Law Council
OF AUSTRALIA

5 April 2012

The Manager, Contributions and Accumulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: intrafundconsolidation@treasury.gov.au

Dear Sir or Madam

Exposure Draft – Intra-fund consolidation of superannuation interest

I am pleased to enclose a submission on the exposure draft of *Superannuation Legislation Amendment (Stronger Super and Other Measures) Bill 2012: Intra-fund consolidation of superannuation interests*.

This submission has been prepared by the Law Council of Australia's Superannuation Committee, which is a committee of the Legal Practice Section of the Law Council of Australia. It has not been considered by the directors of the Law Council of Australia due to time constraints.

For ease of reference:

- We have illustrated our key points in the diagrams set out in Attachments 1 & 2;
- Our full, written submission is also enclosed as Attachment 3.

We would welcome the opportunity to discuss our submission further. In the first instance, please contact the Chair of the Law Council of Australia's Superannuation Committee, Ms Heather Gray on (03) 9274 5321 or at heather.gray@dlapiper.com.

Yours sincerely

Margery Nicoll.

Margery Nicoll
Acting Secretary-General

Attachments: 3

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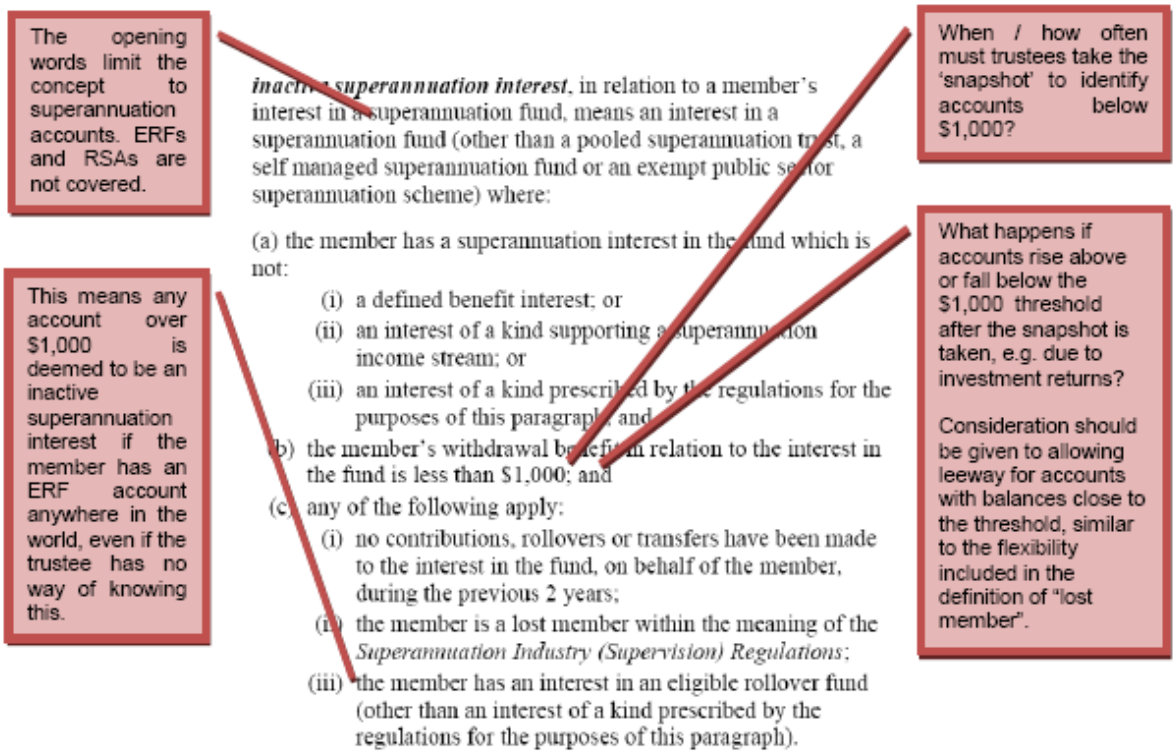
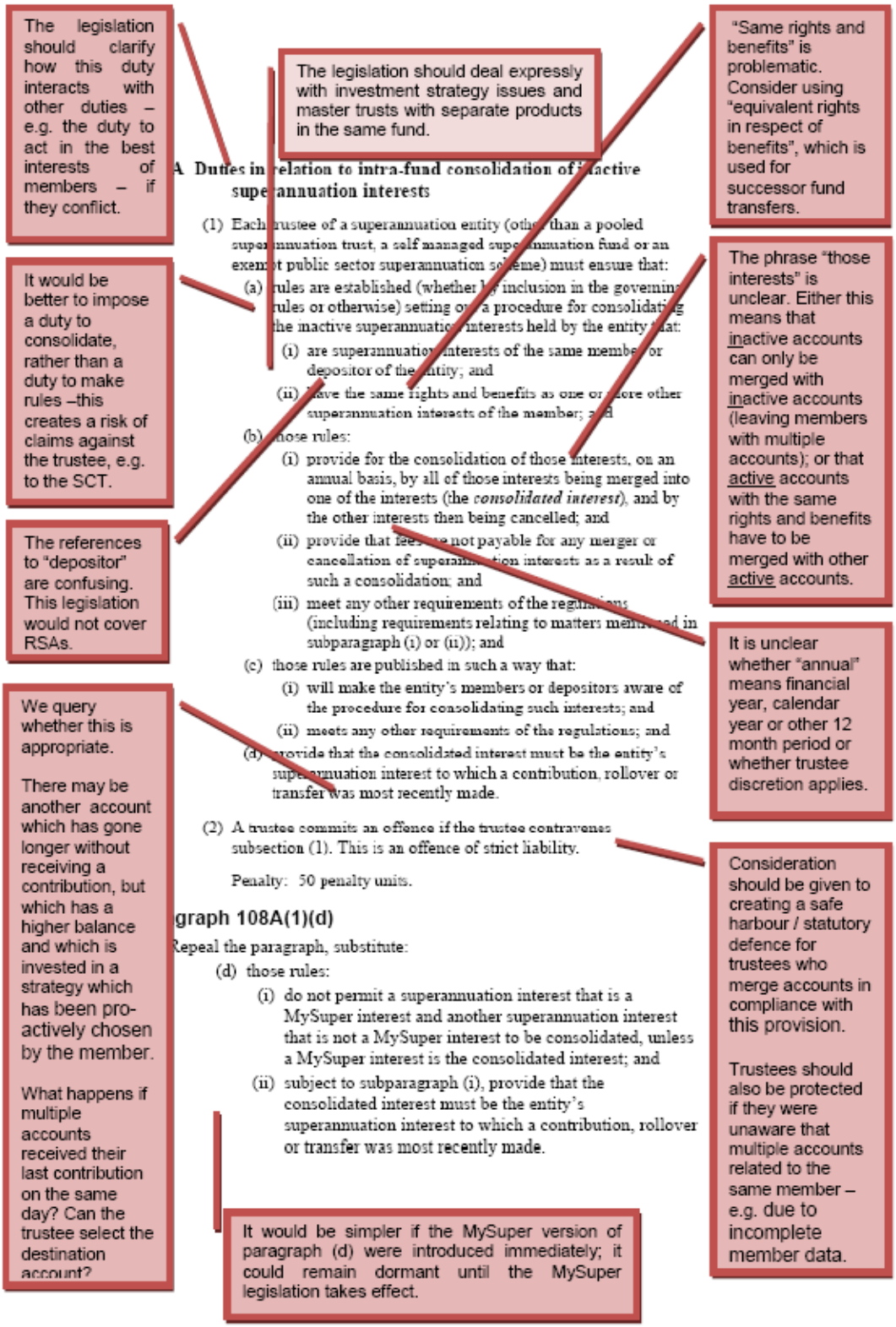
Attachment 1:

Problems with the definition of "inactive superannuation interest"



Attachment 2:

Problems with the duty to consolidate accounts



Law Council
OF AUSTRALIA

Exposure Draft – Intra Fund Consolidation of Superannuation Interests

The Treasury

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

5 April 2012

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1. About the Law Council of Australia, Superannuation Committee

The Law Council of Australia is the peak national representative body of the Australian legal profession, and represents about 56,000 legal practitioners nationwide.

This submission has been prepared by the Law Council of Australia's Superannuation Committee, which is a committee of the Legal Practice Section of the Law Council of Australia.

The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provide comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

2. Executive summary

From a legal point of view, the draft legislation would generally be workable in simple cases where a member has multiple inactive accounts in the same investment option in the same sub-plan and either no active accounts or only one active account.

