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ASFA Policy and Industry Practice

Super System Review – Phase Two: Operation and Efficiency

ASFA Submission

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Association of Superannuation Funds of Australia

ASFA Secretariat
Level 6
66 Clarence Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 1005
Ph: +61 2 9264 9300
Fax: +61 2 9264 8824

Outside Sydney
1800 812 798

Website: www.superannuation.asn.au

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

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1. Superannuation is an essential piece of social infrastructure

As a piece of social infrastructure provided largely by the private sector, superannuation is a distinct and special sector deserving different treatment from other sectors of the financial services industry. The trustee system (and for corporate arrangements equal representation on trustee boards or on policy committees) is unique to the superannuation industry and provides the opportunity for employer and employee representatives to sit around the same table. Trustees have a fiduciary duty to act the best interests of fund members.

Superannuation is unique in that it creates long term household savings where these savings may otherwise not have been generated. It benefits families through assisting them to save for retirement and contributes to a financially comfortable and dignified retirement outcome for individuals.

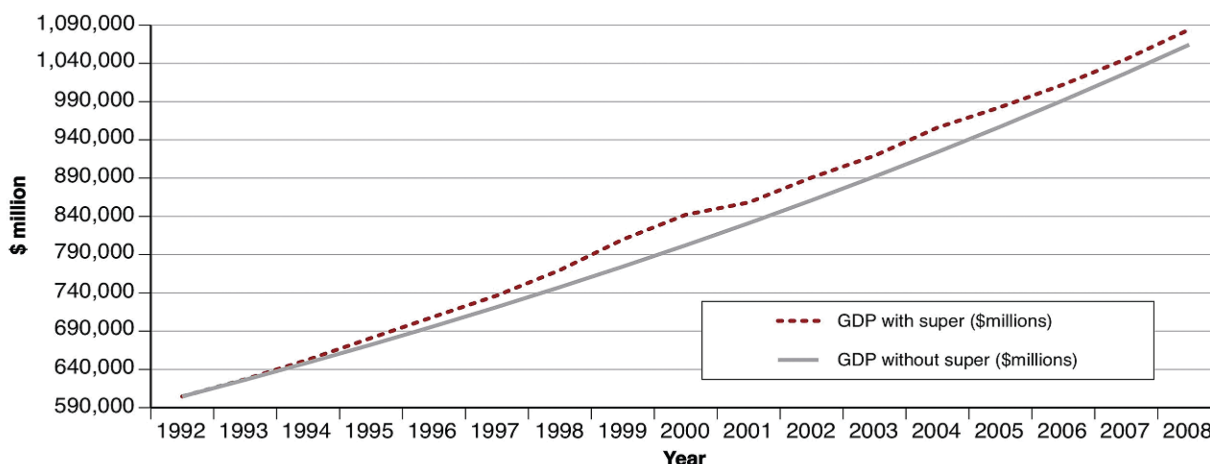
The Government recognises superannuation as an essential piece of infrastructure, comprising two of the three pillars of Australia's retirement income policy. Superannuation receives significant tax advantages, has a comprehensive regulatory regime and is compulsory for a significant part of the workforce.

1.1 Importance of superannuation to the Australian economy

ASFA commissioned a report, prepared by The Allen Consulting Group in September 2009, titled "Better living standards and a stronger economy: the role of superannuation in Australia". The report had three main conclusions:

1. Superannuation contributes to a better retirement income for all Australian families including low and middle income earners;
2. Superannuation provides a major benefit to the Australian economy – it is estimated to have increased GDP by 1.8% (see Figure 1), and superannuation money represents 23% of the Australian share market; and
3. While superannuation receives tax concessions, it also provides significant revenue to Government. Superannuation is not just a cost item of between $5 and $25 billion a year (depending on how Treasury measures it) but also generates $15 billion a year in tax revenue. This is made up of direct contributions to the tax base, tax resulting from the economic activity generated by superannuation, and the reduction of the burden on the Government in terms of paying for the Age Pension.

Figure 1: GDP with super and GDP without super



Chris Bowen, the Minister for Superannuation, Financial Services and Corporate Law, in a speech on 21 October 2009 delivered a ringing endorsement of the role super has played in Australia's economy during the global financial crisis, stating that *"We can't underestimate the importance of superannuation in Australia's resilience over the last two years. As companies around Australia have sought to recapitalise, superannuation has played an absolutely vital role. And in fact, in Australia the proportion of the market that has been recapitalised is higher than any other developed country over the last two years and that simply would not have been possible without superannuation."*

A summary report based on the research undertaken by The Allen Consulting Group, which discusses the positive benefits of superannuation to the Australian economy, to Government and to families is attached as Appendix 2.

1.2 Recommended regulatory changes

Given the importance of the superannuation industry, it is vitally important that it is well regulated.

At present superannuation funds themselves are well regulated by APRA, ASIC and the ATO (amongst other regulators). However there are two areas which we feel need to be brought within the regulators' net.

The first is superannuation fund administrators. It is common for superannuation funds to outsource their administration. Another common situation is a large conglomerate organisation where the administration is performed "in house", but by a different company within that organisation.

ASFA recommends that:

- Where the administration for a superannuation fund (or RSE) is performed by a separate entity, APRA should regulate that entity.

ASFA has had feedback from third party administrators that they would like to be regulated by APRA. The feedback is that there are times when the administrators want to ask questions of APRA or enlist their assistance to solve an issue. However as APRA does not currently regulate these businesses, they do not have the ability to respond to such requests.

