Industry Super Australia

Melbourne
Casselden Place
Level 39, 2 Lonsdale St,
Melbourne, VIC 3000
P: (03) 9657 4321

Canberra
Dialogue
GF, 4 National Circuit
Barton, ACT 2600
P: (02) 6269 5710

9 March 2023

General Manager, Policy
Australian Prudential Regulatory Authority
By email: ***superannuation.policy@apra.gov.au***

APRA Discussion paper – Superannuation transfer planning: Proposed enhancements

Industry Super Australia (ISA) is a collective body for funds that carry the Industry SuperFund symbol. ISA manages research, advocacy, and collective projects on behalf of those funds and their five million members. Our aim is to maximise the retirement savings of all our members.

ISA welcomes the opportunity to comment on APRA's proposed amendments to Prudential Standard SPS 515 Strategic Planning and Member Outcomes (SPS 515) and the proposed updated transfer planning guidance. ISA broadly supports APRA's efforts to facilitate a more efficient successor fund transfer (SFT) process and we have provided some general comments below on specific issues that can act as a barrier to an SFT or increase the time and cost of an SFT.

We have proposed regulatory or legislative change to address identified issues of concern. ISA considers that such relief would support timely, well-executed and less costly SFTs which would in turn enhance member outcomes and make SFTs a more attractive prospect for successor funds. In summary we recommend:

- legislation be introduced to facilitate the transfer of nominations/authorisations made by members from the transferring fund to a successor fund
- each relevant jurisdiction pass legislation exempting asset transfers that occur as part of an SFT from stamp or transfer duty liability
- the SIS legislation be amended to allow transferring funds to impose limited blackout periods on their member accounts to facilitate an SFT and until that time APRA make regulation or give class order relief from the portability requirements for transferring funds
- each relevant jurisdiction pass legislation clarifying that secret commission offence provisions do not apply to an SFT
- APRA should include requirements and guidance for a scaled approach depending on the context in which the SFT has arisen, the nature and complexity of the SFT, and the size of the transferring/successor fund. In addition, APRA should allocate appropriate resources to ensure SFTs progress promptly and efficiently at regulatory touch-points
- AUSTRAC should provide a general exemption from the tipping off provisions to enable transferring funds to advise successor funds (provided the successor fund is a reporting

entity under the AML/CTF Act) of any Suspicious Matter Reports they have made in relation to members being transferred as part of a SFT process

- APRA clarify its guidance and consider class order relief with respect to the application of the equivalent rights test where, as part of an SFT, members are transferred from one MySuper product to another MySuper product
- in communications to members about failing the performance test, funds should be able to include information about an agreed merger if there is a reasonable expectation that the merger will take place in the next 12 months, and
- ASIC should provide guidance to clarify that a successor fund that provides information about the SFT and their fund to members of a transferring fund would not breach the hawking prohibition, where there is a reasonable expectation that the SFT process will be completed in the next 12 months.

While we appreciate that many of our recommendations are outside APRA's remit, we have nevertheless raised them for completeness and in the expectation that APRA will pass them onto Government and, where appropriate, the relevant agency.

Prior nominations/authorisations

There are a number of circumstances in which a member authorises or nominates a third party in relation to actions or benefits arising from their membership of a fund, for example a death benefit nomination or an authorisation for a financial adviser to be paid from the members' account. There are also circumstances where a member has given certain authorisations about their preferences in relation to their account, for example consent for their fund to communicate via email or mobile phone. These types of prior nominations/authorisations will typically end when the member's account is transferred to the successor fund as the nominations/authorisations have been granted to the transferring licensee. To seek new nominations/authorisations from the entire membership would lead to a significant administrative burden for the successor fund.

In practice, deeds of transfer may be drafted to seek to transfer these nominations/authorisations to the successor fund. However, these types of clauses have never been tested in the courts so there is still uncertainty for funds regarding the effectiveness of the nomination/authorisation.

Recommendation: legislation be introduced to facilitate the transfer of nominations/authorisations made by members from the transferring fund to a successor fund.

Tax Relief

Potential capital gains tax liability has been cited as a barrier to mergers in the past. The recent passage of legislation[1] that makes capital gains tax relief permanent for merging funds provides certainty and removes this hurdle.

[1] Treasury Laws Amendment (2020 Measures No.1) Bill 2020

However, no such relief has been provided from state-based stamp or transfer duty liability. During the merger process, transferring real assets is a cumbersome and expensive process for funds. While we recognise this is beyond APRA's remit, it would reduce regulatory burden and create efficiencies if similar legislation were passed to provide relief from the need to apply for stamp or transfer duty relief in each separate jurisdiction to facilitate a SFT.

Recommendation: Each relevant jurisdiction pass legislation exempting asset transfers that occur as part of an SFT from stamp or transfer duty liability.