However, the Committee has identified several technical legal issues which will give rise to significant problems in particular circumstances if left unaddressed. For example:

- The proposed provisions will not work in cases where a member has multiple active accounts, which is not uncommon. Either the provisions only require inactive accounts to be combined with other inactive accounts (leaving the member with additional active accounts in the same fund) or they require active accounts to be combined with other active accounts. Neither scenario seems to be intended.

- The references to eligible rollover funds and depositors are unworkable. The definition of "inactive superannuation interest" needs revision, especially if consolidation is intended to apply to eligible rollover funds and retirement savings accounts. As currently drafted, any superannuation account less than $1,000 is deemed to be an inactive superannuation interest if the member has an eligible rollover account anywhere in the world, even though the trustee would have no way of knowing this.

- It is questionable whether the account that most recently received a contribution is the most appropriate 'destination account' for consolidation purposes, especially where other accounts (which have gone longer without receiving a contribution) might have a higher account balance and have been invested in a different investment strategy actually chosen by the member.

- Requiring consolidation across other accounts which have the "same rights and benefits" is problematic. The extent to which differences in (or similarities between) investment strategies are a relevant consideration should be expressly stated in the legislation. Further, or alternatively, the Committee recommends leveraging off the successor fund transfer regime which focusses

on ‘equivalent rights in respect of benefits’, which is a concept which trustees, administrators, regulators and their advisers all understand.

- In the case of superannuation master trusts, consolidation should only be required within the same sub-plan and not across different sub-plans which may be related to different employers and/or products marketed as different products.

- The legislation should clarify whether the duty to consolidate is intended to override the duty to act in the best interests of members in cases where those duties conflict. For similar reasons, a statutory safe harbour should be provided to protect trustees from claims by disgruntled members in cases where trustees have consolidated accounts to comply with their legal obligation to do so or where members complain to the Superannuation Complaints Tribunal that a trustee’s refusal to vary its consolidation rules on a particular occasion was unfair or unreasonable due to the individual circumstances of particular members.

- The legislation should clarify the ‘snapshot’ date for determining whether or not an account balance is above or below the $1,000 threshold and protect trustees in cases where an account changes from being above/below this threshold in the time between taking the snapshot and processing consolidations. Similarly, it should be clarified whether the requirement to consolidate on an annual basis is intended to apply on the basis of a financial year or calendar year basis or whether trustees have discretion in this regard.

- Trustees should be protected from liability in cases where they were unaware that a member had more than one interest in the relevant superannuation fund, for example, due to incomplete member data.

- The Committee notes that, as a practical consequence of consolidating accounts, some members will be exposed to higher costs as a result of their consolidated account ceasing to be treated as a protected account if the consolidated account has a balance of more than $1,000. Similarly, consolidated accounts with balances of more than $5,000 will become subject to the family law splitting provisions, making those accounts accessible by former spouses upon the dissolution of marriage and so forth.

In this submission, for ease of reference, the Committee has used the phrase “active account” to refer to any superannuation interest held by the same member in the same fund, other than an inactive superannuation interest (as defined in the proposed legislation), which has the same rights and benefits as the inactive superannuation interest – this might be an account that actively receives contributions or possibly even an account that does not receive contributions (and is inactive in a lay sense) but which has an account balance of more than $1,000 and provides the same rights and benefits as an inactive account.

These issues, and several additional issues, are explained in further detail below.

3. Problems where member has one or more active accounts

At a technical level, there are some problems with how the proposed section 108A of the *Superannuation Industry (Supervision) Act* 1993 (Cth (the SIS Act) has been drafted giving rise to unnecessary ambiguity.

These ambiguities give rise to some significant consequences and need to be addressed, because either:

- the legislation will only require inactive accounts to be consolidated with other inactive accounts, meaning that, in simple cases where a member has one inactive account and one active account, there will be no obligation to consolidate the inactive account with the active account – in other words, the legislation will fail to work as intended in the circumstances outlined in the example at paragraph 3.26 of the Explanatory Memorandum; and/or

- the legislation will require all inactive accounts and all active accounts to be consolidated, which the Committee does not believe is the intention. There should be no requirement for active accounts to be consolidated in cases where the member has multiple active accounts.

The Committee has illustrated the source of the ambiguity in Figure 3.1 below.

