Super Update

January 2021

Draft legislation for the Budget changes released

On 27 November 2020 Treasury released consultation draft legislation for the three main Budget changes to super — stapling (which Treasury calls a single default account), the underperformance test and changes to the best interests duty.

Stapling

The legislation will amend the existing Choice of Fund rules in the SG (Administration) Act to enable an employer to meet those rules if:

- the employee's employment started on or after 1 July 2021
- the employee has no chosen fund for receiving SG contributions
- the employer has requested the ATO to identify whether the employee has a stapled fund (employers will not be permitted to independently determine whether the employee has a stapled fund, they must do so via the ATO)
- the ATO has notified the employer that the employee has a stapled fund and
- the contribution is made by the employer to the stapled fund.

If the ATO notifies the employer that the employee has a stapled fund, contributions by the employer to its default fund (where the employee has not made a choice) will no longer meet the Choice of Fund rules. According to the draft Explanatory Memorandum, the new law has been drafted such that all employers will be able to satisfy the Choice of Fund rules by making contributions to an employee's stapled fund even if they could have satisfied those rules using one of the other provisions in the legislation. It also states (at paragraph 1.27) that these new rules will prevent employers from relying on an existing workplace determination or enterprise agreement where the employee already has a stapled fund and started their employment on or after 1 July 2021. Employees whose employment with their employer commenced prior to 1 July 2021 will not be affected by the changes.

Details of the conditions for a fund to be a stapled fund, as well as processes for how and when the ATO will respond to requests for information, will be in regulations that have not yet been released.

Underperformance test

The draft legislation requires APRA to conduct annual performance tests for MySuper products and other products that will be specified in regulations. Most of the detail on how the test will work will also be in regulations, including:

- the time frame in which APRA must conduct the tests
- as noted above, the products that will be covered (other than MySuper products — the legislation refers explicitly to them)
- the methodology to calculate a product's performance and benchmark
- a discretion that will be granted to APRA to provide flexibility in applying the test
- the form and contents of the notice that trustees will have to provide members if they fail the test
- the requirements to be met for the prohibition on accepting new members to be lifted
- formulae for the ranking of products by APRA according to various metrics including fee levels and investment returns.

The draft Explanatory Memorandum notes other information that may also be in the regulations, including various rules around the exercise of the discretion power by APRA. This power will allow different requirements to be specified for different types of products. It would also allow, for example, discretion for the test to only apply to products with a minimum number of years of performance (but APRA will be able to ensure trustees cannot create new products to deliberately avoid being subject to the performance test). It may also cover circumstances where two or more products should be treated as one for the performance test — the Explanatory Memorandum gives the example of where a trustee transfers members from a product that is close to failing (or has previously failed) the performance test into a new but similar product in order to bypass the consequences of failing one or more performance tests.

Trustees will have to notify members within 28 days of APRA giving notice of the test results where the product has failed the performance test. This requirement will be inserted into the covenants in section 52 of the SIS Act, as will the prohibition on accepting new members where the test is failed in two consecutive years. The prohibition will apply at the product, not fund level, although APRA will have the discretion to treat two or products as one, to prevent trustees circumventing the prohibition by moving members to a new but substantially similar product.

The draft legislation also includes measures to strengthen APRA's powers to manage underperforming products, via a new power for APRA to make prudential standards on what the legislation calls "resolution planning". There will be a new definition of a "resolution" of an entity inserted in the SIS Act, which the Explanatory Memorandum states will have the same meaning as it does in the legislation that covers other regulated entities. In the Life Insurance Act, for example, a resolution is in general terms the process by which APRA or other relevant persons manage or respond to an entity being, or likely to become, unable to meet its obligations. The measures are intended to ensure that APRA has the power to set prudential standards on resolution planning and to ensure that trustees are prepared for a range of contingencies, including the possibility that the prohibition against accepting new members into a product may lead to a material deterioration in the financial condition of the fund.

Changes to the best interests duty

The legislation will amend the general covenant in the SIS Act to require a trustee to perform the trustee's duties and exercise its powers in the best financial interests of the beneficiaries — the word "financial" will be inserted. There will also be a specific provision noting that this obligation will apply in respect of payments to a third party by or on behalf of the trustee.

