



MySuper consultation working group

Issues paper on advice and insurance commissions within super

March 2011

PROPOSED REFORM

The implementation of financial advice reforms is being progressed as part of the *Future of Financial Advice* (FOFA) process. These reforms have implications for both MySuper and Choice products.

This issues paper considers the FOFA reforms in the context of the Stronger Super recommendations relating to advice where they overlap, and any other areas of Stronger Super reform that are not covered by FOFA but otherwise relate to financial advice and insurance commissions. This issues paper provides an opportunity to comment on both sets of reforms in the context of the Stronger Super recommendations.

As discussed in more detail later in this paper, the general framework under MySuper is for advice to be provided in one of three ways:

- Intra-fund advice – subject to it being consistent with the trustee’s best financial interests duty and the allocation of costs to be deducted from member accounts as determined by the trustee;
- Personal and general advice – requested by the member, subject to the proposed FOFA adviser charging regime, and costed on a fee-for-service basis deducted from the account of the individual member; or
- At the expense of the employer – employers must pay directly for superannuation-related advice to be provided to them or their employees rather than deducting these expenses from the members’ superannuation account balances (consistent with recommendation 1.10 of Stronger Super).

ISSUES

Issue 1 – Provision of advice and services (other than intra-fund advice)

General considerations

The sole purpose requirements contained in section 62 of the *Superannuation Industry (Supervision) Act 1993* (the 'sole purpose test') prescribe the core and ancillary purposes of regulated superannuation funds, and these are limited to the provision of a range of prescribed or approved retirement or retirement related benefits to members.

Advice offered by the trustee will have to be consistent with the sole purpose test. For example, member awareness, education and financial advice programs, targeted at superannuation fund specific issues such as benefit features (including insurance options, the making of binding death benefit nominations etc) or investment choices offered in the fund would be consistent. However, other programs or activities such as those targeted at broader, non-superannuation savings and investments, and products or services such as investment or tax advice and health insurance would fail the sole purpose test.

Written agreement (FOFA reform)

The Government response (Stronger Super) supports the recommendation that advice (other than intra-fund advice) to members of a MySuper product should only be provided on request of the member (recommendation 1.9). Similarly, the Government announced that it supports the equivalent recommendation in respect to any other product of the choice architecture model (recommendation 1.22). The response notes that these recommendations have been adopted as part of FOFA and the Government is consulting on implementation details through the FOFA process.

A key objective of MySuper is to provide a better deal for default superannuation members. Integral to achieving this is ensuring that MySuper members only pay for product features they actually benefit from. The Government is concerned that default members are subsidising the cost of general or personal advice provided to a select few members – paying for services that provide no benefit to them.

Consequently, provision of financial advice to MySuper members will be subject to written agreement by the member. Individual members will be able to request general or personal advice from the trustee and be individually charged for this (see issue 2 for discussion of costs).

The risk of members in Choice products and self-managed superannuation funds paying for advice they may not be aware of is low, as all members will be engaged with their superannuation. Nevertheless, requiring written agreement would provide an additional safety net for these members. It is proposed that members of these products should benefit from any written agreement requirement agreed to as part of the FOFA reforms.

Advice provided at the request of individual Choice members would operate no differently to MySuper or other products, requiring written agreement for advice. As members moving to Choice products will be required to provide written agreement to join the product, requiring written agreement to provide advice seems easy to facilitate. As long as there is adequate disclosure of product features as part of the written agreement to join the Choice product, it may not be necessary to require separate written agreement with respect to advice.

Question 1.1 Are there any reasons why superannuation products should have different requirements for written agreement?

Question 1.2 What level of advice is currently offered as an embedded feature of superannuation products? How would such advice operate in the Choice sector?

