AIST

10 March 2023

General Manager, Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Email: superannuation.policy@apra.gov.au

Dear Sir/Madam

Transfer planning in superannuation: Proposed enhancements

Brief

AIST supports a principles-based approach to planning for successor fund transfers and wind-ups that is flexible and proportional to the circumstances of the fund.

About AIST

Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public sector superannuation funds. As the principal advocate and peak representative body for the $1.7 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research. AIST advocates for financial wellbeing in retirement for all Australians regardless of gender, culture, education, or socio-economic background. Through leadership and excellence, AIST supports profit-to-member funds to achieve member-first outcomes and fairness across the retirement system.

Submission

AIST thanks APRA for the opportunity to provide input to this consultation.

We welcome APRA's general approach of strengthening and simplifying the planning approaches undertaken by funds and providing updated guidance for successor fund transfers and wind-ups. In elevating current guidance into the prudential standards, we support a principles-based approach that is flexible and proportional to the circumstances of the fund.

AIST sees merit in funds that may be at risk of underperforming having demonstrated forethought about their ability to execute a successor fund transfer. However, we note that for many consistently well performing funds the need to draw upon and activate such a detailed transition plan is very unlikely to occur. As such, the level of planning required for what would largely be a hypothetical SFT

Level 23, 150 Lonsdale Street
Melbourne VIC 3000
T +61 3 8677 3800
F +61 3 8677 3801
info@aist.asn.au
www.aist.asn.au

master plan, as either a transferring or receiving fund, should be commensurate with a fund's APRA oversight and prudential engagement situation and status, as well as its actual circumstances. Otherwise, both the opportunity and financial costs of complying with a potentially substantial new regulatory requirement will be ultimately borne by fund members for arguably little or no contemporary benefit. This would consequently not be, in our view, in those members' best financial interests.

Application to strategic mergers and recipient funds

The emphasis of the consultation is on funds that would be at risk of needing to transfer members for performance, scale or crisis management reasons. Attachment B only contemplates a necessary transfer and need for remedial action, highlighting that these proposals are intended to strengthen risk management. What is lacking, in our view, in these considerations is the application of requirements for funds that may:

- Have a low likelihood of being compelled to transfer members out of the fund due to performance or other failure
- Not actively pursue mergers as part of a strategic growth strategy
- Selectively seek only strategic mergers that add benefit to its members
- Be unwilling to absorb poor performing funds due to the costs and drag on performance leading to poorer member outcomes for their existing membership.

A large (whether in assets or members) consistently performing fund that is most unlikely to be required to merge due to poor performance or other failures is still required to have an exit plan to meet both the requirements of *CPS 190 Financial Contingency Planning* and the proposed amendments to SPS 515, despite being significantly more likely to be the recipient of smaller funds. The proposed ability to meet the requirements of both standards with the one plan is valuable in limiting duplication of the need to have a credible remediation or exit plan, but stresses that an exit plan is still needed as a potential recipient fund.

The consultation paper contemplates that funds may receive members but is limited on how the enhanced standards would apply, such as whether the transfer plan is required to capture this scenario in addition to the exit plan.

A large performing fund with no current potential partners, nor intent to actively seek one, could be challenged in documenting the detail of credible trigger frameworks, complexity, product and systems alignment, potential barriers, etc for an inbound transfer unless compelled by APRA to accept transferring funds in the course of APRA's supervision of industry consolidation.

For this reason, the preparation requirements should be neither too detailed nor prescriptive.

Level and frequency of documentation

SPS 515 currently requires trustees to undertake an annual member outcomes assessment and business performance review, both of which feed into the annual business planning process and the monitoring of which would contribute to the trigger frameworks for transfer decision-making. It is logical that the periodic review of transfer options and preparedness would also fit within this framework, whether as an inclusion to the Business Plan or as a stand-alone document.

APRA should clarify its expectations on this point as interpretations of regularity and demonstrable documentation could include high-frequency or standing items in board papers and minutes or infrequent reviews only undertaken every few years.

