

CORPORATE SUPER ASSOCIATION

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Mr Paul Costello
Chairman
Stronger Super Peak Consultative Group
MySuper Working Group
C/o The Treasury
Langton Crescent
PARKES ACT 2600

By e-mail to StrongerSuperMySuper@treasury.gov.au

Dear Mr Costello

MYSUPER: ISSUES ARISING FOR DEFINED BENEFIT SUPERANNUATION FUNDS

We refer to MySuper Working Group discussions attended by our Mr Mark Cerché, and to the Treasury Consultation Papers including that entitled “Defined Benefit Funds” issued between March and May 2011.

We wish to raise issues regarding the particular implications for defined benefit funds of the MySuper proposals and related Cooper Report proposals. We consider that it would avoid future complexity if these issues received early consideration during the design and drafting processes.

The issues of concern are:

- the implications for the SG status under MySuper of a defined benefit plan where the notional employer contribution rate for the plan is less than 12%;
- the implications for the SG status under MySuper of a defined benefit plan where the isolation of the defined benefit plan is not straightforward because of complex benefit design;
- how the process of introduction of operational risk reserves would work for defined benefit funds;
- the introduction of automatic transfer of balances and the implications for members of defined benefit funds whose balances would be transferred.

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Background: the Corporate Super Association

Established in 1997, the Association is the representative body for large corporate superannuation funds and their employer-sponsors. The Association represents a total of 24 funds with some 317,000 individual members. Our funds control member assets with a current value of \$30 billion. We represent about 35% of corporate fund assets. In general, our member funds are sponsored by corporate employer sponsors with membership restricted to employees from the same holding company group, but we also include, in our membership, two public sector funds and two multi-employer funds with similar employer involvement and focus.

Many of the funds we represent include defined benefit divisions. Many of the defined benefit divisions are closed to new members, but there are also several that remain open. Many of the members are entitled to a combination of defined and accumulation benefits.

The situation of defined benefit funds under increased SG minimum requirements

We are concerned about the implications for eligibility of defined benefit plans to receive minimum SG support for members, where SG minimum support increases and the fund's structure changes.

Implications for eligibility to receive minimum SG support

Under current requirements for minimum Superannuation Guarantee support, existing defined benefit funds obtain actuarial certification that the support provided is at least sufficient to meet minimum support requirements under the Superannuation Guarantee Administration Act 1992.

However, we understand that there are some funds where the level of support provided may not currently be sufficient to meet the proposed 12% minimum support requirement.

Most such funds would have the facility under their governing rules to increase benefits. We are concerned about how such funds will be dealt with under the proposed arrangements, which would in general deem defined benefit plans to meet the requirements (generally met only by MySuper products) for recipients of employer minimum SG support.

In particular, we are concerned about the situation where, instead of increasing defined benefits, the difference between the notional employer contribution rate and the required 12% is made good by a method other than by simply increasing defined benefits, for example by contributing further defined contributions. In this situation, the defined benefit plan does not on its own appear to meet the proposed requirement to be deemed to be a MySuper product. We would like to discuss this issue with a view to constructive resolution.

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Isolation of defined benefit plans (for SG compliance)

A related issue to the above is the difficulty in isolating defined benefit plans of defined benefit funds, for the purposes of deemed MySuper status for SG purposes. Many defined benefit funds offer a combination of defined benefit and accumulation benefits. More complex arrangements are common where, for example,

- a person accesses full defined benefit membership only after a period of service, and if he or she leaves prior, receives an accumulation benefit;
- a benefit is defined, in certain circumstances, in terms of the higher of an accumulation amount or a defined amount.

To clarify, the form of benefits in a defined benefit funds will in many cases differ depending on the situation of the particular member on exiting the fund, or otherwise drawing benefits. For example, a member may be entitled, on resignation or transfer out, to an accumulation benefit (as the entirety or part of his or her benefit), or to the greater of an accumulation amount or a defined benefit; but on retirement may have access to a benefit that consists entirely of a defined benefit. In relation to the fund, the member's interest partakes of both defined benefit and accumulation characters and only events will determine which it is. We believe that it would be helpful to make the rules for MySuper products sufficiently flexible to take these situations into account. It may be helpful to define all such members as defined benefit members and to have these members' interests subject to rules applicable to defined benefit members as a whole.