Annual renewal (FOFA reform)

The Government announced (Stronger Super) that it supports the recommendation that members of MySuper products should only be provided with advice (other than intra-fund advice) about superannuation under arrangements that require the member to renew the advice service each year following the issue of a renewal notice by the adviser (recommendation 1.12). Similarly, the Government announced that it supports the equivalent recommendation in respect to any other product of the choice architecture model (recommendation 1.25). The response notes that these recommendations have been adopted as part of FOFA and the Government is consulting on implementation details through the FOFA process.

The Government has undertaken extensive consultation through FOFA in relation to the general application of the compulsory annual renewal requirement for advice provided outside superannuation products. It is envisaged that the ultimate approach adopted by the Government will apply equally to superannuation products so that there is a consistent approach across the financial services sector.

Regular renewal would ensure that members that lose touch or do not continue to monitor their superannuation do not continue to pay for advice they are not receiving. Members of superannuation products should not have different renewal requirements than those that would apply to other financial products.

Question 1.3 Are there any reasons why superannuation products should have different requirements for annual renewal?

Standard form for provision of advice service and annual renewal (FOFA reform)

The Government announced that it supports ASIC (in consultation with industry) devising a standard form which requires clear identification of the advice service to be provided where a fund member first opts in to receiving advice or renews an ongoing advice service (recommendation 1.13).

Consultation is underway in relation to the form of the compulsory annual renewal notice for advice provided outside superannuation, including whether a precise form will be prescribed. It is envisaged that the ultimate approach adopted by the Government will apply equally to superannuation products so that there is a consistent approach across the financial services sector.

Issue 2 – Cost of advice and services (other than intra-fund advice)

Cost of advice to employers

The Government has announced (Stronger Super) that costs of advice provided to employers will no longer be borne by members of MySuper products or other products in the choice architecture

model (recommendations 1.10 and 1.23). For example, the costs associated with advice on selecting a default fund for employees is expected to met by employers, as selecting a default superannuation fund is an employer obligation (to meet superannuation guarantee requirements). This applies to the costs of such advice in relation to both MySuper and Choice products. Currently, some trustees allow for employer costs to be deducted from member accounts, whereas other employers directly pay for the advice they receive from the advice provider.

Question 2.1 Are there any impediments to implementing these recommendations?

Cost of advice to members - deductibility

Where general or personal financial advice has been requested by the individual member, the cost of obtaining the advice can be deducted from the account of the individual member. This applies to members of both MySuper and Choice products. As noted above, the member must provide written agreement for costs to be deducted (recommendation 1.9).

As part of improving transparency in regard to costs of advice and making it simpler for members to understand what advice is available to them, the written agreement to request advice will state the cost of advice that will be deducted from the member's account.

Question 2.2 Are there any impediments to implementing these recommendations?

Cost of advice to members – bundling (FOFA reform)

The Government response supports in principle the recommendation that neither advice to members (other than intra-fund advice), nor advice to employers should be 'bundled' with MySuper products (recommendation 1.8). Similarly, the Government announced that it supports the equivalent recommendation in respect to any other product of the choice architecture model (recommendation 1.25).

As noted above, employer costs are no longer allowed to be passed on to members. Consequently, these costs are no longer relevant costs for superannuation trustees when charging fees to members.

If advice obtained by individual members of MySuper or Choice products is subject to written agreement, the costs are fully disclosed, and commissions and volume payments are banned, then the cost of advice is automatically unbundled. In instances where a member has both MySuper and choice products (including SMSFs), in order to ensure there is no regulatory imbalance or opportunities for arbitrage, it is essential that advice on the different product types is not bundled.

Question 2.5 Are there any impediments to implementing these recommendations?

Issue 3 – Commissions within super

Commissions in relation to advice in superannuation (FOFA reform)

The Government announced that trustees of MySuper products should not pay or fund any commissions, volume or similar payments in respect of superannuation advice or products or

services provided to members of MySuper (recommendation 1.11) and other products (recommendation 1.24).

The Government has undertaken extensive consultation through FOFA in relation to the general application of a ban on commissions in relation to advice provided in superannuation and other financial services. It is envisaged that the ultimate approach adopted by the Government will apply equally to superannuation products so that there is a consistent approach across the financial services sector.

