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12 February 2014

Subject: Superannuation Discussion Paper "*Better regulation and governance, enhanced transparency and improved competition in superannuation*"

Dear Sir/Madam,

Mercer is pleased to lodge a submission on the discussion paper on the important topic of "*Better regulation and governance, enhanced transparency and improved competition in superannuation*".

Outlined in the following pages is our recommendation on the issues prescribed in the Paper. A detailed response on each of the issues will be forwarded early next week.

Please contact me or David Knox (03 9623 5464) if you would like more information on our comments and recommendations.

Yours sincerely,

A handwritten signature in black ink, appearing to read "David Anderson", written over a light blue horizontal line.

David Anderson
Managing Director & Market Leader, Pacific

Copy: David Knox

Part 1: A Better Approach to Regulation

ISSUE	MERCER'S RECOMMENDATION
<p>Improving efficiency and reducing red tape</p>	<p>Our recommendations to improve efficiency and reduce red tape include:</p> <ul style="list-style-type: none"> ▪ Allowing funds to continue providing insurance covering loss of limbs/sight and inability to perform daily living activities and similar definitions beyond 1 July 2014 ▪ Varying the scope and format of the remuneration disclosure requirements ▪ Amending the various Acts, Regulations and Class Orders so that disclosure requirements are easier to follow by appearing in a single place ▪ Reviewing current disclosure requirements to enable funds to more effectively communicate to members in a cost efficient manner ▪ Clarifying and enabling all disclosure material to be issued using electronic means ▪ Specifying notional taxed concessional contributions (as used for concessional contributions limits) as the amount of notional defined benefit contributions for Division 293 tax purposes ▪ Enabling deferred Division 293 tax to be paid from any superannuation fund (rather than just the fund in which the benefit accrued) ▪ Amending Tax Ruling 2010/1 to provide a more practical approach to determining the maximum deductible personal contribution for a year and requiring the ATO to take into account the likely costs on the industry of any future methodology changes it proposes ▪ Conducting a cost benefit analysis of the APRA statistics with the aim of significantly reducing reporting requirements. Greater emphasis should be placed on the value and cost to fund members rather than the value which might be obtained by non-members from results published by APRA ▪ Removing the tax on death benefits with the cost being at least partly offset by the removal of the anti-detriment provisions ▪ Modifying Part 9 of the SIS Regulations by deleting the existing requirements for Funding and Solvency Certificates and additional requirements for funds which are technically insolvent. Consideration could be given to replacing them with requirements which are more consistent with SPS 160 ▪ Clarify that certain actuarial services are not subject to the Tax Agents Services legislation.

Part 2: Better Governance	
ISSUE	MERCER'S RECOMMENDATION
<p>Mandated percentage of independent directors on superannuation boards</p>	<p>It is difficult to argue that superannuation funds should be held to a different standard of governance to those applicable to Australian listed companies, Approved Deposit Institutions, Life Insurers and General Insurers. They all have requirements for a majority of independent directors on the board.</p> <p>Therefore we believe it is inevitable superannuation will be held to the same standard as other APRA regulated entities in the finance and insurance sector.</p> <p>The presence of suitably qualified independent directors on superannuation trustee boards will ultimately strengthen our superannuation system, and a consistent approach to director representation across all segments and entities will provide a simplified structure for effective governance of the superannuation industry.</p> <p>We recognise the need for a transition period for all regulated entities to meet the same standard. Some meet this requirement today. Others will require substantial reform of the board composition to meet this long term standard. As such, for the transition period, we recommend a principles-based board composition and effectiveness program be adopted and enforced via APRA Prudential Standards.</p>
<p>Definition of 'Independent'</p>	<p>The definition of "external director" in Section 601JA(2) of the Corporations Act should be used for independent directors. Modifications would be necessary to exclude officials of any organisation (such as a Union, employer body or employer) who appoint the directors of the trustee board.</p> <p>The definition of independent should, as far as possible, be consistent with other definitions relevant to corporations because inconsistencies generally lead to greater complexity and red tape. Consideration should also be given to whether there should be greater alignment with other definitions, for example the definition of non-executive director in Superannuation Prudential Standard SPS 510.</p> <p>We also suggest a principle which encourages trustee board members to be a member of the fund. This would be assisted by legislation clarifying fund members do not have a conflict of interest merely in relation to them being a member of the fund.</p>
<p>Should</p>	<p>We believe the chair of superannuation trustee boards should be independent.</p>