The above situations are widespread, and we would be pleased to discuss at an early stage.

The proposed establishment of operational risk reserves

We have a number of concerns regarding the potential approach to the establishment of operational risk reserves. For defined contribution funds, we have major concerns about the equity issues involved in the setting aside of a bloc of current members' funds, the period of time over which this could be done and the period of time over which any withdrawal from such a reserve could be made good. We are concerned that policy in this area should be constructed with the clear view that superannuation funds differ in many important respects from deposit taking institutions such as banks. Balance sheet leverage, and the risks associated with extending consumer credit, are not applicable concerns. Hence the tiers of capital associated with banks and ADIs are simply not required. The appropriate focus is on the purpose of the proposed reserve, which is to guard against the operational risks as discussed in APRA's Draft Prudential Practice Guide SPG 235. These typically include administration errors and unit pricing errors, and are not concerned with risks such as credit risk and the market risks faced by banks. We are concerned to avoid a timing approach to the establishment and maintenance of the proposed reserves that might otherwise be coloured by the precedents already existing in the other APRA regulated institutions, which as indicated are subject to risks in which superannuation funds do not participate.

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Issues specific to risk reserves of defined benefit plans

For defined benefit pools, the issues involved in the establishment and maintenance of the reserve are quite different from those applicable to defined contribution funds. The establishment of an operational risk reserve in a defined benefit plan would have a direct impact not on the current members but on the obligations of the employer sponsor. Questions which will need to be addressed revolve around the method of establishment of the reserve. Will there be an actual amount set aside on the balance sheet, or will there be a process for agreeing with APRA an appropriate target vested benefit index (increased by a reserve percentage)?

A common issue with all funds is the fate of the reserve on any merger or winding up of the fund, and this again can give rise to inequity between current and past members and other parties.

The above issues need to be addressed and discussed with the funds concerned, preferably before policy is promulgated.

Proposed automatic consolidation of balances

We realise that there has long been concern about multiple individual balances and that various policy approaches are being considered to mitigate this problem. We have heard that one approach under consideration would involve the effective amalgamation of TFN declaration form and Choice of Fund form, with a tick required for agreement to join the employer's default fund (or alternatively, provision of the name of the preferred fund). Selection of the employer's default fund could then imply automatic consolidation of existing balances.

If such an approach is being considered, we would have serious reservations including the following.

Lack of time and opportunity for employee to make a considered decision

We would be concerned about

- the fusion of the tax file number declaration, which is the provision to the employer of factual information which does not require choice or consideration, with
- the important investment and insurance issues associated with choosing or defaulting into a fund (defaulting arguably in itself involves a choice).

We believe that such a decision should not be made within the time frame required for the provision of a TFN to a new employer, but that sufficient time should be permitted for review and discussion of the person's fund options, and, where required, the taking of advice.

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Automatic consolidation of balances

We would be concerned about the automatic consolidation of all other balances into the chosen or default fund because:

1. There could be loss of insurance cover and particularly of insurance cover under automatic acceptance.
2. Certain employees may have more than one job and may not want the contributions associated with one employment, which is not associated with an award, to go into the award fund required under the other employment.
3. Certain employees may wish to maintain more than one fund for risk control or other reasons.
4. There may be very immediate financial implications associated with the automatic consolidation of a balance. In the defined benefit context, where the fund may be an untaxed fund, this could include the immediate requirement to pay a bill of 15% relating to the untaxed balance.

We believe that there is a case for automatic consolidation of minor balances, but would propose that a dollar limit be set on the amounts to which such treatment could be extended. This may not be the full solution where a person wishes to maintain two funds (as in the example (2) of two employments indicated above), and has only recently joined the second fund, hence has not yet accumulated a balance over any minor limit. We would appreciate the opportunity to discuss these issues, prior to the making of final policy decisions.

We would appreciate if we could be consulted on these important issues prior to the time when you make formal recommendations to the Minister.

We look forward to further discussion.

Yours sincerely



Bruce McBain
Chief Executive Officer
Corporate Superannuation Association