

# MySuper consultation working group

## Issues paper on Defining MySuper

March 2011

### PROPOSED REFORM

As part of the Stronger Super package of reforms, the Government announced that it will introduce a new low cost and simple superannuation product called MySuper that will replace the existing default superannuation investment options available to members, after an appropriate transitional period (recommendation 1.2). MySuper products will be able to be offered within regulated superannuation funds from 1 July 2013 (recommendation 1.1).

The key objective of MySuper is to deliver a better deal for all default fund members, including through improving the simplicity, transparency and comparability of superannuation products.

MySuper will provide members with simple and cost effective default superannuation. Standardised product features will enable members and employers to compare products more easily on the basis of a few key features – cost, investment performance, and the level of insurance coverage. To facilitate member and employer comparison of MySuper products, the Australian Prudential Regulation Authority (APRA) will be required to collect and publish performance data (recommendation 10.3).

Trustees wanting to offer a MySuper product will be required to hold a specific MySuper licence issued by APRA (recommendation 1.7(a)). The exact nature of the licensing is considered later in this paper (see Issue 1). The ongoing costs of regulating MySuper products will be met through the supervisory levy charged on all APRA-regulated superannuation funds.

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) will be amended to give APRA a range of new powers specific to the implementation and ongoing supervision of MySuper products. This will include, for example, powers to issue a direction to a trustee to comply with MySuper licence conditions; to vary licence conditions; to accept an enforceable undertaking where MySuper licence conditions are breached; and to revoke a MySuper licence condition. The SIS Act will be amended to enable APRA to issue prudential standards in relation to superannuation, and this will enhance APRA's ability to flexibly supervise MySuper products (recommendation 10.2).

MySuper is designed to sit within existing structures in order to minimise costs and disruption for stakeholders. Trustees will only be able to offer one MySuper product within a regulated superannuation fund to achieve the Government's key objectives of simplicity, transparency and comparability.

It is proposed that a MySuper product be defined as:

- being whole or part of an APRA-regulated superannuation fund (other than a small APRA-regulated superannuation fund);
- having separately identifiable assets and separately identifiable members;
- resulting in entitlements for each member that are limited to those features of the MySuper product; and
- being issued by a registrable superannuation entity (RSE) licensee who is authorised to offer a MySuper product.

The SIS Act and other relevant legislation would also need to be amended to ensure that the MySuper products have the following minimum fundamental features:

- a single diversified investment strategy (recommendations 1.6(a) and 1.7(c));
- restrictions on unnecessary or excessive fees, including<sup>1</sup>:
  - banning commissions in relation to retail investment products and group insurance<sup>2</sup>;
  - new standards for the payment of performance fees to fund managers;
  - a ban on entry fees charged to new members;
  - exit fees limited to cost recovery; and
  - switching fees not payable to the trustee in their personal capacity or any other person.
- standardised reporting requirements written in plain English<sup>3</sup>;
- a requirement to accept all types of contributions (recommendation 1.7(b)); and
- life and total and permanent disability (TPD) insurance (where available, depending on occupational and demographic factors) offered on an opt-out basis<sup>4</sup>.

Members of MySuper products will only be able to be moved out of a MySuper product involuntarily if they are transferred to an Eligible Rollover Fund (ERF), to another MySuper product (for example, where a member is moved to another MySuper product as part of a merger), or as required under legislation (recommendation 1.16).

Further, while MySuper products may offer retirement income stream products that are in the best financial interests of members, these features will not be mandatory, at least in the initial implementation phase of MySuper<sup>5</sup>. As part of the consultation, we will consider whether intra-fund advice should also be a mandatory feature of MySuper in its initial phase.

The SIS Act will need to be amended to ensure that, in addition to the existing obligations as an RSE licensee, trustees of MySuper products must meet the following specific obligations:

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<sup>1</sup> See separate issues paper on fees and costs

<sup>2</sup> See separate issues paper on financial advice

<sup>3</sup> See separate issues paper on data and disclosure

<sup>4</sup> See separate issues paper on insurance

<sup>5</sup> See separate issues paper on retirement income products

- to formulate and give effect to a single diversified investment strategy, aimed at optimising MySuper members' best financial interests as reflected in long-term net returns (recommendations 1.6(a) and 1.7(c));
- to ensure a fair and reasonable allocation of costs between MySuper and other products (recommendation 1.7(d)); and
- to actively consider and declare on an annual basis whether the MySuper product has sufficient scale in both assets and membership to provide optimal benefits to members (recommendation 1.6(b)).

Once granted the power to do so, APRA will issue prudential standards which will expand on the trustee duties and MySuper features that are established by the SIS Act and regulations. It is not yet possible to specify the content of these standards in detail as they will depend on the final changes to the SIS Act, as well as industry feedback.

At this stage, the intention is to have broad parameters set out in the legislation, with implementation requirements set out in the standards. APRA will release draft prudential standards for consultation which articulate what trustees must do to meet their statutory duties and further define the features of MySuper to support the high-level requirements in the legislation. This consultation will be undertaken separately.

