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COVID-19 and regulatory implications for superannuation

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The exponential growth and impact of COVID-19 has not only affected most industries and our everyday lives, but in particular has had significant repercussions within the superannuation industry. In this update, we make some general observations and examine the responses from the key Australian regulators and what this means for superannuation trustees, as well as their directors and senior management.

Early access to superannuation – what are my obligations as a trustee?

On 16 April 2020, APRA updated its frequently asked questions (**FAQs**) regarding COVID-19, outlining the regulator's expectations for superannuation trustees on the early release of benefits.

As explored in our March 2020 wrap up article, from 20 April 2020, eligible individuals affected by COVID-19 can apply for an early release of their superannuation. The *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) (**Act**) allows individuals impacted by COVID-19 to access up to $10,000 for 2019-20 and 2020-21 financial years which is released from their superannuation or retirement savings account on compassionate grounds. The Act also provides that eligible individuals will not be required to pay tax on amounts released and the amounts withdrawn will not be taken into account with respect to any income or means tests.

On 4 May 2020, APRA published its Early Release Initiative (**ERI**) data collection for the first week ending 26 April 2020, which showed that superannuation trustees:

- received 665,310 applications for early release of superannuation;
- processed 162,879 applications; and
- paid members $1.3 billion, with the average benefit paid being $8,002.

The ERI data also shows for applications paid within the first week of the new scheme, trustees took approximately 1.6 days to make payments to eligible members after receipt of their applications from the Australian Tax Office (**ATO**). APRA intends to publish updated data every Monday. The ERI data is available on APRA's website.

So what does this mean for RSE licensees? In APRA's updated FAQs, the regulator has pointed to the statutory obligations which require trustees to pay a benefit to their members as soon as practicable, after having received a copy of a determination from the ATO. APRA also expects that where RSE licensees have not identified any red flags, payments will generally be made within five business days of receipt of a determination. In circumstances where the RSE licensee has identified red flags and additional fraud or verification steps are required, or in circumstances where funds are originating from a defined benefit fund, the process may take longer. However, APRA still expects that RSE licensees make such payments "as expeditiously as possible", acknowledging that the timeframes may be extended due to the possible high demand.

In the event that an RSE licensee follows APRA's guidance but fraud nevertheless occurs, what is APRA's position with respect to civil penalties and trustee liability? Where the RSE licensee has adequately demonstrated to APRA that it has followed the regulator's approach to early release payments as stipulated in the FAQs, APRA has noted that it is unlikely to take such action (see FAQ #12). The Australian Transaction Reports and Analysis Centre (**AUSTRAC**) recently introduced a new rule under the *Anti-Money Laundering and Counter-Terrorism Financing Act* (Cth) (**AML/CTF Act**) that stipulated that an RSE licensee is not required to carry out the customer verification under the AML/CTF Act before the release of benefits due to COVID-19. APRA's updated FAQs are available on their website.

Consequential impacts on liquidity, strategy and disclosure

RSE licensees should generally be mindful of their statutory duties, which include regularly reviewing their investment strategy including the liquidity of investments (and potential use of derivatives), exercising the care and skill of a prudent superannuation trustee, performing duties and exercising powers in the best interests of their members. Some critical questions that trustees and their directors should be currently addressing include:

- Does the fund's investment strategy, restrictions and concentration need to be reassessed?
- Does the trustee's liquidity management plan (as required in accordance with APRA's Prudential Standard SPS 530 *Investment Governance*) need to be reviewed to consider adverse liquidity events and the actions the RSE licensee will take in response?
- Has the trustee utilised APRA's Prudential Practice Guide CPG 233 *Pandemic Planning*?
- Have existing restrictions at the underlying asset level been breached and if so, how should this be addressed (for internally or externally managed investments, direct and indirect)?
- Is the valuation of the fund's unlisted and illiquid assets appropriate or should they be revalued?
- What are the trustee's powers, rights and obligations under the trust deed and Product Disclosure Statement (**PDS**) and do they require amendment?
- Does the composition of funds in certain asset classes need to be appropriately adjusted in order to reflect market volatility?
- What arrangements do you have in place with third-party service providers including custodians and investment managers and are service standards being monitored and met?
- Does the trustee need to update its policy governing hardship and access to super on compassionate grounds (for instance, to avoid foreclosure or for medical expenses)?
- Where derivatives are used, what potential margin or collateral calls may need provisioning and have changes in valuations triggered any termination events?

