulation, which does not have any clear benefits for fund members, would run counter to Government initiatives such as the reduction of red tape and the current Productivity Commission study aimed at identifying areas for improvement in the efficiency of the superannuation system.

We have set out in the Appendix some further comments on the DDO proposals.

## **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, 224,000 members and more than \$21 billion in assets under management.

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

Yours sincerely



**Dr David Knox**  
**Senior Partner**

## Appendix

### 1. What is a 'product' for the purposes of the DDO?

As proposed, the new design and distribution obligation (DDO) regime generally applies to a financial product if it requires disclosure in the form of a product disclosure statement (PDS). It appears to apply when the 'product' is issued. MySuper products are excluded.

Let us consider how this would apply to products offered by a super fund. For many super funds:

- there is a single PDS for a new accumulation phase member interest
- the PDS covers both MySuper and Choice investment options, with MySuper as the default
- depending on the fund's rules, the interest will generally be issued when the first contribution is received or when the member's employment commenced
- the PDS covers both MySuper and optional insurance, with MySuper as the default

In our view the 'product' being issued in accordance with the PDS is a new accumulation phase interest in the fund. Therefore as drafted it would appear the DDO will require the trustee to determine a single Target Market Determination (TMD) for accumulation interests. If this is so, how does the MySuper exclusion work?

Or is it intended that each investment option available to the member be treated as a separate 'product' for the purposes of the DDO? In this case is the DDO intended to require the trustee to make a TMD for every investment option except MySuper? In our view this would add little to the information about investment options that is already provided by super funds.

Let us now consider insurance provided by superannuation funds. Is it intended that any insurance available to the member be treated as a separate 'product' for the purposes of the DDO, even though it is part of the same interest as the investment component? If yes, will the DDO require the trustee to determine a TMD for every insurance option? Or for every insurance option except the default MySuper insurance? Again, in our view this would add little to the information about insurance options that is already provided by super funds.

Moreover it appears that the obligation to ensure that products are issued in line with the TMD only applies at the point of issue. It does not apply if subsequent contributions are made or if a member later switches to a new investment option, as no new interest is issued at this point, nor is a new PDS required. We agree it would be unworkable to apply the DDO in these circumstances, but make the point to illustrate that the application of the DDO requirements to superannuation products (excluding MySuper) would add little value, at least for the vast majority of fund members.

## **2. Obligation not to distribute where target market determination may not be appropriate**

For the purposes of the above obligation, a target market determination may not be appropriate if the issuer knows, or ought reasonably to know, that a review trigger has occurred, or another event or circumstance has occurred, that would reasonably suggest that the determination is no longer appropriate. In these circumstances:

- Issuers are prohibited from dealing in, or providing financial product advice in relation to, the product until they have reviewed the determination and, if necessary, made a new determination.
- Issuers must, as soon as practicable, take reasonable steps to ensure regulated persons are directed not to distribute the product until they are notified that the review is complete, and where applicable, are notified of the new determination.
- A regulated person must comply with any such direction.

In our view these proposed rules are unreasonably tight. To illustrate our concerns by way of example, let us look back to the 2016 Budget announcement of the \$1.6m cap on transfers to pension accounts and assume the DDO applied then:

- Prior to the announcement, there would have been no reason for a TMD for a pension product to have made any reference to a limit on the amount that could be transferred in.
- At some point after that time, would Treasury expect that a pension product TMD would include reference to one of the target market determinants being, for example, that the retiree has not already fully utilised their transfer balance cap?
- At what point would Treasury expect this event to trigger a TMD review – immediately after the Budget) announcement (7.30 pm 3 May 2016) or when the relevant legislation was passed (November 2016) or when the legislation took effect (1 July 2017, though some transitional rules started applying earlier)?

- Let us assume that this was a TMD review trigger on 3 May 2016 (Budget night). Under the proposed rules as we understand them:
  - The trustee would have to reject any pension applications that had not been processed at that point until after the TMD was revised and the pension application was confirmed to be in accordance with the new TMD and re-submitted
  - During this time (until after the revised TMD was promulgated) neither the fund's financial advisers nor independent advisers (after they are advised by the fund of the TMD review) would be permitted to provide any advice regarding the pension product - presumably including about the transfer balance cap and whether or not the pensioner might be affected by it (the strong likelihood being 'no').
  - In our view this outcome would be unreasonable and unworkable

We suggest the DDO regime should be flexible enough to allow advice and issue of products to continue to customers who are clearly unaffected by the matter giving rise to the TMD review.