Figure 3.1: Problems with the duty to consolidate

108A Duties in relation to intra-fund consolidation of inactive superannuation interests

(1) Each trustee of a superannuation entity (other than a pooled superannuation trust, a self managed superannuation fund or an exempt public sector superannuation scheme) must ensure that:

(a) rules are established (whether by inclusion in the governing rules or otherwise) setting out a procedure for consolidating the inactive superannuation interests held by the entity that:

(i) are superannuation interests of the same member or depositor of the entity; and

(ii) have the same rights and benefits as one or more other superannuation interests of the member; and

(b) those rules:

(i) provide for the consolidation of those interests, on an annual basis, by all of those interests being merged into one of the interests (the ***consolidated interest***), and by the other interests then being cancelled; and

Drafting notes:

If "those interests" only means inactive accounts, then there is no obligation to consolidate an inactive account with an active account;

BUT

If "those interests" includes inactive accounts and all other accounts with the same rights and benefits, then there is an obligation to consolidate active accounts with other active accounts (as well as with inactive accounts).

In light of the above, it is clear that section 108A is in need of modification in order to ensure that:

- the legislation has the effect contemplated by paragraph 3.26 of the Explanatory Memorandum; and
- the legislation does not require the consolidation of active accounts.

The Committee would therefore suggest that section 108A(1)(b)(i) be revised along the following lines:

> *"(i) provide for the annual consolidation of each inactive superannuation interest (if any) on the following basis:*
>
> *(A) if the member has no superannuation interests of the kind referred to in sub-paragraph (a)(ii) and has more than one inactive superannuation interest, by consolidating the inactive superannuation interests into any one of those inactive superannuation interests selected by the trustee; or*
>
> *(B) if the member has one or more inactive superannuation interests and also one or more other superannuation interests of the kind referred to in sub-paragraph (a)(ii), by consolidating:*
>
> *a. each of the inactive superannuation interests; and*
> *b. at least one of the interests of the kind referred to in sub-paragraph (a)(ii) and, if there is more than one interest of that kind, the rules may provide for the trustee to select one or more of those interests,*
>
> *into any one of the interests referred to in this sub-paragraph, as determined by the trustee."*

4. Confusing references to eligible rollover funds

The definition of "inactive superannuation interest" includes a reference to members who have an interest in an eligible rollover fund: see proposed sub-paragraph (c)(iii). The Committee suspects the intention here may be for the new provisions to require inactive accounts in eligible rollover funds to be consolidated.

However, the drafting is problematic for several reasons. Apart from the fact that the opening words of the definition limit the concept to superannuation interests (and not eligible rollover fund interests), the definition has been drafted in a way which means that any superannuation account with a balance of less than $1,000 will be deemed to be an inactive superannuation interest if the member has an eligible rollover fund interest anywhere in the world: even though the account might be active in the sense of having received contributions in the last 2 years and even though the trustee would have no way of knowing whether or not any particular member has an eligible rollover fund interest.

If mandatory consolidation is to apply to eligible rollover funds, the definition of "inactive superannuation interest" needs to be restructured so as to specifically include eligible rollover fund interests. In doing so, the Committee queries whether there would need to be a $1,000 threshold or whether there should simply be an obligation to consolidate eligible rollover fund interests whenever a member has

multiple interests in the same eligible rollover fund, regardless of the account balances concerned.

The problems with the proposed drafting are summarised in Figure 4.1 below.

Figure 4.1: Problems with the definition of "inactive superannuation interest"

Drafting note: *This suggests that the definition only applies to interests in superannuation funds and not eligible rollover fund or retirement savings accounts.*

inactive superannuation interest, in relation to a member's interest in a superannuation fund, means an interest in a superannuation fund (other than a pooled superannuation trust, a self managed superannuation fund or an exempt public sector superannuation scheme) where:

(a) the member has a superannuation interest in the fund which is not:

(i) a defined benefit interest; or

(ii) an interest of a kind supporting a superannuation income stream; or

(iii) an interest of a kind prescribed by the regulations for the purposes of this paragraph; and

(b) the member's withdrawal benefit in relation to the interest in the fund is less than $1,000; and

(c) any of the following apply:

(i) no contributions, rollovers or transfers have been made to the interest in the fund, on behalf of the member, during the previous 2 years;

(ii) the member is a lost member within the meaning of the *Superannuation Industry (Supervision) Regulations*;

(iii) the member has an interest in an eligible rollover fund (other than an interest of a kind prescribed by the regulations for the purposes of this paragraph).

