



21 July 2017

TO: ALL RSE LICENSEES

FINAL PRUDENTIAL PRACTICE GUIDE SPG 227 SUCCESSOR FUND TRANSFERS AND WIND-UPS – RESPONSE TO SUBMISSIONS

On 24 November 2016, the Australian Prudential Regulation Authority (APRA) released for consultation draft *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups* (SPG 227).¹ Draft SPG 227 responded to industry requests for further guidance on successor fund transfers (SFTs) in recognition of ongoing consolidation in the superannuation industry.

Consultation closed in mid-February 2017, with nine submissions received, two of which are private and confidential. The non-confidential submissions are available on APRA's website.²

Submissions raised a number of issues which APRA has considered and, where appropriate, addressed in revised SPG 227. The key issues raised in submissions, together with APRA's response, are outlined in the attachment to this letter.

Submissions raised some matters that were not directly relevant to the scope of SPG 227, including legacy products and the operation of s. 29WA(5) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). These matters are not reflected in SPG 227 but APRA will give consideration to them at a future time.

Final SPG 227 is available at:

<http://www.apra.gov.au/Super/PrudentialFramework/Pages/superannuation-ppgs.aspx>

Please contact your APRA responsible supervisor if you require further information.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Pat Brennan', written over a light blue horizontal line.

Pat Brennan
Executive General Manager
Policy and Advice Division

¹ <http://www.apra.gov.au/Super/Pages/Release-draft-successor-fund-transfers-RSElic-Nov2016.aspx>.

² <http://www.apra.gov.au/Super/Pages/submissions-draft-guidance-transfers-wind-ups-Nov16.aspx>.

ATTACHMENT

RESPONSE TO SUBMISSIONS

Equivalent rights - rights under the trust deed

Draft SPG 227 outlined what may constitute a 'right' for members of an RSE in the context of 'equivalent rights'. Submissions raised concerns that this guidance did not give sufficient weight to the rights of members arising under the trust deed and, in the absence of explicit reference to the trust deed, RSE licensees may fail to consider the terms of the trust deed. Concerns were also raised that the guidance did not address the need for the trust deed to provide an RSE licensee with the power to undertake an SFT.

APRA has revised SPG 227 to make it clear that members' rights arise from the governing rules in addition to rights arising from legislation and the general law, and also that an RSE's governing rules need to provide an RSE licensee with the power to transfer members' benefits to a successor fund.

Equivalent rights – legally enforceable rights

Draft SPG 227 outlined what APRA considers to be a legally enforceable right, and specifically that features which are determined, and can be changed, at the discretion of the RSE licensee are not rights. Examples of such features included the amount of fees that will be charged to a member, product features and particular investment options. Submissions raised concerns with this view and stated that, in certain circumstances, these types of features may effectively be rights in some RSEs.

Members' rights arise from the governing rules of an RSE, legislation and the general law. As a result, the members in one RSE may not have the same rights as members in another RSE. Accordingly, APRA has revised SPG 227 to confirm that the features provided as examples may, in some circumstances, be rights, and that features and rights will be determinable according to an RSE's governing rules, legislation and the general law.

Equivalent rights – bundle of rights

Draft SPG 227 outlined APRA's view that the assessment of equivalent rights may be undertaken on a 'bundle of rights' basis. Submissions queried how this test should be applied given the significance of some rights, suggesting that rights must be carefully evaluated in assessing equivalence and that there may be different groups of members to be considered.

Whilst APRA acknowledges these concerns, APRA's view remains that the assessment of 'equivalent rights' means that the members' rights in the successor fund (receiving RSE) are required to be equivalent but not equal, allowing for the equivalent rights assessment to be based on a member's 'bundle of rights' rather than on an assessment of each individual right (a line by line approach). APRA agrees that how this assessment is undertaken in practice will depend on each individual RSE licensee's circumstances. Revised SPG 227 now clarifies that, in assessing the bundle of rights, APRA expects an RSE licensee to give appropriate weighting to significant rights and the materiality of any changes to individual rights.

Equivalent rights – individual member/groups of members

Draft SPG 227 reflected APRA's view that the assessment of equivalent rights may be conducted based on groups of members with common characteristics. Submissions raised concerns regarding the assessment being based on groups of members as the legislation requires that equivalent rights be assessed at the individual member level.

Whilst the legislation does require that the test be conducted at the member level, APRA considers that it would be open to an RSE licensee to consider equivalent rights based on groups of members with common rights. Revised SPG 227 clarifies that, in grouping members for the purpose of considering whether their rights are equivalent, an RSE licensee must continue to comply with the trustee covenants, including the duties to act fairly in dealing with different classes of beneficiaries and with beneficiaries within a class.

MySuper to MySuper successor fund transfers

Draft SPG 227 covered SFTs between MySuper products, and specifically APRA's view that the transfer of members' benefits in a MySuper product to another MySuper product would generally satisfy the equivalence test. This view is based on the provisions of Part 2C of the SIS Act, which sets out the characteristics of a MySuper product (chiefly in section 29TC). Submissions suggested that this approach may be overly simplistic and queried whether SFTs between MySuper products would always satisfy the equivalence test. Submissions stated that fees, crediting rates, investment strategies and other such factors may be considered rights in certain MySuper products, so that submissions suggested an alternate view that not all MySuper products would be considered equivalent.

