

## Superannuation Industry (Supervision) modification declaration No. 1 of 2014

### EXPLANATORY STATEMENT

#### Prepared by the Australian Prudential Regulation Authority (APRA)

*Superannuation Industry (Supervision) Act 1993*, section 332

Under section 332 of the *Superannuation Industry (Superannuation) Act 1993* (the Act), APRA may, in writing, declare that a modifiable provision is to have effect, as if it were modified as specified in the declaration, in relation to a particular person or class of persons, or a particular group of individual trustees or a class of groups of individual trustees. The modifiable provisions<sup>1</sup> include the operating standards for regulated superannuation funds made under Part 3 of the Act and which are contained in the *Superannuation Industry (Supervision) Regulations 1994* (the Regulations).<sup>2</sup> Regulation 4.07E is an operating standard and therefore a modifiable provision.

On 7 April 2014, APRA made Superannuation Industry (Supervision) modification declaration No. 1 of 2014 (the instrument) which modifies regulation 4.07E of the Regulations.

The instrument applies to all RSE licensees of regulated superannuation funds.

The instrument commences upon registration on the Federal Register of Legislative Instruments.

#### **1. Background**

Subregulation 4.07E(2) provides that, if a regulated superannuation fund does not self-insure, in relation to a particular risk, a trustee of the fund may, on and after 1 July 2013, provide an insured benefit, in relation to that risk, to members of the fund only if the benefit is fully supported by an insurance policy provided by an insurer.<sup>3</sup>

Subregulation 4.07E(3) provides an exception in relation to a person who was a member of a fund that self-insured and that person was transferred to a successor fund, or to a fund under Part 33 of the SIS Act, that did not self-insure in relation to the risk. Under that exception the receiving fund may self-insure in relation to the member and the risk even if the receiving fund did not self-insure as at 1 July 2013. However, this exception ceases to operate after 1 July 2016 and only applies in relation the member actually transferred.

Subregulation 4.07E(4) applies where a regulated superannuation fund self-insured on 1 July 2013 in relation to a particular risk. It prohibits such a trustee from providing an insured benefit to its members on or after 1 July 2016 unless the insured benefit is fully supported by an insurance policy provided by an insurer.

An exception to the prohibition in subregulation 4.07E(4) is provided by subregulation 4.07E(8). The prohibition in subregulation 4.07E(4) does not apply in relation to defined benefit members of the fund if, on 1 July 2013, the defined benefit fund self-insures in relation to defined benefit members and, on or before 1 July 2013, the fund was not prohibited from self-insuring by a condition imposed on the trustee's RSE licence (the

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<sup>1</sup> 'Modifiable provision' is defined in section 327 of the Act.

<sup>2</sup> See paragraphs 327(1)(a) and (h) of the Act.

<sup>3</sup> Self-insurance is discussed in *Prudential Standard SPS 160 Defined Benefit Matters* and *Prudential Standard SPS 250 Insurance in Superannuation*. APRA's interpretation of the meaning of 'the risk' is that it refers to a type of insured benefit, e.g. death, permanent incapacity, temporary incapacity.

relevant condition being condition B.1 of a RSE licence).<sup>4</sup>

APRA has become aware that regulation 4.07E may have limited the ability of RSEs to accept successor fund transfers from self-insuring defined benefit funds, as the successor fund could only continue the self-insurance after 1 July 2016 if it had been permitted to self-insure on 1 July 2013 (in relation to defined benefit members and the risk) and actually did so at that time. Industry was concerned that this might adversely impact on future merger activity that might otherwise be in the best interest of superannuation fund members.

For example, assume Fund A self-insured in relation to defined benefit members up to and including 1 July 2013, and there was no condition on its RSE licence prohibiting self-insurance. Under subregulation 4.07E(8), Fund A may continue to self-insure defined benefit members in relation to the risk after 1 July 2016. However, if Fund A transfers self-insured defined benefit members to Fund B under successor fund arrangements, and Fund B did not itself satisfy subregulation 4.07E(8) as at 1 July 2013, Fund B will only be able to continue the self-insurance of the transferred members until 1 July 2016 (under subregulation 4.07E(3)), and will not be able to extend the self-insurance arrangements to new members of the relevant defined benefit division or subfund. The modification declaration is intended to address these concerns.

## **2. Purpose and operation of the instrument**

The purpose of the instrument is to provide for an additional exception to subregulations 4.07E(2) and (4) to facilitate successor fund transfers of self-insured defined benefit members.

The effect of the instrument is that the restrictions in subregulations 4.07E(2) and (4) will no longer apply to RSEs to the extent that they have received a successor fund transfer of defined benefit members where the transferring defined benefit members were self-insured in their original fund.

Specifically, if on or after 1 July 2013 defined benefit members transferred to the fund from the original fund under successor fund arrangements, and the original fund self-insured in relation to the transferring members and the particular risk, the successor fund may continue the self-insurance in relation to defined benefit members and the risk.

The successor fund may self-insure in relation to the transferring members and other defined benefit members (including new members) of the fund. This is because the reference to 'defined benefit members' in the opening words of new subregulation (8A) is not restricted to the 'transferring defined benefit members' referred to in subsequent paragraphs of the subregulation. For example, this could include new defined benefit members of the successor fund who joined the fund, some time after the transfer of the transferring members, upon becoming employees of the employer of the transferring members.