The second area is ratings agencies that rate superannuation funds. There are a range of companies performing this service, and we are aware that some have Australian Financial Services licences and others do not.

ASFA recommends that:

- All superannuation ratings agencies must hold an ASIC Australian Financial Services Licence, and be licensed as a principal.

2. E-enabling the superannuation industry

ASFA has been grappling with the issue of improving the processing efficiency of the superannuation industry for more than a decade. Our vision is to have all superannuation transactions performed electronically. Whilst significant progress has been made in this regard, there is a long way to go to eliminate cheques and paper from the industry.

2.1 Low take-up of data standards

ASFA has been instrumental in the development of electronic commerce standards for enrolling new members, for the paying of contributions and for rolling over benefits between superannuation funds.

Despite concerted efforts to secure adoption of the standards, through the superannuation, wealth and investment management electronic commerce (swimEC) initiative, there has been limited take-up. There are several reasons for this, including the cost of implementation and the risk of there being limited take-up by other parties in the system, such as contributing employers and other funds. The industry by and large has utilised data formats that suited their own systems, only standardising on formats which have been imposed by government (eg. the standard choice form) or where there is a common system in use (eg. a payroll service or clearing house).

2.2 Evolution of superannuation has led to complexity

In part, the inefficient nature of superannuation administration process is a direct outcome of the way in which occupational superannuation arrangements have evolved in Australia.

Over more than a century superannuation in Australia has evolved from being an employment benefit conferred on employees by only a few employers (principally governments and large corporations), to a legislated right for most employees. Flowing from this, the employer/superannuation fund relationship has changed from:

- the employer nominating a specific fund to receive all contributions in respect of all of their eligible employees; to
- under choice of fund arrangements, many employers being obliged to contribute to multiple funds.

As the right to receive superannuation spread to more employees, superannuation funds merely extended their existing contribution arrangements to more employers. This, combined with the introduction of choice of fund arrangements, has resulted in most employers being required to deal with multiple superannuation funds. The absence of a uniform manner in which to deal electronically with superannuation funds has resulted in increased contributions payment complexity for employers, particularly with respect to choice-of-fund contributions.

Current projections for the Australian superannuation landscape in 2025 are that the overall industry will be $3 trillion in size with $2 trillion of this held in APRA regulated entities.

By 2025 there will also be considerably more employees and employers than today's numbers of approximately 8 million and 1 million respectively. Without significant progress in member identification processes there could also be considerably more member accounts that the present 32 million.

2.3 The problems with current processes

Looking holistically at current processing arrangements, particularly with respect to new member enrolments, the payment of contributions and the rolling over of superannuation benefits, they are clearly inadequate for the current environment and will also clearly be inadequate going forward.

The challenge for industry is, and has been, how to improve these processes.

Many funds have adopted innovative solutions and the advent of clearing houses has simplified the contribution task for many employers. Whilst this has required the establishment of another layer of administration with associated costs, it is arguable that this is more efficient (and therefore cheaper across the industry) than every employer or superannuation fund performing this function for themselves, often manually.

Where employers have chosen not to use a clearing house or similar arrangement they are generally faced with different electronic contribution arrangements for each fund they are required to interact with. This causes significant difficulty for

employers, resulting in many of them resorting to using paper and cheque, the lowest common denominator, for their choice of fund contributions. While this simplifies the employer process, it imposes significant processing costs on the recipient funds and therefore fund members.

2.4 Why is the superannuation industry different?

Overcoming the barrier to adoption of electronic commerce solutions is a greater challenge for the superannuation industry than for other industries where large leaps in technology have been introduced.

In the banking sector change has been driven either by a dominant market player or by a few large players banding together. In the case of the stock exchange's CHESS and SEAT systems, the solution was imposed by the stock exchange (which was owned by the brokers) on its broker members – a limited universe of stakeholders. Despite this apparent simplicity we have been advised that this was an extremely complex project, and this does not auger well for introducing complex changes across the entire superannuation industry.

In the superannuation industry, with more than 460 APRA regulated funds (excluding SAFs), neither the critical mass nor the power exists for a single fund, or a group of funds, to force the change that is necessary.

As employers are operating in a compulsory system, superannuation funds cannot compel employers to interact electronically by rejecting contributions. Specifically, due to the compulsory nature of superannuation (employers are required to comply with the *Superannuation Guarantee (Administration) Act 1992)* and the trustee duty to act in the best interests of the fund's members, there is limited capacity for a superannuation fund to direct the manner in which contributions are to be made.

ASFA does not consider that a 'big bang' solution is possible due to the compulsory nature of superannuation and the large number of players involved in the system (460 funds and 1 million employers). Rather, ASFA considers that a better approach is to develop a vision for the superannuation system and then to define the building blocks that need to be put in place to deliver the vision. Central to that vision is a significant degree of compulsion.

2.5 The vision

The focus of the industry must be on improving outcomes for superannuation fund members. A critical component to achieving this is to improve the efficiency of the system and reduce the costs of participation for all players (employers, intermediaries, funds and service providers). That is, total industry costs must be reduced, not merely shifted between players.

The contributions process is the area that generates the most administrative cost for many superannuation funds. In order to improve efficiency and reduce costs the goals are:

- to remove paper and cheques from the system, and
- to improve the quality of the data in the system (this in turn will reduce the number of lost and multiple superannuation accounts).

However, this can only be achieved by making it easier for employers to make contributions and, at the same time, providing employers with a good experience (commensurate with a system that requires compulsory participation).