Portability relief

The portability provisions of the SIS legislation[2] require RSE licensees to transfer a member's benefits from the fund on the member's request, generally within 3 business days of receiving a member request.

During the SFT process, it is necessary for the transferring fund to impose a blackout period (usually up to 10 days) during which members are unable to make changes to their accounts while the accounts are being transferred to the successor fund. This would ordinarily constitute a breach of the portability provisions (and potentially also a breach of the RSE licence condition under s29E(1)(a) of the SIS Act which states that the RSE must comply with the RSE licensee law).

A trustee can apply to APRA for relief from the portability requirements. APRA will assess these applications on a case-by-case basis. This creates inefficiencies and uncertainty for all parties involved in a SFT in circumstances where it is not possible to execute the SFT without some restrictions on portability.

Recommendation:

- the SIS legislation should be amended to allow transferring funds to impose limited blackout periods on their member accounts to facilitate an SFT; and
- until that time APRA should make regulation or give class order relief from the portability requirements for transferring funds.

Crimes Act

In some cases, superannuation funds seeking to engage in SFTs have been concerned about committing a technical breach of statutory "secret commission" offence provisions, which prohibit the receipt or solicitation of a benefit as an inducement or reward for an appointment of trustees absent approval of the court or all members of the fund.[3] This is because SFTs may involve the provision of indemnities or other promises from the successor fund trustee to the transferring fund trustee.

The Queensland Supreme Court recently held that the Queensland and Victorian secret commission offence provisions did not apply to a proposed SFT because the transaction involved a transfer of members and assets from one trust to another, rather than the

[2] Refer in particular Part 3 Div 2 and Div 3 of the SIS Act 1993 and Div 6.5, r 6.34 of the SIS Regulations 1994
[3] See for example, s442F of Schedule 1 to the *Criminal Code Act 1899* (Qld) and s180 of the *Crimes Act 1958* (Vic)

appointment of a trustee.[4] However, there have not yet been similar decisions made in relation to the secret commission offence provisions in Western Australia or New South Wales and so there remains some ongoing uncertainty. Again, we appreciate this is beyond APRA's remit but resolving this uncertainty would reduce the cost of SFTs.

Recommendation: Legislation be passed in all relevant states clarifying that secret commission offence provisions do not apply to an SFT.

Tipping-off Provisions

Under the 'tipping off' provisions in the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth) (AML/CTF Act) a transferring fund is prohibited from disclosing to the successor fund any suspicious matter reports (SMR) submitted, or required to be submitted, to AUSTRAC in relation to a member, including any information from which it could be inferred that the transferring fund has submitted (or is required to submit) an SMR.[5] This means that the transferring fund is prevented from advising the successor fund of any transferring members identified as high AML/CTF risk and the underlying reason for attributing a high-risk rating. A breach of the tipping off provisions is a criminal offence and has serious consequences, including up to two years imprisonment.

The tipping off provisions are intended to both protect the privacy of the customer who is the subject of the SMR, but also to ensure any law enforcement investigations are not compromised. However, in the context of an SFT, where:

- the member's account is being wholly transferred and the transferring fund wound up,
- the transferring fund will have no ongoing role in relation to the relevant member, and
- the successor fund is a reporting entity with AUSTRAC, and therefore must establish, implement, and maintain an AML/CTF program, undertake ongoing due diligence and monitor transactions, and detect and report unusual transactions and suspicious matters to AUSTRAC,

it does not appear inconsistent with the intention of the AML/CTF Act, or specifically the tipping off provisions, for the relevant information regarding the members of the transferring fund to be communicated to the successor fund. In fact, such communication may promote the purposes of the AML/CTF Act by ensuring that the current trustee has knowledge of the matters that are the subject of the legislation and can undertake actions consistent with its AML/CTF obligations in circumstances where the previous trustee is no longer a reporting entity.

We note that AUSTRAC has exemption powers to provide regulatory relief from the tipping off provisions.[6] In 2020-21 over one third of the exemptions granted by AUSTRAC involved regulator relief from the tipping off provisions.[7] AUSTRAC has itself noted that the increasing number of exemption applications in relation to Part 11 of the AML/CTF Act (secrecy and access), particularly the tipping off provisions, suggests the regime is not 'fit-for-purpose'.[8] ISA

[4] *H.E.S.T. Australia Ltd v Attorney-General (Qld): Mercy Super Pty Ltd v Attorney-General (Qld)* [2022] QSC 221
[5] Section 123 of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006*
[6] Section 248 of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006*
[7] AUSTRAC'S Self-Assessment against the Regulator Performance Framework 2020-21, page 8
[8] AUSTRAC Annual Report 2021-22 page 91

considers that the application of the tipping off provisions to the transfer of members as part of an SFT may not have been contemplated by the legislation and that therefore an exemption from the tipping off provisions for SFTs where the receiving fund is a reporting entity would be appropriate and proportionate.

