



# MySuper consultation working group

## Issues paper on Transition to MySuper

April 2011

### PROPOSED REFORM

MySuper will replace existing default options within default funds, for employees who do not make a choice of fund. Superannuation funds will be able to offer MySuper products from 1 July 2013.

After an appropriate transitional period employers will be required, for those employees who have not chosen a fund, to only make contributions to a MySuper product. The Government has indicated it will require Fair Work Australia to review the default funds named in modern awards so only those funds meeting MySuper requirements continue to be included as default funds.

This transitional period is proposed to allow the trustees of existing default funds to continue to accept employer contributions for employees who have not chosen a fund, while they move to comply with the new requirements.

All new contributions for 'default' members will be made to MySuper products following the end of the transitional period. In addition, it is important to provide a framework that facilitates the migration of existing accounts of 'default' members to a MySuper product. This would allow a 'default' member's entire balance to benefit from the proposed MySuper protections.

In the most straightforward scenario, where a fund has a single default option, the fund's trustee may be able to convert that existing option within their fund to meet the MySuper licensing requirements. In this case, the existing 'default' members will not move.

It is expected many trustees wishing to offer MySuper products will choose to convert existing default options to comply with MySuper product requirements, with minimal disruption to members.

However, where there are multiple default options within a fund, or multiple sub-plans each with a different default option, migration to a MySuper product raises additional issues.

Trustees will need to give consideration to differences that exist between these default options in areas such as:

- investment strategies; and
- the range and level of auxiliary member services.

While it may be possible for trustees to adjust differing default investment strategies to align with a single 'MySuper' strategy, changes to the auxiliary services offered to members may constitute provision of a new superannuation interest.

In the latter circumstance, trustees will need to migrate existing 'default' members' accounts from their current default options within default funds, to the fund's new MySuper product. This will involve moving members either individually (by obtaining either their implicit or explicit consent), or as a group (by merging an existing default option with the MySuper product with members' consent or subject to the trustee acting in the best interests of beneficiaries).

Consideration is required of arrangements to facilitate the movement of existing 'default' members from the default options within default funds to a MySuper product.

## ISSUES

### Issue 1 – Identifying existing default options

A key starting point for trustees will be to identify the current investment options that represent a 'default option', for possible conversion to, or merger with, a MySuper product.

In some funds, trustees permit individual employers to tailor their default superannuation product to the needs of their employees (for example, in areas such as the investment strategy or level of services provided). Consequently, these funds may have multiple 'default options'.

In addition, current arrangements can provide for an employee who has been placed in an employer's sub-plan within a fund, to be transferred to another sub-plan or division when they subsequently leave employment with that employer. In effect, this new sub-plan or division becomes the default option for those employees who did not choose this product. It is believed that around 40 per cent of members in the corporate superannuation market could be in these 'personal' divisions.

Question 1.1	What are the difficulties in identifying the current 'default option(s)' within a fund?
Question 1.2	Where funds currently have multiple default options, what difficulties are anticipated in identifying which will become their MySuper product?
Question 1.3	Are there difficulties in identifying sub-plans to which 'default' members may have been automatically transferred (flipped)? If so, what are they?
Question 1.4	How common are arrangements that automatically transfer members to another division within a fund after leaving employment? Are members automatically transferred to another sub-plan, or are they transferred to another division within their former employer's sub-plan?

### Issue 2 – Disclosure

The transfer of members to a new MySuper product (by whatever means), potentially triggers the existing Corporations law product disclosure regime.

The implication is that, depending on the type of transfer and the circumstances, trustees may need to provide their MySuper Product Disclosure Statement (PDS) to each member whose existing

default option account is transferred to the MySuper product, and potentially satisfy the significant event disclosure requirements.

Where the transfer involves the issue of a new financial product, even in the straightforward scenario identified above, each transferring member would need to be provided with the MySuper PDS. This may significantly increase the cost of transition to MySuper for superannuation funds.

However, temporary disclosure requirements could be put in place for the transition to MySuper. For example, the requirements could be satisfied through a summary of the MySuper product's terms and conditions, or by reference to an online PDS, in the opt-out letter (see Issue 5 – Transfer of individual members). It is noted that shorter PDSs are also currently being developed.

Question 2.1 What cost effective approaches could be adopted to ensure transferring 'default' members are given appropriate opportunities to receive/access relevant information regarding their new MySuper product?

