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SUPER FUND TRANSFERS AND WIND UPS

Will the rationalisation now occur?

Shaun McGushin

The merger of superannuation funds (funds) is becoming a hot topic following several years of scrutiny. Indeed the Australian Securities and Investments Commission has recently stated publicly that it will look to litigate against underperforming funds and this may force at least 100 smaller funds out of the system[2]. Clearly funds that have apparently failed to act on behind-the-scenes encouragement from the Australian Prudential Regulation Authority (APRA) to merge may now be forced to do so or to act with far more urgency.

The Productivity Commission's review of the efficiency and competitiveness of the superannuation system and the Hayne Royal Commission into the financial services sector have both highlighted this as an issue of some concern in their reports released earlier this year. In particular, the Productivity Commission found that mergers were often abandoned against the best interests of the members. In an effort to encourage mergers that would benefit members, the Productivity Commission, in its *Superannuation: Assessing Efficiency and Competitiveness Inquiry Report,* has recommended that trustee boards of APRA-regulated funds should be required to disclose to APRA when they enter into a memorandum of understanding in relation to any merger and if a merger does not proceed, to disclose the reasons why and what was in the members' best interests (recommendation 20).

In the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry,* Commissioner Hayne appears to be in favour of mergers and also recommended that trustees be prohibited from being in other roles in order to prevent conflicts of interest, as well as the introduction of penalties where the duties of trustees are breached (recommendations 3.1 and 3.7).

The reports of these commissions should hopefully lead to some restructuring of the industry here regardless of whether all the recommendations are in fact adopted. In addition, there will also be greater industry focus following key changes in the 2018 Federal Budget that have since been legislated, particularly in relation to the move to force funds from 1 July 2019 to transfer inactive accounts with a balance of less than $6,000 to the Australian Tax Office, which will likely lead to noticeably fewer membership numbers for a number of funds.

The question remains as to whether or not some funds will look to control their destiny to some extent and in the best interests of their members and be proactive here.

It is now timely to go back and have a look at how mergers may occur in the industry. In this regard we will consider transfers or mergers that are carried out using Successor Fund Transfers ('SFT'), and which are regulated by *Superannuation Industry (Supervision) Act 1993 ('SIS*

The quote

Clearly there are significant efficiencies that can be obtained by a transfer through the SFT route.

Act') and the Superannuation Industry Regulations 1994 ('SIS Regulations'). An SFT involves the direct transfer of all members and their benefits from one fund to another, with the transferor fund being subsequently wound-up. SFTs are conducted by the trustees on behalf of the members, and therefore their consent is not required (SIS Regulations 1.03(1)). This paper will also detail APRA's expectations of any registrable superannuation entity (RSE) contemplating or conducting an SFT, as provided in the Prudential Practice Guide *SPG 227 – Successor Fund Transfers and Wind-ups (PPG SPG 227)*.

Clearly there are significant efficiencies that can be obtained by a transfer through the SFT route. How hard then is it for an SFT to be effected? There are several obligations attached to an RSE licence that must be observed during this process:

- Under the SIS Act, an RSE must ensure that they act in the best interests of the members (s 52(2)(c) and s 52A(2)(c).
- Because there is no consent from the members, both the receiving RSE or fund and the transferring RSE or fund must ensure that both the fund transferred into, and the fund transferred out of, are equivalent in respect of their rights and benefits. The rights the members had in the transferring RSE have to be equivalent to the rights they will receive in the receiving fund (SIS Regulations 1.03(1)).
- There are also additional obligations for providers of MySuper products (see for example, SIS Act, s 29VN).

In light of this, it is imperative that trustees and managers assess their options carefully when considering merger opportunities, and ensure that any agreement entered into adheres to the governance standards expected by APRA. Indeed, given the recent events, we would think some trustees and managers should be at least proactively considering the costs and benefits of a merger.

Bests interests of the beneficiary

There is a general obligation in the SIS Act for the trustee and directors to act in the best interests of the beneficiaries at all times (s 52(2)(c) and 52A(2)(c)). There is also a further obligation for providers of MySuper products to promote the financial interests of the beneficiaries who hold the product (s 29VN). Due to the findings that members' interests were not being prioritised in the consideration of mergers, this obligation was a significant area of concern for both the Royal Commission and Productivity Commission, and particular notice should be taken to ensure that they are adhered to going forward.

Clearly, both the transferring and receiving RSE that undertakes an SFT will do so after having assessed that it will be in the best interests of the members.

There are several examples given by APRA as to what constitutes appropriate reasons for undertaking an SFT that represent an assessment in the interests of the members. These include:

- to enhance member outcomes or experience
- access to greater economies of scale
- the receiving RSE has superior internal or external resources
- insolvency or wind-up of the RSE (PPG SPG 227).

The basis for undertaking the SFT should be clearly documented by the RSEs, and this should include the assessment as to why it is in the best interests of members.

These obligations are underscored by the conflicts management framework that is required to be in place under SPS 521. This requires RSE licensees to identify all potential and actual conflicts and seeks to ensure that processes are in place to avoid or manage any conflicts that may occur.

Equivalent rights assessment

The SIS Regulations require that a receiving RSE can only be a successor fund where there is a conferral of 'equivalent rights' on the incoming members. This means that:

- the fund confers on the incoming members equivalent rights (they do not have to be equal) to the rights that the members had under the original fund in respect of the benefits;
- before the transfer, the trustee of the receiving fund has agreed with the transferring trustee that the receiving fund will confer on the members equivalent rights to the rights that the members had under the transferring fund (r 1.03(1)).