Improving the quality of data in the system and the manner in which the data is delivered (to both fund members and to employers) will have a large impact on efficiency. It will reduce the number of lost and duplicate accounts, and greatly reduce the cost of the administrative time spent trying to gather missing data or clean up incorrect data. It will also reduce the amount of administrative time spent in rejecting contributions which are incorrect or where inadequate data has been provided.

When the data that is needed by superannuation funds is captured electronically and the payment and the data are linked a superannuation fund can adopt straight through processing administration arrangements and an employer can be quickly advised of instances where the designated fund cannot process a particular contribution. This reduces the need for pre-verification of contributions (which requires a central database of superannuation fund member information).

The rollover process is another area that generates cost for many superannuation funds, but more importantly is time consuming and difficult for fund members. The goal here is to make it faster and easier for superannuation fund members to rollover between funds.

ASFA considers that in developing solutions for contributions and rollovers, the world must be looked at from both a contributor's (employer and member) perspective and the superannuation fund's perspective.

Any solution should recognise that in an employer's ideal world there would be the capacity to *use a single method and a single transaction process to meet all of their superannuation obligations.* This is discussed more below in 2.6.

Similarly, in a superannuation fund's ideal world *all contribution information would be received electronically and the money and the contribution information would be linked.*

ASFA considers that these two ideal world views are reconcilable, but not without government intervention and changes in superannuation fund and employer processes. Such changes will need to include some degree of compulsion.

2.6 Measures required – the building blocks

To achieve these ideal worlds a number of building blocks are required. It is recommended that the following measures are implemented.

1. Superannuation funds must have the capacity (either directly or through a service provider) to receive and send contribution and rollover information electronically, in accordance with agreed data standards. This will involve a modification of superannuation licensing requirements in the Superannuation Industry (Supervision) Act 1993 (SIS).
2. Superannuation funds must be allowed to use the Tax File Number (TFN) as a primary search key for all superannuation processes. Changes may be required to the TFN legislation and/ or the Privacy Act and Guidelines to achieve this.
3. There must be a minimum data requirement and a messaging standard for superannuation contributions and rollovers. These standards must then be made compulsory through changes to SIS and the SG legislation.
   The superannuation industry should work with appropriate groups (e.g. the Australian Payments Clearing Association) to define a data messaging standard and minimum data requirements for superannuation contributions and rollovers.
4. Superannuation funds must be prevented from accepting contributions or registering a new member unless the accompanying information meets the compulsory data standards, and unless agreed minimum data has been provided.
   In order to achieve this, the SIS legislation should be amended to prevent a fund registering a person as a member of a superannuation fund, or accepting a contribution unless a prescribed minimum amount of information about the person has been provided (eg. name, residential address and DOB) and the data meets the prescribed messaging standards.
   The data requirements could be linked to the basic information that an employer is required to obtain from an employee such that the employer is able to meet their PAYG withholding obligations. It is important to note that this minimum data set does not have to include the TFN as the employer may not have been given this by their employee, and the fund can source this information from the ATO (under SIS Section 299TA).
   We recognise that there could be difficulties with this in the initial stages, particularly for ERF and successor fund transfers where the previous fund does not already hold the data. As such, the legislative change may need to include some exceptions to this general rule.
5. It is a more efficient use of resources to collect and record accurate data at the point of enrolment rather than having to amend records and rectify errors down the track. To fulfil their SG requirements, employers should be required to provide contributions electronically in accordance with the prescribed data messaging standard. That is, employers must also provide – electronically – an agreed minimum set of data about the contributor and for whom the contribution is being made.
   The central thrust of the SG legislation, and hence how employers view their obligations is to get the right amount of money into a superannuation fund. The notion that a fund trustee should be able to clearly identify the member that contribution is being made for is implicit, rather than explicit, in the SG Act. That is, the legislation states that contributions must be for "the benefit of" an employee but does not set out what information must be provided with a contribution.
   The Superannuation Guarantee (Administration) Act 1992 (SG Act) should be amended to require contributions to be made electronically according to the prescribed data messaging standard, and to require a minimum set of data that is sufficient to enable the beneficiary of the contribution to be clearly identified. That is, to be a valid SG contribution the employer must meet both the choice of fund requirements and the superannuation guarantee (SG) contribution data requirements.
   ASFA recognises that a minimum data requirement may provide an unrealistic burden on employers. To overcome this, it is suggested that the information required be restricted to information contained on an employment declaration form and that, where the employer does not hold the information (or receive it from the employee) the employer should be able to pay the SG contribution without penalty to the Australian Taxation Office (ATO). For example, for enrolment of a new fund member the required information could include the first name, surname, DOB, residential address and gender of the person. As discussed in point 4. above, the TFN would not be mandatory as not all employees provide a TFN to their employer.
   The ATO would administer the data requirements, but would work with the industry in developing the requirements, formats and definitions. The ATO is seen as the appropriate body to administer the data requirements as they are the ultimate

recipient of all of the information. They also require the information to effectively carry out the task of administering a range of superannuation laws. The ATO should be given the legislative power, and be required, to actively enforce the requirements. We note that this requirement is premised on the availability of appropriate, low cost electronic portals. Please refer below.