The investment covenant in Section 52(6) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) requires the trustee to regularly review and give effect to the investment strategy for the whole fund and each investment option, having regard to, amongst other things, the liquidity of the investments covered by the strategy, expected cash flow requirements and the ability to discharge its existing and prospective liabilities. Pursuant to APRA's SPS 530 *Investment Governance*, 'liquidity' primarily means the ability of the trustee to meet benefit payments, rollover and transfer requests or intra-fund investment switching requests from beneficiaries in accordance with the regulations and governing rules. 'Liquidity risk' is then the inability to meet obligations as and when they fall due without incurring unacceptable losses. Assessment of liquidity risk should account for member demographics at the fund and investment option level, the quantum and nature of illiquid assets within the investment strategy, and sensitivity of the asset allocation to any changes in market or member sentiment, which may trigger member switching, porting or otherwise accessing super and thereby increasing the need for liquidity.

In light of APRA's MySuper Product Heatmap and Data Insights paper released in December 2019, trustees should also be considering the 'hot spots' or key areas of industry and regulatory concerns, and perhaps an enlivened focus on the RSE licensee's net cash flow ratio, alongside bear market relative investment performance, fees and costs, and sustainability of member outcomes. In particular, concern has been raised in relation to some of the smaller superannuation funds which are most at risk of liquidity issues, with poor net cash flow and sub-optimal performance as highlighted in the Heatmap in the lead up to COVID-19. There has also been recent industry speculation regarding liquidity concerns as a consequence of COVID-19 involving at risk industries, as well as the Government's early release of superannuation acting as a catalyst for the merger of some smaller funds.

What other changes has the Government's stimulus package had on superannuation payments?

Due to the impact of COVID-19 and continuing volatility in financial markets, this has negatively affected account balances for some superannuation pensions and annuities. In order assist pension and annuity account balances recover from the downturn, the Government has also introduced a reduced minimum annual payment for account-based pensions and annuities, allocated pensions and annuities, as well as market-linked pensions and annuities. The Act has reduced the minimum payments by 50 per cent for the 2019-20 and 2020-21 financial years. Further information is also available on the ATO's website.

In light of all these changes, if they haven't already, trustees should be assessing any changes to their Trust Deeds, PDS and related documents, and in addition, identifying whether they must notify their members of any 'significant events' or 'material changes.'

The Government has announced a reduction to the Social Security deeming rates from 1 May 2020. The upper deeming rate will be 2.25 per cent and the lower deeming rate will be 0.25 per cent. These reductions will be made in order to replicate the low interest rates and its impact on the income from savings. Information about the Government's stimulus payments to households to support growth is available on its website.

ASIC and APRA's correspondence with superannuation trustees

On 1 April 2020, ASIC and APRA issued a letter to all RSE licensees reminding trustees of their obligations during the COVID-19 pandemic. The regulators have been working closely with individual trustees to ensure that they adequately understand their obligations and have robust pandemic plans in place. The letter stipulates that the regulators consider current circumstances require trustees to:

- make new business arrangements;
- amend priorities;
- adjust their short-term investment strategies;
- maintain sufficient levels of liquidity in order to sustain the operation of their funds; and
- comply with their usual responsibilities including their duty to comply with the law and duty to act in the best interests of their members.