Commissions in relation to insurance in superannuation (FOFA/SS reform)

The Government has announced (Stronger Super) that it will ban commissions on group insurance in relation to MySuper (recommendations 1.14 and 5.12) and will consider whether to extend the ban to other products in the choice architecture model. Trustees of MySuper products will not be able to pay premiums for insured member benefits that include commissions in relation to group insurance. The Government announced that it will consult on whether to ban commission on individual risk insurance within MySuper products or any other product in the choice architecture model.

Trustees will be required to offer default opt-out life and TPD insurance to all members in MySuper and choice products (with limited exceptions). In addition, trustees will be allowed to offer income protection insurance (sometimes known as income continuance or temporary disability insurance).

Under MySuper, group insurance would be bought by the trustee on behalf of members and offered by the trustee to members as a default strategy, with individual members able to increase or reduce their level of insurance under the group insurance contract. Under this model, it is not clear what role there would be for individual risk insurance, but it is unlikely to be significant.

Some superannuation funds may offer individually underwritten risk insurance through a superannuation product. This is usually offered where the trustee does not have a group risk insurance contract, so is expected to have little relevance to MySuper products.

Unlike commissions paid in respect of non-superannuation life insurance, life insurance commissions paid to advisers/brokers as part of superannuation can be deducted from superannuation account balances. Consequently, arguments about affordability of advice are less relevant in the context of superannuation.

Some analysts have suggested that life insurance will become more affordable in the event of a ban, with insurers having more incentive to compete on price and value to retain market share (whether this assists in boosting overall insurance levels is unclear, because cost of premiums does not appear to be the sole cause of underinsurance or non-insurance). This would arguably reduce premiums deducted from superannuation accounts, which would improve the retirement income of members.

FOFA is currently considering whether the ban on commissions in relation to retail investment products should be extended to risk insurance more generally (not just superannuation).

Question 3.1 What impact would banning commissions have on insurance offered to superannuation members? What is the likely impact on premiums and insurance penetration?

Question 3.2 Should different rules apply to MySuper products? Why?

Question 3.3 Should different rules apply to group risk insurance and individual risk insurance offered by superannuation trustees?

Question 3.4 What other measures should be considered to improve outcomes for consumers?

Issue 4 - Intra-fund advice

Definition of intra-fund advice – what is covered (FOFA reform)

Intra-fund advice can be a useful mechanism for providing simple, low cost and easily accessible advice to superannuation members. The Government has made it clear that the expansion of simple or limited financial advice is an important priority for the FOFA reforms, which include an extension of intra-fund advice into new topics, for example: transition to retirement; intra-pension advice; nomination of beneficiaries; superannuation and Centrelink payments; and retirement planning generally. The Government is looking at options for implementing this policy including through the expansion of existing regulatory guidance.

As part of implementing these reforms, it will be necessary to define the scope of intra-fund advice. This definition would need to reflect the fact that the vast majority of what is referred to as intra-fund advice is generally provided by an outsourced financial adviser and does not make use of the intra-fund Class Order relief (CO 09/210). One option would be to define intra-fund advice as general or personal advice limited solely to a member's interest in a superannuation fund that is provided, or arranged to be provided, by the trustee of the superannuation fund.

The definition of intra-fund advice will need to reflect the introduction of two distinct types of products, MySuper and Choice, which APRA-regulated funds may offer. Trustees will not be able to offer intra-fund advice on investment strategies (and therefore to switch between MySuper and Choice products). This would be subject to the requirements for switching advice (see discussion in issue 4 – switching advice).

Currently, intra-fund advice is facilitated through ASIC Class Order Relief for super trustees (CO 09/210) and/or through regulatory guidance (RG 200) that clarifies how advice about a member's existing interest in their super fund can be provided in a compliant manner. Currently, there is no reference to or definition of intra-fund advice in legislation. In order to exempt intra-fund advice from adviser charging and annual renewal, it will be necessary to define intra-fund advice in legislation.

