29 May 2018

Law Council
OF AUSTRALIA

Legal Practice Section

Manager, Regulatory Framework Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam

PROPOSED LEGISLATION: PROTECTING YOUR SUPER PACKAGE

1. I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia (**the Committee**)[1] regarding the *Protecting Your Super* package which was announced in the 2018-19 Budget and released for comment on 8 May 2018.

2. This submission does not seek to raise issues concerning matters of practice or policy. Rather, the Committee has responded to specific questions and makes some general observations relating to the Committee's objective of ensuring that the law relating to superannuation in Australia is sound, equitable and demonstrably clear.

Comments applying to all Schedules

3. *Overriding terms of trust deeds:* It is possible that some superannuation fund trust deeds may contain provisions which are inconsistent with the highly specific legislative scheme proposed in Schedules 1 to 3 (for example, as to member notifications, fees and insurance coverage). Accordingly, the Committee suggests that consideration be given to including a new provision similar to:

    - existing s 29VQ of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) which states that a provision of the governing rules of a superannuation fund is void to the extent that it is inconsistent with certain statutory obligations; and/or
    - existing s 29XB of the SIS Act which states that a trustee is not subject to any liability to a member of a fund for an action taken to give effect to certain statutory obligations.

4. *Carve-out for retirement phase account:* The Committee notes that all the proposed reforms in Schedules 1 to 3 appear to apply to accumulation accounts in the retirement phase (such as account-based pensions), and queries whether some carve-outs should be drafted in. For example, the definition of 'inactive' applies to

[1] The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

Telephone +61 2 6246 3788 • *Fax* +61 2 6248 0639 • *Email* mail@lawcouncil.asn.au
GPO Box 1989, Canberra ACT 2601, DX 5719 Canberra • 19 Torrens St Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.asn.au

accounts which have not had contributions made or rollovers received, but this is exactly what would happen to an account-based pension account because the law does not permit contributions to be made to a pension.[2] Likewise, the Committee queries whether there might be other exceptions needed from the inactive account provisions where a member is invested in a temporarily suspended or frozen investment fund.

Schedule 1 - Fees charged to Superannuation members

Fee cap for administration and investment fees

5. *Pro-rating for ceasing to hold product:* Under proposed s 99G(4), the fee cap that would otherwise apply in respect of a six-month period will, where a member acquires a product during the relevant six-month period, be pro-rated to reflect the part of the period during which the product was in fact held. However, there is no equivalent provision that applies where a member ceases to hold a product part-way through the relevant six-month period. In that case, the fee cap would not be pro-rated; it would, instead, be the full fee cap amount determined for the six-month period. This asymmetry may or may not be intentional and the Committee merely notes it for consideration.

6. *Rebate as an alternative to complying with administration/investment fee cap:* By its terms, the fee-charging rule for low-balance accounts in proposed s 99G(2) would appear not to allow the standard administration and investment fees to be charged if they exceed the cap. However, the Committee notes that the same outcome could be achieved by applying a rebate at the end of the six-month period (or on exit) so as to put the member in relevantly the same position they would have been in had the relevant fee deductions ceased upon reaching the relevant cap. The Committee queries whether formulating the rule in a manner that enables relevantly the same outcome to be achieved but by this alternative means might increase the practicability of implementing the rule without undermining the policy objective. If so, then in addition to changing the terms of s 99G(2), it might also be necessary to introduce a further qualification to s 29TC(d).

7. *Tax effects:* The Committee suggests that it may be helpful to set out in the proposed new law, a clarification as to how the tax effects on administration fees are to be taken into account in applying the fee cap. By way of example, see the helpful explanatory notes concerning GST found in the Australian Securities and Investments Commission's (**ASIC**) *Corporations (Life Insurance Commissions) Instrument 2017/510*, at the end of sections 5 and 6.