The issue of liquidity has been at the forefront of the regulator's focus, with concerns regarding the monitoring of liquidity and ensuring funds are capable of fulfilling their payment obligations, including the early release of superannuation. In particular, the regulators have reminded trustees that they should be:

- performing regular and detailed liquidity stress testing and ensuring stress testing scenarios incorporate changes to future net cash flows, behaviour of members and market conditions;
- recognising areas of heightened attention with respect to liquidity, for example with the increased switching activity by members or deterioration in the liquidity profile of their investments, and consequently taking appropriate action; and
- evaluating the impact on liquidity of their liabilities and any contractual commitments, including but not limited to currency hedging programs and reviewing their securities lending arrangements.

Trustees should consider whether the valuation of their unlisted and illiquid assets remains appropriate and if not, whether any assets need to be revalued.

APRA and ASIC have also stressed the need for trustees to proactively communicate with their members and ensuring any questions from members are promptly and accurately responded to. The regulators have reminded trustees that they must respond to requests for information and should also be proactively contacting the regulators where emerging or evolving risks are identified.

With respect to insurance in superannuation and the importance of maintaining public confidence in the superannuation system, ASIC and APRA's letter stipulates that trustees should:

- understand how life insurance cover provided through superannuation may be affected by public health restrictions and economic conditions. By way of example, insurance policy clauses that relate to employment, work hours and any exclusions, such as pandemic clauses;
- consider how members' insurance may be impacted by a reduced account balance as a consequence of the market downturns and early release of funds;
- clearly communicate these impacts to members; and
- work closely with insurers and support members who may face additional difficulties in lodging a claim, for example, difficulties in obtaining medical appointments and providing evidence of disability.

A copy of the letter is available on ASIC's website.

Temporary no-action position for expanded intra-fund advice and other advice relief

On 14 April 2020, ASIC introduced three temporary measures to assist the superannuation industry in providing affordable and timely advice to consumers during the COVID-19 pandemic. The *ASIC Corporations (COVID-19—Advice-related Relief) Instrument 2020/355* (**Instrument**) affects the disclosure obligations for superannuation funds, as well as financial advisers and registered tax agents. In particular, the Instrument allows advice providers, including those from superannuation funds, not to give a statement of advice (**SOA**) to clients when providing advice about early access to superannuation.

ASIC also separately provided a temporary no-action position from 14 April 2020 until 25 September 2020 for superannuation trustees by expanding the scope of personal advice that financial advice providers may provide on behalf of the superannuation trustee as 'intra-fund advice.' 'Intra-fund advice' is generally scaled advice that the superannuation trustee provides to members where the cost of the advice is borne by all members of the fund. The purpose of the no-action position is to confirm that, subject to the conditions being satisfied, ASIC will not take action in relation to personal advice with respect to the COVID-19 early release scheme provided as intra-fund advice that would otherwise breach section 99F of the SIS Act. Section 99F of the SIS Act provides that the trustee of a superannuation fund must not directly or indirectly pass the cost of providing financial product advice in relation to a member of the fund on to any other member of the fund to the extent that the advice is provided by the trustee or a person acting as an employee with the trustee, the advice is personal advice and the advice meets any one of the specified circumstances, including where the member receives periodic advice.

ASIC has stipulated that it will not take action against a superannuation fund for failing to comply with section 99F of the SIS Act where each of the following apply:

- personal advice is provided by the trustee, or another person acting as an employee of, or under an arrangement with, the trustee;
- the advice is focused on advising the member on whether they should access the COVID-19 early release scheme and is not about any other subject matter; and
- the advice addresses the following as relevant for the member:
    - the member's need for the early release of superannuation, for example, for cash flow or budgeting;
    - government benefits available for the member, for example, JobKeeper Payment, household support and income support payments;

  - the member's alternative sources of support or relief, for example loan or rent relief and existing financial resources;
  - the impact on the member's retirement income by assessing the COVID-19 early release scheme;

  including referencing the member's household circumstances.