In addition, APRA should review other elements of the performance assessment cycle in the existing SPS 515 requirements and guidance. Per our submission to the *Strategic planning and member outcomes: Proposed enhancements* consultation, these include:

- Merging the Business Performance Review into the annual Business Plan
- Reviewing the timing and value of the Member Outcomes Assessment to consumers, in line with other disclosure requirements
- Bringing forward APRA's publication dates for annual statistical publications
- Developing a database accessible by APRA-regulated entities to facilitate consistent benchmarking and comparison between funds.

Transfer preparedness

We agree with APRA's proposal that the level of preparedness should be commensurate with the need for readiness. That is, that a staged approach to preparedness should be adopted based on the likelihood of a transfer being executed, the complexity of the transfer (i.e. number of members, product offering, involvement of third parties and material service providers, etc) and the RSE licensee's trigger framework.

An appropriate level of preparedness would be for an RSE to have an understanding of potential merger partners and their suitability (noting APRA's professed aversion to 'bus-stop' mergers) and to have sound preparation in place to support a merger – should one ever eventuate – the degree of which should be linked to the trigger framework. This will ensure that the need for ongoing review and maintenance of detailed materials is relative to the need to draw upon them and resources are not devoted to undertaking copious amounts of work unnecessarily.

'Sound preparation' following the activation of an early trigger could include assessing the tools, resources and information required to facilitate a transfer, e.g. a pro-forma roadmap, board and regulator engagement requirements, draft project plans and communication templates, templates for completing equivalent rights and resourcing plans, etc. It could also include a preliminary review of the availability of fund information that would be drawn upon to support due diligence.

This would enable funds to act relatively quickly if member outcomes are not being delivered or there's an opportunity (and appetite) to transfer members in from another fund.

While APRA has identified appropriate preparatory steps for an effective trigger framework in Attachment B, we suggest that these steps be re-ordered as follows to reflect the order these steps would ordinarily be undertaken by a fund:

- establish effective governance arrangements to support timely and unconflicted decision making in a transfer;

- identify barriers, including legislative, operational, cultural, and practical barriers;
- determine how to address barriers and identify deal-breakers at an early stage;
- develop plans for implementing a timely transfer and engaging with APRA during the process;
- undertake appropriate due diligence; and
- develop the business case for a transfer, including how it will deliver better outcomes and address any concerns driving the potential need for a transfer.

RSE licensee decision-making

In the discussion paper, APRA notes that it had observed instances where “RSE licensees have struggled to balance the need for compliance with complex legal obligations with a pragmatic approach pointed at the orderly completion of a transfer” and that “Barriers to transfers also include legal matters, such as the application of the equivalent rights test and due diligence costs.”

The equivalent rights requirement represents a large risk for destination funds, both from a member and regulator perspective, so funds dedicate considerable time and financial resources to undertaking this analysis. Equivalency of insurance in particular opens up funds to the risk of potential legal action, including class actions, as both the individual and group insurance arrangements could vary significantly between funds. As such, funds are generally very conservative rather than pragmatic in their approach to this assessment.

One suggestion for addressing this hesitancy is to introduce safe harbour provisions for funds if they can demonstrate they have acted in good faith around ensuring members have (broadly) equivalent rights. This could be particularly considered appropriate where both the transferring and continuing fund are APRA licensed MySuper funds already, and therefore common to both are a standard and prescribed set of appropriate minimum standards commensurate with holding a MySuper RSE licence.

In the case of a fund accepting a transfer of members from an underperforming fund, significant cost and time savings would be achieved where funds who have failed the performance test are deemed to have equivalent rights in respect of benefits. The performance test only applies to MySuper options which, as referenced above, don’t materially differ in their features between funds, and while most funds also have choice members it would be unusual for a fund to transfer only its default members following a test failure. This would place a stronger weighting on the improved Member Outcomes in the destination fund against other rights of the transferring members, while offsetting the potential poorer Member Outcomes of the recipient fund’s existing membership.