Submissions queried whether SFTs from a MySuper product with a lifecycle investment option to a MySuper product with a single diversified investment strategy would also be considered equivalent, given that this scenario was not specifically identified in draft SPG 227. Some submissions sought further guidance on APRA expectations regarding how an RSE licensee might promote the financial interests of MySuper members.

As stated above, RSEs do not all have the same rights, and rights arise from the governing rules of an RSE, legislation and the general law. Notwithstanding this, APRA considers that the core characteristics applicable to MySuper products (per Part 2C of the SIS Act) apply to all MySuper products, regardless of whether the product has a single diversified investment strategy or a lifecycle investment strategy.

APRA considers that the factors identified in submissions (i.e. fees, crediting rates, investment strategies and other such factors) are features that, in most cases, may be amended by an RSE licensee in accordance with the governing rules of an RSE. However, APRA acknowledges that the governing rules of some RSEs may identify such factors as rights (rather than features) and it is possible that some RSEs' governing rules may be unable to be amended. Further, an RSE licensee's overriding duty is to act in the beneficiaries' best interests, meet their fiduciary obligations and comply with the law (including the trustee covenants). In this context, an RSE licensee would only amend the governing rules of an RSE, or consider or undertake an SFT, after taking into account all relevant duties and obligations.

APRA remains of the view that members' rights in one MySuper product would **generally** be considered equivalent to members' rights in another MySuper product, meaning an SFT between MySuper products would **generally** satisfy the equivalence test. SPG 227 clarifies that the rights of members in MySuper products **generally** arise from the MySuper product characteristics set out in the SIS Act, and MySuper members therefore do not **generally** have a right to be in a particular MySuper product. SPG 227 also clarifies that an SFT from a MySuper product with a lifecycle investment strategy to a MySuper product with a single diversified investment strategy will usually be able to occur.

Draft SPG 227 refers to an RSE licensee's obligation to promote the financial interests of MySuper members, and sets out APRA's view that a thorough evaluation of the features of a successor fund (receiving RSE) would assist an RSE licensee to demonstrate that it has acted to promote the financial interests of the MySuper members. APRA's view is that this guidance

is sufficient, and an RSE licensee is able to seek further legal advice on these matters where needed.

Strategic direction, business plan and due diligence assessment

Draft SPG 227 stated that APRA expects a decision to undertake an SFT would be consistent with the strategic direction and business plan of an RSE licensee. Draft SPG 227 also reflected APRA's expectation that a documented due diligence and risk assessment process would be in place for assessing alternative RSEs and that an RSE licensee would document its reasons for the decision. Submissions raised concerns that this approach may not be suitable in all circumstances, in particular where an unplanned SFT opportunity arises and where a limited number of RSEs are to be considered for an SFT, for example, as a result of an employer sponsor changing its default RSE.

APRA recognises that many different circumstances may result in an SFT being contemplated by an RSE licensee, with a range of possible approaches in planning for, and managing, SFTs. For example, an SFT opportunity may arise unexpectedly and an RSE licensee, in considering the SFT, may consider it to be in the best interests of the beneficiaries. An RSE licensee may form this view even where an SFT was not previously contemplated and is therefore not included in the strategic direction and business plan of an RSE.

APRA has revised SPG 227 to more clearly express that an RSE licensee is expected to be able to demonstrate that a decision to undertake an SFT is the result of a rigorous decision-making process and that the decision has been formally documented. APRA expects a receiving RSE licensee would review its strategic direction and business plan following an SFT to reflect the addition of the new membership into its business operations. Where a transferring RSE licensee's business operations will continue after an SFT, APRA also expects the RSE licensee would review its strategic direction and business plan to reflect the reduced or adjusted scope of its business operations.

APRA acknowledges that, in some cases, it may be appropriate for an RSE licensee to consider only a limited number of RSEs for an SFT and that this may affect the scope of due diligence and risk assessment undertaken. Revised SPG 227 clarifies that, in such circumstances, an RSE licensee would be expected to document the criteria and basis for considering only a limited number of RSEs and the basis for its view that this decision is in the best interests of the beneficiaries.

Transfers under Part 18 of the SIS Act

Submissions suggested that, in the event of an SFT not proceeding or for other reasons, it may be appropriate for APRA to include guidance on the merger of RSEs to be carried out under Part 18 of the SIS Act. APRA's view is that guidance on Part 18 transfers and mergers is not appropriate in SPG 227. Part 18 of the SIS Act deals with the amalgamation of RSEs under a different basis from that for SFTs.

Clarity of language

Submissions raised concerns that draft SPG 227 reflected inconsistent and inaccurate references to 'transfer of members' (rather than the 'transfer of members' benefits') and to 'rights' (rather than 'rights in respect of the benefits'). Submissions also suggested that draft SPG 227 did not consistently distinguish between when the guidance was relevant to a transferring RSE licensee or a receiving RSE licensee. APRA has clarified the language used in SPG 227 in these areas.