This provides the trustees with a level of discretion, which represents in effect a deferment by APRA to their judgment. However, it should also be noted that there must be an actual equivalency.

It is essential, therefore, that in undertaking an SFT the 'rights' of members in respect of their benefits and the equivalent rights of the receiving fund be assessed. The definition taken by APRA is a narrow one, wherein they consider a 'right' to be a legally enforceable one, whether under the RSE's governing rules, the general law or legislation. APRA also distinguishes rights from features 'which are determined, and can be changed, at the discretion of the trustee' (PPG SPG 227). Such features include 'the amount of fees that will be charged to a member, product features and particular investment options'. The extent to which any trustee has the discretion to make such changes depends on the trust deed of the fund, and therefore the position can and will differ between funds.

As the rights of one fund may only be a feature in another, APRA expects that there should be a proper and complete assessment of the rights and features of the transferring and receiving funds in light of the governing rules of the respective funds on each end of the transfer (PPG SPG 227). The assessment here is necessary as part of the determination of whether an SFT is in the best interests of the members.

APRA views rights conferred by the receiving fund

should be equivalent, but that does not mean that they have to be equal. The rights should therefore be assessed as a 'bundle of rights' where significant rights and material differences are considered together. Despite the fact that this test applies to each member individually, APRA states that for the sake of practicality 'it may be appropriate to consider equivalent rights based on groups of members with common characteristics'. This is a sensible approach and this clarification has helped to address the issues where the stringent application of this requirement previously led to trustees replicating investment options in their own funds.

Given the current regulatory environment noted above, it is imperative that any merger opportunity is appropriately assessed by the trustees to ensure that the result would be compatible with the equivalent rights test, is in the best interests of the members, and that they have the evidence to back up any such assessments.

If there are doubts as to whether a superannuation fund can rely on this method of transfer then an alternative is provided for in Part 18 of the SIS Act, which allows the transferor and transferee to make an application for approval of the transfer. While this is an option if reasonable attempts to effect a transfer under another provision of the SIS Act or SIS Regulations have failed, it may be looked upon as a real or safe option for trustees to consider if they are unable to come to a definitive view on the benefits of the members and equivalent rights. It would also provide certainty if APRA does approve of the transfer. In that regard, APRA may perhaps be more readily disposed to approve of a transfer by some of the smaller funds it has been previously encouraging to merge. APRA 'may' only approve a transfer here if relevantly:

(a) reasonable attempts at transfer under another provision of the SIS Act or under the SIS Regulations have failed
(b) the transfer is reasonable in all the circumstances having regard to, among other things, the benefit entitlements of members under the transferring and receiving funds and the likely effect on the amount of those entitlements if the members were to remain in the transferring fund
(c) the transfer would not adversely affect interests of members and beneficiaries of the receiving fund; and
(d) the receiving fund has an RSE licence (SIS Act, s 146).

MySuper-to-MySuper SFTs

The position of MySuper-to-MySuper SFTs appears to be more easily satisfied in most cases as APRA considers that such a transfer would generally satisfy the equivalence test. APRA notes that all MySuper products have the same core characteristics under Part 2C of the SIS Act (see PPG SPG 227, paragraph 24).

APRA says that the equivalent rights test will generally be satisfied and an SFT will be able to occur where:

- a transfer from a transferring RSE's MySuper product with a single diversified investment strategy to a receiving RSE's MySuper product with a single diversified investment strategy of a lifecycle investment option, and vice versa; and,
- a transfer from products with different features, for example, a different asset allocation or investment strategy, different applicable fees or different insurance offerings (PPG SPG 227, paragraph 25).

While the features of the MySuper products do not have to be equivalent, they are not to be ignored. RSE licensees have an obligation to promote the financial interests of the members of the RSE who hold the MySuper product (SIS Act, s 29VN). APRA expects that a prudent transferring RSE would make an assessment of the features of the products offered by the receiving RSE when considering an SFT. The features do not have to be the same, however there must be a demonstration that the selection of the MySuper product in the receiving RSE was in the financial interests of the members.

Winding up an RSE after SFT

The transferring RSE will be wound-up following the SFT where there is a complete transfer to a receiving RSE of the members' benefits, such as in the case of a merger, and its registration will be cancelled (SIS Act, s 29N). Before winding-up is commenced, the SIS Regulations require a transferring licensee to notify APRA of the decision to transfer without the members' consent, and preferably as soon as is practicable. Additionally, APRA expects that the transferring and receiving RSEs formally agree on how minor residual assets or liabilities are to be managed after the completion of the SFT.

Following the completion of the SFT, the transferring RSE should apply to APRA to have their licence cancelled (SIS Act, s 29G(2)(a). If this involves complete transfer of benefits out of a MySuper product, the authority to offer the MySuper product would be cancelled, and this would end the process (s 29U).

During the process of winding-up it is expected that the RSE meets the appropriate reporting obligations.

Conclusion

In view of the reports provided by the Productivity Commission and the Hayne Royal Commission, RSEs should be encouraged to at least give some consideration to the future of their funds and this should include the benefits or otherwise of potential mergers. We would expect that there will be an increase in the number of SFTs that will be conducted over time, although given past indications, there may need to be some active encouragement for this to occur in some cases. In light of the scrutiny of this area, it is imperative that RSEs, whether they proceed with an SFT or otherwise, ensure that not only should they do what is in the best interests of the members, but that they also be seen to be doing so.

1. The author would like to acknowledge the contribution of Daniel Gallagher, Paralegal, Ash St. for his assistance in producing this article.

2. *The Australian Financial Review,* 'Banking & Wealth Summit', 27 March 2019, pp 1,3.