Additional guidance is also requested about the due diligence process more broadly when accepting an underperforming fund, such as which elements are at the discretion of the trustee vs the regulator.

Transfer of MySuper assets

The proposed requirements outlined in Attachment A provide APRA with the authority to require a fund to be pre-positioned to undertake a transfer of MySuper assets in a 90-day period. This implies that while pre-positioning and decision making would be completed, the actual execution phase must be completed within 90 days. This timeframe is not realistic and should be reviewed.

The execution phase only commences once a decision has been made to undertake the transfer and is contingent on third party involvement. In addition to the guidance outlined in Attachment B, this phase includes:

- Devoting resources to undertaking the transfer, including appointing any required specialist staff or services to fill knowledge or support gaps
- Engaging with the receiving fund to ensure business plans are in alignment and progressing due diligence to the binding stage
- Determining which underperforming assets are to be liquidated as opposed to transferred in-specie, and analysing the underlying strategic asset allocations in both funds to determine whether investments need to be realigned
- Determining whether investment options, insurance and annuity products need to be grandfathered or realigned
- Engaging with material service providers, reviewing contracts and ensuring availability to undertake elements of the transfer
- Sequencing with custodians, administrators and the ATO for the transfer member data and ensuring its audit
- Engaging with employer groups and employers, particularly for large multi-employer funds with default fund status arrangements
- Engaging with regulators (in particular APRA, ASIC, ATO and State Revenue Offices) for approvals, relief requests, confirmation and other assistance without the benefit of dedicated resources to facilitate speedy resolutions
- Integrating the operational backend systems to support consolidated reporting, potentially requiring a staggered approach to data aggregation and a period of resource intensive duplication of reporting obligations that could lead to errors

A preferred approach is for APRA to provide a recommended rather than mandatory timeframe for a RSE licensee to transfer MySuper assets in the event that the authority to offer a MySuper Product is cancelled. This timeframe should be no less than 5 months for smaller or simpler transfers where there is already high alignment.

APRA has stated that it intends for the requirements relating to the transfer of MySuper product assets to come into effect from 1 July 2023. It is recommended that a transitional period of 12 months apply to allow funds to implement any system and process changes required to comply with the new requirements.

As timely and successful transfers are contingent on third parties beyond the trustees' control, there needs to be a level of involvement with them well ahead of the execution phase. APRA should provide close engagement with funds from at least the signing of the Memorandum of Understanding onward. This chould be either a dedicated APRA team with extensive merger knowledge or the fund's supervision team. Consideration of potential transfer timing based on a fund’s size and complexity could also be factored into service contracts with material outsourced providers such as administrators and custodians.

Barriers and execution phase guidance

Due to many funds having limited practiced SFT experience, it would be beneficial for APRA to work with industry on guidance specifically related to this area. This could be by way of a APRA Guidance Note or a less formal guide/handbook. The guidance could usefully and instructively include a generic checklist outlining areas an RSE needs to be aware of and consider, along with sharing of lessons learnt from industry transfers that have occurred. If there was universal sharing there would be a more consistent approach to member transfers in addition to the industry as a whole being more prepared.

For example, the guidance could include how funds should handle situations where a member holds units in both a MySuper and a Choice offering, the funds have incompatible systems, and so on. Sharing of common universal challenges will ultimately allow funds to prepare better, and also allow member transfers to happen in a timelier manner aligned to member expectations.

Funds with applied merger experience have also raised a number of items that act as currently barriers to efficient mergers and should be addressed either in guidance or by amendment to the legislation.

Portability requirement

An administration ‘black out’ period is often required in which members are unable to make changes to their accounts for a period either side of the transfer. Typically, this is up to 5 days for the receiving fund but may be up to 10 days in the transferring fund. This means that rollovers may not be paid within the legislative timeframe and would cause a breach of the 3-day portability requirement unless specific APRA relief is granted. This creates an additional administrative burden for both trustees who are required to devote time and resources to applying for portability relief prior to the SFT.

