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Your Future is now: Superannuation reforms pass Parliament

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The passage of the Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (YFYS Bill) in Parliament during June, marked one of the largest shake-ups to Australia's superannuation system in decades. The Your Future, Your Super (YFYS) reforms were designed to address a number of structural issues with the existing system by affording greater protection to superannuation account holders as well as improving the performance and accountability of superannuation funds.

Your Future, Your Super reforms

In essence, the YFYS reforms:

- require employers to make contributions for employees commencing from 1 November 2021 to an employee's stapled fund, as distinct to an employer's default fund
- introduce a new annual performance test, which prohibits trustees from accepting new contributions for those products that underperform for two consecutive years
- amend the best interests duty, such that trustees and directors are required to act in the 'best financial interests' of their beneficiaries
- remove an exemption for trustees regarding the disclosure of their portfolio holdings.

The purpose of this paper is to consider each of these reforms in greater detail.

Reducing the creation of multiple accounts

The YFYS Bill amends the 'choice of fund' rules in Part 3A of the *Superannuation Guarantee (Administration) Act 1992* (SGAA). Previously, if an employee did not elect a superannuation fund into which an employer would pay their superannuation contributions within the relevant time period, an employer would be able to comply with the choice of fund rules by making contributions on behalf of the employee into the employer's chosen default fund.

In its *Superannuation: Assessing Efficiency and Competitiveness* report (PC Report), the Productivity Commission identified that the unintended consequence of this action was the creation of multiple superannuation accounts by employees when changing jobs which resulted in a structural flaw in the system as it reduced retirement savings due to duplicate fees and insurance premiums paid on those accounts. While the recent *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019* sought to address existing multiple

accounts, by ensuring that 'inactive accounts' are consolidated into a person's 'active account', these reforms did not prevent the creation of new multiple accounts for employees.

Under the new section 32C(1A) of the SGAA, in respect of an employee who commences employment on or after 1 November 2021 and who does not otherwise choose a superannuation fund within the specified time, employers will be required to:

- request via an approved form, that the Commissioner of Taxation identify whether the employee has a stapled fund (i.e. employers are not permitted to independently determine whether an existing fund is a stapled fund for the employee)
- make superannuation contributions to the stapled fund where the Commissioner has notified the employer that the employee has a stapled fund.

Provided the employer makes the above request to the Commissioner and the Commissioner has notified the employer that there is no stapled fund for the employee, an employer can then make contributions to the employer's chosen default fund.

This will apply similarly for employees starting on or after 1 November 2021 where the employee is subject to a workplace determination or enterprise agreement made before 1 January 2021. This builds upon previous changes made under the *Treasury Laws Amendment (Your Superannuation, Your Choice) Act 2020*, which prevents employers from relying on workplace determinations or enterprise agreements entered into on or after 1 January 2021 to satisfy the choice of fund rules.

It is proposed that the Australian Taxation Office will establish and maintain a digital service to receive and respond to requests from employers about whether a stapled fund exists for their employee. Any such system must ensure that responses are provided with sufficient time to allow employers to comply with their choice of fund requirements.

What is a stapled fund?

Broadly speaking, a stapled fund has the following basic requirements:

- it is a 'complying superannuation fund', in respect of which the employee is a member
- as far the Commissioner is aware, the fund is able to accept contributions from the employee's employer
- the Commissioner is able to disclose information about the employee or their fund to the employer (and the employer's agent, if the agent made the request).

The draft regulations also set out tie-breaker requirements to determine an employee's stapled fund where an employee has two or more funds that meet the basic requirements above.

In addition, the YFYS Bill noted:

- Circumstances where an employee's stapled fund is subject to a successor fund transfer. In this event, employers can continue to make contributions to the successor fund without making any further requests to the Commissioner as to whether the employee has a stapled fund.
- Late contributions due to a fund notified by the Commissioner not in fact accepting contributions from the employer on behalf of the employee.

