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Dear Ms. Richards

Consultation on draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (draft SPG 227)

The Financial Services Council (**FSC**) has over 100 members, representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies.The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Thank you for the opportunity to provide a submission on draft SPG 227. Given the importance of the issue for our members and the complexity of the topic, we would appreciate a further consultation opportunity prior to the draft being released in final.

In this submission, references to the Act, unless otherwise indicated, are references to the *Superannuation Industry (Supervision) Act 1993.*

APRA's draft guide to successor fund transfers (**SFTs**) and wind-ups is a very positive and welcome step forward in clarifying a number of processes and legal considerations to facilitate the rationalisation of funds within the superannuation industry.

Consultation on draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (draft SPG 227): FSC Submission: 17 February 2017

Our members are supportive of the approach and most of the guidance as set out in the draft. However, we make the following comments in relation to specific paragraphs in the draft guide:

1. **Terminology:** There are a number of terminology references that need to be reviewed and addressed for consistency. For example, there are references to *transfers of members* and *transfers of rights* in various places. Likewise, there are inconsistent references to *best interests* or *best financial interests* as well as *rights to benefits* and *rights and benefits*.
   Paragraph 9 defines "the transferring RSE licensee" but the term is not consistently used throughout the document. There are many references to "an RSE licensee" which then does not make it clear whether the expectation is on the transferring RSE licensee or receiving licensee.
   In this context, we note that the guide should mention the RSE's power under the trust instrument to transfer **in addition** to the requirements around the ability to transfer under the Act and Regulations. The previous (now archived) circular, *Superannuation Circular No. I.C.4*, gave far more context around this and also set out the relevant legal provisions more clearly;

2. **Equivalency-Timing:** (paragraphs 6 and 7) - In our view, the member's rights only need to be equivalent at the *time of transfer*. What happens before or after are best interests and powers considerations for the respective RSEs. Unless there is a full transfer of all members of a fund, best interests obligations imposed on the transferring trustee will continue to apply to that trustee for the remaining members in the transferor fund;

3. **No unnecessary delay:** (paragraph 8) - We suggest this be rephrased to "in a prudent and planned manner, having regard to the size complexity and scale of the transfer". Data transfers, unwinding contracts and investments may be some considerations. On data transfers, it may be useful to refer to the ISAT Protocol, (**attached**), which contains commentary around data for successor fund transfers. It also contains some references to the law as to what is a successor fund transfer and consideration of super stream requirements. These comments also are relevant to the paragraphs dealing with Data Management at page 14 of draft SPG 227;

4. **Existing Members:** (paragraph 10)-In our view, the relevant reference should be to the best interests of members as a whole. This is because the receiving trustee needs to consider members' interests at time of transfer and subsequently. The impact on rights to benefits (there should be no change) and other member benefits are some of the best interests considerations. · In summary then, in our view the duty of the receiving RSE Licensee in respect of the existing members of the receiving fund is to act in the best interests of the members as a whole. This is both in terms of general law duties and those as a consequence s.52(2)(c) of the Act. A requirement to 'not adversely affect the rights and benefits of existing members' is a particularly high test to meet as opposed to what is recognised as the legal duty of act in the best interests of the existing members as a whole. We recommend this statement is altered to reflect the well-recognised and universally acknowledged 'best interests' duty apply rather than a 'not adversely affect' test;

5. **Documented Due Diligence And Risk Assessment Process:** (paragraph 12)-
   Our view is that the documentation of an assessment of alternative RSEs is appropriate. It may be useful to expressly recognise that this assessment does not necessarily require a formal tender process (which may be more relevant to a stand-alone corporate superannuation fund looking to wind up for instance or a large employer plan looking transfer from a Public Offer standard employer sponsored fund).

   However, as we have indicated, the expectation that an RSE licensee as a universal rule, would assess alternative RSEs is both onerous and impractical. It is onerous because the number of alternative RSEs is significant and it is impractical because a transferring RSE licensee would not have sufficient access to information about the alternative RSEs. Perhaps the language should be, rather than alternative *RSEs that may potentially receive the transferred members…*, a more neutral but still effective obligation could be expressed as *...RSEs under consideration that may potentially receive the transferred members*. This would accommodate also the tendering process that applies where a full or partial SFT occurs.

In this regard, we note that in conglomerates with many RSEs within the group, it will most often be appropriate to conduct an assessment and analysis of appropriate receiving funds within the group. This could be expressly recognised with the guidance.