- **APRA should provide standing relief to exempt trustees from the 3-day portability requirement where the portability request cannot be actioned within the normal timeframe due to the ‘black out’ period required to facilitate an SFT.**

Transfer of nominations and elections

There are a number of actions that members can take on their super accounts that are binding on the trustee who receives the election but no longer apply once the trustee changes. These include binding death nominations, third-party financial adviser authorities, consent-based communications preferences and insurance opt-ins for members who were aged under 25 prior to 1 April 2020 and who remain under the age of 25 at the SFT date.

Best practice is to migrate notes relating to these nominations but it is incumbent on members to reinstate their preferences should they wish them to still be binding after an SFT into a new fund.

This is impractical and creates both an additional administrative burden and poor service experience for members who hold a reasonable expectation that prior actions remain valid.

- **All nominations, authorities and elections should transfer to the receiving fund and be binding on the new trustee.**
- **All members who hold standard insurance in the transferring fund should automatically be provided with cover in the new fund, irrespective of age.**

Tax matters

Members benefits maybe eroded by tax implications during the transfer. Specifically, these include:

> *Tax roll over relief:* where the transition of in-specie investments is required to the receiving fund, the transition, change of control or change of beneficial owner may crystallise duties or taxes. In these instances, the receiving fund will seek roll over relief from the relevant authority (e.g., state, commonwealth, or international regulators) until the assets are realised (rather than when the change is affected during the transfer).
>
> *Forgoing of accumulated tax losses in the incoming fund:* in certain instances, the incoming fund carries accumulated tax losses which are a benefit to the current fund membership. However, an impact of the SFT may result in the accumulated tax losses being forgone to the detriment of the members.

- **We recommend that relevant State and Federal governments provide automatic relief against the unintended tax consequences flowing from SFTs.**

Secret commissions and criminal law

Secret commissions offence provisions prohibit the receipt or solicitation of a benefit as an inducement or reward for the appointment of a trustee and are regulated on a state-by-state basis.

The Queensland Supreme Court recently found that secret commission offence provisions in Queensland and Victoria are not engaged in the context of SFTs regulated under the Superannuation Industry (Supervision) Regulations 1994 (Cth), because SFTs do not involve the appointment of a new trustee. Rather, an SFT involves only a transfer of members and assets, and therefore, there is no 'appointment' of a trustee which would cause the offence provisions to be enlivened.

The case sets a precedent for the operation of the provisions in Queensland and Victoria but, as it did not consider the position under similar secret commission offence provisions in Western Australia and New South Wales, a level of uncertainly remains. This adds to merger costs by way of legal advice and mitigation.

- **Legislation should be passed in all relevant states to confirm that secret commission offences do not apply to SFTs.**

Transitional changes between product failure and merger

Once a MySuper product has failed a performance test twice it becomes closed to new members, including new members that would otherwise join the fund under employer default fund arrangements. If there is an active merger process underway, this creates a short period between the product failure and completion of the merger in which employers are unable to onboard new employees to either fund without breaching their default fund obligations. This creates an administrative headache for employers and risks disadvantaging new employees who would otherwise benefit from being either accepted briefly into the existing default fund and then transferred to the better fund or placed into the recipient fund directly.

Depending on the extent to which the merger is progressed and the risk of it not proceeding, APRA could consider granting relief to the new member ban for funds that are actively merging.

APRA could also consider guidance and relief in other areas of governance for actively merging funds in order to facilitate easier merger processes, e.g. interim board representation or certain reporting obligations. Clarity and transparency on the expectations of what board governance and composition models and transitional periods that APRA expects would allow governance negotiations to proceed with more confidence.

Merger communications to members

Once a product has failed a performance test, the fund is obliged to notify its members of this occurrence using prescribed wording that encourages members to consider moving to a different product. There is no flexibility to provide an explanation that the fund is in the process of merging into a better performing product.