Implementing the fee cap

8. The Committee notes that it is unclear from the Exposure Draft whether the $6,000 threshold for the purposes of the fee cap applies to: (a) the total value of a member's interest in a fund; or, (b) the amount within *each* MySuper product or choice product. On one reading, it would be possible (for example) for a member to have $5,000 in six different choice products (representing a total balance of $30,000) and still have the amount of their fees capped. This would not appear to be the policy intent, but arises from the wording of proposed s 99G. This is because s 99G applies if a fund were to 'offer a choice product or MySuper product' and the member 'has an account balance with the fund that relates to the product that is less than $6,000'. If each investment

[2] *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 1.06(1)(a)(ii).

option is a separate product (as seems to be the schema of the section) then the fee cap applies for every investment option that has less than $6,000 invested in it.

9. With regard to choice products, it should also be borne in mind that the cap applies to the aggregate of administration fees and investment fees. It is unclear whether the concept of 'investment fees' for the purpose of the SIS Act is the same as the concept of 'investment fees' for disclosure purposes under the *Corporations Act 2001* (Cth), as modified by ASIC's Regulatory Guide 97 (Disclosing fees and costs in PDSs and periodic statements) – the latter of which can incorporate substantial components on account of indirect costs incurred by interposed vehicles into which a choice product has made investments, especially where unlisted property is involved. While there are good legal reasons why the concepts are not the same, in practice we suspect most funds will assume that they are. If so, in practical terms, this will mean that much of the per cent cap (or possibly even more than the 3 per cent cap) could be consumed by indirect costs incurred by entities other than the fund itself (i.e., interposed vehicles) as a result of the member's investment choices, which could diminish the amount which a fund can actually recover for administering the account and for its own investment expertise. The Committee makes this observation in passing so that the implications of the proposals are fully understood in the context of other reforms. If the intention is for a fund to retain up to 3 per cent of a low account balance as a contribution towards the actual costs of maintaining the account, that may not be the actual outworking of the proposals.

10. The Committee is also concerned that there is the potential for arbitrage insofar as a member who temporarily rolls out most of their account balance immediately prior to the balance test day, leaving less than $6,000, and then rolls a substantial amount back in immediately afterwards, would be entitled to have their combined administration fees and investment fees capped at 3 per cent of whatever immaterial residual balance was left in the account on the balance test day. This could be open to abuse and we suggest that some modification be made to address such a situation.

11. The Exposure Draft makes it clear that a fund will not breach the MySuper fee charging rules to the extent that some MySuper members pay different fees as a result of their fees being subject to the cap. However, it is unclear whether fees must otherwise be calculated in the same way for all members (subject to the cap) or whether it will be permissible for there to be an altogether different regime for members with low account balances that would be subject to the cap. For example, say that a fund charges a standard fee of $180 per annum. For a member with a $6,000 cap, this equates to 3 per cent. Is it the case that, for all members with account balances less than $6,000, those remaining members must be charged precisely 3 per cent or would it be possible to charge those members a lower fee of, say, only 2 per cent?

<u>Exit fees</u>

12. *Exit costs charged by outsourced providers:* The Committee assumes that the intent of the legislative ban on exit fees is not intended to interfere with a trustee's right of indemnification from trust assets for actual costs incurred in the administration of the fund. With that assumption in mind, the Committee observes that if exit fees cannot be charged to members, actual costs incurred by superannuation fund trustees by way of charges imposed by their outsourced administrators to process benefit payments will need to be incorporated in other cost recovery methods. That is, under the current law, exit fees can only be charged on a cost recovery basis. So the actual costs incurred (and which are currently passed onto members) will need to be paid for by other means. It will not necessarily reduce the costs incurred by trustees through services

provided by outsourced administrators. Because the definition of 'administration fee' in s 29V(2) includes 'costs incurred by the trustee', fees for processing benefit payments charged by administrators will need to be absorbed within the general administration costs charged to all members.

Schedule 2 - Insurance for Superannuation members

13. *Proposed date of effect:* The Committee queries whether the date of 1 July 2019 used in the application and transitional provisions is realistic, having regard to the renegotiation of group insurance arrangements that will inevitably be required across the industry as a consequence of these measures.