ASIC's no-action position is subject to each of the following conditions being met:

- the trustee must notify ASIC that it will rely on the no-action position by emailing 'super.enquiries@asic.gov.au', which must be done either before first relying on the no-action position or within 30 days of first relying on it;
- the member must have sought the advice rather than the trustee or provider initiating the advice;
- before providing the advice, the advice provider must determine, in their opinion, that the member is likely to be eligible for the COVID-19 early release scheme, describe the scope of the advice, alert the member to relevant public factual information and existing general advice of the fund concerning the COVID-19 early release scheme, and confirm that the member wishes to seek more advice; and
- where the trustee engages an external provider to provide the advice, this must be done at a cost to the fund consistent with the trustee's best interests duty and in line with the expectation that the only advice to be given is directly related to whether the member should access the COVID-19 early release scheme.

ASIC has also stipulated that the temporary relief and no-action position is available provided that:

- clients are provided with a record of advice (ROA) (when an SOA would usually be required);
- the advice fee, if any, is capped at $300;
- the advice provider is required to establish that the client is entitled to an early release of their superannuation; and
- the client is an existing client that has that has previously been given an SOA by the providing entity (or associated providing) through the provision of personal advice in relation to one or more classes of financial product(s).

The Instrument also allows advice providers to give a SOA up to 30 business days after time-critical advice has been provided, rather than the normal five business days. ASIC has also provided temporary relief allowing for the provision of an ROA to existing clients even though their personal circumstances have changed due to COVID-19 and the client sees an adviser of the same AFS licensee or practice, not their original adviser.

Other information trustees can provide to their members without relying on the no-action position includes:

- directing members to government information available on ASIC's Moneysmart website and ATO information;
- providing factual information about assistance, including the application process and various Government programs that address financial hardship;
- services available from financial counsellors;
- providing general advice; and
- providing personal advice as intra-fund advice that is within the terms of s 99F of the SIS Act.

ASIC has noted that they will conduct surveillance checks to ensure superannuation trustees and advisers are acting in the best interests of their members and clients. The regulator expects, in accordance with general Australian financial services (**AFS**) licensee obligations, that there is evidence of appropriate resources, procedures, training and controls to ensure that quality advice is provided that is consistent with their no-action position. Further information about ASIC's temporary relief measures is available on the regulator's website.

Are trustees still required to hold annual members' meetings?

In accordance with Section 29P of the SIS Act, RSE licensees must hold an annual meeting of members of the superannuation entity for each year of income of the entity. ASIC has clarified that trustees must still comply with this obligation and most have until 31 December 2020 to provide members with notice of the annual members' meeting, meaning that they can potentially be held as late as March 2021. It is also worth highlighting that electronic and virtual annual members' meetings are permitted in accordance with the Explanatory Memorandum to the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019*. Further information for superannuation trustees is available on ASIC's website.

APRA's new commencement dates for prudential standards CPS 226 and CPS 234

On 16 April 2020, APRA also announced its revised commencement dates for two cross-industry standards. APRA CPS 226 Margining and Risk Mitigation for Non-Centrally Cleared Derivatives (phase-in of initial margin requirements) has been revised to a commencement date of 1 September 2021 and 2022, depending upon the implementation phase. APRA will defer the next two phase-in periods regarding initial margin requirements for non-centrally cleared derivatives by 12 months, following the decision by the Basel Committee on Banking Superannuation and the International Organisation of Securities Commissions.

APRA CPS 234 Information Security (third-party arrangements transition provision) has also been granted a six-month extension from 1 July 2020 to 1 January 2021, although this is provided on a case-by-case basis. Entities that are seeking a six-month extension must advise APRA of the nature of their third-party arrangements and how risks are being monitored in these situations. With increased cyber risks in the current environment, entities should be vigilant on information security. For more information, please visit APRA's Media Release.

Impact of COVID-19 on liquidity and investments

Liquidity pressures have significantly increased following recent legislative changes to enable early access to super, in addition to existing compassionate grounds. Large scale unemployment has also directly impacted super fund contributions and cash flow, particularly those funds with an undiversified member base drawn from highly impacted sectors such as hospitality, tourism and retail. Global investment markets have also become volatile with various consequences. One of those impacts is a tendency for members to switch from growth assets into more defensive investment options such as cash, though this is not always the best strategy for the member, or the fund, as it crystallises losses. For this reason, one legislative change allows some pensioners to reduce their drawdown and sale of assets into a bear market. As some super funds and managers are forced to sell down listed and unlisted assets, others may see historic buying opportunities.