Drafting note: *This means that any superannuation account with a balance less than $1,000 automatically becomes an inactive superannuation interest, just because the member has an eligible rollover fund interest somewhere in the world, even if the superannuation account actively receives contributions and even if the trustee has no way of knowing whether the member has any eligible rollover fund accounts.*

5. Confusing references to "depositors"

For the most part, the proposed provisions focus on members of superannuation funds. However, there are two sub-paragraphs within the proposed section 108A which, unlike the other provisions, make reference to "depositors".

It is unclear what the references to "depositor" are intended to achieve or how they would operate.

If the intra-fund consolidation rules are intended to apply only to superannuation interests, the references to "depositor" should be deleted.

However, if the provisions are intended to apply to retirement savings accounts, then the Committee notes the following:

- The definition of "inactive superannuation interest" does not include retirement savings accounts;
- Subject to our following comment, all of the other proposed provisions (which currently focus only on superannuation interests) would need to be amended so as to apply to retirement savings accounts and depositors (as applicable); and
- In the Committee's opinion, the consolidation of retirement savings accounts ought to be dealt by way of amendments to the retirement savings account legislation, rather than the SIS Act.

6. Directionality of the consolidation

The proposed section 108A(1)(d) would require all accounts being consolidated to be transferred into the account which most recently received a contribution, rollover or transfer.

While this would provide trustees and administrators with clarity as to which account must be the destination account in most cases, there may be cases where more than one account held by the member received a contribution on the same day, in which case it would be unclear which account must be the destination account. Ideally, the provisions would accommodate this possibility and perhaps give trustees the discretion to select the destination account in that situation.

More generally, however, the Committee queries whether it is appropriate for the legislation to require the destination account to automatically be the account which most recently received a contribution, rollover or transfer, especially if the accounts being consolidated are invested according to different investment strategies.

For example, if the member's inactive account is invested in the default option but has received a contribution more recently than another account (e.g. which has a balance of more than $1,000) which is invested in a strategy which the member has actively chosen, the Committee queries whether it would be more appropriate for the destination account to be the one which has the higher account balance and which has been invested in a strategy which has actually been chosen by the member (i.e. rather than the account that most recently received a contribution).

As a technical drafting matter the Committee notes that:

- the proposed section 108A(1)(d) refers to "the entity's superannuation interest", which the Committee presumes is incorrect and intended to be a reference to

"the member's superannuation interest";
- the Exposure Draft contemplates section 108A(1)(d) being repealed and replaced on 1 July 2012 with a new provision which precludes a My Super account being consolidated into a non-My Super account. It would be preferable if this provision were simply to take effect immediately.

7. Potential remains for multiplicity of accounts

The Committee notes in passing that the draft legislation leaves open the possibility that members may continue to have a multiplicity of accounts. For example:

- Members may continue to have multiple inactive accounts because the inactive accounts have different rights and benefits and are therefore outside of the consolidation regime;
- Members may continue to have multiple active accounts in addition to their consolidated (and formerly inactive) account.

The Committee presumes this is intentional.

8. Meaning of same rights and benefits

The proposed section 108A(1)(a)(ii) purports to impose a safety-net by ensuring that only accounts which have "the same rights and benefits" are ever consolidated.

Paragraph 3.15 of the Explanatory Memorandum is difficult to understand, but it seems to suggest that this might require all of the accounts requiring consolidation to be invested in the same investment option or according to the same investment strategy. If this is the intention, section 108A(1)(a)(ii) should specifically make reference to investment considerations, because the current reference to "rights and benefits" suggests a more esoteric comparison must be made between the various accounts.

The requirement for there to be the "same rights and benefits" is also problematic because it imposes an impossibly strict requirement on trustees. It makes no allowance for minor or incidental differences in rights and benefits, meaning that, even if there is a slight difference between the inactive accounts, they will fall outside of the consolidation regime.

For example, technically speaking, unless two active accounts have exactly the same account balance (and therefore identical withdrawal benefits), the two accounts would provide different withdrawal benefits (in dollar terms) and would therefore fall outside of the consolidation regime.

Similarly, the drafting leaves open the question of what changes can be made to the rights and benefits of the account after consolidation has occurred.