A new provision in the SIS Act will reverse the burden of proof in relation to the new duty — it will explicitly be presumed in civil (but not criminal) proceedings that a trustee or director (as applicable) did not perform their duties and exercise their powers in the best financial interests of beneficiaries unless the evidence is provided to the contrary. As well as not applying to criminal proceedings, the reversal of the burden of proof will also not apply to actions to recover loss or damage under section 55 of the SIS Act (such as class actions) — it is intended to only apply to civil actions brought by a regulator. There will be no materiality threshold applying to the best financial interests duty.

Consultation on the draft legislation closed on 24 December 2020, and the industry has already begun to raise concerns with the performance test in particular. But much of the detail of these changes is in regulations which have not yet been released and in new powers for APRA with little or no information on how they will be exercised. With such a short time frame to the proposed start date of 1 July 2021 and many other changes already occupying trustees and their teams — outcomes assessments, RG 97 and the new design and distribution obligations, to name just three — we would encourage the government to release the draft regulations and sufficient information to assess APRA's new powers at the earliest opportunity.

Various ASIC releases including a new Regulatory Guide

ASIC released a number of reports and consultations over the last couple of months of 2020, as well as a Regulatory Guide on the new design and distribution obligations.

Consultation on promoting access to affordable advice

A consultation paper on promoting access to affordable advice to consumers was released on 17 November 2020. *CP 332* seeks input from industry participants and stakeholders to help ASIC understand the issues and impediments relating to the supply of good quality affordable personal advice as well as any practical steps that could be taken by ASIC and industry to improve consumer access to such advice. A particular focus of the paper is promoting access to quality limited or scaled advice. Consultation closed on 18 January 2021.

Research on insurance in super

On 20 November ASIC released independent research it commissioned on the experiences of super fund members who engaged with their fund about their insurance cover. The research found that the process of obtaining information about or making changes to their insurance presented hurdles to many members. Issues identified included limited knowledge about their insurance and a lack of confidence to navigate what they considered complex web-based information.

A number of research participants engaged with their fund to find out information about their insurance, including how much cover they had and how much they should have. Most members expected this to be a simple self-service process but found that it was not — among other challenges, many members did not understand the demarcation between general information and advice. After interacting with their fund, about a third of the participants spontaneously reported that they felt confused, overwhelmed or uncertain. They found insurance complex and difficult. Some discovered information they did not understand or did not know how to respond to. This often caused them to delay in engaging further with their fund on insurance after their initial interaction.

Potential improvements noted in the report include helping members to understand:

- the differences between the insurance products on offer and between insurance inside and outside super
- whether it is possible to claim on more than one policy and
- the implications of pre-existing conditions on switching insurance.

Other suggestions included providing calculators on fund websites to help members work out how much cover they need and how much it would cost, reminders to check cover when starting a new job, joining a new fund or when life stages change, for example by letter included with their statement, case studies on fund websites that could be written in a more journalistic rather than "PDS style", and encouraging customer support staff to guide members on the phone through website processes.

Consultation on updated consumer remediation guidance

A consultation paper on proposed updates to *Regulatory Guide 256: Client review and remediation conducted by advice licensees* was released on 3 December 2020. This RG applies to all AFS licensees and trustees of all super funds except SMSFs. The consultation paper, *CP 335*, is the first round of a two-part consultation process. This round is intended to give industry the opportunity to provide feedback about the challenges they face in designing and executing remediations. It includes real-life case studies based on remediations in which ASIC has been directly involved, and states that ASIC is keen to understand industry's experience with its own real remediations.

The existing version of *RG 256* will remain in effect until the revised guidance is published. Consultation on this first round closes on 26 February 2021.

ASIC has also released a new booklet entitled *Making it right: how to run a consumer-centred remediation*. It includes a list of key principles setting out what ASIC considers a consumer-centred remediation looks like, including giving consumers the benefit of the doubt and erring in favour of consumers.

Review of occupational classification practices

Over 2019 and 2020, ASIC reviewed the 'occupational default' practices of a sample of 21 trustees who were using a high-risk occupational category as the default in their MySuper products, and the results of the review were released on 3 December 2020.

