RICEWARNER
Insight like no other

21 February 2017

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

Dear Heidi

Submission to Australian Prudential Regulation Authority (APRA) - Successor Fund Transfer

1. About Rice Warner

Rice Warner was established in 1987 to support superannuation funds and businesses operating in the financial services industry. It is an Australian business, owned and controlled by its key executives.

Over the last three decades, it has built a strong reputation for insightful commentary. Its independence means clients can be sure the firm always acts in their best interest and provides unbiased advice. Clients include most large superannuation funds as well as many other participants in the industry (service suppliers to funds, regulators and industry bodies).

Through its research and public policy activities, Rice Warner has built an unrivalled reputation for delivering a unique perspective across the superannuation, wealth management and life insurance industries.

Rice Warner has an interest in Successor Fund Transfers (SFT) as we have assisted many companies and industry funds to merge into other funds. We continue to provide a service to consult to funds wanting to undertake an SFT.

1.1 Background

APRA released a draft Prudential Practice Guideline (PPG) SPG 227 Successor Fund Transfers and Wind-ups for consultation in November 2016. This submission is in respect to that request for comments.

1.2 Commentary and recommendations

We welcome this clarification of APRA's position on RSE obligations with respect to Successor Fund Transfers (SFTs) particularly because of the increased interest in potential mergers of funds in pursuit of improved benefits for members. The clarification of obligations should also improve competition in the market by removing frictions that hinder the movement of member groups from one provider to another.

We support the majority of the provisions, but believe there are some provisions that can be improved. These are outlined below.

1.2.1 RSE licensee obligations

The wording of Item 11 should be revised, as it is possible for an SFT to be contemplated by an RSE due to an approach from another fund that might not fit with the RSE's current strategic plan.

The approach contemplated in Item 12, namely a tender or similar process, for considering potential SFTs is suitable for corporates and smaller funds contemplating exiting the market. The approach is not appropriate and may not be achievable for mergers of larger funds, especially industry funds that represent specific sectors of the economy. The wording should be amended to include the characteristics of these mergers.

This section of the PPG would also benefit from an additional item clarifying the obligations of transferring RSEs of master funds, especially corporate master funds. They should be obliged to act reasonably in satisfying their obligations and should not unduly hinder SFTs of sub-funds to competitors, see Section 2 (RSE licensee obligations).

1.2.2 Members' best interests

Item 17 should be expanded to provide more guidance on how 'promoting the financial interests' of MySuper members should be assessed. The current wording implies that there should be a demonstrable improvement in financial outcomes from any SFT, whereas a maintenance of financial outcomes may well be in members' best interests.

The interests of members should be assessed in aggregate and in groups where appropriate, see Section 3 (Members' best interests).

1.2.3 Equivalent Rights

At item 30(a), APRA considers that transfers of MySuper members from a fund with a single diversified investment strategy to one with a lifecycle option would generally satisfy the equivalence test. At Item 30(b), APRA considers that transfers between funds with different asset allocations or investment strategies would also generally satisfy the equivalence test. The issue is therefore how will transfers from a fund with a lifecycle option to one with a single diversified investment strategy be regarded.

Item 30(b) implicitly suggests that this would also generally satisfy the equivalence test, but it is uncertain and lacks the clarity of the explicit statement in Item 30(a).

We believe that these differences might be relied on by RSEs of funds with lifecycle options to resist or delay the movement of sub-funds to competitors who do not offer a lifecycle option. We believe that this would be against the best interests of members.

We recommend that item 30 be amended to present a balanced perspective, see Section 4 (Equivalent Rights).

1.2.4 Further provisions

We believe that APRA should provide guidance on the level of fees that can be charged for effecting a SFT (for example the transfer of a sub-fund of a master trust). These should not exceed the aggregate exit fees should all members exit the fund individually, see Section 5 (Other provisions).

2. RSE licensee obligations

We support the clarification of licensee obligations, but have some issues with Item 11 and Item 12.

We would expect most activity related to SFTs to be driven by strategic and business plans. There may be situations, however, where an RSE has a strategy of pursuing mergers with equivalent or smaller funds and is approached by a larger or even much larger fund. Such a merger could well be in the best interests of members, but not consistent with the strategic plan (Item 11).

The expectation described at Item 12 is not appropriate for many of the merger opportunities being contemplated by industry funds. As drafted, Item 12 implies that all SFTs will need to be the result of a tender or some process akin to one. This may well be a suitable approach to take in respect of a corporate fund seeking a new home, but it would be unworkable in relation to industry funds seeking mergers.

As an example, we can consider two industry funds that service a common sector of the economy. They have similar, but not necessarily identical, employer and employee sponsors. A merger of the two funds will yield benefits for both sets of members. Item 12 as drafted would, however, imply that both funds would need to canvas the market, including at least the large multi-sector funds, before making a decision to merge. This is unlikely to be in the best interest of members.