<p>superannuation fund boards have independent chairs?</p>	<p>A principle of the desirability rather than mandating independent chairs could be introduced during the transition period.</p>
<p>Process for appointing directors on superannuation fund boards</p>	<p>We recommend each fund be able to determine how its board members are appointed. This could include maintaining the existing appointment process which will avoid considerable expense that may be incurred if appointment processes had to be changed. This flexibility will allow for the most appropriate appointment system for the particular fund. Those responsible for appointing board members would need to take into account the principles and requirements for independent directors.</p> <p>Additional protections would be necessary to ensure an appropriate mix of board members, effectiveness of the board, and mechanisms by which the board can be made more effective and, in extreme cases, replaced. Protections should include the following:</p> <ul style="list-style-type: none"> ▪ APRA able to remove a board or individual and appoint a replacement where APRA considers the Board is not operating effectively ▪ Development of a skills matrix necessary for an effective board (this could include skills and experience and demographic factors appropriate to the fund's particular circumstances) ▪ A requirement for the board to liaise with those responsible for appointing board members to ensure a board which comprises the skills set out in the fund's skills matrix (this is consistent with Superannuation Prudential Standard SPS 510) ▪ Regular independent board effectiveness reviews ▪ Disclosure of whether each board member is independent and, if not, any relationship with an employer/employer organisation, union/employee association or fund promoter ▪ Requirements to disclose the appointment process <p>Amending member disclosure requirements so trustee board directors disclose whether they are a member of the fund.</p>
<p>Management of conflicts of interest</p>	<p>New Governance standards in APRA prudential standards should be revisited in two or three years once practical experience has been obtained. However, consideration could be given to mandatory training in conflicts of interest in relation to superannuation within board members' first two years of office.</p>

Appointment terms for directors	Mandated maximum terms would add further red tape to our system. More importantly it could lead to the loss of highly skilled and experienced directors. Board renewal should be considered as part of the board effectiveness reviews.
Board effectiveness	<p>Boards, as a whole, should be regularly assessed. Board decisions are made as a collective. Individual directors should not be subject to regular performance appraisals.</p> <p>Independent board effectiveness reviews should be conducted at least every two or three years and should concentrate on whether the board is acting effectively and appropriately and whether it could be strengthened by changes to its membership.</p> <p>Board effectiveness could also be improved by establishing a best practice principle that the board set expectations for each of the board members taking into account the fund's strategy, policies, objectives and skills set. These expectations are likely to vary depending on the skill set of each board member.</p>

Part 3A: Choice product dashboard

ISSUE	MERCER'S RECOMMENDATION
Can a choice product dashboard help enhance transparency?	<p>We do not believe product dashboard requirements for choice products should proceed. If they do, this should only occur after detailed consumer testing. At least for some investment options, different requirements to those for MySuper dashboards may be necessary. If the Government does decide to proceed with product dashboard requirements for Choice products, we strongly encourage the delay in their introduction to no earlier than 1 July 2016.</p> <p>Mercer supports the Government's commitment to increasing the quality of information available to superannuation fund members and employers. However – we strongly believe introducing a choice product dashboard would add little value to superannuation fund members. It would largely be disclosure for the sake of disclosure adding a significant compliance burden on funds, resulting in additional unnecessary costs which would be passed on to members.</p> <p>We expect members who choose a particular investment option are generally reasonably engaged with their superannuation. Product dashboards are unlikely to provide relevant information for these engaged/sophisticated members.</p>

Page 6
12 February 2014
Manager, Superannuation Unit
Financial System Division
The Treasury

In any case, the MySuper dashboard requirements are inappropriate in their current format and may confuse members rather than assist them. There are many unresolved problems with MySuper dashboards that should be rectified before consideration is given to dashboards for choice products.

