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Superannuation

Productivity Commission

Locked Bag 2, Collins Street East

Melbourne VIC 8003

AUSTRALIA

Email: super@pc.gov.au

Dear Deputy Chair

Response to the draft report *Superannuation: Assessing Efficiency and Competitiveness*

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide the attached response to the Productivity Commission's draft report *Superannuation: Assessing Efficiency and Competitiveness*, which was released on 29 May 2018.

If you have any queries or comments in relation to the content of our submission, please contact Andrew Craston on (02) 8079 0817 or by email acraston@superannuation.asn.au.

Yours sincerely

Dr Martin Fahy
Chief Executive Officer

Response to the Productivity Commission’s draft report *Superannuation: Assessing Efficiency and Competitiveness*

A.	ABOUT ASFA.....	3
B.	KEY OBSERVATIONS	3
	The Top 10 ‘best in show’	4
	An independent expert panel for Top 10 ‘best in show’ selection	6
	Lifting the bar for MySuper.....	6
	Default for life: defaulting only once for new workforce entrants.....	7
C.	SUMMARY OF ASFA’S POSITIONS ON THE COMMISSION’S RECOMMENDATIONS.....	8
D.	DRAFT RECOMMENDATIONS.....	11
	DRAFT RECOMMENDATION 1: DEFAULTING ONLY ONCE FOR NEW WORKFORCE ENTRANTS	11
	DRAFT RECOMMENDATION 2: TOP 10 ‘BEST IN SHOW’ SHORTLIST FOR NEW MEMBERS	15
	DRAFT RECOMMENDATION 3: INDEPENDENT EXPERT PANEL FOR ‘BEST IN SHOW’ SELECTION.....	18
	DRAFT RECOMMENDATION 4: MYSUPER AUTHORISATION	20
	DRAFT RECOMMENDATION 5: REGULATION OF TRUSTEE BOARD DIRECTORS	23
	DRAFT RECOMMENDATION 6: REPORTING ON MERGER ACTIVITY	25
	DRAFT RECOMMENDATION 7: CAPITAL GAINS TAX RELIEF FOR MERGERS	26
	DRAFT RECOMMENDATION 8: CLEANING UP LOST ACCOUNTS.....	28
	DRAFT RECOMMENDATION 9: A MEMBER-FRIENDLY DASHBOARD FOR ALL PRODUCTS.....	30
	DRAFT RECOMMENDATION 10: DELIVERING DASHBOARDS TO MEMBERS.....	32
	DRAFT RECOMMENDATION 11: GUIDANCE FOR PRE-RETIREES.....	33
	DRAFT RECOMMENDATION 12: EXIT FEES AT COST-RECOVERY LEVELS	34
	DRAFT RECOMMENDATION 13: DISCLOSURE OF TRAILING COMMISSIONS	35
	DRAFT RECOMMENDATION 14: OPT-IN INSURANCE FOR MEMBERS UNDER 25.....	36
	DRAFT RECOMMENDATION 15: CEASE INSURANCE ON ACCOUNTS WITHOUT CONTRIBUTIONS.....	38
	DRAFT RECOMMENDATION 16: INSURANCE BALANCE EROSION TRADE-OFFS	40
	DRAFT RECOMMENDATION 17: INSURANCE CODE TO BE A MYSUPER CONDITION.....	42
	DRAFT RECOMMENDATION 18: INSURANCE CODE TASKFORCE	42
	DRAFT RECOMMENDATION 19: INDEPENDENT REVIEW OF INSURANCE IN SUPER.....	42
	DRAFT RECOMMENDATION 20: AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY.....	45
	DRAFT RECOMMENDATION 21: AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION.....	48
	DRAFT RECOMMENDATION 22: SUPERANNUATION DATA WORKING GROUP	50
E.	DRAFT FINDINGS	52
	DRAFT FINDING 2.1.....	52
	DRAFT FINDING 2.3.....	55

DRAFT FINDING 3.1.....	58
DRAFT FINDING 3.2.....	59
DRAFT FINDING 2.2.....	62
DRAFT FINDING 3.3.....	62
DRAFT FINDING 10.4.....	62
DRAFT FINDING 4.2.....	64
DRAFT FINDING 4.3.....	65
DRAFT FINDING 4.4.....	65
DRAFT FINDING 4.5.....	67
INFORMATION REQUEST 4.1	67
DRAFT FINDING 5.1.....	68
DRAFT FINDING 5.2.....	68
DRAFT FINDING 5.3.....	69
DRAFT FINDING 6.1.....	69
DRAFT FINDING 6.2.....	70
DRAFT FINDING 7.1.....	71
DRAFT FINDING 7.2.....	71
DRAFT FINDING 7.3.....	72
DRAFT FINDING 7.4.....	72
INFORMATION REQUEST 7.1	73
INFORMATION REQUEST 7.2	73
DRAFT FINDING 10.1.....	74
DRAFT FINDING 10.3.....	74
DRAFT FINDING 12.3.....	75
F. CONCLUSION.....	76

A. ABOUT ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$2.6 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 14.8 million Australians with superannuation.

B. KEY OBSERVATIONS

ASFA appreciates the opportunity to provide a submission on the draft report *Superannuation: Assessing Efficiency and Competitiveness* (the draft report). The draft report is the latest stage of the Productivity Commission's (the Commission's) multi-year process to assess the superannuation industry.

The draft report provides a comprehensive assessment of the superannuation system, which if implemented, has the potential to materially transform the industry. There are a number of measures in the draft report that would have a positive impact on consumers and are worthy of further consideration by the Commission and government.

However it needs to be acknowledged that the Australian superannuation system is not broken, and is in fact a world-class private pension system. It is part of a broader retirement income system that is independently ranked as one of the best globally (behind only the Netherlands and Denmark) in terms of sustainability, adequacy and integrity.¹

Australia has the third-largest pool of private pension assets, behind the US and the UK.²

Superannuation aids the sustainability of Australia's Age Pension system. Age Pension expenditure is around 4 per cent of GDP, and is projected to decline over the next four decades – attributable in part to the build-up of private savings through superannuation. In comparison, public pension expenditure across the OECD averages around 9 per cent of GDP, and is projected to increase to around 11 per cent by 2060.³ By 2050, it is expected that over half of all Australian retirees will be self-funded.⁴

The superannuation system is a major source of funding for the Australian economy, including via financial institutions, the share market and private capital markets, and reduces Australia's reliance on foreign capital. It is also a source of stability for the broader financial system.

¹ Mercer 2017, *2017 Melbourne Mercer Global Pension Index*, October (https://australiancentre.com.au/wp-content/uploads/2017/10/2017_MM GPI_Report.pdf).

² OECD 2018, *Pension Funds in Figures*, June (<https://www.oecd.org/daf/fin/private-pensions/Pension-Funds-in-Figures-2018.pdf>).

³ OECD 2017, *Pensions at a Glance: OECD and G20 Indicators: long-term projections of public pension expenditure*, December (https://www.oecd-ilibrary.org/docserver/pension_glance-2017-32-en.pdf?expires=1531363256&id=id&accname=guest&checksum=25BFD5EABB71AC014C4624D9646F8BB2).

⁴ Based on ASFA calculations.

Importantly, superannuation provides important nation-building contributions to infrastructure such as roads and ports, and is driving competition (along with entities based in other countries) in bidding for these projects.

Australia's superannuation system is a success by any measure.