14. *Notice whether or not in writing:* In the application and transitional provisions for proposed s 68AAB, we suggest that in sub-item (5)(a) the words '(whether or not in writing)' should be included immediately after the words 'the member has given the fund notice'. This would result in the adopted policy position appearing much more clearly on the face of the law.

15. *Telephone opt-in:* As a related comment, although strictly a matter of policy, the Committee is unsure why a member, particularly one aged under 25 or with an account balance under $6,000, could not make a positive election verbally by telephone to have insurance coverage? Particularly, having regard to the way in which Australian laws generally now facilitate modern methodologies for business transactions.[3]

16. *Impact on automatic acceptance levels:* The Committee acknowledges that this legislative measure on insurance is policy driven, and it does not comment on matters of policy. However, the Committee queries whether the impact of this measure on automatic acceptance levels (**AAL**) provided by insurers (allowing new employees joining a group insurance arrangement through superannuation to be insured without the provision of health evidence up to the AAL) has been considered given the changed risk profile for group arrangements with new and young members.

17. *Flexibility to allow employer subsidies:* Particularly for employer-sponsored funds or sub-plans within master trusts, the Committee queries why it would not be possible to allow employers to pay for the costs of insurance premiums for members aged under 25 or with an account balance under $6,000. The proposed law does not seem to be drafted in a manner which would allow such an approach, and yet if the employer paid the insurance premiums then the policy of the proposed law would not be offended as there would be no erosion of the account balance. That is, instead of the drafting prohibiting a benefit being provided by taking out or maintaining insurance (ss 68AAA(1), 68AAB(1) and 68AAC(1)), it could ban the insurance coverage being member-funded.

18. *Age 25 test day:* The Committee queries whether consideration has been given to stipulating a balance test day for determining whether a member is under or over the 25 year age threshold and whether there is a grace period following a member's 25th birthday in which insurance can be established (otherwise a fund may be in breach of the MySuper rules by not offering standard cover for a member from the day following their 25th birthday).

[3] See proposed ss 68AAA(2), 68AAB(2), 68AAC(2) and application provision 3 for s 68AAA in sub-item (6)(a)).

19. *Application opt-in:* The Committee queries whether a trustee can treat a member's application for additional units of insurance cover (including a historical application) as an opt-in.

Schedule 3 - Inactive low-balance accounts and consolidation into active accounts

20. *Death benefit to multiple beneficiaries:* In proposed s 29QF(2)(b)(ii) and (4), upon a member's death in the circumstances described, the Commissioner would pay the death benefit to each death beneficiary equally. This presupposes that the Commissioner will, like super fund trustees, gather information about the member's potential beneficiaries (which can be complex, particularly where the member has been in more than one de jure or de facto relationship with children from each, and particularly if there are questions about whether a de facto relationship had commenced or ended shortly prior to the member's death). Further, for small death benefits with multiple beneficiaries, the amounts distributed would be small.

21. The Committee suggests that the law would operate in a more straightforward manner if an order of priority were to be specified such as is set out in intestacy legislation (e.g. to the spouse first, etc.). To accommodate the possibility that a member could have more than one spouse, we suggest that, in a superannuation context, a priority distribution to a spouse living with the member as at the date of death would be consistent with the purpose of a superannuation death benefit. Alternatively, proposed s 29QF(2)(b)(ii) could specify that the death benefit must be paid to the member's legal personal representative in all cases (i.e. for distribution in accordance with the member's will or the laws of intestacy). In this case, proposed s 29QF(4) would not be needed.

Contact

22. The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

    - Mr Luke Barrett, Chair, Superannuation Committee
      T: 03 8831 6145
      E: luke.barrett@unisuper.com.au; or

    - Ms Lisa Butler Beatty, Deputy Chair, Superannuation Committee
      T: 0477 753 941
      E: BeattyLi@cba.com.au.

Yours sincerely

Jonathan Smithers
Chief Executive Officer