To facilitate member and employer comparison of products, APRA will be required to collect and publish data on the performance of MySuper products, including in relation to a regulated superannuation fund's underlying investments.

Defined benefit funds will automatically qualify as a MySuper product and be able to continue to receive contributions in respect of members who do not make a choice of fund (recommendation 6.13). Hybrid funds will automatically qualify only in respect of their defined benefit members. In respect of members who have an accumulation benefit, the hybrid fund will be required to meet the MySuper criteria to continue to be a default for those members (recommendations 6.14 and 6.15).

## ISSUES

### Issue 1 – Licensing of MySuper providers

The Government has stated that superannuation fund trustees wanting to offer a MySuper product will be required to be licensed by APRA (recommendation 1.7(a)).

The preferred approach is to apply a licence condition on existing RSE licences via section 29EA of the SIS Act indicating that the holder is permitted to offer MySuper products. It is envisaged that this licence condition would require the trustee to comply with MySuper requirements set out in the SIS Act, regulations, any other licence conditions and prudential standards, as well as relevant provisions of the *Financial Sector (Collection of Data) Act 2001*, the *Corporations Act 2001* and *Corporations Regulations 2001*. It is also envisaged that the SIS Act would be amended to include a prohibition to prevent the offering of a MySuper product unless the RSE licensee has this additional condition on their licence.

This model would maintain the existing one RSE licence per trustee model without having to create additional classes of licence.

Other potential options for implementing this recommendation are:

- a) leave existing RSE licences unchanged and require trustees wishing to offer MySuper to obtain an additional licence conferring that right; or
- b) create a separate licence class entitling the holder to offer both a MySuper product and choice products, with existing RSE licences changed to only permit the offer of choice products.

The first of these options would result in a departure from the one licence per trustee model, with RSE licensees holding both a licence to offer choice products as well as the licence to offer MySuper products. The second option would result in six licence classes.

As noted earlier, consideration will need to be given to whether a fee would be payable to cover the costs of APRA's assessment of MySuper licence applications.

**Question 1.1** What are the advantages and disadvantages of the canvassed licensing options?

## Issue 2 – Multiple pricing points for different employers

A requirement for a single pricing point for all members of the MySuper product across all participating employers is consistent with the proposal to offer only one MySuper product per regulated superannuation fund. This means that trustees would not be able to impose fees on members that differ on the basis of their employer, but would need to set fees in the best interests of all the default members of the fund.

It has been argued that members of large employers benefit from negotiated discounts, as large employers guarantee considerable additional membership for the fund. However, individual members and employees of small businesses are not benefiting from the same economies of scale. In the current environment, where many large employers provide contributions data in a form that permits automated processing while others persist with cheques and hard copy data, it is conceivable that the administrative cost differentials are of a magnitude that warrants different price points. However, this will be significantly reduced once the SuperStream reforms have been implemented.

Differential pricing based on the size or bargaining power of an employer is inconsistent with the objectives of the MySuper reforms, which seek to provide a largely universal superannuation offering that represents the best deal for all default members. A single pricing point will promote competition through ease of comparability and the need to set a competitive price to attract all members.

**Question 2.1** Are there impediments to a smooth transition from multiple to single pricing points?

### Issue 3 – Multiple brands per regulated superannuation fund

As noted above, it is proposed that MySuper licensed trustees will offer only a single MySuper product. However, the Government noted that it would consider further whether, in limited circumstances, separate brands within a regulated superannuation fund can offer separate MySuper products (response to recommendation 1.7(c)).

Where there are cases of an RSE licensee operating multiple brands within a single regulated superannuation fund, there may be a case for an exception to allow MySuper products to be issued under these different brands. To be clear, a ‘brand’ in this context does not refer to a different product name or sub-plan for different employers, but distinct products offered by different enterprises within the same financial group.

To avoid misleading consumers, RSE licensees offering a single MySuper product will not be allowed to offer that product under more than one product name.

**Question 3.1** Where RSE licensees currently operate multiple brands within a single regulated superannuation fund, what would be the benefits to members if they were permitted to offer MySuper products under those multiple brands?

**Question 3.2** What criteria should be used for determining the situations covered by any exception for multiple brands?

### Issue 4 – Lifecycle investment option

As noted above, it is proposed that a MySuper product will be required to have a single diversified investment option. However, in response to recommendation 1.7(c), the Government noted that it will consider further allowing trustees to offer a lifecycle, or life stage, investment strategy as the single investment option.

Lifecycle investment strategies allow the trustee to automatically alter the investment asset allocation of members on the basis of age or anticipated years to retirement. It is argued that the benefit of lifecycle investment strategies is that younger members, with longer time horizons to retirement can afford to have higher-risk higher-growth investment strategies, whereas it is more appropriate for older members who are closer to the draw-down phase to have a more conservative investment strategy to preserve existing savings. However, lifecycle investment strategies may involve greater costs as the trustee would be required to regularly adjust the fund asset allocation as the age profile of the membership changes.