The draft report observes that the majority of members are in well-performing funds and products, and that, on average, fund members have received net returns of 5.7 per cent over the last two decades. For a member on average income (using the Commission's assumptions), these returns over a working life would lead to a balance at retirement of around \$640,000. This is well above the balance required to fund a comfortable standard of living in retirement.⁵

The system delivers positive outcomes for the vast majority of consumers and the Commission's survey of consumers supports this sentiment.

However the system needs to continue to evolve to meet the needs of consumers where 'one size does not fit all'. In this regard, it is important not to assume everyone is the median consumer. In any distribution, there is a range, and the superannuation system must deliver for those in the range as well as the median. The system must have the capability to deliver for consumers who differ in terms of age, occupation and location. The superannuation system must be innovative, efficient and diverse.

The Commission has identified a range of underperforming products; ASFA is concerned about underperformance and the impact on consumers. ASFA supports strong actions to target habitual underperformance.

However it is important to be clear about what the evidence is telling us — what is the extent of underperformance and what are the robust solutions that will lead to better outcomes for consumers in the long term?

The Top 10 'best in show'

The proposal to allocate default superannuation to Top 10 'best-in-show' funds would dramatically change the retirement funding landscape, and raises questions with respect to innovation, competitive intensity and diversity in the system going forward.

The proposed changes would cause disruption – not without cost to consumers.

A Top 10 'best in show' implies the false conclusion that there are only ten good funds in Australia – this is not the case and is not supported by the evidence the Commission has produced. The Commission's analysis shows that the default system has performed well overall, and for the vast majority of default members.

The Top 10 'best in show' proposal fails to recognise the significant clustering of investment performance beyond the top ten default products (there is not a sharp falling away after the

⁵ Based on ASFA calculations. According to ASFA's retirement standard, the superannuation balance required to achieve a comfortable standard of living in retirement for a single person is \$545,000 (<https://www.superannuation.asn.au/ArticleDocuments/269/ASFA-RetirementStandard-Summary-2018.pdf.aspx?Embed=Y>).

tenth-ranked product), as well as the different age profiles – and consequent degrees of investment risk – for different cohorts of default members.

Traditional economic approaches to improve competition and efficiency tend to focus on increasing the number of participants in a market rather than restricting the number. A Top 10 ‘best in show’ would impact the ability of potential new entrants to enter the market, as it would significantly restrict the number of funds that could access default flows. This is in the context that only four new RSE licences have been granted over the five years to 2016.⁶ A Top 10 ‘best in show’ would make current barriers to entry even higher.

There is a significant risk that a Top 10 ‘best in show’ would add to market concentration and systemic risk. In the absence of long-term default fund flows, funds that are unsuccessful in even a couple of Top 10 ‘best in show’ rounds might no longer be viable.

The Top 10 ‘best in show’ proposal also could create a significant risk of short termism on the part of funds seeking to secure or maintain a Top 10 position – in particular, a focus short-term investment performance at the expense of strong investment governance.

Further, there is a risk that fees (in the form of administration and investment) would become a dominant determinant of being ‘best in show’. This could result in a race to the bottom in terms of service levels and development of passively-managed products.⁷

The Top 10 ‘best in show’ concept would drive the system towards homogeneity. Currently, many funds (such as smaller industry funds and corporate funds set up by large companies for their staff), are able to provide targeted offerings to their members, including tailored insurance and investment approaches, and the importance of this to members should not be underestimated.

Overall the Top 10 ‘best in show’, in combination with other recommendations in the draft report, would have significant implications for the provision of default insurance in superannuation. Default insurance should allow superannuation fund members to obtain and maintain insurance that is suited to their specific needs and circumstances when starting work and as they move from one job to another. It should also allow all members to obtain default cover. This approach is under threat – potentially leading to adverse selection and an increase in premiums.

In the Australian context, ASFA acknowledges the existing system (the Fair Work Commission) that allocates default superannuation to superannuation fund members. A number of ASFA members support continuing this system as a mechanism to allocate default superannuation going forward.

A number of ASFA members support further consideration of a tailored ‘best for individual’ mechanism where default product selection for consumers could be based on a range of factors, such as: age, geography and occupational affinity (which is also a proxy for insurance needs). This could ensure suitable tailoring of default superannuation for individuals and ensure that diversity remains a feature of the default superannuation market.

⁶ Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 292 (word version).

⁷ ASFA notes that fees across the system are trending downwards. The Commission finds that fees for MySuper products average around 0.9 per cent of assets.

An independent expert panel for Top 10 ‘best in show’ selection

ASFA does not support the Commission’s Top 10 ‘best in show’ proposal. However, if it was to be implemented, ASFA considers that the selection panel for the ‘Top 10’ should comprise individuals with considerable expertise in superannuation (and the investment industry), and be independent of government.

That said, ASFA considers it may prove difficult to find individuals who have the required depth of skill, and are free from conflicts of interest.

Lifting the bar for MySuper

ASFA supports strong actions to target underperformance in the system. ASFA is concerned about the impact of underperforming funds/product on affected individuals’ ultimate retirement outcomes.

ASFA considers that ‘underperformance’ needs to be carefully defined to avoid unintended consequences. A well-run fund with strong governance arrangements may record relatively low returns during a narrow period. For example, a fund may be ‘overweight’ in an asset class that is particularly adversely affected by an economic/financial shock. A narrow set of performance criteria, based on historical investment returns, could designate such a fund as ‘underperforming’ – notwithstanding that the fund may have high-quality insurance offerings and member services, as well as the potential to deliver higher investment returns than other funds over the long term.

ASFA supports the Commission’s recommendation to elevate the standard of MySuper products for all default members, not just for new entrants to the workforce/superannuation. This would be an effective mechanism to take the industry forward. It would encourage underperforming funds to successor fund transfer/merge, thereby serving to ‘clear-up the tail’ of MySuper products.

ASFA supports a prescriptive ‘balanced scorecard’ approach that clearly targets habitual underperformance.

Any prescriptive criteria to lift the bar of MySuper more broadly would need to consider factors such as investment performance (long-term and risk-adjusted) and include qualitative and quantitative factors such as:

- success in achieving investment objectives
- quality of governance (including investment governance)
- fees and costs charged to members
- quality and value of insurance
- the provision member services
- the trustee’s risk management processes
- innovation including use of (and capacity to use) technology.

Any prescriptive criteria must be transparent and easy to measure.

Default for life: defaulting only once for new workforce entrants

ASFA is supportive of continuing to reduce duplicate accounts. A default for life mechanism would limit the flow of new unintended superannuation accounts, and help reduce the stock of unintended multiple accounts over time. Combined with a range of other mechanisms (current and prospective), it would help reduce the stock of lost and unclaimed accounts in the system over time.

However there are risks that members might not end up with the default superannuation product that is most suitable for their circumstances, particularly in relation to insurance cover. The individuals most likely to be affected are those who change industries – something that is becoming increasingly prevalent in the modern workforce and is particularly relevant to first jobs.

An alternative option that could be explored would involve people defaulting afresh every time they start a new job. If a default member did not choose a new fund upon changing jobs, the individual would be reallocated to a default fund (based on stronger MySuper authorisation or some other criteria). The balance of the individual's current active default account would be rolled into his/her new default account, thereby addressing the risks around disengagement. Individuals who join the workforce for the first time, or who do not have an active account (and do not make a choice), would be allocated to a default product.

This would limit the proliferation of new unintended superannuation accounts, and help reduce the stock of unintended multiple accounts over time.

However this type of approach would have its drawbacks including involving the opening/closing of accounts and associated insurance arrangements, as well as the transfer of member information and account balances. Funds would incur costs and these would be borne by consumers.