(Also note that we do not believe that an unlegislated Budget announcement with a future effective date should invalidate a TMD – we have simply used this example to illustrate what we regard as inappropriate outcomes of the proposed DDO provisions.)

### **3. Obligation to collect distribution information**

The fourth distribution obligation requires a distributor to collect, and keep records of, distribution information. In particular, the obligation requires a responsible person who deals in, or provides financial advice in relation to, a financial product (distributor) to collect and keep the following distribution information:

- the number, and dollar value, of issues of the product made by the distributor;
- the proportion of those issues that were consistent with the product's target market determination;
- the ways in which the distributor's dealings in, or provision of advice in relation to, the product occurred; and
- the steps the distributor took to ensure compliance with the product's target market determination.

As for Issue 1 above, we are unsure how this is intended to apply in practice for a super fund, particularly in regard to accumulation interests. For many funds, the majority of new members will be joining as default employer-sponsored members. In this event we expect the distributor is the trustee (also see issue 4) – is this correct? Further, in this scenario:

- As noted for Issue 1 above, in our view the ‘product’ being issued in accordance with the PDS is a new accumulation phase interest in the fund
- The interest will be issued when the first contribution is received (say \$200) or when the member’s employment commenced (no consideration at that point)
- Hence will the requirement to record ‘the number and dollar value of issues of the product made by the distributor’ require the trustee to record one new member with a dollar value of \$200 (or nil where applicable) against the investment option the member selects?
- If the member does not select an investment option and hence is defaulted into MySuper, is no record required?

Questions also arise relating to the insurance distribution record required:

- If the member does not select an insurance option and hence is defaulted into the MySuper standard insurance, is any record required?
- If the member does select an insurance option, is any record required?
- If a record is required, what is the dollar value of the issue? We note that insurance premiums are generally deducted from the member’s account, usually on a monthly basis, hence there is no additional consideration paid for insurance when an interest (i.e. an accumulation phase interest including investment and insurance entitlements) is issued.

We trust that these questions adequately demonstrate that the distribution information required is both inappropriate and unclear as currently drafted. It also raises the obvious question about the cost-benefit value of requiring super funds to keep records of this information.

Is it intended that ASIC be able to exempt classes of entities from these provisions or be able to modify the provisions so that they provide relevant and useful data according to the circumstances?

If not, we request that these provisions be removed from the proposed Bill and instead be dealt with by regulation.

#### **4. Super fund employer-sponsors should not be caught under the DDO**

SG legislation requires most employers to contribute to a default fund where the employee does not nominate another fund. The employer may select different default funds for different classes of employees, in accordance with an award or industrial agreement where applicable. The default fund must offer a MySuper product, which is where the employer's SG contributions for the employee will be paid unless they elect otherwise.

Whilst MySuper products are proposed to be excluded from the DDO, it is not clear to us that employers are not caught as 'distributors' of super products under the draft DDO legislation.

We submit that the legislation should ensure that employers who are merely providing PDS's and/or other superannuation product information to their employees in connection with their obligation to provide superannuation for those employees are not caught as 'distributors' of super products and hence become subject to the DDO.

#### **5. Exemption for superannuation products**

Please refer to the body of the letter in relation to our view that the proposed MySuper product exemption should be extended to all superannuation products.

If this is not acceptable, then we request that:

- Super funds that provide a MySuper product (which will apply unless the member elects otherwise) should be exempted; and
- Insurance provided via superannuation should be excluded, on the basis that:
  - super funds are legally restricted to offering insurance products that cover death, total & permanent disability and total & temporary disability;
  - in most cases insurance is obtained as part of the default MySuper product arrangements, which we understand are intended to be excluded from the DDO, and
  - that funds generally offer the same insurance arrangements to non-MySuper members as those that apply to MySuper members; it would not be logical for an insurance product to be exempt from the DDO when offered to a MySuper member but to be subject to the DDO when offered to a non-MySuper member.



- We understand that ASIC will also have the power to exempt a product, or a class of products, on a case-by-case basis. We request that ASIC's exemption powers be sufficiently flexible that it can apply an exemption in circumstances such as a fund merger where some or all the members of one fund are transferred (using successor fund provisions) into a receiving fund and given a PDS for the receiving fund. Applying the DDO obligations in these circumstances seems pointless given all the existing obligations on both trustees.