Question 4.1 How are collective advice services currently provided and in what form? How can these services be provided under MySuper?

Question 4.2 What should be the scope of intra-fund advice? Should it cover both general and personal advice? To what extent should intra-fund advice be accessible equally to all members (for example, is a workplace seminar to only a subset of members intra-fund advice)?

Question 4.3 What restrictions should be applied to intra-fund advice for MySuper compared to choice members?

Provision of intra-fund advice under MySuper

Best financial interests duty

While the costs of intra-fund advice will be discussed in detail later in this section, how intra-fund advice costs can be allocated will have implications for its provision. The Super System Review concluded that the costs of intra-fund advice should not be subject to the same requirements as general and personal advice. Instead, it argued that it should be up to the trustee to determine whether the cost of intra-fund advice is deducted from the accounts of all MySuper members or charged on a user-pays basis.

Where trustees decide to allocate costs to all MySuper members, irrespective of use, trustees will need to justify the provision of intra-fund advice under their duty to act in the best financial interests of members. Trustees of MySuper products will have a specific obligation to formulate and give effect to a single diversified investment strategy, aimed at optimising MySuper members' best financial interests as reflected in long-term net returns (recommendations 1.6(a) and 1.7(c)). Providing intra-fund advice, like other product features, comes with a cost that will have to be justified by the trustee in meeting its best financial interests obligation.

Under this scenario, intra-fund advice must be available equally to all members. This is to ensure that members are not paying for services that are only available to selected members and only benefit a minority of members, such as services provided only to selected employers and their employees.

Alternatively, where trustees decide to provide access to intra-fund advice on a user-pays basis, intra-fund advice will effectively operate under the arrangements for personal and general advice. Intra-fund advice would not need to be subject to the best financial interests duty as it would be up to the member to determine whether it is in their best interests to access it individually.

Question 4.4 Are there any impediments to implementing these recommendations?

Should it be mandated?

The Government announced that it would consider whether MySuper products should be required to offer intra-fund advice and the appropriate timing of any change (recommendations 1.7(m), 7.2 and 7.3). While the Super System Review concluded that trustees offering MySuper products should be required to maintain a facility for providing intra-fund advice to members, the Government is aware there may be substantial costs for funds to meet this requirement that may result in members being

worse off. Consequently, it is proposed that intra-fund advice not be a mandatory feature of MySuper products initially, but left up to the trustee's discretion.

Question 4.5 What are the advantages and disadvantages of mandating provision of intra-fund advice? What data is available on the benefits and costs of providing intra-fund advice?

Question 4.6 Should intra-fund advice be mandated at some point in the future? If so, when?

Should it be offered proactively?

The Super System review recommended that MySuper trustees proactively offer intra-fund advice to members in relation to their insurance (recommendation 5.13), retirement issues as a person nears retirement age (recommendation 7.2) and at periodic intervals during the retirement phase (recommendation 7.3).

Given it is proposed that initially the trustee decide whether intra-fund advice is offered, it would be consistent initially for the trustee to decide how and when it is offered.

Where trustees offer intra-fund advice on a shared-cost basis, uptake of this advice will be part of assessing whether it is in the best financial interests of members. Consequently, trustees that believe intra-fund advice benefits their membership would have an incentive to encourage members to use it. However, where a trustee decides to offer intra-fund advice on a user-pays basis, it is not clear how intra-fund advice could be offered proactively or how the cost of doing so would be allocated to members.

Question 4.7 Should trustees offering intra-fund advice be required to offer it proactively? Would this benefit MySuper members?

Question 4.8 Should any requirement to offer it proactively apply to shared-cost intra-fund advice only?

Does intra-fund advice require written agreement or annual renewal? (FOFA reform)

The Government announced that it supported the Super System Review recommendations to exempt intra-fund advice from the written agreement and annual renewal requirements applying to general and personal advice (recommendations 1.9, 1.12, 1.22 and 1.25).