In summary, ASFA supports recommendations that will make a strong Australian superannuation system even stronger and welcomes further discussions with the Commission as the final report is prepared.

C. SUMMARY OF ASFA'S POSITIONS ON THE COMMISSION'S RECOMMENDATIONS

Recommendation	ASFA position	
1: DEFAULTING ONLY ONCE FOR NEW WORKFORCE ENTRANTS	na	ASFA considers there are pros and cons with Draft Recommendation 1.
2: 'BEST IN SHOW' SHORTLIST FOR NEW MEMBERS	Not support	<p>ASFA does not support the Commission's draft recommendation for a Top 10 'best in show'.</p> <p>ASFA acknowledges the current arrangements under the Fair Work Act.</p> <p>ASFA acknowledges other potential fund-selection mechanisms, including a tailored 'best for individual' mechanism.</p>
3: INDEPENDENT EXPERT PANEL FOR 'BEST IN SHOW' SELECTION	Not support	ASFA does not support establishing an independent expert panel to select a Top 10 'best in show'.
4: MYSUPER AUTHORISATION	Support	ASFA supports elevating the threshold for MySuper authorisation to raise the standard for all MySuper products. This would encourage underperforming funds to successor fund transfer/merge, thereby facilitating an orderly transformation of the system.
5: REGULATION OF TRUSTEE BOARD DIRECTORS	Qualified support	ASFA supports 'in principle' the Commission's recommendations, however notes that most elements are canvassed within the existing regulatory framework – mainly through APRA's recently-enhanced prudential standards. Legislative change is therefore not required to achieve all of the outcomes sought by the Commission.
6: REPORTING ON MERGER ACTIVITY	Support	ASFA supports a framework that promotes mergers where they are in the best interests of members. If a reporting framework were introduced it would be necessary to ensure it did not act as a disincentive for funds to execute a Memorandum Of Understanding.
7: CAPITAL GAINS TAX RELIEF FOR MERGERS	Support	ASFA considers the absence of ongoing CGT relief has been a significant barrier to fund consolidation/mergers. Uncertainty over whether relief will be available may serve as a deterrent to mergers, given trustees must take into account the benefits and costs of a merger in determining whether it would be in members' best interests.

Recommendation	ASFA position	
8: CLEANING UP LOST ACCOUNTS	Qualified support	<p>ASFA considers the ATO should repatriate all existing lost super to members' active accounts.</p> <p>ASFA considers the ATO should move member money directly from an inactive account to an active account rather than it going to the ATO.</p> <p>ASFA supports exemptions from 'auto-consolidation' where members have explicitly rejected it or where there is clear engagement with the member's superannuation fund.</p>
9: A MEMBER-FRIENDLY DASHBOARD FOR ALL PRODUCTS	Qualified support	ASFA supports easy-to-understand dashboards. While achievable for MySuper products, work would need to be done to ensure that dashboards work for choice products. An appropriate timeframe for implementation would be required.
10: DELIVERING DASHBOARDS TO MEMBERS	Qualified support	ASFA supports easy-to-understand dashboards. Particularly with respect to any choice product dashboard, work would need to be done to ensure it is meaningful to members and relevant to their decision-making.
11: GUIDANCE FOR PRE-RETIREES	Qualified support	<p>ASFA supports the ATO guiding pre-retirees to relevant websites, subject to clarity on:</p> <ul style="list-style-type: none"> • how this would work in practice • the interaction with financial advice; and • the potential link to CIPRs.
12: EXIT FEES AT COST-RECOVERY LEVELS	Qualified support	ASFA supports a total exit fee ban for existing and future products, with exemptions for partial benefit transfers and family law payments.
13: DISCLOSURE OF TRAILING COMMISSIONS	Support	ASFA supports transparent disclosure delivered in a manner that is useful for members when they are evaluating their benefits and making financial decisions.
14: OPT-IN INSURANCE FOR MEMBERS UNDER 25	Not support	ASFA does not support moving to an opt-in framework for new members under 25 as there is adequate evidence that young people (and their dependants) benefit from the current settings. ASFA notes that recommendation is similar to proposed changes in 2018-19 Budget.

Recommendation	ASFA position	
15: CEASE INSURANCE ON ACCOUNTS WITHOUT CONTRIBUTIONS	Not support	ASFA does not support ceasing insurance for all superannuation accounts that stop receiving contributions. ASFA notes that recommendation is similar to proposed changes in 2018-19 Budget.
16: INSURANCE BALANCE EROSION TRADE-OFFS	Qualified support	ASFA notes that the draft recommendation is broadly consistent with the Insurance in Superannuation Voluntary Code of Practice.
17: INSURANCE CODE TO BE A MYSUPER CONDITION	Qualified support	ASFA is supportive of working with the regulators, and other relevant stakeholders to advance the Insurance in Superannuation Voluntary Code of Practice.
18: INSURANCE CODE TASKFORCE		A two year timeframe to assess the effectiveness of the Code and to investigate alternative monitoring and reporting arrangements in collaboration with the regulators ASIC and APRA is sensible. During that time, the Code owners, including ASFA will be able to explore with ASFA members whether the Code should be a condition of a MySuper license or mandatory through some other mechanism.
19: INDEPENDENT REVIEW OF INSURANCE IN SUPER		ASFA also supports the commissioning of an independent review of insurance in superannuation within four years.
20: AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY	Qualified support	ASFA broadly supports the elements of the recommendation, but the details require careful consideration. Any proposed regulatory requirements should be assessed to ensure they would achieve their intended purpose and not merely impose an additional compliance cost and burden on industry.
21: AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION	Qualified support	ASFA broadly supports the elements of the recommendation, but the details require careful consideration. Any proposed regulatory requirements should be assessed to ensure they would achieve their intended purpose and not merely impose an additional compliance cost and burden on industry.
22: SUPERANNUATION DATA WORKING GROUP	Qualified support	ASFA supports a coordinated approach to data collection and supports a centralised governance structure in some form. Any such governing or consultative body should include representatives from relevant government agencies as well as industry.

D. DRAFT RECOMMENDATIONS

DRAFT RECOMMENDATION 1: DEFAULTING ONLY ONCE FOR NEW WORKFORCE ENTRANTS

COMMISSION'S DRAFT RECOMMENDATION 1

Default superannuation accounts should only be created for members who are new to the workforce or do not already have a superannuation account (and do not nominate a fund of their own).

To facilitate this, the Australian Government and the ATO should continue work towards establishing a centralised online service for members, employers and the Government that builds on the existing functionality of myGov and Single Touch Payroll. The service should:

- allow members to register online their choice to open, close or consolidate accounts when they are submitting their Tax File Number when starting a new job
- facilitate the carryover of existing member accounts when members change jobs
- collect information about member choices (including on whether they are electing to open a default account) for the Government

There should be universal participation in this process by employees and employers.

ASFA considers there are pros and cons with *Draft Recommendation 1*.

The Commission's proposed mechanism: Defaulting only once for new workforce entrants

The draft report proposes that default superannuation accounts should only be created for members who are new to the workforce or do not already have a superannuation account (and do not nominate a fund of their own).

For an individual, the only occasion where he/she would be 'defaulted' into a MySuper account would be where he/she does not have an active superannuation account. This would largely apply to individuals who enter the workforce for the first time. It also would apply to individuals who have worked previously but do not have an active account – such as individuals who re-enter the workforce after a period of absence.

ASFA considers there are pros and cons with the Commission's proposed mechanism.

Pros

The Commission's proposed mechanism would limit the flow of new unintended superannuation accounts. This would help reduce the stock of unintended multiple accounts over time.