While the reduction in multiple accounts and fees that have the potential to erode retirement savings is not necessarily a bad thing, there is still some question as to whether the stapled fund is providing the best outcome for employees. This will primarily depend upon the performance of the relevant stapled fund, but also on benefits that are at times heavily negotiated by employers on behalf of employees that might now be lost. These include for example, reduced administration fees and insurance premiums or other benefits, including access to income protection insurance.

Addressing underperforming superannuation products

Another structural flaw in Australia's superannuation system that was identified in the PC Report was entrenched underperforming superannuation products. As a result, it recommended requiring all APRA-regulated superannuation funds to be subject to annual outcomes tests for their MySuper and other offerings, with consequences for failing these tests.

Trustees already have a requirement to conduct a self-assessed annual outcome assessment for MySuper and choice products. The annual outcomes assessment requires trustees to consider whether the assessed product is promoting the financial interest of beneficiaries with regard to certain criteria, including the product's risk, return and fees and costs. In saying this however, the annual outcome assessment does not include an objective performance test, nor any immediately operative consequences.

Now in addition to the annual outcome assessment, the YFYS Bill seeks to implement the Productivity Commission's recommendation by inserting a new Part 6A into the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Some of the key requirements set out under Part 6A include:

- **MySuper and choice products:** APRA must conduct an annual performance test, each financial year, on 'Part 6A products' offered by regulated superannuation funds other than those with fewer than five members.

This will effectively capture MySuper products or choice products when the trustee makes decisions regarding the product's exposure to certain sectors and the underlying assets invested in by the product. This is expected to capture most choice products, other than for example, platform-type offerings which allow members to choose investments to construct their own superannuation portfolio. The draft regulations also indicate that the annual performance test will not cover certain products, such as defined benefit or pension products.

The quote

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The quote

Section 52(2)(c) of the SIS Act has been amended to require trustees of registrable superannuation entities to perform the trustee's duties and exercise the trustee's powers in the best financial interests of their beneficiaries.

- **APRA determination and notification:** APRA must determine whether a Part 6A product has passed or failed the annual performance test for each financial year and must notify trustees of the superannuation products of the results of the annual performance test. The results will also be published by APRA online.
- **Notification to beneficiaries:** trustees of superannuation products that fail the annual performance test must notify beneficiaries who hold the product, that their product has failed the annual performance test. Such notification is generally required to be given within 28 days of APRA giving the trustee notice of its test results.

The exposure draft regulations also require a trustee to publish on its website that a product has not passed the test for the first time, or when the product has not passed the test previously. The exposure draft regulations specify the form and prescribed information that must be included in the notification, so as to ensure that there will be a consistent approach taken to how information about underperformance is presented to beneficiaries.

- **Prohibition on accepting new beneficiaries:** trustees of superannuation products that fail the annual performance test in two consecutive years are prohibited from accepting new beneficiaries into the superannuation product, unless APRA lifts the prohibition (if certain circumstances specified in the regulations are satisfied).

These changes will mean individuals will be prevented from entering into persistently underperforming superannuation products. However, beneficiaries who hold an interest in the product at the time the product becomes subject to a prohibition may continue to hold the product and continue to make contributions to that product. Trustees will also still be able to accept a beneficiary into another product offered by the trustee where that product is not subject to a prohibition, since the prohibition operates at the product level and not the superannuation entity level.

The amendments relating to the new annual performance test apply in relation to MySuper products from 1 July 2021. For other classes of beneficial interests in a regulated superannuation fund specified in the regulations the performance test will apply on and after 1 July 2022.

The requirements for the annual performance test will be set out in the regulations. Based on the exposure draft regulations, the test will be passed for a product provided the product's 'actual return' minus the 'benchmark return' is greater than or equal to 0.5% on average over, generally speaking, an eight year period, where a product's:

- 'actual return' is the annualised net returns the product actually achieved, where net returns are the net investment return including relevant administration fees and expenses
- 'benchmark return' involves the construction of an annualised benchmark net return that is tailored for each product.

It is an interesting conundrum for superannuation trustees. Superannuation is a long term game, and yet returns are being judged on short term performance. This sort of paradigm shift may potentially see superannuation trustees become more risk-averse, and turn away from long term or risky investments like alternative investments or private equity, where returns may only be expected in the long term.