6. Superannuation funds should be required, within a suitably short prescribed timeframe, to advise a contributor if a contribution was unable to be processed.
   In order to achieve this, the SIS regulations contributions standard (as well as section 1017E of the Corporations Act) should be modified.
   In addition new SIS regulations should be made which standardise how contributions that cannot be accepted are to be returned to the contributor, what information must be provided by the fund to the contributor and the timeframe in which the contribution must be returned.
   In combination with the other proposed changes, introducing such a requirement would *reduce the need for a central database of member information.* That is, rather than establishing complex and costly member validation processes at the employer end, the emphasis should be on superannuation funds quickly detecting and returning the, ultimately, small number of contribution transactions that cannot be accepted.
7. It must be easy for members to rollover their money between superannuation funds. In order for this to happen:
   - A superannuation fund should not have to re-verify any part of a member's identity if another APRA regulated fund has already verified that information – they should be able to rely on the other fund's verification.
   - A standard form and standard industry process is required.
   - Where a superannuation fund has received the agreed minimum required data and notification from another APRA regulated fund that the member's identity has been verified and the data items match, the fund should have to make the rollover payment without seeking further information from the member.

   This would require changes to SIS (in order to give comfort to trustees) and to AML/CTF legislation.
8. In order to reduce the incidence of potential illegal early release, and also reduce the incidence of contributions made to an incorrect bank account, the Australian Business Register's (ABR) Super Fund Lookup application should be modified to provide access to product information and bank account details. Access to the bank account details would be on a restricted basis.
   This will allow superannuation funds to validate that the correct bank account has been given for payments and contribution data. It would also assist in the prevention of fraudulent early release of superannuation monies, as the superannuation fund could check that the bank account to which they are transferring a benefit is actually the bank account of the receiving superannuation fund.
   To support this process legislative change is required to make it mandatory for all APRA and ATO regulated superannuation funds to provide bank account details to the ABR.
9. The superannuation industry should work with the finance sector to develop processes that will allow more information to be carried with financial transactions.
   This would enable better validation of data and transactions passing through the system, and reduce the likelihood of monies being directed to incorrect accounts. It would also overcome the current situation whereby not all data presented to the banking system is validated (for example to check that the account name matches the account number) and not all data received is passed on to the receiving bank financial institution (for example fields can be truncated).

The superannuation industry (including funds, administrators, intermediaries and employers) should be given a two year implementation lead time before any new mandatory requirements outlined above become compulsory.

2.6.1 Electronic portals – still a market gap

Part of the vision is that the employer needs a "one stop shop" – a single method and a single transaction process to meet all of their superannuation obligations – i.e. to pay SG contributions, additional employer contributions (salary sacrifice) and member after tax contributions (made out of post tax salary on behalf of an employee) to both the employer default fund and an employee's chosen fund. In other words, the capacity in a single process to pay all contributions for all employees is required.

Such an interface is currently provided by a range of players (eg. a fund offering a clearing house service, clearing houses, hubs, specialist payment services, payroll companies, banks, credit unions etc) to employers. Although these interfaces may differ in design and features, where the arrangement currently meets the employer requirement of a single contribution process for all contributions and the information is being delivered electronically to the destination superannuation funds, ASFA sees no need to disturb the relationship.

Many large employers are offered this "one stop shop" service for free, or for a low cost as a result of their size. However many small employers have not had access to such a service for a reasonable price.

The Government's contributions clearing house solution for small employers, which is to be delivered by Medicare, will offer a free service to employers with twenty or fewer employees. However there is still a gap in the market whereby employers with more than twenty employees will still not have access to a cost effective services. This is for several reasons including the fact that they are too small to be offered a free or low cost service by existing providers, who primarily deal with large employers.

The private sector may well act to fill this gap, however in the absence of private sector providers, the Government could consider offering the new Medicare clearing house services to employers with more than twenty employees to fill this gap in the market. This would be a paid service and not a free service, but the aim would be for Medicare to provide it for a reasonable cost.

2.7 Consolidation should not be compelled

Current projections for the Australian superannuation landscape in 2025 are that the overall industry will be $3 trillion in size with $2 trillion of this held in APRA regulated entities.

In November 2009 Jeremy Cooper, chair of the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, hypothesised[1] that, should there be considerable consolidation in the industry, the APRA regulated portion of the industry, in 2025, could consist of fewer than 30 funds, with three of the funds being around the $200 billion mark, another four at the $100 billion mark and the remaining $1 trillion, comprising another 20 funds, having an average size of $50 billion each.

ASFA believes that the push for consolidation is pre-emptive. ASFA is in favour of consolidation where it is in the best interests of members, and in fact we believe it will continue apace and we are advocating legislative changes to make it easier.

However, we believe that the real issue is scale. We support superannuation funds achieving scale in terms of their operations (such as investment and administration) however consolidation is not the only way in which this can be achieved. It can also be achieved through the merging of back office operations. Once the key initiatives recommended in this paper are implemented, super funds will experience significant efficiency gains and the additional marginal gain from consolidation will be less. As such there will be less argument for consolidation on efficiency grounds alone.

Whilst larger, consolidated entities have scale and the potential to do things that smaller funds cannot, smaller funds can have their own valuable attributes. It should be up to trustees to determine the structure and size of fund that best delivers benefits for their members.

ASFA recommends that:

- Consolidation of superannuation funds should be encouraged but not compelled.
- In order to facilitate consolidation the Government should provide permanent Capital Gains Tax rollover relief.

[1] Speech to the ASFA National Conference, Melbourne, 12 November 2009.

3. Fees and charges

3.1 A mandated ceiling on fees would be counter-productive

A major issue facing the industry is the quantum of fees paid by members, which can have an adverse impact on members' long term savings. An article by Josh Fear[2] states that "fees across the superannuation sector are around 1.35 per cent of funds under management". On a typical superannuation balance of $80,000 this equates to $90 per month. Section 9.3.1 of the Issues Paper poses the question of whether or not there should be a ceiling on fees in super. An article written by Peter Mair[3] suggests that "total costs limited to less that 1 per cent of member account balances, is achievable".