Combined with a range of other mechanisms (current and prospective), the Commission's proposal would help reduce the stock of lost and unclaimed accounts in the system over time.⁸

⁸ ASFA notes that the Commission's proposed mechanism to reduce lost accounts (*Draft Recommendation 8*) is similar to the government's proposed changes in its *Protecting Your Super Package*. ASFA's comments on the Commission's proposed mechanism are later in this submission (page 28).

For an individual who otherwise might have unintentionally acquired a superannuation account(s), he/she would likely have a higher superannuation balance (than otherwise would be the case), due to lower fees and additional investment income (on a higher balance).

- Generally speaking, these effects would likely be proportionally greater for lower-balance accounts.

Cons

The Commission's proposed mechanism would mean that some members might remain in default superannuation products that, while once suited to their circumstances, would become less suitable for them over time – especially with respect to insurance.

- An individual's new job may be a high-risk occupation. The individual's default product may not provide adequate insurance cover compared with insurance arrangements that are more tailored for the individual's new job/industry.
 - For example, consider an individual who begins his/her career in the hospitality industry, but later works in the construction industry.
 - Under *Draft Recommendation 1*, if the individual does not change his/her superannuation product (when he/she changes job), the insurance arrangements may not be the most suitable for his/her new circumstances.

More broadly, the Commission's proposed mechanism may change the role of superannuation fund trustees in designing and providing products that best meet the needs of particular cohorts of members (including lifecycle MySuper products).

An alternative mechanism: Defaulting upon changing jobs

Box 1 outlines a potential alternative mechanism. In effect, a default member would have a single default account that would be reallocated (to a MySuper product) when the member changes jobs. This alternative mechanism has pros and cons.

Box 1: An alternative mechanism – ‘single default account’

In effect, a default member would have a single default account that would be reallocated (to a MySuper product) when the member changes jobs.

Upon changing jobs, if a default member did not choose a product he/she would be reallocated to another MySuper product. The balance of his/her current default account would be rolled into his/her new default account.

- The mechanism would need to identify those individuals whose current active account is with a default product to ensure that only default members would be reallocated.

For each individual, his/her new default product would depend on the specific model for determining the group of potential products (such as those addressed in *Draft Recommendation 2*).

Prior to being reallocated, the individual would be encouraged to review information about his/her new fund, and be prompted whether he/she would like to remain in his/her current fund.

Individuals who join the workforce for the first time or who do not have an active account (and do not make a choice), would be allocated to a default product.

Pros

As is the case for *Draft Recommendation 1*, the alternative mechanism would limit the flow of new unintended superannuation accounts. This would help reduce the stock of unintended multiple accounts over time.

As is also the case for *Draft Recommendation 1*, for an individual who otherwise might have unintentionally acquired a superannuation account(s), he/she would likely have a higher superannuation balance (than otherwise would be the case).

If allocation was based on a tailored default (‘best for individual’) or similar quality filter/mechanism that took into account factors such as an individual’s age and occupation, a default member would, any point in time, likely be in a product that suits their current circumstances – for example, with respect to insurance requirements and stage-of-life.

Cons

For an individual, a job change would involve the opening/closing of MySuper accounts and associated insurance arrangements, as well as the transfer of member information and account balance. The funds involved would incur costs associated with these events – such as administration costs and buy/sell costs. It is likely that the member leaving would bear the immediate cost through the buy/sell spread.

It is likely that a large proportion of fund/product changes would occur without individuals’ explicit permission – notwithstanding mechanisms to prompt individuals whether they would like to remain with their current fund. Particularly for individuals who are only intermittently engaged with their superannuation, a change of fund/product could be confusing.

Where members are reallocated, the differences in insurance offerings might be substantial and some members might actually be disadvantaged. In particular, some members might lose some

elements of their insurance cover/benefits.

- Given the transitory nature of the default member base, with the average Australian worker changing jobs every three to four years, insurers may not be able to offer the same favourable rates, automatic acceptance and other terms and conditions as is currently the case.
- For example, five-year premium guarantees may not be possible, and rates might be higher due to less certainty around the number of lives insured.

When members are reallocated, there would be a crystallisation of losses/gains on investments. This would be a more significant issue at times of heightened market volatility – where a member could suffer a significant and permanent loss in the value of his/her portfolio.

DRAFT RECOMMENDATION 2: TOP 10 ‘BEST IN SHOW’ SHORTLIST FOR NEW MEMBERS

COMMISSION’S DRAFT RECOMMENDATION 2

A single shortlist of up to 10 superannuation products should be presented to all members who are new to the workforce (or do not have superannuation account), from which they can choose a product. Clear and comparable information on the key features of each shortlisted product should also be presented. Members should not be prevented from choosing any other fund (including an SMSF).

Any member who fails to make a choice within 60 days should be defaulted to one of the products on the shortlist, selected via sequential allocation.

The ATO should embed the shortlist and accompanying information into the centralised online service.

Not support

ASFA does not support the Commission’s draft recommendation for a Top 10 ‘best in show’.

ASFA acknowledges the current arrangements under the *Fair Work Act*.

ASFA acknowledges other potential fund-selection mechanisms, including a tailored ‘best for individual’ mechanism.

ASFA does not support the Commission’s draft recommendation for a Top 10 ‘best in show’.

ASFA acknowledges there are some potential benefits of the proposal. For individuals, being presented with a list of only ten MySuper products may make the process of choosing a product (from the list) easier – compared with, for example, a longer list of products. This, in conjunction with a rigorous selection mechanism/process, would reduce the risk that a new default member would end up in a poorly-performing fund.

However, ASFA has a number concerns with the Commission’s proposed Top 10 ‘best in show’. In broad terms, the proposal, while likely to make it easier for consumers to choose a product, risks a race to the bottom in terms of the products presented to consumers. ASFA considers the draft report does not explore sufficiently the potential adverse consequences of the Top 10 ‘best in show’ for consumers.

An arbitrary benchmark

In essence, a Top 10 ‘best in show’ is an arbitrary benchmark that would exclude products that would deliver quality outcomes for consumers (even for the most objective selection panel, identifying a ‘Top 10’ would not be a straight forward exercise).

The Commission’s statistical analysis supports the fact that there are considerably more than ten high-quality MySuper products that are delivering, and will continue to deliver, quality outcomes for their members. For example, as the Commission’s analysis reveals, the clustering of high levels of

investment performance among MySuper products extends far beyond a 'Top 10'.

ASFA's response to *Draft Finding 2.3* notes there is a wide dispersion of asset allocations and risk profiles even among non-lifecycle MySuper products. Particular points within economic/financial cycles favour different asset classes (and thus asset allocations), but over long periods of time returns tend to revert to mean (as seen in investment markets and for funds, in Australia and overseas). With respect to a 'Top 10', this means that products might be within the 'Top 10' at one point in an economic/financial cycle, but subsequently drop out merely due to the stage of the cycle.

As a result, some members would be allocated to a product that would be subsequently removed from the 'Top 10'. Although such a product would not be 'poor-quality' just because it dropped out of the 'Top 10', equally it would not be 'poor-quality' given it would be one of many other products outside the 'Top 10' that would have passed some form of stringent authorisation (which ASFA has suggested be tightened – see ASFA's response to *Draft Recommendation 4*).

The key issue here is that high-performing funds outside the Top 10 'best in show' would no longer receive default contributions. This would affect the viability of some of these high-performing funds.

Effects on the default product market

ASFA also has concerns about the longer-term effects of the Commission's Top 10 'best in show' proposal on the MySuper product market.