In addition, it will be interesting to see the impact on those superannuation funds that invest directly in infrastructure or private equity, a trend some superannuation funds have embraced of late. Trustees may turn to more passive asset management strategies that track the relevant benchmark that is to be chosen by APRA.

Best financial interests duty

The YFYS reforms have also introduced a 'best financial interests duty'. *The Superannuation Industry (Supervision) Act 1993* (SIS Act) sets out a number of covenants that are taken to be included in the governing rules of superannuation entities. Previously, this included that each trustee of the entity must perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries.

The PC Report found that superannuation entities did not always act in the best interests of beneficiaries, which reflected not only misconduct on the part of the trustee, but also a lack of clarity around what is expected of trustees under the best interests duty under in the SIS Act. It therefore recommended that the Government pursue greater articulation of what is meant for a trustee to act in members' best interests under the SIS Act.

Section 52(2)(c) of the SIS Act has thus been amended to require trustees of registrable superannuation entities to perform the trustee's duties and exercise the trustee's powers in the best financial interests of their beneficiaries. This new duty, which applies from 1 July 2021, also extends to directors of corporate trustees as well as trustees of SMSFs. It must be said, that this articulation is not inconsistent with how the courts have interpreted the best interest duty to date, but somewhat focuses the attention of a trustee when considering its decisions.

The intent of these amendments is to increase the accountability of trustees when executing their fiduciary duties, which includes decisions such as investing beneficiaries' money or incurring day-to-day essential as well as discretionary expenditure.

In terms of expenditure, trustees will need to have robust evidence to support such expenditures when exercising their powers. The Explanatory Memorandum to the YFYS Bill notes that provided expenditure is essential to the operation of a superannuation entity, and the proper reporting and monitoring frameworks are put in place by the trustee to ensure that the expenditure is necessary and provided on competitive terms, then the expenditure decision would likely be

regarded as being in the best financial interests of beneficiaries.

When a fund undertakes expenditure that might be considered discretionary or non-essential to the ongoing operation of the superannuation entity, it should expect greater scrutiny for the basis of the expenditure.

The Explanatory Memorandum also provides some practical examples of expenditure that is, and is not, in the best financial interests of beneficiaries. One example that would not be in the financial interests of beneficiaries is a decision by a fund to spend beneficiaries' funds on well-being and counselling services in order to provide a holistic retirement experience.

Meanwhile, spending by a fund on a television marketing campaign designed to increase members, and thereby reduce the fees paid by existing members, but fails to actually do so could still be in the best financial interests of beneficiaries if the trustee is able to produce:

- detailed analysis that shows previous campaigns delivered an increase in members
- evidence as to why unforeseen events may have reduced the effectiveness of the more recent campaign.

However, perhaps the biggest change for superannuation trustees, other than SMSF trustees, is the evidentiary burden of proof. This has been reversed in respect to actions brought by a regulator, as distinct to actions to recover loss or damages brought by a beneficiary, meaning that the onus is now on the trustee to prove they performed their duties and exercised their powers in the best financial interests of their beneficiaries. As a result trustees now need to have strong systems and processes in place to ensure that they can point to evidence, like quantifiable metrics, as well as keep clear records of their decision making processes.

The YFYS Bill initially included the ability to prohibit a trustee from making certain payments or investments prescribed the regulations, however these amendments were later dropped over fears it would give the federal government wide powers to intervene in the business of superannuation funds.

Portfolio holdings disclosure

The YFYS Bill removed an exemption in the soon to be implemented portfolio holdings disclosure rules in the *Corporations Act 2001*. Set to commence 31 December 2021, the rules will generally require trustees to publish information about their disclosable investment items on their website. These rules previously contained an exemption that allowed a trustee to choose not to disclose up to 5% of investment items in each investment option. The original exemption was introduced as an attempt to protect those assets where disclosure under the portfolio holdings disclosure requirements was not permitted as a result of confidentiality undertakings or where disclosure could reveal commercially sensitive information. **FS**

Note: Final regulations associated with the YFYS legislation were registered on 5 August 2021.