There is no doubt that overall costs in the industry should and will come down, particularly following improvements to e-commerce and data standards as outlined in section 2 above. This reduction in costs will drive a reduction in fees for fund members.

Whilst improved efficiency will drive a reduction in average costs, it's important to recognise that many funds are currently very cost efficient. A report prepared by Deloitte[4] on behalf of the Investment & Financial Services Association (IFSA) found that the most efficient of Australian funds compares favourably with the most efficient funds internationally. The report further concludes that "Australian funds, especially larger funds in each sector, are broadly competitive globally on administration and investment fees".

ASFA's position is that there should be no mandated ceiling on fees for the following reasons:

1. There will be a temptation for funds to peg fees to the ceiling where their fees are currently lower than the ceiling.
2. Government may be tempted to keep reducing the ceiling in response to advocacy and lobbying both from within and outside the industry.
3. A mandated ceiling would diminish competitive forces and pre-determine value and price without having regard to competitive pressures.
4. There needs to be a focus on the value provided as well as the fees charged. A ceiling may preclude a high service, bundled offering. Superannuation funds would start to charge for individual services on a "user-pays" basis in order to get their fees under the limit. As such the "pooling" benefits of costs being spread across large numbers of members would be eroded, and members may end up with a very basic standard offering with a range of optional, expensive additional services. The overall cost to a member under this scenario could increase.
5. There is the possibility that superannuation funds would sacrifice quality in order to keep their costs down. For example there could be less incentive to invest in systems development or enhancing services as this may push up costs to the point where they may not be recoverable through fees where fees are just below or at the ceiling.

3.1.1 Suggested alternatives

ASFA contends that the following measures would be more effective in reducing fees than a mandated ceiling:

- The e-commerce initiatives outlined in section 2.6 above should be implemented as soon as possible. This will start to drive efficiencies and generate cost and therefore fee reductions.
- Legislative changes to remove impediments preventing trustees from closing down legacy products, which are a big driver of high costs for some funds. Currently impediments exist which can make product rationalisation a lengthy, complex, risky and expensive process. These include legal constraints (limited mechanisms in the current regulatory framework) and the potential adverse tax consequences for investors (eg. capital gains tax, exposure to Stamp Duty). Legislative change is required in order to remove these impediments without diluting consumer rights, such as introduction of a single legislative mechanism to enable product rationalisation and the amendment of relevant tax laws to provide tax neutrality where rationalisation has been undertaken. Please refer to our response to section 10.5 of the Issues Paper in Appendix 1.
- Trustees need information so that they can measure and benchmark the efficiency and underlying cost of their operations compared to similarly structured superannuation funds. Please refer to section 4.2 below for a further discussion on this.
- Enabling members to compare funds on all fees they pay – i.e. a more relevant league table published by the regulator (this is discussed further in section 4.1.3 below).

Rather than applying pressure on trustees to ensure their fund's fees fit below an arbitrarily determined ceiling, trustees should instead be made accountable to members on how they spend their fund's financial resources.

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[2] Super slick, Josh Fear, ABC Unleashed, 16 October 2009

[3] The 1 per cent solution, Peter Mair, Australian Financial Review, 1 September 2009

[4] IFSA 2009 International Superannuation & Pension Fund Fees, Deloitte, 21 September 2009

To drive accountability, greater transparency throughout the industry is required. Better comparability will drive greater competition (and, subsequently, further industry consolidation). Please refer to section 4 below for a further discussion on comparability.

3.2 Disclosure of fees

ASFA policy is that members should have access to transparent information in order to understand their superannuation. A major issue with respect to fees is the lack of consistency and transparency in the manner in which they are disclosed to members. Major improvements are required to allow fund members to be able to clearly understand the top-line fee they are paying and what they actually get for it.

3.2.1 Fee disclosure in PDSs

Whilst the current fee disclosure regime (such as the fee templates in fund PDSs) is a step in the right direction in terms of standardising the way fees are presented, the manner in which the fees are calculated and disclosed is not helpful for members for a number of reasons including:

- They are based on a member's account balance of $50,000 which distorts the figures for those with substantially smaller or larger balances;
- There are layers of fees for underlying investment arrangements which are not always disclosed;
- Averaging of the fees means members find it difficult to relate what they pay to what is actually disclosed – especially where there are complex fee structures involving rebates or discounts, or where there are performance fees;
- There is no link in the disclosure between the fees members pay and the services they receive (eg. a low cost, basic service fund versus a high cost, high service fund).

Section 8.2.3 of the Issues Paper suggests that four categories or "buckets" of fees and charges could be useful in enabling comparisons between funds. The four buckets are consistent with what is currently disclosed in PDSs, and ASFA supports the use of those categories.

However we believe that a further breakdown of the annual (or ongoing) fees is required to enable like-with-like comparison of superannuation funds.

The table below outlines these proposed fee 'buckets' along with ASFA's suggested 'buckets':

Fee buckets proposed in Issues Paper	ASFA's proposed further fee buckets for the annual (or ongoing) fees
Entry fee Exit fee Annual member account fee Annual asset level fee	Investment fee Advice fee Other fees

There are good reasons for ASFA's proposed buckets.