A key risk is that, over time, the products in the 'Top 10' may tend towards homogeneity – with respect to investment strategy, but also other aspects. In order not to lose 'Top 10' status, funds may tend to adopt similar investment strategies for their MySuper products (such as low-cost index funds), which might not be in the best interests of members. This may also increase systematic risk.

With respect to insurance, it is likely that offerings would be generic in nature, which would not be tailored to workers in jobs/industries with specific insurance requirements – seriously disadvantaging workers in high-risk occupations. Given the transitory nature of the default member base, rates and terms and conditions would be less favourable than those currently able to be offered.

Further, there would be little incentive for funds to innovate where this is costly in the short term, even where there are prospects for longer-term benefits for members.

On the other hand, funds with products outside the 'Top 10' might take-on additional risk in order to boost investment returns to be selected as a 'Top 10' product (once in the 'Top 10', funds could then re-adjust investment strategy). This approach may not be in the best long-term interests of the products' current members.

Other quality funds may eschew 'competing' for inclusion in the 'Top 10'. For example, the Top 10 'best in show' may make it difficult for funds to make reasonable business plans (per APRA's requirements), including with respect to long-term investments – due to the high degree of uncertainty regarding future membership and therefore cash-flows. That some funds would decide not to 'compete' would represent a loss for individuals who might have otherwise become members

of those funds (as has happened in tender processes internationally – for example in Chile).⁹

Alternative mechanisms

ASFA acknowledges the current arrangements under the *Fair Work Act*, and notes that some of ASFA’s members are supportive of these arrangements. ASFA also acknowledges other potential fund-selection mechanisms, including a tailored ‘best for individual’ mechanism (Box 2).

Box 2: An example of a tailored ‘best for individual’ mechanism

A tailored shortlist of default products could be devised for each individual, based on a range of factors, such as: age, occupation and location.

Selection could be overseen by some form of independent body, and could utilise data-matching technologies.

The tailored shortlist would be presented to all members who are starting a new job, from which they could choose a product.

All shortlisted products would have to pass a MySuper benchmark.

A tailored ‘best for individual’ mechanism could maintain diversity in the default market and generate innovation and competition, including from new entrants, focussed on meeting the needs of members. That said, the greater the degree of tailoring (for each individual), the greater the reliance on the availability of robust and accurate member information to generate suitable tailored shortlists.

⁹ ASFA 2017, *The Chilean Pension Tender Model*, February (https://www.superannuation.asn.au/ArticleDocuments/359/ASFA_Chilean_tender_model_paper.pdf.aspx?Embed=Y).

DRAFT RECOMMENDATION 3: INDEPENDENT EXPERT PANEL FOR ‘BEST IN SHOW’ SELECTION

COMMISSION’S DRAFT RECOMMENDATION 3

The Australian Government should establish an independent expert panel to run a competitive process for listing superannuation products on the online shortlist. This panel should select from products submitted by funds that meet a clear set of criteria (established beforehand by the panel) and are judged to deliver the best outcomes for members, with a high weighting placed on investment strategy and performance.

The panel should have flexibility to select up to 10 products, with the exact number at the discretion of the panel based on the merit of each product and what is most tractable for members, while maintaining a competitive dynamic between funds for inclusion.

The panel should be comprised of independent experts who are appointed through a robust selection process and held accountable to Government through adequate reporting and oversight.

The process should be repeated, and the panel reconstituted, every four years.

Not support

ASFA does not support establishing an independent expert panel to select a Top 10 ‘best in show’.

Under *Draft Recommendation 3*, the Commission envisages an ‘independent expert panel’ to oversee selection of default products for the Commission’s Top 10 ‘best in show’. ASFA does not support establishing an independent expert panel to select a Top 10 ‘best in show’. As outlined in our response to *Draft Recommendation 2*, we have significant concerns with a Top 10 ‘best in show’.

However, if it was to be implemented, ASFA considers that the selection panel for the ‘Top 10’ should comprise individuals with considerable expertise in superannuation (and the investment industry), and be independent of government. ASFA considers that both would be required for the public to have confidence that the decisions of the panel were in the best long-term interests of consumers.

That said, ASFA considers it may prove difficult to find individuals who have the required depth of skill, and are free from conflicts of interest.

The Commission acknowledges this point in its draft report with respect to its proposed ‘independent expert panel’ for the Top 10 ‘best in show’. The Commission notes that the panel should “strike the right balance between expertise and independence”,¹⁰ although it is unclear what this would mean in practical terms.

Further to the Commission’s proposed ‘independent expert panel’, there is a risk of political influence on panel membership. In particular, that the membership of the panel would be reviewed and altered upon a change of government.

¹⁰ Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 474 (word version).

In addition, it is not clear from the draft report whether the cost of running the Commission's proposed 'independent expert panel' would be recouped from the superannuation industry (and, as such, ultimately borne by fund members).

DRAFT RECOMMENDATION 4: MYSUPER AUTHORISATION

COMMISSION'S DRAFT RECOMMENDATION 4

The Australian Government should legislate to allow APRA to apply the MySuper outcomes test.

Authorisation rules for MySuper should be further strengthened to require funds to:

- obtain independent verification — to an audit level standard — of their outcomes test assessment, comparison against other products in the market, and determination of whether members' best interests are being promoted, at least every three years
- report to APRA annually on how many of their MySuper members switched to a higher fee choice product within the same fund.

Funds that fail to meet these conditions — or persistently underperform (for five or more years) an investment benchmark tailored to their asset allocation by a material margin, as determined by APRA — should have their MySuper authorisation revoked.

After implementation, the Australian Government should commission an independent review, every five years, of the effectiveness of the MySuper authorisation rules (including the outcomes test) at meeting their objectives.

Support

ASFA supports elevating the threshold for MySuper authorisation to raise the standard for all MySuper products. This would encourage underperforming funds to successor fund transfer/merge, thereby facilitating an orderly transformation of the system.

ASFA supports strong actions to target underperformance in the system. ASFA is concerned about the impact of underperforming funds/products on affected individuals' ultimate retirement outcomes.

Defining 'underperformance' is difficult

ASFA considers that 'underperformance' needs to be carefully defined to avoid unintended consequences.

The draft report assesses underperformance within cohorts of funds/products by benchmarking net investment returns against reference portfolios. As noted in ASFA's response to *Draft Findings 2.1 and 2.3*, the Commission's approach has some limitations with respect to comparing investment outcomes.

More broadly, however, identifying underperformance using a narrow set of criteria – and relying just on historical investment returns – risks unintended consequences. A well-run fund with strong governance arrangements may record relatively low returns during a narrow period. For example, a fund may be 'overweight' in an asset class that is particularly adversely affected by an economic/financial shock. A narrow set of performance criteria, based on historical investment returns, could designate such a fund as 'underperforming' – notwithstanding that the fund may have high-quality insurance offerings and member services, as well as the potential to deliver higher

investment returns than other funds over the long term.

Elevation of MySuper

Further on the theme of underperformance, elevating the threshold for MySuper authorisation would raise the standard of MySuper products for all default members, not just for new entrants to the workforce/superannuation system. This would encourage underperforming funds to successor fund transfer or merge, thereby serving to ‘clear-up the tail’ of MySuper products and facilitate an orderly transformation of the system.

This would mean that funds which are performing well and delivering good outcomes for their members would be able to concentrate on remaining competitive, being innovative and implementing incremental improvements over the medium to long term.

Overall, this would allow a diverse and healthy market of funds to be maintained.