Meanwhile, we recommend the following changes:

- Show net investment return rather than net return to reduce confusion and provide more appropriate information
- Review the risk measure which should be based more on the risk of providing unacceptable retirement outcomes
- Remove requirements to show dashboards on periodic statements
- Clarify the fees to be disclosed
- Clarify the term “return target”
- Consider showing returns for periods shorter than 10 years where 10 years’ experience is not available.

Part 3B: Portfolio holdings disclosure	
ISSUE	MERCER'S RECOMMENDATION
<p>What level of portfolio holdings disclosure is appropriate?</p>	<p>We believe the current legislative requirements are overly onerous and the compliance costs will far outweigh the benefits.</p> <p>Mercer supports disclosure of portfolio holdings to the extent this does not impose an onerous regulatory burden and or excessive costs. This could be achieved by amending the disclosure requirements to reflect the following principles:</p> <ul style="list-style-type: none"> ▪ Not require a look through to assets underlying pooled funds (with some other look through exemptions) ▪ Include a materiality threshold determined on a size basis – eg. Assets more than 2% reported with those under a confidential agreement de-identified. <p>With such changes, funds would be able to place more emphasis on providing information on a product (or option) basis rather than a whole of fund basis. This will be more relevant to members considering a particular investment option.</p>
<p>Implementation issues</p>	<p>The 1 July 2014 timetable appears to be unachievable, particularly if reporting to the individual product level is required. Delaying the commencement date for portfolio holding disclosure by at least one year, would allow industry and regulators appropriate time to determine an appropriate level of reporting that provides useful and informative information to members without significantly increasing the burden on superannuation funds. As such the earliest feasible reporting date would be 1 July 2015.</p>

Part 4: Improved competition in the default superannuation market	
ISSUE	MERCER'S RECOMMENDATION
<p>Transparency, contestability & reducing red tape</p>	<p>Mercer recommends the provisions specifying default funds be removed from Modern Awards with employers being able to choose any fund offering a MySuper as their default.</p> <p>The existing model is not transparent or contestable and provides additional cost and administrative complexity for employers, employees and superannuation funds. We are particularly concerned that many employees and other members of superannuation funds will be adversely affected financially by the new requirements.</p> <p>This will avoid the following outcomes which are likely to arise if the legislation is not amended:</p> <ul style="list-style-type: none"> ▪ An estimated million new accounts may need to be established because the current employer default fund is not listed in the relevant Modern Award, resulting in <ul style="list-style-type: none"> ○ a blow out in the number of lost members ○ two sets of administration fees for relevant employees, potentially on an ongoing basis as it is unlikely many will go to the effort of merging their existing and new accounts. For those who do merge accounts, a withdrawal fee will be incurred ○ A potential loss of insurance cover where members may not satisfy the relevant underwriting requirements to be eligible for cover in their new fund and who may lose existing cover permanently if they rollover their existing account to the new fund or if their existing account is no longer sufficient to provide ongoing insurance cover ▪ Hundreds of thousands of employees potentially becoming members of funds which are less appropriate to their circumstances (including higher fees and less appropriate insurance arrangements) ▪ Additional cost and red tape for employers in choosing a new default fund, advising employees and processing requests from employees who wish to retain their existing fund ▪ Additional cost and red tape for employers who have employees covered by more than one Modern Award where it may be necessary to have different default funds for different groups of employees and potentially change an individual employee's default fund each time the employee changes roles and becomes subject to a different Modern Award with the adverse impacts on the

Page 9
12 February 2014
Manager, Superannuation Unit
Financial System Division
The Treasury

- employee being repeated each time
- Significant costs being incurred by superannuation funds in applying to the Fair Work Commission for listing under in excess of 100 Modern Awards. These costs will be passed onto members.