Our recommendation is that this item be redrafted to provide that RSEs should have documented due diligence and risk assessment processes for assessing any RSE that might receive transferring members. The RSE should also document the reasons why it decides to proceed or not to proceed with a particular SFT. RSEs that do conduct a tender or equivalent process should document the reasons why they have chosen a specific receiving RSE.

2.1 Master trusts

The provisions in the PPG do not explicitly deal with master trusts. The issue that concerns us is the capacity for trustees to hinder or thwart legitimate transfers of corporate sub-funds from one RSE to another. We have seen a number of examples of this where the transferring RSE cites its obligations in regard to SFTs to obstruct a sub-fund moving to a competitor.

The determinations as discussed in Section 4 (Equivalent Rights) will assist in this regard, but APRA should consider adding a determination to this section that obliges RSEs of master funds to act reasonably and that unreasonable delays are against the interests of members.

3. Members' best interests

We support the determinations in respect of members' interests, but have a query regarding the requirement at Item 17 that RSEs must be able to demonstrate how an SFT decision will promote the financial interests of MySuper members. The implication of this provision is that the SFT must yield demonstrable, positive financial benefits for members.

It is clear that an SFT that erodes members' benefits is against their interests, but it is quite possible that an SFT may only deliver equivalent financial outcomes. An example is a small fund that is struggling to maintain its membership and asset base. It might want to move its members to a bigger, more robust fund that essentially provides the same benefit levels, fees etc. There will be no demonstrable, positive financial benefit from the transfer, but the outcome would be better than if nothing had happened and these members had faced rising fees and declining service standards.

Some extra explanation of what APRA would regard as 'promoting the financial interest of members' would be welcomed. The concept of best interest should also follow principles similar to those provided for determining Equivalent Rights, namely that interests should be considered in aggregate and for groups where appropriate.

4. Equivalent Rights

We welcome and support the clarification of the requirement for the preservation of equal rights because uncertainty in this regard has unnecessarily complicated and delayed many SFTs. In particular, we support the determinations that:

- 'Rights' are limited to legally enforceable rights (Item 21).
- Product or fund features that are determined by or can be changed by the RSE are not rights (Item 23).
- The assessment of rights should be carried out in aggregate on a 'bundle of rights' basis rather than a 'line by line' basis (Item 25).
- The assessment of rights should be carried out for groups of members where appropriate (Item 26).
- All MySuper products offer equivalent rights and it is not necessary for the transferring and receiving RSEs to have equivalent MySuper products or for those products to have identical features.
- The equivalence test will generally be met for transfers between MySuper products with different asset allocation or investment strategies, different fees or different insurance offerings.

We note that at Item 30(a) APRA considers that the equivalence test will generally be met for a transfer from a MySuper product with a single diversified investment strategy to one with a lifecycle investment option. We have no objection to this determination, but believe that transfers from MySuper products with lifecycle investment options to those with single diversified strategies should be similarly explicitly regarded as meeting the equivalence test.

The determinations at Items 23, 25, 29 and 30(b) implicitly support the proposition that such transfers generally meet the equivalence test. Our concern is that, if only transfers to lifecycle options are explicitly nominated as satisfying the equivalent test, RSEs with lifecycle options may use the lack of an explicit statement for transfers out of these options to hinder or delay transfers that would be in the best interests of members. Many corporate master funds, for instance, offer lifecycle options and it would be unfortunate if sponsors and members were hindered in their desires to move their business to another

provider (for instance a cheaper industry fund with a single diversified investment option) by a lack of clarity in respect of such a transfer.

Item 30 should explicitly recognise movements in both directions between funds with single diversified investment options and those with lifecycle options as generally meeting the equivalence test.

5. Other provisions

We support the provision in relation to the remaining sections, namely:

- planning and carrying out an SFT
- governance and managing conflicts
- operational risk financial requirement (ORFR)
- calculating benefits
- member communications
- project planning
- data management
- wind-up of and RSE after a successor fund transfer
- post implementation review.

The provisions should be expanded to include guidance in relation to costs and fees. In particular, fees charged by RSEs to effect an SFT (for example for a master trust sub-fund moving to another master trust) should be reasonable and based purely on costs incurred. These fees should definitely not exceed the exit fees on a per member basis. Moving members in bulk should be lower than these fees because of economies of scale.

This submission was prepared and peer reviewed for APRA by the following consultants.

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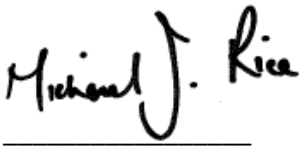

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