If the legislative intention is to focus on investment strategy, the Committee would suggest that the drafting should require substantial continuity in investment strategy immediately following the consolidation. That said, the Committee would urge a more principled approach and leave the question of investment strategy to the trustee to determine pursuant to its general duty to act in the best interests of members. If the legislation were to be too prescriptive, this would raise questions as to how similar investment objectives, strategic asset allocations and the

permitted ranges within which actual allocations may deviate from the strategic allocation must be.

To the extent that other rights and benefits are to be considered, the Committee would suggest borrowing from the successor-fund transfer regime and requiring that there be "equivalent rights in respect of benefits". Superannuation trustees, administrators and their advisers are familiar with this terminology from the successor fund transfer context (which, incidentally, also involves benefits being transferred without the consent of the member) and are comfortable with its meaning and with the pragmatic approach taken by Australian Prudential Regulation Authority (APRA) when assessing whether two different products might, on the whole, provide equivalent rights in respect of benefits, notwithstanding technical differences on a side-by-side comparison.

The impact of consolidation on members' insured benefits is a key consideration which should specifically be considered, with appropriate carve-outs from the obligation to consolidate where there is a significant risk of adverse impacts on the value of insured benefits.

9. Impact on master trusts

Consideration should also be given to the treatment of superannuation master trusts with separate sub-plans, possibly relating to different employers or different intermediaries who are marketing branded or badged products which, although separately marketed, technically form part of the same master trust. The proposed drafting would arguably require consolidation of accounts across different sub-plans if the threshold requirement is simply that there be some equivalence or similarity of the rights and benefits offered by each product. To address this, the definition of "inactive superannuation interest" should focus on interests in the same sub-plan, rather than on interests in the same fund.

10. Interaction with other duties

As a technical matter, the legislation ought to make it clear how the duty to consolidate inactive accounts interacts with a trustee's other legal duties, most obviously the duty to act in the best interests of members. The Committee presumes the intention is that the duty to consolidate would override the duty to act in the best interests of members; i.e. that it is not intended that trustees can choose not to consolidate accounts on the basis that doing so would be contrary to the best interests of members. If so, this should be clearly stated in the legislation.

That said, to the extent that the legislation will leave trustees with some discretion (perhaps, for example, regarding which account should be the destination account when consolidating accounts), the duty to act in the best interests of members should apply to the exercise of that discretion.

11. Differences between a duty to consolidate versus a duty to make rules and the need for a safe-harbour

The proposed section 108A would require trustees to make rules which in turn require the consolidation of accounts in the prescribed circumstances.

The Committee queries whether, as a matter of principle, it would be clearer if section 108A were to directly require trustees to consolidate accounts, rather than taking the indirect approach of requiring rules to be made.

To the extent that the legislation expressly provides trustees with discretion as to the mechanics of implementation (by leaving trustees to formulate their own rules), trustees will be exposed to the risk of complaints being made to the Superannuation Complaints Tribunal by members who are disgruntled by the consequences of consolidation, for example, inferior investment returns in respect of the consolidated account, higher costs through the loss of member protection or as a result of the consolidated account becoming accessible by a former spouse (which are issues which the Committee explains further below in this submission).

In light of the above (including our comment regarding the interaction between mandatory consolidation and the duty to act in the best interests of members), the Committee recommends that the legislation clarify the legal position of trustees in no uncertain terms. Given the legislative intention seems to be that trustees must consolidate and have no discretion not to consolidate, whatever the circumstances, it would seem appropriate to provide a statutory safe-harbour to protect trustees who comply with the legislation.

12. Incidental discretions as to timing and account balances

The definition of "inactive superannuation interest" focuses on accounts which have a balance of less than $1,000.

No guidance is given as to the date on which this is to be determined by trustees.

In practical terms, due to the effect of positive and negative investment returns, some account balances may oscillate between being above and below this threshold. It is possible, for example, that an account balance may be less than $1,000 for most of a financial year but be slightly above $1,000 on the day on which the trustee or the administrator identifies the accounts which are to be consolidated. It is not clear what course of action a trustee is required to take in this situation.

Equally, it is possible that an account may change from being under the $1,000 threshold to above the threshold in the period between the day on which the trustee or the administrator identifies the accounts to be consolidated and the day on which the consolidations are actually processed (or vice versa).