### Issue 3 – Converting an existing default option

Some default options within default funds may not be able to comply immediately with MySuper requirements. This may be because they do not meet the requirements for a MySuper product. This could be due to the existence of existing contractual arrangements, for example, in respect of commissions (whether for advice or on insurance products). These contractual arrangements may not be able to be overridden legislatively due to constitutional considerations.

As an example, for a number of existing default options within default funds, trustees currently have arrangements whereby monies in those options are used to pay product-based up-front or trailing commissions or other similar payments, or to make payments that relate to volume, in respect of superannuation advice or other products or services provided to members.

Under the proposed arrangements, trustees of MySuper products will not be permitted to pay or fund these types of commissions or payments. Consequently, where these payments are made under a contractual arrangement, trustees will need to terminate or amend the contractual agreements before seeking to convert the default option to a MySuper product.

Providing a reasonable transitional period might allow current insurance contracts, for example, to lapse and subsequently be renegotiated on terms consistent with MySuper requirements, including that a member can opt-out of insurance arrangements at any time and that no commissions are involved in instances of group insurance.

One option for individual funds, or investment options within funds, where a trustee faces issues in complying with specific MySuper criteria within the transitional period, could be for the Australian Prudential Regulation Authority (APRA) to provide the trustee with an extended transitional period in which to comply fully (on a case by case basis, and possibly using prudential standards making powers).

An additional transitional issue arises where a trustee decides to offer MySuper and 'choice' products in the same fund. It may be necessary to alter the trust deed (with prospective effect) to reflect the multiple products. The governing rules of the fund would need to ensure that the interests of members of one product are separately identifiable from the interests of members of other products. To assist funds to transition to MySuper, consideration could be given to legislate that the trust deed of funds offering MySuper products will provide for this separation.

Question 3.1	What contractual impediments are there to converting an existing default option to a MySuper product?
Question 3.2	To what extent will these impediments be addressed through the renegotiation or lapsing of contractual arrangements?
Question 3.3	What issues arise in relation to existing contracts with service providers that might pose significant problems for existing default options in converting to MySuper?
Question 3.4	To what extent will changes to trust deeds be necessary in order for existing default options within a default fund to comply with the MySuper requirements?
Question 3.5	Should APRA have the power to extend the transitional period for those funds that need to renegotiate existing contracts, or to let them lapse?
Question 3.6	What time period would be required to enable the phasing out, where necessary, of existing contractual arrangements with service providers?

## Issue 4 – Sub-plan/fund mergers

Under the proposed new arrangements each MySuper product would have standardised features and a single diversified investment strategy.

### Mergers

Currently, the trustees of a fund may provide individual employers with their own sub-plan which can be used as their default fund.

To comply with the proposed new arrangements, trustees may decide to merge the default option of each of these sub-plans into a MySuper product within their fund.

Trustees would need to consider the circumstances of each group of affected members in deciding how to conduct a merger, with specific focus on each element of the existing product – namely, the expected risk, return, cost and tax characteristics of the investment option; cost and coverage of insurance; and administrative costs and services.

This should not present a significant impediment where there is little difference between the individual sub-plans' default options, other than 'branding'. However, where there are multiple 'default' sub-plans with different fee structures and/or service provision, there may be issues with respect to the transfer of those sub-plans into a single MySuper product.

Where significant differences in the benefits provided do exist, trustees may feel constrained from merging the employer 'default' sub-plans by the legislative covenant requiring them to exercise their duties and powers in the best interests of the beneficiaries. If this is the case, trustees will need to consider transferring members individually to a MySuper product within the fund (see Issue 5 – Transfer of individual members).

A merger of sub-plans may also be subject to contractual obligations the trustee may have to service providers. Existing insurance arrangements might also act as an impediment to a merger.

## Transfers

Where a trustee decides not to offer a MySuper product, or to provide the product through another fund, the trustee must satisfy the fund transfer rules of the Superannuation Industry (Supervision) Regulations (SIS Regulations) in order to transfer 'default' members to a MySuper product.

Regulation 6.29 of the SIS Regulations provides that a trustee cannot transfer a member's benefits unless:

- the member has given consent to the transfer;
- the trustee reasonably believes the receiving fund has the member's consent; or
- the transfer is to a 'successor fund'.

Therefore, a member can only be involuntarily transferred to a 'successor fund'. A successor fund is defined by regulation 1.03 of the SIS Regulations as a fund which confers on the member equivalent rights to those the member had in the original (transferor) fund.