Recommendation: AUSTRAC should provide a general exemption from the tipping off provisions to enable transferring funds to advise successor funds of any SMRs they have made in relation to members being transferred as part of a SFT process (provided the successor fund is a reporting entity under the AML/CTF Act).

'One size fits all' process – nature, size and complexity

The proposed enhancements in APRA's discussion paper focus on effective planning in the event of a crisis or as a response to certain triggers (for example, failure of the legislated performance test), and ensuring funds are prepared to take action promptly to promote the financial interests of their members. However, SFTs can also occur due to Trustees taking strategic decisions to set members up for sustainable benefits over the long term.

Following on from this, we recognise that not all SFTs are the same in nature, size or complexity. The SFT process and the proposed changes to APRA guidance impose substantial regulatory burden on both transferring funds and successor funds, regardless of the context in which a decision to merge has been taken, the size of the funds involved and the complexity of the SFT.

Funds tend to adopt a conservative approach to compliance with APRA requirements in order to avoid negative regulatory attention and may therefore carry out more work than may otherwise be required, or considered proportionate, by APRA in the context of a specific fund transfer, particularly if the transferring fund is at the smaller end of the spectrum. The time and cost of meeting the regulatory requirements for an SFT can act as a disincentive for larger, performing funds to take on smaller, underperforming funds and can make it more difficult for smaller funds to find a suitable successor fund. A recent Accenture report commissioned by ISA found that "Funds have found the cost of mergers often means they are not viable for larger funds without a clear overriding strategic benefit."

A more scaled regulatory approach, with a clearer road-map or set of requirements for funds of different sizes, and with different drivers for merging, would help avoid funds spending time and money on tasks that may not be necessary, thereby improving the speed and attractiveness of fund transfers.

Recommendation: As part of its enhancements to the SFT planning process, APRA should include requirements and guidance for a scaled approach depending on the nature and complexity of the SFT, and the size of the transferring/successor fund. In addition, APRA should allocate appropriate resources to ensure SFTs progress promptly and efficiently at regulatory touchpoints.

Equivalent Rights Analysis

Funds are required to undertake an analysis to ensure that the legally enforceable rights conferred on members by the receiving RSE licensee are equivalent to those the members had

under the transferring RSE. This analysis can take significant time and resources to complete and reports on the assessment can run between 10 to 100 pages long. In the discussion paper, APRA notes that the application of the equivalent rights and due diligence costs can act as barriers to transfers.

The time and cost of the equivalent rights analysis is, in particular, unnecessarily burdensome in the context of MySuper-to-MySuper SFTs. In its Prudential Practice Guide SPG 227 – Successor Fund Transfers and Wind-ups (SPG 227) APRA states that it considers that a SFT of members from a transferring RSE's MySuper product to a receiving RSE's MySuper product would generally satisfy the equivalence test.[9] However, the subsequent regulatory guidance is then unclear. While APRA notes that all MySuper products have the same core characteristics and that therefore the equivalence test will be met, APRA goes on to state that in addition to meeting the equivalent rights test, it expects a prudent transferring RSE licensee would also consider the features of a proposed receiving RSE in selecting or narrowing the range of suitable MySuper products for an SFT.[10] APRA considers that the features of a MySuper product include asset allocation, investment strategy, fees and insurance offerings.[11] It is not clear how some (or all) of these may be materially different and yet the equivalent rights test would be deemed satisfied.

While APRA considers that a 'line by line' comparison of every feature is unlikely to be necessary, it also considers that a thorough evaluation of the features of a proposed receiving RSE would assist a transferring RSE licensee to demonstrate that it has acted to promote the financial interests of the relevant members. In light of the legal requirement of the equivalent rights test and the unclear regulatory guidance, the funds involved in an SFT will generally take a conservative approach in conducting due diligence regarding MySuper products, adding time and cost to the SFT process.

In its discussion paper, APRA has indicated that it proposes to provide enhanced guidance outlining expectations of prudent practice when preparing for a timely and efficient SFT. The proposed content of the guidance is summarised in Attachment B, however, the attachment does not appear to contemplate specific guidance on the equivalent rights test.

Recommendation: APRA should clarify its guidance on the circumstances in which a transfer of MySuper-to-MySuper products will be deemed to meet the equivalent rights test, and consider whether, for certainty, it should provide class order relief from the requirement to comply with the equivalent rights test in relation to MySuper products.

Communications with members – interaction between the performance test and the SFT process

Where a fund has failed the performance test, it is required under section 60E of the Superannuation Industry (Supervision) Act 1993 (SIS Act) to communicate this to its members in the form set out in Schedule 2A of the of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations). The prescribed form requires funds to advise members that their superannuation product has performed poorly and that they should consider switching to a better performing product.