In these cases, a trustee may be exposed to liability either because they consolidated an account without there being a legal requirement to do so or because they (arguably) failed to comply with the requirement to consolidate.

Similarly, the proposed legislative provisions contemplate there being annual consolidations but are unclear as to whether this means financial year, calendar year, rolling 12 month period and/or whether the same annual period must be adopted for the purposes of all members.

It would be desirable to include additional provisions which:

- Identify the date on which trustees must determine whether an account balance is above or below the $1,000 threshold or whether trustees have discretion in this regard;
- Create leeway for account balances which are very close to the $1,000 threshold (in the same way that the 'lost member' provisions create an exception for accounts where there is a reasonable belief that the account will exceed the threshold within a defined period in the future);

- Protect trustees where account balances fluctuate between being above and below the $1,000 threshold; and
- Clarify whether 'annual' means once each financial year or calendar year or whether trustees have discretion in this regard.

13. Miscellaneous impediments to consolidation

It is conceivable that, in particular circumstances, there may be other impediments to consolidating accounts which may place trustees in a position from which they cannot fulfil the duty to consolidate. For example:

- The investment option in which the inactive accounts are invested may be 'frozen';
- There may be a payment flag or a flagging order under the *Family Law Act 1975* (Cth) (Family Law Act) which precludes the trustee from dealing with the inactive account.

Ideally the legislation would contemplate appropriate exemptions in these circumstances.

14. Identifying inactive accounts

As drafted, the duty to consolidate accounts is a strict duty that would apply even if trustees are unaware that inactive accounts relate to the same member.

In the immediate instance, pending the implementation of the SuperStream reforms, there is potential for trustees to be unaware (or lacking confidence) that inactive accounts relate to the same member, especially where trustees and administrators hold incomplete member data (for example, if there are several accounts in the name of 'John Smith' and the trustee does not have other identifying details of the member(s)). This risk will diminish once the Australian Tax Office implements a system for trustees to obtain tax file numbers for the purposes of identifying members.

However, in the meantime, consideration should be given to transitional relief which protects trustees in the event of inadvertent breaches of the duty to consolidate.

15. Indirect consequences for member protection and family-law splitting

Although the Committee understands that the member protection standards will be reviewed, the Committee notes that intra-fund consolidations may result in some members losing the benefit of member protection for low account balances, while those provisions continue to apply.

From an operational perspective, many superannuation funds comply with the member protection standards on an account-by-account basis. This means that many accounts with balances of less than $1,000 are currently protected from fees and charges, even though there may be no legal obligation to protect those accounts where the member's total withdrawal benefit from the fund (i.e. across all accounts) might be over the statutory threshold.

In light of this, an immediate consequence of consolidating accounts may be that some members actually start incurring higher costs, as a result of their account

balances exceeding $1,000 post-consolidation and ceasing to be treated as protected.

Similarly, the Committee notes that where consolidation has the effect of causing the consolidated account to have a balance of more than $5,000, this will mean that the consolidated account would become subject to the Family Law Act provisions providing for splittable payments upon the dissolution of marriage (whereas previously the unconsolidated accounts may have fallen outside the scope of those provisions because each account was individually less than the $5,000 threshold).

16. Implications for identification of lost members

A question arises as to whether a consolidation of accounts would be a relevant transaction for the purposes of determining whether or not a member is a lost member.

Quite apart from the legal question of whether or not a consolidation should be regarded as a contribution, rollover or transfer to the fund for the purposes of applying the definition of 'lost member' (and in the Committee's view it probably would not be), there is a separate operational question of whether or not existing administration systems will be able to distinguish a consolidation from other types of transactions for the purposes of identifying and processing lost member accounts.

The Superannuation Committee of the Law Council of Australia would welcome the opportunity to discuss these issues further. In the first instance, please contact the Chair of the Law Council of Australia's Superannuation Committee, Heather Gray on (03) 9274 5321 or at heather.gray@dlapiper.com.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its constituent bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's constituent bodies. The Law Council's constituent bodies are:

- Australian Capital Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Independent Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of approximately 56,000 lawyers across Australia.

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2012 Executive are:

- Ms Catherine Gale, President
- Mr Joe Catanzariti, President-Elect
- Mr Michael Colbran QC, Treasurer
- Mr Duncan McConnel, Executive Member
- Ms Leanne Topfer, Executive Member
- Mr Stuart Westgarth, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.