The modification declaration is intended to allow new defined benefit members to join the self-insurance arrangement only where those defined benefit members have a connection (for example, through a common employment relationship, or membership of the same division or subfund) with the transferred defined benefit members and would otherwise have been permitted to join the self-insurance arrangement within the original fund.

The successor fund may permit defined benefit members of the self-insurance arrangement to

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<sup>4</sup> APRA's interpretation of the exception in subregulation 4.07E(8) is that it permits a defined benefit fund that self-insured defined benefit members in relation to a particular risk on 1 July 2013 (and there was no condition on the trustee's RSE licence prohibiting this) to extend that self-insurance to other defined benefit members after that date.

change insurance categories within the self-insurance arrangement. For example, where the self-insurance arrangement covers temporary incapacity and death, a defined benefit member who has only had death cover may add temporary incapacity cover to their existing arrangement (subject to the fund's own requirements).

However, the successor fund may not itself make changes to its insurance offerings within the self-insurance arrangement so as to extend those self-insured offerings to different risks. The modification declaration is not designed to allow a successor fund to self-insure in relation to an entirely new risk, e.g. to allow self-insurance in relation to permanent incapacity where the original fund only self-insured in relation to death. However, this does not mean that the successor fund's terms of self-insurance of that risk have to be precisely the same as the terms of self-insurance in the original fund. .

The successor fund may undertake a subsequent successor fund transfer of the members in which case subregulation (8A) will apply to the subsequent successor fund transfer and allow relevant defined benefit members to be self-insured in the third (or subsequent) fund.

If the original (i.e. transferring) fund self-insured in relation to the transferring members on 1 July 2013, it must have complied with subregulation 4.07E(8) – see paragraph 4.07E(8A)(c). This paragraph will not be relevant if the original fund did not have the relevant members on 1 July 2013, i.e. if the original fund received the members under a successor fund transfer after that date before arranging the transfer under consideration.

The modification declaration applies subject to any condition imposed by APRA on the licence of the RSE licensee of the fund. For example, in the case of some RSE licensees of receiving RSEs, this relief will be conditional upon APRA revoking RSE licence condition B.1 from the receiving RSE licensee's licence in respect of the transferring defined benefit members.

It is APRA's view that this modification declaration is necessary to ensure that regulation 4.07E does not adversely affect RSE licensees considering a successor fund transfer and does not hinder the free movement of defined benefit members. Industry had raised concerns that a restriction on the free movement of defined benefit members has the potential of resulting in sub-optimal outcomes where the self-insuring defined benefit fund would otherwise be able to reduce costs and improve service standards by merging with another RSE. APRA has accepted this possibility and takes the view that the current drafting of regulation 4.07E was unintended regarding its effect on successor fund transfers of defined benefit members.

### **3. Consultation**

APRA undertook a short consultation on an exposure draft instrument from 5 February 2014 to 18 February 2014. Submissions were received from one RSE and a number of industry bodies. All submissions were supportive of the general approach taken to facilitate successor fund transfers of funds with self-insured defined benefit members.

The consultation raised three concerns with the drafting of the exposure instrument.

Firstly, the submissions raised concerns that the exposure draft instrument did not allow new defined benefit members to join the self-insurance arrangement within the successor fund at any time in the future. The submissions contended that the current subregulation 4.07E(8) has no restriction on this matter. (APRA agrees with this interpretation of subregulation (8)). As noted above, the purpose of the instrument is to facilitate successor fund transfers and ensure that the provisions of regulation 4.07E apply in the same way after a successor fund transfer. The instrument as determined permits self-insurance of new defined benefit members, i.e. it is not restricted to the transferring members.

Secondly, the submissions raised concerns that the exposure draft instrument did not allow defined benefit members to add or change insurance categories within the self-insurance arrangement of the successor fund. As noted above, the instrument as determined permits defined benefit members to change insurance categories, where 'the risk' / insurance category is already included in the self-insurance arrangement.

Finally, the submissions raised concerns that the exposure draft instrument did not provide for further successor fund transfers of self-insured defined benefit members after an initial successor fund transfer. The instrument as determined permits further successor fund transfers.

APRA agreed that the instrument should facilitate the same arrangements for a successor fund transfer that exist for an ongoing fund under regulation 4.07E. The proposed instrument was therefore revised to provide for these matters.

#### **4. Regulation Impact Statement**

The instrument is minor or machinery in nature and does not substantially alter existing arrangements. The Office of Best Practice Regulation has therefore advised APRA that a Regulation Impact Statement is not required for this legislative instrument.

#### **5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

## ATTACHMENT A

### **Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

#### **Superannuation Industry (Supervision) modification declaration No. 1 of 2014**

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (“HRPS Act”)

#### **Overview of the Legislative Instrument**

Superannuation Industry (Supervision) modification declaration No. 1 of 2014 (the instrument) is designed to ensure that RSEs receiving self-insured defined benefit members as part of a successor fund transfer are able to continue the self-insurance arrangement in respect of defined benefit members beyond 1 July 2016.

#### **Human rights implications**

APRA has assessed the instrument against the international instruments listed in section 3 of the HRPS Act and determined that it does not engage any of the applicable rights or freedoms.

#### **Conclusion**

The instrument is compatible with human rights because it does not limit human rights or raise any human rights issues.