ASIC noted that trustees often have limited data on members' occupational categories, and they often select the highest risk category as the default to ensure that all members are covered regardless of their occupation. However, in the products ASIC looked at, on average the price of default insurance for the highest risk category was around double that of the lowest risk category. In five cases, the average for the highest risk category was between three and four times that of the lowest. The review also found:

- significant variation in the sophistication of trustees' assumptions and in the factors they took into consideration when designing their default category
- disclosure that ASIC considered to be poor by some funds, including about the relative cost of premiums in different categories and, in the case of 15 trustees, the use of a generic label such as "standard" or "general" for the most expensive category
- processes for members to update their occupational category that were generally not readily apparent or accessible.

ASIC considers that trustees may be contravening their legal obligations if they fail to ensure that insurance premiums charged to members are based on appropriate statistical assumptions. ASIC suggests that funds should make efforts to gather better occupational data about their members so that default settings are based on appropriate statistical assumptions and are fair and reasonable.

Other suggestions for improvement include ensuring that:

- occupational default labels used promote understanding of the level of risk and cost of the category and that trustees take prompt action to address any mis-categorisations
- disclosures to members clearly explain the member's occupational category, the cost of the insurance in that category and whether the member may be eligible for an alternative category that is less expensive or provides a greater level of cover
- members can easily amend their personal information so that premiums are charged based on accurate information.

New Regulatory Guide on design and distribution obligations

On 11 December ASIC released *RG 274 Product design and distribution obligations*, along with a response to submissions report. The new Regulatory Guide explains ASIC's interpretation of the design and distribution obligations (DDOs), the regulator's expectations for compliance, and its general approach to administering the DDOs. It includes a new requirement for issuers and distributors of products to implement and maintain robust and effective product governance arrangements to ensure that they comply with the DDOs. It also includes an example on how the DDOs apply to superannuation products where the product includes various investment options as well as insurance cover. ASIC has clarified that such products are likely to involve a single target market determination that describes multiple sub-markets for some investment options or groups of investment options offered as part of the product.

The DDOs commence from 5 October 2021 and generally apply to products for which the trustee is required to prepare a PDS, but not MySuper products or defined benefit interests.

Retirement Income Review report released

The final report of the Retirement Income Review was released on 20 November. The Review found that the Australian retirement income system is effective, sound and its costs are broadly sustainable, even given the uncertainty around the current pandemic. It observed that, while there are areas where Australia's retirement income system can be improved, overall, it is well placed to deal with economic volatility and the challenge of an ageing society. It is ranked very highly in international comparisons of retirement income systems.

On superannuation, key observations included:

- Compulsory superannuation allows people to achieve a retirement income that better reflects their pre-retirement income. As the superannuation system matures, people will increasingly fund more of their own retirement. But the Age Pension will continue to support the retirement income of a large proportion of people.
- Superannuation savings are supported by tax concessions for the purpose of retirement income and not purely for wealth accumulation. Yet most retirees leave the bulk of the wealth they had at retirement as a bequest.
- The home is the most important component of voluntary savings and is an important factor influencing retirement outcomes.
- Saving for retirement involves forgoing consumption in working years. When there is compulsory superannuation, the rate should be set at a level that balances pre- and post-retirement living standards for middle-income earners. It is challenging to set a single SG rate that suits all Australians.
- A rate of compulsory superannuation that would result in people having an increase in their living standards in retirement may involve an unacceptable reduction in living standards prior to retirement, particularly for lower-income earners. The weight of evidence suggests that increases in the SG rate result in lower wages growth and would affect living standards in working life.
- Other than for low income earners, replacement rates are the most appropriate basis for assessing whether the retirement income system delivers adequate income in retirement. The suggested benchmark replacement rate is 65-75 per cent.
- Under the legislated increase in the SG to 12 per cent, the projected replacement rate for future retirees with typical working lives exceeds the suggested 65-75 per cent benchmark rate across most income levels, assuming people draw down their savings in retirement.

The Review report did not contain any formal recommendations but was intended to provide a fact base for the current state of Australia's retirement income system to support future policy decisions.