Funds are also separately required to notify members of a decision to undertake a merger, under the significant event notice requirements.

As such, the fund is obliged to send separate merger communications, with conflicting messaging about the need to proactively consider switching or do nothing to be automatically transferred, which drives up funds’ communications costs, confuses members and provides them with a poor experience of communication saturation, particularly if they also hold investments in the fund’s choice options.

- **Funds should be permitted to include information about agreed and impending mergers in performance test communications.**

On the other side of the merger equation, the successor fund potentially risks breaching anti-hawking provisions should they communicate with the transferring fund’s members ahead of the merger being complete. This limits their ability to collaborate with the transferring fund in pre-merger communication strategies, e.g. both funds’ representatives running education sessions at large employer sites about the destination fund and benefits of the merger.

- **ASIC should provide guidance to clarify that anti-hawking restrictions would not be breached once a SFT has progressed to a sufficient extent.**

Historical performance

Tax considerations (e.g. state stamp duty) and other financial considerations often impact the selection of which of the two merging entities will be the successor fund. The performance history of the successor fund is then carried forward into the merged entity.

In cases where the successor fund is smaller than the transferring party or comprised of historic mergers (or both), this performance history may not be reflective of the actual returns delivered to the bulk of the merged entity's membership. Disclosures to members, regulators and the market may be significantly misrepresented as a result since they only reflect the experience of a small cohort of members in the merged entity. This has the potential to be construed as misleading.

- **Performance history of actual received returns of the largest cohort of members (taking into account previous SFTs) should carry forward into the new fund, regardless of which fund is nominated to be the receiving fund.**

Currently, the disclosure of merger-related costs is bundled into total fees per RG 97. This potentially disadvantages receiving funds due to the impact on performance measures which then impacts heatmaps, performance testing and historical performance disclosure.

APRA is currently considering enhancements to the Operational Risk Financial Reserve (ORFR) which would oblige funds to hold a 'baseline component' amount to meet the costs of undertaking a successor fund transfer. Once fully funded from general reserves, the ORFR does not represent an ongoing cost to members.

- **Fee disclosures should be revised to provide more information about transaction costs related to undertaking a merger, as distinct from ongoing operational and capital expenditure.**

MySuper authorisation

While it is ordinarily intended that a merged fund will align the transferring fund to the successor fund in order to offer a single MySuper option to all members immediately upon SFT, there may be circumstances in which this is not immediately possible. In these circumstances, it may be necessary for the recipient trustee to apply for a second MySuper authorisation prior to SFT. The time and costs associated with applying for a second MySuper authorisation (for example, using the 'material goodwill' exemption in s 29TA of the SIS Act) can be significant, and the threshold requirements difficult to satisfy (e.g. in the case of s 29TA, the requirement to show that members have a connection to the transferring fund, not just brand awareness).

There are also significant costs associated with delaying the transfer date in the event that a second MySuper authorisation is not granted, including replanning costs associated with communicating to key stakeholders, replanning the transfer phase delivery milestones across a number of key functions, replanning and resequencing of the integration phase milestones and reengagement with administration suppliers.

- **We recommend that APRA issue guidance and clarification on how the requirements of s29TA of the SIS Act may be met, and/or consider taking a facilitative approach in**

circumstances where the application for a second MySuper authorisation has been made to facilitate an SFT.

In these circumstances (which would not include the SFT of a distressed fund into a successor fund), the provision by APRA of a transitional/temporary second MySuper authorisation (e.g. for a period of 12 months) may also provide sufficient time to enable the receiving fund to complete the SFT and make the necessary alignments to transfer the MySuper option and prevent the need to seek a second MySuper authorisation.

Data transfer and systems integration

- **We recommend that APRA update the superannuation data standards to require uniform use of SuperStream for transferring data within the superannuation industry.**

For further information regarding our submission, please contact [redacted], Senior Manager, Advocacy & Research via email at [redacted]

Yours sincerely,

[redacted]

Eva Scheerlinck

Chief Executive Officer