Firstly, there is a need to separate out investment fees (on a consistent basis) so that investment performance can be calculated the same way by all funds (refer to section 4.1 below). Separate identification of such fees will also drive competition in the investment management market.

Secondly, there is a need to separate out advice fees because different superannuation funds offer markedly different service levels for advice, and it is important for members to be able to understand what they are paying for and utilise the services accordingly. For example if they do not want advice they may prefer to choose a fund that does not offer this service. It should be noted that the level of advice fee should always be shown. If the fee can be turned on or off, it should be displayed. If there is no such fee, a nil amount should be displayed (for example this could be the case where the costs of advice are "embedded" into the operating costs of the fund, and no fee is charged to members for the service). (Note we also recommended in 3.2.1 above that advisory fees should be paid on a fee for service basis rather than in the form of a commission).

This split of the ongoing fees of a fund would also be useful in any future league table which displays fees. It allows a consistent link between investment return and fees, as the first category of fees will be deducted from the return under the new mandatory calculation method (please refer to section 4.1.1 below).

We note that it may be difficult to deconstruct overall fees in the manner proposed in the Issues Paper, particularly with the existence of performance based fees (since performance fees are not consistently disclosed), although it could be argued that the same difficulty in relation to performance based fees exists under both fee 'bucket' models;

What is important is, whatever 'buckets' are used, the industry needs clear rules for what goes into each 'bucket' as this is the starting point for fee comparability – without clear rules in place, any initiatives to improve comparability between funds is doomed to failure. Also needed is clarity around other fees (i.e. outside of those that can feasibly be classified into one of the 'buckets') driven for example by legislative change, particularly for specific individuals (consider for example fees for Family Law services). Under ASFA's proposed buckets these fees would be included in the "other" category.

Comparisons between funds should not focus just on fees. The real interest for members is the "value" they receive – i.e. the investment performance (and other services they receive) relative to the fees that they pay.

ASFA makes the following recommendations in terms of fee disclosure:

- Standard definitions are required of "investment" fees, "advice" fees and "other" fees (including administration and all other fees). It should be compulsory for superannuation funds to categorise their fees into these "buckets" on the same basis.
- The industry needs consistent standards for the disclosure of investment fees such that fees for underlying investment arrangements are disclosed.
- It may be more useful to show the fees in the PDS based on three different account balance amounts (eg. $25,000, $50,000 and $100,000) so that members can compare a figure closer to their own balance. However we recognise that this is trading off simplicity for accuracy.
- Advisory fees should be paid on a fee-for-service basis, rather than in the form of commission.
- There needs to be a consistent and enforced methodology for calculating superannuation fund investment performance, both in terms of the fees and costs deducted and the tax treatment. Please refer to section 4.1.1 below.

ASFA's view is that the industry should ensure easy-to-understand information on fees is available to all members and then look at ways to better educate members and provide them with access to low cost financial advice, so that they are more effectively (and readily) able to exercise choice.

4. Comparing superannuation funds on a like-with-like basis

4.1 Comparability for fund members

4.1.1 Consistent method of calculating investment returns

ASFA considers that the ability of fund members to choose a superannuation fund and to select an investment option within a fund would be greatly enhanced by the presence of a consistent and enforced methodology for comparing fund investment performance.

Currently different superannuation funds deduct different fees from the gross investment return to calculate their post-fee return, so that often the real rate of return is not known. Also different funds have different methods of levying fees (some have higher percentage fees and some have higher dollar fees deducted from accounts).

ASFA recommends that:

- Investment returns should be measured on a consistent post tax and post fee basis. There should be standard rules around which fees should be deducted from the investment return.

4.1.2 Classifying investment options

Currently investment options are categorised by classifying the assets as either "growth" or "defensive" then using this split to categorise a diversified investment option into "High Growth", "Growth", "Balanced", "Conservative" etc. The problem is that there is no standard methodology for either categorising assets as growth or defensive, or for determining whether the option is "Growth", "Balanced" etc.

In order to achieve like with like comparisons of investment returns, there is a need for prescription of standard terminology and methodology of risk disclosure that must be mandated to be used by the whole superannuation and investment industries.

ASFA's view is that ASIC or APRA should establish these standards in conjunction with investment experts. ASFA has already done considerable work in this regard and would be happy to work with the regulator to achieve this.

In terms of any standardised labelling, the industry needs a dynamic model rather than a static model in order to take into account the evolving nature of investments. It would be preferable if the industry moved on from the simplistic binary growth/defensive definition to more meaningful risk assessment and disclosure, taking into account the various risks associated with complex investments. The outcome of this complex work could be an easy-to-understand expression of risk in a range from "very high risk" to "low risk".

ASFA recommends that:

- In order that fund members can be clear about what they are choosing, and so that investments can be fairly compared, investment options within superannuation funds must be measured and disclosed on a compulsory standardised basis in terms of their risk/return profile.
- If investment options continue to be categorised in the current way, there needs to be a compulsory standardised way of categorising assets into "growth" and "defensive" and compulsory rules for placing investment options into the categories of "growth", "balanced" etc.

4.1.3 League tables

ASFA's preference is for a consistent form of disclosure that assists meaningful and easy comparison of the fees, features and benefits or services of superannuation products. Fundamental to achieving this is a set of meaningful and consistent league tables that measure funds (and investment options) on a like with like basis in terms of their risk, long term investment performance, fees and other key metrics. Importantly, ASFA considers it necessary to report these matters at the investment option level.