The Review report, together with the government's comments on it to date, seem to be indicating there is an increased likelihood there may be a deferral of the next scheduled SG increase due to occur on 1 July 2021. The report also noted that the cost of the earnings tax exemption in retirement will grow faster than the growth in the economy as the system matures and that it provides the greatest boost to retirement incomes of higher-income earners. While there have not been any comments on this aspect from the government to date, we wonder whether this is another area that might be the focus of future reform.

News in brief

Portfolio holdings deferral instrument made

On 7 December 2020, the long-awaited instrument deferring the commencement of the portfolio holdings requirements, first announced in April 2020, was made. *ASIC Corporations (Amendment and Repeal) Instrument 2020/921* confirms that the first reporting date for the new disclosure requirements will now be 31 December 2021.

Latest MySuper Heatmap released

The December 2020 iteration of APRA's MySuper Heatmap was released on 18 December 2020, along with a paper outlining key insights from the Heatmap. For the first time, the paper names funds that APRA considers underperformed in three areas — investment returns, fees and costs, and sustainability. The media release noted that over the 12 months since the first Heatmap was published:

- 11 of the MySuper products that underperformed the investment benchmarks have exited the industry;
- 71 per cent of MySuper members (10 million members) are paying less in total fees and costs; and
- an estimated $408 million saving in total fees and costs has been achieved.

APRA Insight publication

On 2 December 2020 APRA issued the fourth edition of its *Insight* publication for 2020. The content included insights from APRA's pandemic data collection, including on fund liquidity, fraud risk, service provider disruptions and demographics of members accessing the early release scheme, and a discussion on how a skills matrix can help transform superannuation trustee board capability.

Various APRA superannuation statistical publications released

Highlights of APRA's September 2020 Quarterly Superannuation Performance publication, issued on 24 November 2020, included the following:

Table 1: **Highlights of APRA's September 2020 *Quarterly Superannuation Performance* publication**

	Sept 2019 ($ billion)	Sept 2020 ($ billion)	Change
Total superannuation assets	$2,939.7	$2,891.3	-1.6%
Total APRA-regulated assets	$1,970.0	$1,953.8	-0.8%
Of which: total assets in MySuper products	$779.2	$753.6	-3.3%
Total self-managed super fund assets	$758.5	$728.2	-4.0%

APRA noted that there was a 1.6 per cent reduction in the value of total superannuation assets over the 12 months to 30 September 2020, mainly a result of investment losses sustained across the industry during the March quarter. It also noted that employer contributions over the year were buoyed by JobKeeper payments and increased by 4.1 per cent. Benefit payments for the year to September 2020 were $112.3 billion, including approximately $34 billion paid under the Early Release Scheme which came into effect on 20 April 2020.

APRA's MySuper statistical publication for the September 2020 quarter was issued on the same date. This report is issued on a product by product basis and APRA do not report overall summary statistics.

On 16 December 2020 APRA released its annual fund-level and MySuper statistical reports for the year ended 30 June 2020. The reports contain detailed profile and structure, financial performance, financial position and membership information as well as information on fees at the fund level and MySuper product level respectively.

A guide to key changes

The dates that follow were correct as at the time of publication of this edition of *Super Update*.

Table 2: **A guide to key changes**

Date	Change
1 Jul 2021	Next scheduled increase in SG (to 10.0%).
1 Jul 2021	Proposed start date for performance tests for MySuper products.
5 Oct 2021	Design and distribution obligations for certain super products (excluding MySuper and defined benefit products) commence.
31 Dec 2021	Current first reporting date for portfolio holdings disclosure.
1 Jul 2022	Start date for application of “shorter” PDS regime to multi-funds, platforms and hedge funds.
1 Jul 2022	Proposed start date for performance tests for certain Choice options.
30 Sep 2022	Final date for *RG 97 Disclosing fees and costs in PDSs and periodic statements* to apply to PDSs.
1 Jul 2023	Start date for publication of product dashboard for certain ‘choice’ products.
1 Jul 2023	MySuper product dashboards to be included in periodic statements.
1 Jan 2024	Commencement of section 29QC of the SIS Act.
1 Jul 2024	Start date for website disclosure of certain information relating to employer-sponsored sub-plans.

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