In addition, we note the comments in this paragraph that

> *…certain paragraphs may also be relevant to other types of bulk transfers of a group of members, for example, bulk transfers completed with member consent or from an eligible rollover fund to an active superannuation account.4*

We support the use of the guidance for Eligible Rollover Fund transfers as a means of providing further clarity in terms of what factors should be taken into account in those circumstances.

6. **Outcomes Test?** Paragraph 15 might be read as giving the impression that the relevant test is an outcomes test. The case law and statutory provisions make it clear that this is not the case-the test is whether the trustee has acted in the best interests of members. Accordingly, we suggest that the words commencing with "including whether …" to the end of the sentence, be deleted;

7. **Inclusive Reasons for an SFT?** (paragraph 16)-Although this paragraph is expressed not to be one of limitation, it may be useful to consider adding the following factors, by way of example-

   (a) more robust governance arrangements, such as the presence of a majority of independent directors on the trustee Board and the presence of various governance-related committees and delegations;
   (b) more diversified investment and product choice;
   (c) more favourable product features in the transferee fund;
   (d) "better" insurance arrangements in the transferee fund;
   (e) whether an employer or other sponsor has indicated its willingness to support the transferee fund.

8. **Unable to implement SFT:** (paragraph 20)- We note that the manner in which this paragraph currently is drafted may give the impression that you are anticipating that a decision to transfer is first made and then identification of a successor fund and then analysis. Such an approach of

course worked effectively with the ADA regime, as in that case, there was a legal requirement to act.
If this analysis is correct, then placing the steps in this order may "lock" an RSE into a transfer, once a decision has been made that it is in the best interests of members to effect an SFT.
Further, we feel that the obligation of a trustee in such circumstances should be put as no higher than one that the RSE should consider if it is appropriate to review the SFT generally, which is a step a prudent trustee would undertake.

9. **Rights of Members:** (paragraph 22)-The expression "rights of members" as used in this paragraph does not reflect the statutory language of equivalency of "member's rights in respect of benefits". The former expression connotes a very broad set of "rights", which is not consistent with the statutory intention. The Regulations made under the Act define a successor fund as follows-

> *"successor fund, in relation to a transfer of benefits of a member from a fund (called the "original fund"), means a fund which satisfies the following conditions:*
>
> *(a) the fund confers on the member **equivalent rights to the rights that the member had** under the original fund in respect of the benefits;*
>
> *(b) before the transfer, the trustee of the fund has agreed with the trustee of the original fund that the fund **will confer on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits**".*

(Regulation 1.03) (Our emphasis)

For completeness, we note that any statutory rights should remain constant, unless for some reason there has been grandfathering of those rights.

10. **Meaning of Rights:** (paragraph 23) – By way of general comment, we note that the relevant case law is quite fluid at the moment. There are some cases before the courts that may shed further light but these cases do not deal with successor funds. These cases demonstrate that rights in respect of benefits requires very close analysis and

it would be more prudent for APRA to qualify or caveat these statements.

For example, trust deed fee maxima, or RSE statements that certain fees will be waived for the life of the investment may be rights in themselves. The same applies to embedded guarantees. Another example is the right to charge a fee up to a specified cap (which may be interpreted as a right not to be charged over the "cap").

In this context, we note that paragraph 25 refers to a "bundle of rights" concept. We appreciate that this concept, like rights in respect of benefits, is difficult to define with any certainty. However, if any clarification of this concept can be provided, subject to the qualifications and caveats mentioned above, this would be useful.

We note that an RSE licensee typically has a **personal** right to charge fees in accordance with the relevant trust deed. A consideration of whether to change such fees does not usually involve fiduciary considerations including whether such a change in fees is in the best interests of members. An RSE licensee of course may have other personal rights under the governing rules, which do not involve fiduciary obligation or considerations. Accordingly, we recommend the third sentence in this paragraph is amended to reflect the appropriate legal characterisation of personal rights. The following wording in that sentence in particular is not correct as a matter of law-

> *…an RSE licensee would need to be able to demonstrate that any changes to the RSE's features are in the overall best interests of members.*

11. **Groups of Members:** (paragraph 26)-We note and agree that this is what commonly occurs in a practical sense. Nevertheless, the analysis must occur at a member level. It would be useful if this could be made clearer in the paragraph.

12. **Regulation 13.16:** (paragraph 27)- One issue which has arisen is whether the Regulation 13.16 requirement of preservation of the members' right or claim to accrued benefits and the amount of accrued benefits, impacts upon early release or other exit fees.