The broader ramifications for the superannuation industry are expected to be significant, if other previously less significant crises are a guide. The disruption to business continuity is unmistakable. The difference with this crisis is the systemic global shock and almost uniform government-led market and societal intervention with unique demand and supply distortions. However, with banks offering to suspend repayments for six months on the grounds of hardship, the pandemic curve flattening and petrol at historical lows, does this call into question the need to access super early? In the current climate, the magnitude of outflows will necessitate constant fund reviews of liquidity, investment strategy, rebalancing portfolios and strategic asset allocations.

If you have any questions or would like to better understand your obligations as a trustee or director of a superannuation fund, and particularly in responding to the changing financial environment due to COVID-19, please contact us.

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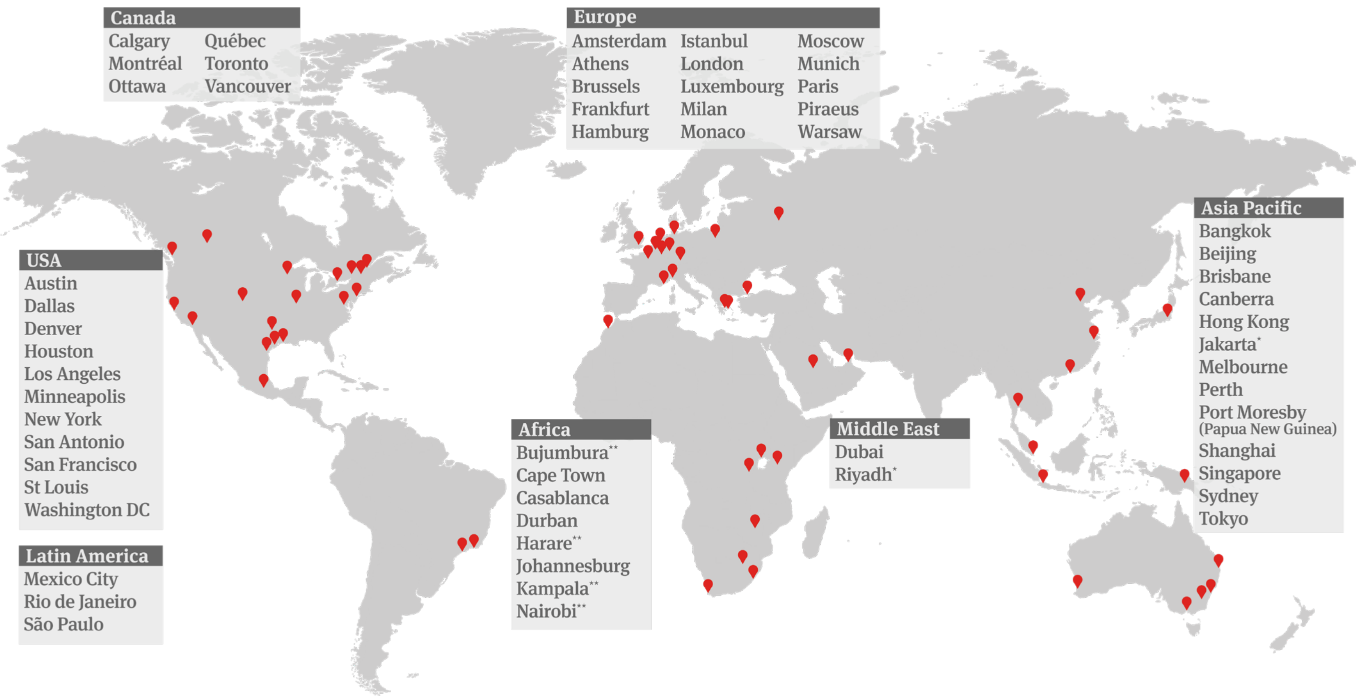

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