While, if allowed, it would be up to the trustee to determine whether a lifecycle investment strategy is in the best financial interests of members, analysis undertaken as part of the Super System Review concluded that there is not a strong financial case for mandating lifecycle investing as a means of smoothing investment returns.

Lifecycle investment strategies would make comparisons of MySuper products more difficult for members and employers, as a single investment strategy would not apply to all members. Further,

lifecycle investment strategies would make it difficult for APRA to publish simple, meaningful, and comparable data. For example, the average net return would be less representative of each member's actual return than if a single investment strategy applied to all members.

**Question 4.1** What data can industry provide to demonstrate the benefits to MySuper members (in both performance and costs) from lifecycle investment strategies?

**Question 4.2** If lifecycle investment strategies are permitted, how would these operate while maintaining the simplicity, transparency and comparability of MySuper products?

## Issue 5 – Scale and mergers

The trustee of each MySuper product will be required to examine and conclude annually whether its MySuper products have sufficient scale (with respect to both assets and number of members) to continue to provide optimal benefits to members (recommendation 1.6(b)).

Scale is an important aspect in optimising operating costs and investment opportunities in the best interest of members of a superannuation fund. As funds increase in size (in terms of both assets and number of members) trustees are better able to exploit economies of scale and reduce investment, advice and operating costs per member. Consequently, a regular consideration of scale is an important feature of the trustee's duty to act in the best financial interests of members.

The objective behind this requirement is that scale is regularly assessed in the context of optimising net returns. Trustees will be required to determine whether the overall scale of the regulated superannuation fund (not just the MySuper product) in respect of asset holdings and membership is sufficient to provide optimal benefits for MySuper members. Adequate scale should not be thought of as having to meet an absolute target number but rather as a requirement to consider the scale that would best meet the needs of the particular members of the regulated superannuation fund. APRA will develop prudential standards to provide further details on the trustee's requirements to meet this obligation.

To further facilitate additional fund scale, the Super System Review recommended that the successor fund transfer rules<sup>6</sup> be changed and capital gains tax (CGT) relief be provided.

Regulation 6.29 of the *Superannuation Industry (Supervision) Regulations* provides that a member can only be involuntarily transferred to a 'successor fund', which is defined by regulation 1.03 of the regulations as a fund which confers on the member equivalent rights in respect of the transferred benefits to those the member had in the original (transferor) fund.

The Government announced that it would consider changing the successor fund transfer test to be one of 'no overall disadvantage' rather than equivalent rights (recommendation 10.9). 'No overall disadvantage' would mean that, on balance, the overall package of rights and entitlements that the member has in the existing fund must not be diminished in the new fund. There may be merit in changing this definition if it facilitates fund mergers and additional fund scale without adversely affecting the rights of members.

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<sup>6</sup> Note that successor fund transfer is a major transitional issue and will be considered further in a separate discussion paper on transitional issues. This paper focuses on a permanent change in definition.

Under the current taxation law, where assets are transferred between superannuation funds as part of a merger of the funds the transferring entity will be liable to pay capital gains tax (CGT) on any gains arising from the transfer. CGT is a realisation based tax, generally applying at the time of a change of ownership of an asset (however occurring), including when superannuation funds merge. This creates a potential impediment to fund mergers.

The Government announced that it does not support an extension of existing CGT roll-over relief, however, it does support in principle, appropriate relief for superannuation funds which are required by APRA to merge in order to meet licence conditions (recommendation 10.11). CGT roll-over relief is normally provided where there is no change in the underlying ownership of assets or where the transaction is involuntary, such as where funds are forced to merge. The Government supports this roll-over relief because it satisfies the policy rationale of providing roll-over relief for transactions that are compulsory in nature.

Trustees will have the ability to choose not to offer a MySuper product and to continue to only offer 'choice' products. These 'choice' funds would be required to transfer the assets and members of any default investment options to another fund offering a MySuper product. CGT roll-over relief would be available only for transfers of assets under the specific direction of APRA. The CGT roll-over relief may only be necessary for a short transitional period during which the MySuper reforms are implemented, to allow existing default funds to be converted to MySuper products. It could be for a period such as two years or five years from the commencement of MySuper. Permanent CGT roll-over relief should not be necessary in the long term, as funds will either offer MySuper products or operate only in the choice of fund market.

**Question 5.1** Do the existing successor fund transfer rules provide a significant disincentive to regulated superannuation fund mergers?

**Question 5.2** Can the successor transfer rules be changed to encourage industry consolidation without adversely affecting members?

**Question 5.3** If a temporary CGT roll-over relief were to be provided to regulated superannuation funds required to merge as a result of the MySuper reforms, what time period would be necessary for funds to merge to achieve superannuation industry consolidation? Should the CGT roll-over relief be available permanently?

**Question 5.4** Should roll-over relief be available for capital gains and capital losses only or for revenue gains and revenue losses also?