An issue arises where, for example, a member was placed in a default option in a 'default' sub-plan by their employer, and the default option provides generous insurance coverage that cannot be matched by a MySuper product. The MySuper product would therefore not satisfy the successor fund test.

APRA Circular I.C.4 sets out an interpretation of what the term 'equivalent rights' entails. The superannuation industry has tended to follow this Circular closely, and consequently exercised caution in giving effect to transfers.

The Super System Review noted that in practice most trustees will not agree that there are 'equivalent rights' unless the transferring fund's governing rules are replicated in the receiving fund's governing rules. The Review therefore recommended amending the successor fund transfer test so that it is one of 'no overall disadvantage' rather than 'equivalence'.

The Government has announced it will consider amending the successor fund transfer test, which is also relevant in the context of merger decisions by trustees to achieve sufficient scale. Consideration could also be given to providing a temporary carve-out to the successor fund test to permit the merger of individual funds with a MySuper product.

Requiring the transfer of 'default' members to a MySuper product under legislation would need to address issues that might arise if the acquisition of property is considered to be on other than just terms. Consideration also needs to be given to whether a potential corporate or personal liability arises for trustees in these circumstances.

## Choice Members

In some cases, the merger or transfer of members from an existing default option to a new MySuper product may affect members who had chosen a specific default option. The question arises of whether these members should be contacted and provided with a suitable notification period in order to give them an opportunity to elect to move to another sub-plan (see Issue 5 – Transfer of individual members).

Given choice of fund in an employment context is given effect through the employer, funds will not easily be able to identify those members who are ‘choice’ members, and those who are ‘default’ members.

### Capital Gains Tax (CGT) roll-over

In the context of encouraging efficiency throughout the superannuation system, the Super System Review also recommended that CGT roll-over be permanently available to the industry to facilitate fund mergers and rationalisation to achieve economies of scale. The Government announced it does not support an extension of existing CGT roll-over, while noting it supports in principle appropriate relief for superannuation funds which might be required by APRA to merge in order to meet licence conditions.

The merger of existing default options within a fund into a MySuper product within the fund may or may not give rise to a CGT event depending on the circumstances. The pooling of sub-plan investments within a fund may mean that no CGT event arises. Where a CGT event does arise, there is a CGT exemption for the members of a fund which disregards the capital gain or capital loss arising from a CGT event in relation to their interest in the fund. There is also a CGT exemption for a trustee of a fund in relation to CGT events in respect of units that a fund holds in a pooled superannuation trust, a common form of holding fund assets outside the fund.

The sale of particular assets by the fund to facilitate the transfer of assets between the various sub elements of the fund may give rise to a CGT event, but any resulting capital gain or capital loss would need to be considered as part of the fund’s overall tax position.

Consequently, the absence of the broader CGT roll-over proposed by the Review is not likely to be a significant impediment to default option mergers within the same fund.

Question 4.1	Given MySuper is proposed as a single investment option, what issues are likely in consolidating sub-plans, and will the consolidation be able to be achieved with temporary modification of existing rules?
Question 4.2	Where a trustee considers there is not strict equivalence of benefit for a group of members between their existing default option and the MySuper product, is clear communication of the differences and a capacity for members to opt out to a choice product sufficient to protect their interests?
Question 4.3	What protections are necessary for the trustee in consolidating sub-plans into a single MySuper product?

### Issue 5 – Transfer of individual members

The transfer of individual members to a MySuper product will have to comply with rules such as those in regulation 6.29 of the SIS Regulations.

As well as providing for the involuntary transfer of member benefits (through the successor fund transfer test), regulation 6.29 also allows a member’s benefits to be transferred where the member has given the trustee their consent to the transfer.

To satisfy this requirement, it is proposed that trustees would need to write to each 'default' member who is not already in a default option (or sub-plan) that can be merged readily with a MySuper product within the fund (for example, can easily satisfy the successor fund transfer test).

Trustees could write on the basis of requiring either the member's explicit agreement to be transferred (that is, the member needs to opt in), or their implicit agreement (that is, to opt out if not wanting to transfer).

A key consideration in the framing of the MySuper proposal is the intent to protect the interests of members who have not exercised a choice of fund. This suggests there is a fundamental issue with adopting the opt in approach (that is, in writing to members who have defaulted, seeking their explicit agreement to be moved).