Currently, fund comparative information is being published by the prudential regulator APRA. Going forward, if a wider range of comparative information is to be provided then perhaps ASIC, with its consumer protection role, is the more appropriate entity to publish league tables. Regardless of which regulator publishes the comparative information, they need to have expertise and knowledge of products and services offered throughout the industry.

ASFA recommends that:

- New league tables be established with input from a cross-industry board of industry representatives who would proactively review both the process and the material on a regularly scheduled basis.
- The information, including investment returns, should be collected and provided for all the investment option(s) within each super product. Due to the large number of options in many funds, a summary should be shown of the key investment options in each fund. The information shown in the summary could be as follows:
    - where a fund has a default option containing the majority of assets, that option could be shown,
    - if the majority of the assets are spread over 2 or 3 main options, they could all be shown, or
    - for a fund with a spread of money between many options, where there is a "flagship suite" of diversified options, these could be shown.
- Returns should be shown on an after-tax basis where applicable – not all funds do this at present (eg. wraps or platform products, where tax is shown on an individual level not the fund level). We recognise the difficulty experienced by platforms in relation to after-tax reporting as tax is calculated at an individual level, however ASFA's position is that trustees should report returns on an after-tax basis where applicable.
- Asset allocations/ranges should be provided for each key investment option shown.
- In addition to annual returns, results should be shown on both a 5-year and 10-year rolling time horizon in order to counter short-termism. Also, the results should be published once a year rather than every quarter, otherwise there is a danger of adding more complexity and cost to the system (particularly if funds have to continuously provide information) for little benefit to members.
- The results should be published in a timely manner – eg. research houses generally publish results by the end of the month following the relevant quarter-end. If the information continues to be published quarterly, the results should be released closer to this timeframe. However, as stated in the previous bullet point, ASFA's view is that the results should be published once per year rather than quarterly. But regardless of the frequency, the results should certainly be published no later than one quarter after the end of the applicable period, in order for the information to be relevant.
- The information published should ideally cover more aspects of the fund beyond investment returns such as fees, risk, services offered, insurance offerings and an overall "value" rating.
- Given the extent of the above suggestions, we recommend that the published information be accompanied by a brief summary, with references to the more detailed information.
- The comparative information should be freely and publicly available.

4.1.4 Proposed "traffic light" system

The Issues Paper raised the possibility of using a "traffic lights" system on fees and charges for website and disclosure documents (eg. Red - 150bps and above; Amber - 100bps to 149bps; Green - below 100bps). There is general agreement within ASFA's membership that such a method of comparison is too simplistic and at odds with the concept of clear, concise and effective disclosure.

There are a myriad of fee structures that makes any valid comparison across funds with different fee structures impossible to compare using something as fundamental as a traffic lights system (for example, one fund could charge 0.5% across a total member balance whereas another fund could charge 0.75% up to $100K, 0.5% for the next $100K and 0.25% once the balance is over $200K.) What is required is more meaningful league tables to aid comparability and transparency.

Although superannuation is a basic right of employees, superannuation is not a homogenous product. Superannuation funds operate in a competitive environment and distinguish their product through features and services. ASFA considers that a traffic light system, by reflecting only one aspect of a fund, would distort consumers' decision making process. There may be little benefit in an individual selecting a green traffic light fund over say an amber traffic light fund if the result was that the member did not consider the benefits of, say, the wider investment choice, binding death benefit nominations, capacity to roll into a pension product and access to free financial advice offered by the full service amber light fund.

ASFA's experience is that simple graphic displays tend to distort decision making and may lead to simplistic decision making that may not be in the consumer's best interest. An example of this is research conducted by ASFA on Product Disclosure Statements. The research revealed that consumers tended to select a fund where they identified with the people pictured on the cover of the disclosure document, rather than on the information contained within the document.

4.2 Benchmarking for fund trustees

It is important for trustees to be able to benchmark themselves against other funds in terms of the underlying cost (and therefore the efficiency) of their operations and services. This will allow them to target areas for improvement and over time continually refine their operations to reduce their costs. This information will be used by trustees for operational improvement purposes rather than being released to members (who are more interested in fees and net investment returns).

It is unreasonable to compare a fund with hundreds of contributing employers, for example, with a fund with only one employer (or very few employers). What is required is a way for trustees to accurately measure and compare the efficiency and costs of different parts of their operations against other funds – i.e. an efficiency index.

We note that Ernst & Young have recently commenced a pilot program involving a number of large funds from different industry sectors. This pilot will investigate the feasibility of establishing an efficiency index. Whilst the viability of an efficiency index is yet to be proven, the concept of an index which drives trustees to improve the efficiency of their operations would seem to be a worthwhile and useful endeavour.

Such an index would also enable stakeholders and government to have overall industry (not individual fund) metrics to accurately and objectively monitor trends in the efficiency of the industry over time.

We recommend that superannuation trustees have information which will allow them to benchmark the efficiency of their operations compared with other similar funds.

5. Investments

5.1 "Lifecycle" default options should not be mandated

Trustees must be able to provide a seamless default for retiring members who do not exercise choice. It is a core ASFA policy that decisions around investments should not be prescribed, but should instead be left up to trustees to determine.

ASFA does not support "lifecycle" or "glide path" fund structures being mandated as the default investment option. Whilst these defaults have some intuitive appeal, we believe that there are some issues which would make them not suitable as a default for all funds. Trustees should neither be compelled to nor prohibited from introducing such a model.

Please refer to our response to question 6.2.3 in Appendix 1 for a full discussion of this issue.