A prescriptive ‘balanced scorecard’ approach

While the focus rightly should be on long-term performance, ASFA considers that a prescriptive outcomes test, akin to a ‘balanced scorecard’ approach, could be adopted.

A prescriptive ‘balanced scorecard’ approach could focus primarily on whether the best interests of members are being promoted.

This approach would be broader, more accurate and more equitable than a small number of prescribed measures. There would have to be flexibility to look forwards (not just backwards), and to take account of idiosyncratic risk. Furthermore, a ‘balanced scorecard’ approach would enable consideration of qualitative aspects, in addition to quantitative measures, such as the provision of insurance.

Importantly, a ‘balanced scorecard’ approach could address the issue of how to assess new entrants to the market or those products that materially change their investment strategy (where it is not possible or appropriate to take account of past investment performance), in a way that a prescriptive focus on past investment performance would not be able to do.

Box 3: Factors that could be included in a 'balanced scorecard'

- Net investment performance, adjusted for risk and tax (for the longest time period that is feasible).
- Shorter-term net investment performance: this could help account for funds that have turned around their performance – such as by re-vamping their investment governance (for example, a product may have had poor performance in the early part of the assessment period, which drags down the long-term average, but recent performance is strong).
- Success in achieving investment objectives: this would be particularly useful where products have different cohorts/demographics and so have different investment strategies.
- As the above measures are backward-looking and do not account for idiosyncratic risk, consideration of investment governance processes. This could be used, on a case by case basis, where a fund does not meet a quantitative return benchmark.
- Quality of broader governance measures.
- Fees and costs charged to members, including administration fees and investment fees.
- Quality and value of insurance.
- The provision of member services, including advice.
- The trustee's risk management processes.
- Innovation in the fund/product.

To achieve an orderly transition there would be a need to develop an appropriate process for APRA to:

- identify poorly-performing funds
- determine what the trustee needs to put in place/resolve/achieve
- set a deadline for trustee action
- revoke MySuper authorisation where a deadline is not met.

That said, there would need to be some flexibility for APRA in revoking MySuper licences (for example, funds could miss an investment benchmark by a material margin if there is another Global Financial Crisis).

ASFA would be happy to work with the Commission to develop a prescriptive 'balanced scorecard' approach for an elevated threshold for MySuper authorisation.

DRAFT RECOMMENDATION 5: REGULATION OF TRUSTEE BOARD DIRECTORS

COMMISSION'S DRAFT RECOMMENDATION 5

The Australian Government should legislate to:

- require trustees of all superannuation funds to use and disclose a process to assess, at least annually, their board's performance relative to its objectives and the performance of individual directors
- require all trustee boards to maintain a skills matrix and annually publish a consolidated summary of it, along with the skills of each trustee director
- require trustees to have and disclose a process to seek external third party evaluation of the performance of the board (including its committees and individual trustee directors) and capability (against the skills matrix) at least every three years. The evaluation should consider whether the matrix sufficiently captures the skills that the board needs (and will need in the future) to meet its objectives, and highlight any capability gaps. APRA should be provided with the outcomes of such evaluations as soon as they have been completed
- remove legislative restrictions on the ability of superannuation funds to appoint independent directors to trustee boards (with or without explicit approval from APRA).

Qualified support

ASFA supports 'in principle' the Commission's recommendations, however notes that most elements are canvassed within the existing regulatory framework – mainly through APRA's recently-enhanced prudential standards. Legislative change is therefore not required to achieve all of the outcomes sought by the Commission.

Dealing with each element of *Draft Recommendation 5* in turn:

- As noted in the draft report, funds are already required to assess the performance of the Board and individual directors in accordance with APRA's *Prudential Standard SPS 510 Governance* (SPS 510).
- SPS 510 requires that:
 - when determining the overall composition of the Board, an RSE licensee would ordinarily take into account the RSE licensee's business and strategic plans, and the skills and capabilities required to effectively oversee the implementation of that strategy.
 - when appointing new directors an RSE licensee would assess the skills and capabilities of nominated candidates against the role and responsibilities of the vacancy and the Board as a whole – including consideration of committee vacancies.
- SPS 510 requires Boards "to consider whether its annual Board assessment would be best undertaken by a party who is free from connection to the RSE licensee or its associates. At a minimum, APRA expects the Board assessment would be undertaken by an external party at least every three years."
- ASFA notes that many APRA-regulated funds have appointed independent directors. ASFA's view on an appropriate regulatory framework for independent directors is set out below.

Legislation that would prescribe how a Board meets their prudential obligations contained in prudential standards appears to be counterintuitive. A better approach could be to adopt the

principles-based approach that applies to ASX-listed entities under the ASX Corporate Governance principles.¹¹

For example, if APRA was so minded, through SPS 510 it could encourage trustees to consider using and publishing a skills matrix as a tool for gap identification. However, trustees may utilise other mechanisms to make determinations in relation to skills and competence, so their focus should be on adequately demonstrating appropriate consideration.

Where there are issues with Board compliance with the relevant prudential requirements (for example *Draft Finding 9.3* suggests many Boards fail to undertake third-party evaluation of Board performance), APRA should seek remedy in their annual prudential and ongoing reviews of the RSE licensee, including taking appropriate enforcement action.

Regarding the appointment of independent directors, factors that may assist in achieving additional appointments of independent directors to Boards include:

- That any regulatory definition of independent is appropriate for superannuation funds and that a principles-based approach for determining independence is adopted, whereby the capacity to exercise independent judgement is the core principle.
- RSE licensee Boards should be charged with determining director independence. APRA's role should be to review trustee determinations in this regard.
- The equal representation arrangements (for funds to which they currently apply) in relation to the remaining two-thirds of the Board, should be retained, together with the two-thirds voting rule.

A notable strength of the two-thirds voting rule in the representative model is that it ensures different elements of the trustee Board come together to ensure members' best interests. The two elements (independence and two-thirds rule) need not be mutually exclusive. The benefits of the two-thirds rule can be maintained in a model that also incorporates independent directors.

¹¹ The Corporate Governance Council 2014, *Corporate Governance Principles and Recommendations: third edition*.
<https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>

DRAFT RECOMMENDATION 6: REPORTING ON MERGER ACTIVITY

COMMISSION'S DRAFT RECOMMENDATION 6

The Australian Government should require trustee boards of all APRA regulated superannuation funds to disclose to APRA when they enter a memorandum of understanding with another fund in relation to a merger attempt. For mergers that ultimately do not proceed, the board should be required to disclose to APRA (at the time) the reasons why the merger did not proceed, and the members' best interests assessment that informed the decision.

Support

ASFA supports a framework that promotes mergers where they are in the best interests of members.

If a reporting framework were introduced it would be necessary to ensure it did not act as a disincentive for funds to execute a Memorandum Of Understanding (MOU).

ASFA broadly supports this draft recommendation.

In its regular reviews of trustees and funds APRA could include, within the scope of such engagements, a requirement on the trustee to provide particulars of any formal merger or acquisition proposals – either instigated or received by the trustee.

If the trustee was the instigator this could include information with respect to the strategic drivers, the business case, the potential benefits of the proposal, the likely costs and risk mitigation – including for risks arising from a merger not proceeding.

If the proposal was received by the trustee (rather than instigated) and not progressed, an 'if not, why not' position could be provided to APRA citing the key reasons why the proposal was not progressed.

Consideration could be given to require trustees to maintain a register of potential mergers, including details of any due diligence performed and member best interest assessments.

