

Appendix 2

ASFA's response to the Review Panel's Phase One – Preliminary Report

On 14th December 2009 the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (the Cooper Review) released their Phase One – Preliminary Report entitled "Clearer Super Choices – Matching Governance Solutions" (the report).

1. CHOICE ARCHITECTURE MODEL

While ASFA is supportive of a superannuation system that focuses on member needs rather than product or industry sector perspectives, ASFA does not support the proposed choice architecture model as we believe there are significant issues with what has been proposed.

In particular, we question whether the Choice architecture proposed in the report will lead to significant cost reductions compared with improving inefficiencies in the system (through improvements in electronic commerce) and achieving scale (through fund mergers and further consolidation, which is likely to continue). We further question whether what is being proposed cannot, in fact, be accommodated in the existing system which allows for default funds.

We have identified a number of significant issues and practical considerations in regard to the proposed Choice architecture and regarding the report more generally. These are discussed below.

Proposed architecture would increase costs and cause significant disruption

Transitioning the majority of Australians (who are default members) to new "Universal" superannuation funds would be disruptive and would involve considerable expense for the superannuation fund, costs which are ultimately borne by the fund members. Many members themselves would also bear some direct expenses as part of the move if they are transitioned from one fund to another (due to rounding of unit prices, buy/sell spreads etc). Transition to such a system would lead to substantial disruption and costs for both fund members and to the industry.

Such a dramatic disruption would also require a significant amount of additional staff resources; resources which superannuation funds and their administrators do not currently possess. Many smaller funds in particular could struggle with the additional costs and drain on resources that would result from having to move members from one fund to another.

In addition, requiring trustees to establish new "Universal" superannuation funds would likely erode economies of scale which currently exist, which would be counter-intuitive to the desired outcomes of the Review and would likely lead to inferior outcomes for members.

There would also be substantial difficulties around trustees determining which members are in the default fund because they are disengaged as opposed to those members who have actively chosen the default fund because it is a well balanced portfolio and suits their individual goals. ASFA contends that many "Universal"/default members are highly engaged with their superannuation – they take out extra insurance, make voluntary contributions and make decisions on when and how to transition from employment to retirement. It is wrong to assume that those in default funds are disengaged and subsidising members who actively select an investment option.

Investment strategy should not be mandated for Universal fund

ASFA believes that a single investment strategy for Universal funds is appropriate. However, the structure of the investment strategy itself (eg. percentage exposure to 'growth' assets etc) should not be mandated. It is a core ASFA policy that decisions around investments should not be prescribed, but should instead be left to the trustee, exercising its fiduciary responsibilities and knowledge of the demographics of their membership and the size of their account balances.

In addition, we do not support the mandating of "lifecycle" or "glide path" structures. Whilst these structures have some intuitive appeal, we believe that there are some issues which would make them unsuitable as a default for all Universal funds. A single strategy that is not too conservative would likely produce better outcomes for members since age-based defaults generally result in asset allocations which are too conservative over a full lifecycle, and as a result have not been a better risk management model over time for a default option than a long term balanced/growth default option. Also, a single investment strategy may provide trustees with more flexibility in responding to market circumstances than they would otherwise have if they established more crafted (and costly) default investment strategies based on age or some other criteria not necessarily fitting any particular circumstances.

Discouraging member engagement

ASFA has some concerns around the Review Panel's view of Universal members as characterised in the following statement about the architecture: "It recognises that direct engagement in superannuation decision-making is not currently a priority for a large portion of the population". This is certainly the situation now. However, we would be concerned if the proposed architecture was established under the assumption that this will always be the case.

ASFA believes that many Universal members are currently engaged with their superannuation or will, over time, progress to be engaged members, a trend that has already commenced and will continue. Certainly in ASFA's experience through research we have undertaken, members are more engaged with their superannuation, and more informed about investment matters more generally, since the Global Financial Crisis. Whilst many Universal members will not necessarily be involved in investment decisions, *they still need to (and should be encouraged to) engage with their super* and make decisions regarding such matters as the level and type of contributions they make, the insurance cover they need etc.