5.2 No maximum number of investment options

ASFA's view is that there should not be a prescribed maximum placed on the number of investment options offered by a superannuation fund, including within a default fund. These considerations are part of a trustee's fiduciary duty and should be left to the trustee to determine – no further prescription is required in this regard.

Platform style superannuation and retirement funds with broad investment choice can offer an attractive alternative to a Self Managed Superannuation Fund (SMSF) for members who do not want to act as trustee of their own fund but who want greater control over where their superannuation is invested.

Please refer to our response to question 6.2.5 in Appendix 1 for further discussion.

5.3 Standardised labelling

It is critical that superannuation fund members can compare superannuation investment options on a like-with-like basis. As discussed in section 4.1 above, there must be a standard way of calculating investment returns, as well as more consistent labelling or categorisation of investment options.

Another component associated with the comparability of funds/investment options, relates to the information published by APRA. What is needed is comparative information (or league tables) that will allow users of the data to compare funds on a like with like basis (refer to section 4.1 above).

6. There should not be a single national default fund

Sections 6.2.1 and 6.2.2 of the Issues Paper pose the question of whether members who do not make an active fund selection would be better served if there were a small number of default funds, or a single default fund such as a government operated national fund, that their employer could choose. The premise for the suggestion appears to be that such a structure for default fund members would reduce costs, provide access to economies of scale and resolve the portability issues that some employees face when changing jobs.

ASFA believes there should not be a single national default fund, for the following reasons:

- It would undermine the importance of member engagement.
- It makes very little sense in an already well established system – the Australian system is not starting from scratch and defaults are already well developed.
- Australia is envied internationally for having a privately managed and run superannuation system where benefits are linked to actual assets and where members generally have both fund and investment choice – as stated previously, having a national default fund runs counter to the choice environment.
- Isolating members from investment risk basically involves introducing defined benefit arrangements, which are likely to be unaffordable if applied to the entire population.
- There is a danger that superannuation assets invested in a national default fund would be funnelled by a future government into their preferred investment areas (eg. infrastructure projects) which may not necessarily be viable or would not necessarily generate the best returns for members.
- Current defaults are in the great bulk of cases in very good low cost funds associated with the employer (public sector and corporate funds, including sub-plans for corporates) and/or are specified in industrial agreements and awards. There is no evidence that the selection is unsuitable and little evidence of deficiencies in current defaults which largely involve low cost funds.
- Furthermore, any fund that wishes to qualify for tax concessions must meet stringent prudential and other statutory requirements. In this context, it is a questionable efficiency measure to introduce another default arrangement (particularly where there are questions as to how that entity would operate in comparison to peer providers from a regulatory perspective).
- Many employers, particularly large employers, make use of tender or other formal evaluation processes and have access to assistance of expert advisors before selecting a default fund.
- A national default fund would face severe problems in establishing national default insurance provisions.
- A government operated national default fund would only be attractive to small businesses if existing e-commerce and contribution issues were addressed. If these issues addressed, which our submission argues should be, then there would be no demonstrable reason to establish a national default fund.

Please refer to our answers to questions 6.2.1 and 6.2.2 in Appendix 1 for more information.

7. Consideration regarding a national ERF

Currently there are sixteen (16) eligible rollover funds (ERFs) registered with APRA. Concern has been raised over the apparent high administration cost for ERF members and the rapid growth of both ERF assets and member accounts over the past five years. Prior to addressing the case for a single national ERF, both of these statements need to be put in context.

The Issues Paper references a Rice Warner[5] report that the ERF sector was the highest cost superannuation sector in 2008 at an average rate of 2.49% of account balances. As at June 2008 the average account size in ERFs was $930. Therefore, in dollar terms, the average cost is approximately $23 per annum or less than 50 cents per week, a moderate sum when compared with average dollar administration costs of other sectors of the industry. This is reflective of the fact that the services provided by ERFs are fundamentally different (i.e. lesser) than those offered by non-ERF funds.

From 2003 through to 2008 the number of accounts in ERFs grew from 3.6 million to 5.9 million. ASFA suggests that this growth is largely reflective of:

- The large number of disinterested members who, for a range of reasons, fail to avail themselves of their legislated right to consolidate their superannuation accounts, and
- A desire by superannuation funds to limit the impact of the cost of member benefit protection of small balance accounts on active account holders by transferring small inactive accounts to an ERF.

There is an intuitive appeal about having one national ERF providing a single place for individuals to go to find their lost superannuation. However, any decision on the desirability of a national ERF should be taken only after actively considering the following changes that have the potential to have a significant impact on the structure of the ERF market:

- Following the recent passage of legislation, the ATO is in the process of advising superannuation funds of the accounts of departed temporary residents that are to be transferred to consolidated revenue. Many of these accounts are in ERFs.
- There is currently before parliament legislation that will require, on an ongoing basis, the transfer to consolidated revenue of all lost member accounts where the account balance is less than $200 or where the trustee considers they will never be able to pay out the member benefit.

The impact of both of the above may result in considerable consolidation within the ERF market with the prospect of only a few large ERFs remaining.

ASFA recommends that:

- Consideration of a national ERF is deferred until the full implementation of the government's departed temporary resident and small balance transfer measures.
- In the meantime a charter should be introduced for ERFs specifically setting out the function of an ERF including the requirement that the ERF operator should be actively trying to reunite the monies in the ERF accounts with the account owners. SIS changes may be required in order to make this a clear obligation for the operator of the ERF.

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[5] IFSA and Rice Warner Actuaries (2008), Superannuation Fees Report – Market Segment Analysis at 30 June 2008: June 2008