18 February 2014

Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 20001

via email: superannuation.policy@apra.gov.au

Dear Sir/Madam

Consultation on proposed Modification Declaration – Superannuation Industry (Supervision) Regulations 1994, r. 4.07E(8)

Thank you for the opportunity to comment on the draft Modification Declaration set out in Helen Rowell's letter to RSE licensees of 5 February 2014.

The Institute strongly supports the objective of the draft Modification Declaration, being to permit the continuation of defined benefit (DB) self-insurance arrangements in the new fund after a successor fund transfer (SFT).

We are pleased that APRA is acting quickly to address the deficiencies in the current legislation in this regard. However we consider that the draft Modification Declaration only goes part way to achieving the above objective.

The deficiencies in the draft may best be explained by way of example. For ease of reference let us say that the original fund (Fund A), sponsored by Company A, transfers via an SFT into Fund B. Sub-Fund A is created in Fund B to cater for the continuation of the DB arrangements (previously provided via Fund A) to transferred Fund A members and the provision of the same arrangements to new employees of Company A who join Sub-Fund A. In our view the circumstances covered by the Modification Declaration need to allow for:

(a) self-insurance of new employees of Company A who join a self-insured DB category of Sub-Fund A (as would have been allowed in the original fund); and

(b) changes in self-insured risks for an existing Sub-Fund A DB member who moves, for example, from a category without a temporary disability income benefit to a category with a self-insured temporary disability income benefit (as would have been allowed in the original fund); and

(c) for more than one SFT e.g. if self-insured DB Fund A SFTs to Fund B that did not self-insure on 1 July 2013, Fund B could use the draft Modification Declaration conditions to continue the self-insurance of transferring Fund A members; but if Fund B then SFTs to Fund C (that did not self-insure on 1 July 2013), Fund C could not continue the self-insurance as Fund B (the original fund in this second SFT) would fail the conditions of draft Modification Declaration condition (8A)(d) as it did not self-insure on 1 July 2013.

If circumstances (a) and (b) are not covered, it is likely to create significant additional complexity and equity issues (and may even be a barrier to an SFT in some circumstances), as well as potential practical problems such as obtaining external insurance for very small numbers of members.

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It may also be useful for the Modification Declaration to provide APRA with the power to approve self-insurance in other circumstances. For example, where the receiving fund has a small DB group which is externally insured and the original fund has a large DB group, which is self-insured, it might make sense following the SFT for the small DB group already in the receiving fund to also become self-insured (as they are part of a much bigger DB pool), but the legislation won't allow this.

Accumulation Funds

We note that issues (a), (b) and (c) above are not catered for by SIS r4.07E(3). We recommend that the Modification Declaration be extended to cover these circumstances for accumulation funds as well as defined benefit funds.

Furthermore, we have had queries from actuaries as to whether r4.07E adequately caters for run-off of self-insurance claims for accumulation funds. For example, an accumulation fund may cease offering self-insured benefits at 30 June 2015 but may retain a liability for self-insured claims incurred in the period up to 30 June 2015 for a significant number of years. The fund may not be able to find an insurer willing to insure this outstanding liability, or it may assess the cost of such insurance as unreasonably expensive. In some cases the fund may have ceased to offer self- insurance many years ago and the likely remaining liability may be very low. We note that r4.07E(9) specifically provides for relevant members to retain their entitlement to make claims and be paid self-insured benefits in the run-off period beyond 30 June 2016 and hence we understand that such a fund would not be considered to be in breach of r4.07E if the run-off period extends beyond 30 June 2016. Could you please advise if this is not correct?

RSE licence Condition B.1

Whilst it doesn't affect the Modification Declaration, we also wish to query an aspect of the footnote on page 1 of the letter which indicates that RSE licence Condition B.1 states: "If the RSE licensee undertakes to provide any benefits that are life insurance (including disability) benefits to members, those benefits must be wholly determined by reference to life policies issued to the trustee from a company registered under the Life Insurance Act 1995."

We note that this does not appear to be in accordance with the decision to permit disability insurance to be provided by general insurers, as reflected in paragraph 6(a) of SPS 250 which refers to insured benefits being provided via "insurance acquired by an RSE licensee from a life company registered, or taken to be registered, under section 21 of the Life Insurance Act 1995 **or a general insurance company or Lloyd's underwriter authorised, or taken to be authorised, under the Insurance Act 1973**" (emphasis added).

If required, we would be happy to discuss our views on this matter. Please do not hesitate to contact David Bell, Chief Executive Officer of the Actuaries Institute (phone 02 9239 6106 or email david.bell@actuaries.asn.au) to arrange this, or for any further information.

Yours sincerely

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