Universal members may also wish to consider matters such as taking out a Transition to Retirement Pension or the most appropriate age to retire from full or part-time work. Fund members falling within the Universal category should not miss out on education and advice on such issues merely because they do not wish to exercise fund or investment choice.

For these reasons we do not support the minimal reporting for Universal members under the proposed architecture. ASFA contends that a Universal fund:

- should provide appropriate reporting to educate members and encourage them to engage with their superannuation; and
- should be allowed to offer members financial advice in relation to their superannuation.

Other practical issues

The architecture model also presents a range of practical issues that would need to be considered, for example:

- How would existing members be dealt with?
- How and in what circumstances would members move from one category to another?
- How will members of defined benefit funds be treated?
- Superannuation funds generally do not know which members invested in their default option are true default members, and which have chosen to be there – Can a Choice member choose to become a Universal member?
- What type of choice will move a member from being a Universal member to a Choice member? For example, if they choose an investment option, it is pretty clear that they would become a Choice member, but what if they choose to make additional contributions, or to increase their insurance? Can they do this and remain in the Universal option? Are they still a Universal member or does making any form of decision (eg. around contributions or insurance) mean they are now a Choice member?
- What happens where a fund's existing default option (which ASFA contends should be allowed to be the default fund) already offers 'bells and whistles' beyond those features stipulated for the Universal fund, and these additional features are being provided relatively inexpensively? Should funds be required to cut back on those features already being offered in order to fit the Universal fund criteria?

If a Universal option is introduced, even if it is as an investment option within a fund, it appears that the intention is for it to have pricing below a certain threshold i.e. lower than the main product. Under the proposed model, the "costs of compendious disclosure documents, advertising and transactional infrastructure required to facilitate member investment choice will be borne directly by those in the choice sector" such that there is no cross-subsidisation of costs. It is important to recognise that this will mean an increase in costs for Choice members – perhaps a substantial one in a fund where most members are "default" and the cost of all Choice infrastructure is then spread over a small number of Choice members. We question whether this is the intended (yet inevitable) outcome, particularly where activities such as advertising, which aims to attract new members to the fund, arguably benefits all members through increased scale.

Trustee responsibilities regarding member investment choice

ASFA supports the tiering of trustee responsibilities where superannuation fund trustees have more substantive responsibilities in regard to investment portfolio construction and other default provisions for fund members who have not exercised choice. ASFA agrees with the finding in the report that where a fund member exercises investment choice there should not be an expectation that the trustee will review or overturn the investment choice of a member. In essence, adoption of such an approach would address a number of potential problems which can arise for trustees in meeting the requirements of SIS section 52(2)(f) (i.e. setting of investment strategy) where a member elects to make an investment choice, particularly where a member chooses a specific asset class or classes.

Amending SIS to enable trustees to be subject to member directed investments (possibly within specified parameters) would be very welcome and would allow trustees to offer individually managed accounts within their fund, which would be beneficial for a number of reasons. Firstly, this would create a level playing field

between APRA regulated funds and SMSFs. Secondly, it would cater for the increasing appetite for SMSF style funds but provide the protection of APRA regulation.

2. OTHER PROPOSALS

ASFA supports in principle (or at least has no substantial objection to) the proposals outlined in the Phase One – Preliminary Report regarding:

- no codification of trustee duties,
- levels of training for trustees (although the application of this to representative trustee directors who are appointed rather than elected needs to be clarified),
- performance measurement – i.e. trustees having a standing committee charged with overseeing the performance appraisal of senior management as well as the board itself,
- greater accountability to members through trustees being required to provide reasons for decisions,
- no prescription on the composition of boards,
- no single superannuation regulator,
- no prescription around fund consolidation or the taking up of specified investments, and
- adoption by superannuation funds, where practical, of the ASX governance standards for listed companies.