As noted above, where intra-fund advice is offered on a user-pays basis, the provision of intra-fund advice will be consistent with general and personal advice. Consequently, intra-fund advice offered on a user-pays basis will be subject to written agreement and annual renewal as agreed as part of the FOFA reforms.

Where intra-fund advice is provided on a shared-basis, it will not require written agreement or annual renewal. This reflects that it should be possible for intra-fund advice to be used as a mechanism for providing simple, easily accessible advice where it is in the best financial interests of members.

Costs of intra-fund advice

The Super System Review recommendations and the Government response focus on how to allocate costs for general and personal advice, and consequently do not specifically detail how the costs of intra-fund advice should be allocated to members. However, this is a key issue for the provision of intra-fund advice to members.

The Government announced (Stronger Super) that it did not support a ban on cost cross-subsidisation, but instead announced that trustees will be required to make a fair and reasonable allocation of costs between MySuper and other products (recommendation 1.7(d)). Consequently, the costs of intra-fund advice should be consistent with the fair allocation of costs between MySuper and Choice members.

While the meaning of a fair and reasonable allocation of costs is still to be discussed as part of MySuper consultations¹, this aims to have MySuper products charge fees that represent the costs attributable to the MySuper product, not the costs of the fund as a whole (if it offers Choice products).

An implication of this position is that costs of intra-fund advice can be charged to members whether they use intra-fund advice or not. That is, intra-fund advice would be exempt from the proposed rules applying to general and personal advice that ensure advice is obtained by and charged to the individual member. As noted above, the Super System Review concluded that the cost of intra-fund advice could either be shared across the MySuper membership (like an administration cost) or charged on a user-pays basis.

A consequence of costs being able to be allocated to members irrespective of whether they use it or not is that intra-fund advice would be exempt from the a prohibition on bundling. However, where the trustee opts to provide intra-fund advice under a user-pays system, intra-fund advice costs will need to be distinguished from administration costs.

Question 4.9 What difficulties can be foreseen in separating the costs of providing intra-fund advice from administration costs to facilitate a user-pays system?

Question 4.10 Should trustees be able to bundle the costs of intra-fund advice within the MySuper product? What would be the likely impact of a prohibition on bundling these costs?

Issue 5 – Switching advice

Specific conduct and enquiry duties (FOFA reform)

From 1 July 2013, when there will be both MySuper and ‘choice’ products, the effective regulation of switching advice will be critical to protecting the interests of members. The purpose of MySuper would be undermined if financial advisers and/or trustees did not make members aware of all the consequences of leaving MySuper.

Consequently, persons providing advice to MySuper members recommending that they switch out of a MySuper product will be required to comply with specific conduct and enquiry duties built on the current requirements of section 947D of *the Corporations Act 2001* (recommendation 1.15). Section 947D of the *Corporations Act 2001* imposes additional requirements when advice recommends

¹ See separate issues paper on fees and costs.

replacement of one financial product with another. Applying these duties would ensure that advice covers the consequences of switching, such as charges the member would incur, benefits the member would lose and other significant consequences that are known to the adviser at the time the recommendation to switch is made. The additional requirements will apply to advice whether the alternative product is offered by the same trustee, under a single RSE or is a completely separate product offered by another RSE.

The new best interests' duty under FOFA will also be relevant here. For example, as part of implementing the best interests' duty, consideration is being given to whether the duty should require a person providing personal advice to consider whether a client's financial objectives can be achieved using their existing financial products. This would mean an adviser recommending a client increase their superannuation contributions would need to consider whether these additional contributions should be made to the client's existing (possibly MySuper) superannuation fund as opposed to being directed to a new (possibly choice) superannuation fund.

Question 5.1 Are the duties imposed under section 947D sufficient? Are other duties necessary to ensure MySuper members are protected?