[9] APRA Prudential Practice Guide SPG 227 – Successor Fund Transfers and Wind-ups, paragraph 23
[10] Ibid, paragraph 26
[11] Ibid, paragraph 25(b)

There is nothing prescribed in the SIS Act and its associated regulations (SIS legislation) that prevents an underperforming fund from communicating to members about an upcoming SFT to a better performing fund. However, in its Review of trustee communications about the MySuper performance test (REP 729), ASIC makes clear that "underperforming funds should not be downplaying the importance of the test failure to members" and that "it should not be assumed that at the point that a merger is planned a member's right to choose another superannuation fund becomes unimportant".[12]

ASIC also states that part of the process of a merger itself involves notification of members ahead of the merger occurring to enable them to decide whether to choose another superannuation fund.[13] Under the Corporations Act there is an obligation on a transferring fund to notify its members about a 'material change' or 'significant event'[14] as soon as practicable once a decision is made to transfer member benefits.[15] ASIC has provided guidance that:

Whether there has been a material change or significant event will depend on all the circumstances. For example, if you are taking the steps necessary to plan for and implement member transfers, this is a change or event that must be disclosed to members.[16]

As a result, underperforming funds are hesitant to flag an SFT when communicating with members about failing the performance test because such communications may be considered by regulators to undermine the legislative intent of the prescribed form under section 60E. In particular, the requirement to advise members to consider switching funds.

The communications sent by an underperforming fund to its members – including the letter or email required under section 60E of the SIS Act – should not mislead members about the gravity of failing the performance test. However, in the interests of full disclosure that may assist members who are considering moving to another fund, failing funds that are engaged in an SFT process should have the option to provide that information to members if the SFT discussions are sufficiently advanced. Otherwise, members are more likely to leave the poor performing fund, which makes it a less attractive merger partner (thereby adversely affecting disengaged members in the poor performing fund). It may also act as a disincentive for a performing fund to commence SFT discussions with an underperforming fund.

ISA does not suggest that an SFT is "an excuse to avoid current legal obligations"[17] but we consider that information about an upcoming SFT is as relevant to a member's investment decision in relation to its superannuation product as information about the test failure. Member choice is not a goal in itself but a tool to realise the social policy objectives of the superannuation system. In that context, and considering the well-established facts about engagement, behavioural biases, cognitive limitations, and low financial literacy, members should be provided with relevant information in relation to upcoming transfers to better performing, high quality funds.

---

[12] ASIC Review of trustee communications about the MySuper performance test, June 2022 (REP 729), page 9
[13] Ibid
[14] Refer s1017B of the *Corporations Act 2001* (Cth)
[15] See for example, s1017B(5A)
[16] ASIC Information Sheet 90
[17] REP 729, page 9

Where ASIC has provided relief from the section 60E notice requirements in relation to an imminent SFT, it considered there was a net regulatory benefit in deferring the notification, as the information in the notice would shortly be irrelevant to the member.

We recognise that SFT discussions need to be sufficiently advanced so that the member can be confident that they will end up in a better performing fund within a short timeframe. However, in our view, it may be more appropriate for funds to include this information in their letter to members where the fund has signed a memorandum of understanding or heads of agreement document with high level agreement on the merger, with the expectation that the merger will take place in the next 12 months.

Recommendation: In communications to members about failing the performance test, funds should be able to include information about an agreed merger if there is a reasonable expectation that the merger will take place in the next 12 months.

Communications with members - The Hawking Prohibition

Until the SFT process is complete and the members transferred to the successor fund, the successor fund is prohibited under the hawking prohibition from contacting the members of the transferring fund.[18] However, where a transfer is sufficiently progressed, it is in the interests of the members of the transferring fund to be informed about the successor fund, its products, fees and performance, particularly for disengaged members who are unlikely to contact the successor fund for information. Successor funds are selected for the products and services they can offer transferring members, amongst other factors. Transferring members should be provided with details of these offerings so they are able to make an informed investment decision about their superannuation.

As stated above, in the absence of information about the successor fund, members of the underperforming transferring fund may be more likely to leave the fund, making it a less attractive merger partner and adversely affecting disengaged members in the poor performing fund.

Recommendation: ASIC should provide guidance to clarify that a successor fund that provides information about the SFT and their fund to members of a transferring fund would not breach the hawking prohibition, where there is a reasonable expectation that the SFT process will be completed in the next 12 months.

If you would like to discuss this submission, please do not hesitate to contact me at [redacted] or by phone on [redacted].

[redacted]

[redacted]
Senior Adviser, Policy & Regulatory Affairs

[18] Refer s992A(1) of the *Corporations Act 2001* (Cth)