Such a process would lead to increased transparency and oversight by APRA with respect to mergers, including when a trustee considers a merger not to be in the members' best interests. This would enable APRA to influence the outcome where the members of a fund are likely to be better off if the fund were to merge.

DRAFT RECOMMENDATION 7: CAPITAL GAINS TAX RELIEF FOR MERGERS

COMMISSION'S DRAFT RECOMMENDATION 7

The Australian Government should legislate to make permanent the temporary loss relief and asset rollover provisions that provide relief from capital gains tax liabilities to superannuation funds in the event of fund mergers and transfer events.

Support

ASFA considers the absence of ongoing CGT relief has been a significant barrier to fund consolidation/mergers. CGT relief has been provided on a temporary basis, most recently for mergers before 1 July 2020. Short-term relief does not reflect the reality that mergers typically take some time to complete.

Uncertainty over whether relief will be available may serve as a deterrent to mergers, given trustees must take into account the benefits and costs of a merger in determining whether it would be in members' best interests.

ASFA strongly supports a superannuation industry that is competitive and continuously improving its efficiency and productivity. One effective means by which a fund can achieve scale efficiencies is through consolidation or merger, and it is important that such activity is not impeded by inappropriate tax settings. In ASFA's view, the absence of ongoing capital gains tax (CGT) relief for mergers of superannuation funds has acted as a barrier to fund consolidation and mergers and ASFA would welcome the introduction of permanent/ongoing relief.

Superannuation fund trustees are under a fiduciary duty to act in the best interests of members. When determining whether to merge with another fund, adherence to this duty necessarily involves consideration of the various benefits and costs to members of the potential merger — including the effect of capital gains tax (CGT).

In ASFA's response to the Commission's Stage 1 draft report,¹² we highlighted that (depending on the volatility of the market) after a downturn a fund can carry deferred tax assets of an amount equivalent to 1.5 per cent or more of member account balances. If a merger were to proceed without CGT relief, the benefit of these would be lost. For a member with an account balance of \$70,000, this could represent a reduction in the value of their superannuation account of over \$1,000. In such circumstances, the absence of CGT rollover relief might cause the costs to members, through the extinguishment of deferred tax assets, to outweigh the benefits of any proposed merger.

ASFA has consistently supported the position that the tax legislation should provide permanent CGT relief for mergers of superannuation funds, equivalent to the temporary relief currently provided in Division 310 of the *Income Tax Assessment Act 1997* ("ITAA97").

¹²

ASFA's reasons for this view are as follows:

- The absence of permanent relief presents a significant barrier to consolidation within the industry that is virtually insurmountable during periods where the closing fund's balance sheet is in a deferred tax asset position, and a potential impediment even where the balance sheet is in a deferred tax liability position.
- The granting of relief on a temporary basis only — most recently, for mergers before 1 July 2020 — can fail to reflect the time needed to complete a merger. It can create considerable uncertainty for trustees and has the potential to create significant inequities for members of funds, depending on whether a merger occurs during a period when there is relief or not.
- From a revenue perspective, permanent relief should not involve an overall cost to revenue, as a more efficient industry should deliver higher revenues and broader economic benefits to the community over time.
- Permanent relief would be consistent with the broad structure of Australia's CGT provisions, as comparable relief is available to corporate mergers and for a range of other business reorganisations.

DRAFT RECOMMENDATION 8: CLEANING UP LOST ACCOUNTS

COMMISSION'S DRAFT RECOMMENDATION 8

The Australian Government should legislate to:

- ensure that accounts are sent to the ATO once they meet a definition of 'lost'
- empower the ATO to auto consolidate 'lost' accounts into a member's active account, unless a member actively rejects consolidation
- allow a fund to exempt a 'lost' account from this process only where the member has provided an explicit signal that they want to remain in that fund (prior to the account meeting the definition of 'lost')
- reduce the 'lost inactive' activity threshold from five to two years
- require that all accounts held by Eligible Rollover Funds, regardless of their lost status, are sent to the ATO
- prohibit further accounts being sent to Eligible Rollover Funds.

Qualified support

ASFA considers the ATO should repatriate all existing lost super to members' active accounts.

ASFA considers the ATO should move member money directly from an inactive account to an active account rather than it going to the ATO.

ASFA supports exemptions from 'auto-consolidation' where members have explicitly rejected it or where there is clear engagement with the member's superannuation fund.

ASFA supports the reuniting of low balance inactive or 'lost' accounts with a member's active account unless the member wishes to maintain the low balance account for whatever reason – such as for insurance or to accept a transfer or make a contribution in the future.

We consider that the ability of the ATO to reunite lost superannuation with an active account is a compelling reason why the ATO should move the money directly from an inactive account to an active account rather than it going to the ATO – particularly given the higher investment returns available in a superannuation fund account and the ability for a member to continue to have insurance.

ASFA considers the ATO should repatriate all existing lost super to an active account before sweeping up 'low balance inactive accounts' (as defined in the government's *Protecting Your Super Package*). ASFA supports the threshold of two years for low balance inactive accounts as proposed by the Commission.

Transfer of an account where it is a member's sole account

ASFA questions whether it would be in a member's best interest to transfer a low balance account to the ATO where the member only has one account, and so no alternative active account exists to which the inactive account could be transferred. ASFA has conducted analysis into the relative performance of low balance accounts compared with those held by the ATO. As indicated above, members with balances below \$6,000 are likely to be better off if their account remains with a fund

due to the higher investment returns.

A significant number of Australians could be adversely affected. As at 30 June 2017, 8.9 million individuals had only one account – this represents 60 per cent of all individuals with superannuation.¹³

Other issues for the Commission to consider

ASFA considers the current system of lost, inactive and insoluble account definitions is complex. The addition of the government's proposed *low balance inactive* category makes what is already complex even more confusing. ASFA considers that a comprehensive review of these categories and their application should occur to simplify the regime's operation.

With respect to Eligible Rollover Funds (ERFs), a number of ASFA members use ERFs to help members consolidate their superannuation accounts. We question the Commission's draft recommendation in this regard, and question whether the ATO would be a superior option in most cases.

¹³ ATO, Super accounts data overview: Super accounts held by each Australian (https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/Super-accounts-data/Super-accounts-data-overview/?page=1#Number_of_super_accounts).

DRAFT RECOMMENDATION 9: A MEMBER-FRIENDLY DASHBOARD FOR ALL PRODUCTS

COMMISSION'S DRAFT RECOMMENDATION 9

The Australian Government should require funds to publish simple, single-page product dashboards for all superannuation products.

ASIC should:

- prioritise the implementation of choice product dashboards to achieve full compliance by 1 July 2019
- revise the dashboards to simplify the content and provide more easily comprehensible metrics (drawing on robust consumer testing) by end 2019
- immediately publish all available MySuper and choice product dashboards on a single website, with the information clearly and readily accessible from the area of myGov that allows for consolidation of accounts.

Qualified support

ASFA supports easy-to-understand dashboards.

While achievable for MySuper products, work would need to be done to ensure that dashboards work for choice products.

An appropriate timeframe for implementation would be required.

ASFA agrees with the Commission's stated objective to make superannuation easier for members to navigate.

We support ASIC making all product dashboards available on a central website, such as its MoneySmart website, as this would make it easier for members to access dashboards for a range of products. There would need to be an appropriate timeframe for implementation.

Make super easier to navigate: Dashboards

ASFA agrees there are long-term benefits to members of more comparable product information being made available.

A prerequisite, however, is that work needs to be performed to ensure that dashboards are accurate, clear, simple, meaningful and effective – to ensure members are able to compare returns, fees and risk. Dashboards need to present more-easily comprehensible metrics.