There is an issue as to whether an RSE-initiated transfer affects these or whether in terms of the final SPG, you are anticipating the **licensee's personal right** to such fees will be carried across until the member exits the receiving trustee.
In this context, it would be useful if some practical examples and applications of the broad statement in the paragraph could be supplied.

13. **MySuper issues:** (paragraphs 28-31) – Although perhaps beneficial in this context, we do have some reservations as to whether the formulation contained in particular, in paragraphs 28 and 29,is correct as a matter of law. For example, paragraph 28 refers to an SFT from one MySuper product to another as one which would *generally satisfy the equivalence test.* However, this invariably must depend upon the trust deed or other "governing rules". The MySuper regime only sets minimum requirements and the statements appear too broad. This formulation perhaps should be recast along the lines of *more likely* to *satisfy the equivalence test*.
We do not agree as stated in paragraph 29 that *all MySuper products offer the same rights…* as we have mentioned, there may be rights which differ as between these products; however, the boundaries of each MySuper products must be the same.
In relation to the comments made in paragraph 30, we assume the intention is to encourage trustees not to take an overly restrictive view of the equivalence test in this context. However, it would be useful, particularly when this paragraph is read with paragraph 31, if the guidance could also refer to transfers between broad product classes, would satisfy the equivalency test (for example, diversified to diversified). In order to circumvent any assumptions it may also be helpful to explicitly mention the reverse scenario (lifecycle investment option to single diversified investment strategy) is allowable. Alternatively, the guidance should make it quite clear that any relevant examples given are inclusive and not intended to be exhaustive.

In relation to paragraph 31, we note that it is unclear how features like 'return targets' and 'investment strategy' can be assessed from a member best interest perspective (although perhaps this is not as difficult in the case of financial interests test). It could possibly be an assessment of the member demographics and whether the strategy and targets are most appropriate given the fund's demographic profile. Some clarification may be required here.

14. **Planning Process:** (paragraph 33) - By way of a general observation we note that costs are a key consideration and should be mentioned.

In relation to insurance matters, we note these are addressed, in an inclusive fashion, in paragraph 33(f). We acknowledge that insurance matters are key matters for consideration and the three items included at sub-paragraph (f) are done so on an inclusive basis. However, we recommend paragraph 33(f)(i) be amended to recognise that insurance benefits and insurance policies are not always transferred to the receiving trustee. The receiving RSE may provide equivalent insurance benefits which may be agreed to be provided by the relevant receiving fund insurer under an existing (or enhanced) policy held with the receiving RSE licensee.

Another suggestion in the context of planning (and which is also relevant to wind-ups) is that additional flexibility could be built-in between you and RSE licensees to ensure a timely SFT can be executed and the transferring fund wound up in a timely manner. This includes being able to report to APRA outside of the already established reporting periods and agreeing directly with APRA a mutually beneficial agreed reporting cycle for funds that are subject to a SFT. Additionally, members would welcome any opportunities to streamline the exemptions process (i.e. payments of pensions and contributions splitting) to allow for a more sophisticated transition approach that allows for a timely manner of payments and the reduction of administration work during the critical SFT transition period.

15. **Member communications:** (paragraph 49)-We note that ASIC has also given some detailed commentary around communications to members and what is said here should be consistent with ASIC requirements. We do not know whether ASIC has been asked to comment on draft SPG 227-as you would know, there has been some quite recent ASIC involvement in communication, disclosure and data integrity issues. We would of course like to see consistency in the views and approaches of the Regulators here. We would welcome a coordinated approach with both APRA and ASIC in this area to ensure disclosure and significant event notifications meet both regulators' expectations. This includes both the contents and expected timing and would welcome further guidance on this in the finalised APRA guideline.

16. ***Reporting Standard SRS 602.0 Wind-up*** **(SRS 602.0)** (paragraph 63) – Our comments also relate to SRS 601.0, in particular, the guidance for windup reporting to be lodged within 3 months of the windup date. It would be helpful if there was an opportunity for more flexibility in providing windup reporting when the SFT effective date is not 30 June. For example, if the SFT was effective 30 September (and the assets transferred effective that date), the wind up returns are required to be lodged by 31 December; however some of the required information which is provided by third parties will not be available until some months after the following end of financial year on 30 June.

    While completing SFTs effective 30 June provides clean reporting cut overs, if the transfer involves a change or product or administration system the preference is generally to avoid this date given that this is an extremely intense time of year for administrators for normal "BAU". Thus, SFTs of this type are more commonly effected at other times of the year.