With the opt out approach, the member would be given a period of time (say 60 or 90 days) in which to respond to the trustee. The absence of a response from the member would represent the member's agreement to the transfer.

Under this approach, consideration would need to be given to the issue of potential trustee liability if a member who did not respond, suffered a loss as a consequence of the resulting transfer.

There may be implications for a fund if the majority of members, but not all, accept the transfer to a MySuper product. For example, there could be implications for the fund's liquidity if a significant number of members transfer. In addition, depending on the specific arrangements under which the default option operates, the particular default option may no longer be viable with a significantly reduced membership.

Issues may arise in respect of employees who were originally placed in an employer's sub-plan by default, but were subsequently transferred to another plan on ceasing employment with that employer. Where these members did not elect to be placed in this new plan, the plan is, in effect, their default option. There is an argument that these members should also be moved to a MySuper product.

Issues also arise for the personal divisions of some sub-plans. For example, a member who started in an employer sub-plan may have been transferred into the personal division of that sub-plan on leaving that employer, but may not have made a choice of fund or investment option.

In addition to these 'default' members, the personal division of the sub-plan may also include employees who have made a choice of fund by completing the choice of fund form requesting the employer to make contributions to this division.

Trustees would need to identify the 'default' members in the personal division of the sub-plan and write to them regarding their transfer to a MySuper product within the fund. If a trustee is unable to identify the 'default' members, then they may need to write to all members of the personal division seeking their approval to be transferred to a MySuper product. In these circumstances, an opt out approach may be inappropriate as it could result in genuine 'choice' members being inadvertently transferred to a MySuper product.

Question 5.1	What are the difficulties in identifying who is a genuine 'default' member?
Question 5.2	What are the difficulties in identifying individual 'default' members who have been automatically transferred to another division within a sub-plan?
Question 5.3	What impediments exist to the transfer of individual members?

Question 5.4 Should members whose superannuation arrangements were determined for them (for example, through a collective agreement), be classified as 'default' members?

Question 5.5 To what extent do trailing commissions apply to the default option rather than individual members? That is, will transferring a member to another MySuper product avoid these charges?

## Issue 6 – Length of transitional period

The Government announced that superannuation funds will be allowed to offer MySuper products from 1 July 2013.

The Super System Review recommended the industry should have at least two years to transition to MySuper. In its response, the Government indicated existing default funds will transition after an appropriate period.

Given the issues that may be associated with the transition, consideration will need to be given to what is a reasonable maximum time period for the industry to ensure all default fund members, as at 30 June 2013, are placed in a MySuper product.

Question 6.1 Subject to having appropriate legislative arrangements in place, is a two year transitional period (that is, ending on 1 July 2015) acceptable?

Question 6.2 What difficulties are likely in achieving full transition of default members/sub-plans to MySuper by this date?

## Issue 7 – Default fund selection

The Super System Review recommended the *Superannuation Guarantee (Administration) Act 1992* be amended so only a MySuper product is eligible to be a 'default' fund nominated by an employer. The Government has stated that MySuper products will replace existing default funds after an appropriate transitional period. This could be achieved by providing that in the absence of an employee choice, only a MySuper product qualifies as a complying fund for superannuation guarantee purposes.

The Government also indicated it will request Fair Work Australia to review the default superannuation funds named in modern awards so only those funds offering a MySuper product continue to be included in modern awards as default funds following the end of the transitional period.

A large number of employees are currently covered by agreement-based transitional instruments under the *Fair Work Act 2009*. These transitional instruments may specify 'default' funds which are not MySuper products (approximately 70 per cent of current federal enterprise agreements contain named superannuation funds). It is anticipated many of these instruments would be replaced before the end of a MySuper transitional period.

It is possible some of these agreements may expire (or have expired), and will not be replaced. That is, these agreements will remain in operation. This may give rise to a conflict between an employer's obligation to contribute to a MySuper product and to the fund named in the agreement. Consideration could therefore be given to legislative amendments to override these

agreement-based transitional instruments to the extent they require employer contributions to be made to a non-MySuper product.

It is noted that as part of the transition to the new MySuper environment, the Government will be asking the Productivity Commission to design a process, by 1 July 2013, for the selection and ongoing assessment of superannuation funds that are nominated as default funds in modern awards and enterprise agreements.

This work will be undertaken separately from the current MySuper consultation arrangements.