17. **Post-implementation Review:** (paragraph 64) - We would be interested to understand the particular matters you envisage the review would include. For example are these operational matters or some other category or categories?

Other suggestions

18. What might be helpful in the guidance is a step by step approach of the decision making framework and the process that a trustee needs to go through (in the form of a diagram).
19. It would also be useful to set out some of the further considerations for the receiving trustee. For example, there may be fairness (as well as best interests considerations) if the member benefits have discounts applied from a fund tax surplus, DTA etc.
20. There could also be a recognition that an SFT may be "risk only" in nature.

Other broader government policy matters

There are a number of other matters which raise broader government policy issues which we would be grateful if APRA could note and consider

in this context. These are broadly related to the concepts of transfers of members or product holders' interests in particular arrangements.

1. Whole of platform practical issues

The utility of the SFT mechanism for broad based legacy product and associated administrative platform rationalisation is somewhat limited. Life companies have achieved scale and administrative efficiencies by managing multiple product offerings on the same platforms rather than just APRA regulated super funds in isolation. In order to unwind one part of the platform proposition requires them to potentially impose the fixed cost structure on what is left behind (including non-super policyholders). FSC has responded to various consultations and made multiple representations on the broader based approach to product rationalisation over the past decade to promote a more effective mechanism to address these and other broader financial product legacy issues. This is being supported at a number of levels- see **attached** press clipping. The Actuaries Institute's 2017 pre-budget submission to Treasury is published at http://www.actuaries.asn.au/public-policy-and-media/submissions

2. Retirement Savings Accounts (RSAs).

There is no effective mechanism to transfer RSA accounts.

An RSA is essentially a bank deposit product, with the veneer of a superannuation product. They are not superannuation funds. Just like any other bank deposit, there are only two parties to the contract, the depositor (i.e. a person who uses this as the vehicle for their superannuation savings), and the bank.

Despite the amendments to tax and ancillary legislation, there are no corresponding amendments to the RSA Act, to allow for benefits to be transferred to another RSA or superannuation fund if equivalent rights to benefits could be established. The current definition of "successor fund" under SIS does not cover an RSA.

Section 89 of the *Retirement Savings Account Act* (**RSA Act**), allows for the transfer to an eligible rollover fund. There are no best interest considerations, only requirements set out in

the legislation and regulations. Any additional rights or benefits communicated in the PDS would need to be considered. Apart from section 89, there is no other facility in the RSA Act or in the *Financial Sector (Business Transfer and Group Restructure) Act 1999* to facilitate such a transfer without the consent of the customer.
http://www.austlii.edu.au/au/legis/cth/consol_reg/rsar1997419/s4.33.html

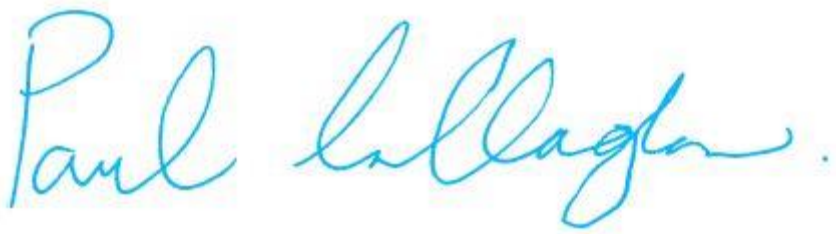
Unlike APRA regulated superannuation funds, the governance of a RSA is a matter for a RSA provider (ie, a Bank) to decide on which area of the entity will undertake the administration, associated governance and reporting requirements. Since there is no interposed entity between the RSA provider and account holder, consideration could be given to developing a customer advocacy framework to help to ensure account holder interests are progressed when transfers are under consideration.

3. Number of MySuper products and number of small super funds

To date, APRA has been requesting trustees to consider scale and other issues for their members. The Government is also considering governance and efficiency issues associated with the super system. As noted above in relation to the whole of platform practical issues, if the Government was able to facilitate broader based product rationalisation regulations it may then become viable to set stricter requirements for all "subscale" superannuation funds and require those superannuation funds by a nominated date to transfer unless they obtain an APRA exemption. For those required to transfer, a similar statutory regime to the ADA transfer regime could be a mechanism to consider.

Should you have any questions in relation to our submission, please contact the writer on 02-9299 3022.

Yours Faithfully



Paul Callaghan

General Counsel