Even more importantly, ASFA considers that dashboards should not be misleading for members and should not create a risk of suboptimal member outcomes.

It is critical that the proposed review and reformulation of dashboards be undertaken in consultation with consumers (as well as independent experts and consumer organisations). This review should include a greater use of appropriate behavioural consumer testing and evidence. The focus of any change should be to ensure that dashboards are an easier and more effective tool for members to

use to make meaningful comparisons between different superannuation products.

While MySuper products lend themselves to a product dashboard, there are considerable issues with respect to choice products. In particular, there are issues with the definition of what is a 'product' for the purposes of a product dashboard. Multiple dashboards for a 'wrap' choice product, with thousands of investment options, some of which are investments in a single asset, would not be a meaningful tool for consumers.

There would need to be an appropriate timeframe for implementation – not only to ensure that the design and content of dashboards are appropriate, but also to provide funds with time to develop and implement necessary systems and processes.

DRAFT RECOMMENDATION 10: DELIVERING DASHBOARDS TO MEMBERS

COMMISSION'S DRAFT RECOMMENDATION 10

The Australian Government should require the ATO to present the relevant (single page) product dashboard on a member's existing account(s) on its centralised online service.

The Government should also require all superannuation funds to actively provide their members with superannuation product dashboards when a member requests to switch from a MySuper product to a choice product within the fund. This should include:

- the dashboard for the MySuper product
- the dashboard for the choice product the member wants to switch to.

Qualified support

ASFA supports easy-to-understand dashboards. Particularly with respect to any choice product dashboard, work would need to be done to ensure it is meaningful to members and relevant to their decision-making.

ASFA agrees that dashboards could also be incorporated into the ATO's centralised online service, which would facilitate members comparing their current superannuation product(s) with other superannuation products. This would make it easier for members to see how their fund is performing and, if desired, switch to a new fund, which could act to increase member driven competition in the market.

Subject to the observations below, we agree that, where members have requested to switch from a MySuper product to a choice product within the same fund, the fund could be required to provide the MySuper dashboard and the choice dashboard, as this would assist members to compare the dashboard for each product and make an informed decision about switching.

As per our feedback on *Draft Recommendation 9*, there are considerable issues with respect to developing a product dashboard for a number of choice products, in particular 'wrap' choice products and platform products.

It is unclear to what extent MySuper product dashboards provide useful information to members. Prior to extending dashboards to choice products, it would be important to establish the usefulness of MySuper dashboards to members, resolve the issues with design and content, and allow an appropriate timeframe for implementation.

It would be critical to ensure that the final design of any choice product dashboard is meaningful to members and relevant to their decision-making. Appropriate consumer testing would be paramount before the policy and final decision regarding the choice product dashboard is settled.

DRAFT RECOMMENDATION 11: GUIDANCE FOR PRE-RETIRES

COMMISSION'S DRAFT RECOMMENDATION 11

The Australian Government should require the ATO to guide all superannuation members when they reach age 55 to:

- the 'Retirement and Superannuation' section of ASIC's MoneySmart website
- the Department of Human Services' Financial Information Service website.

Qualified support

ASFA supports the ATO guiding pre-retirees to relevant websites, subject to clarity on:

- how it would work in practice
- the interaction with advice; and
- the potential link to CIPRs.

ASFA agrees with the need for accessible financial advice and that, as members approach retirement, the financial decisions they need to make are significant – some of which may be irreversible.

With respect to government action to help Australians as they approach retirement, the ATO could guide pre-retirees, when they reach age 55, to online information on the 'Retirement and Superannuation' section of ASIC's MoneySmart website and the Department of Human Services' Financial Information Service website.

While ASFA supports members being guided to more sources of information, which may act as a starting point to take further action, it is not a substitute for quality financial advice – which is important for members who are approaching, or in, retirement. We also note that this information may be of limited benefit to members of defined benefit schemes.

DRAFT RECOMMENDATION 12: EXIT FEES AT COST-RECOVERY LEVELS

COMMISSION'S DRAFT RECOMMENDATION 12

The Australian Government should legislate to extend MySuper regulations limiting exit and switching fees to cost recovery levels to all new members and new accumulation and retirement products.

Qualified support

ASFA supports a total exit fee ban for existing and future products, with exemptions for partial benefit transfers and family law payments.

ASFA supports limiting exit and switching fees to cost recovery levels for all new members and new accumulation and retirement products. However, we note that the government has gone further in the *2018-19 Budget* and looked to ban exit fees completely.

In response to this policy, ASFA has indicated that we support a total exit fee ban for existing and future products. However, we note that the removal of exit fees would transfer exit processing costs to the broader membership.

As such, ASFA does not support an exit fee ban applying to partial benefit transfers. Many funds permit partial withdrawals and the cost of processing partial withdrawals should not be borne by the broader membership.

Likewise, ASFA supports an exemption for payments under the superannuation splitting mechanism in the *Family Law Act 1975*. Family law valuations and payments are complex and the related costs should be attributed only to the parties involved and not borne by the broader membership.

DRAFT RECOMMENDATION 13: DISCLOSURE OF TRAILING COMMISSIONS

COMMISSION'S DRAFT RECOMMENDATION 13

The Australian Government should require superannuation funds to clearly inform, on an annual basis, all members who are subject to trailing financial adviser commissions. This information should include the amount of commissions paid and a notice that trailing commissions are now illegal for new members.

All funds should publicly disclose the extent of trailing commissions and number of affected members in their annual reports and provide this information to ASIC.

Support

ASFA supports transparent disclosure delivered in a manner that is useful for members when they are evaluating their benefits and making financial decisions.

ASFA supports continual improvement in the disclosure regime for superannuation products. It is critical that such disclosure be meaningful to members; not have the potential to mislead and be as consistent as possible across different products to enable logical conclusions to be drawn and comparisons made. In so doing a balance needs to be struck between the cost of compliance and effective outcomes, to ensure the provision of information is cost-effective.

DRAFT RECOMMENDATION 14: OPT-IN INSURANCE FOR MEMBERS UNDER 25

COMMISSION'S DRAFT RECOMMENDATION 14

Insurance through superannuation should only be provided to members under the age of 25 on an opt in basis. The Australian Government should legislate to require trustees to obtain the express permission of younger members before deducting insurance premiums from these members' accounts.

Not support

ASFA does not support moving to an opt-in framework for new members under 25 as there is adequate evidence that young people (and their dependants) benefit from the current settings.

There is adequate evidence that young people (and their dependants) benefit from the current settings:

- The automatic allocation of a basic level of death and disablement insurance allows younger Australians to obtain cover that they otherwise would not seek out or be able to obtain or afford.
- The cost to younger people for the insurances they obtain under current settings is modest and affordable for the majority.
- Younger people would be unlikely to take up insurance in an opt-in framework leaving millions of workers without protection, which would exacerbate underinsurance in Australia.
- In effect, the removal of younger lives from the current risk pools for insurance in superannuation would have an impact on the pricing arrangements between insurers and funds that would lead to higher premiums for fund members that retain cover and/or greater risk controls being applied to them.

The issues that lead to extreme cases of inappropriate account balance erosion can be addressed in ways that would not undermine the sustainability of automatic, group insurance arrangements.

ASFA agrees with the Commission's *Draft Finding 8.1* that in "extreme cases" insurance premiums could lead to higher than intended financial impacts on retirement balances. We also agree that "in terms of premiums paid, default insurance in super offers good value for many" (*Draft Finding 8.2*).

Accordingly, solutions are required that remedy the extreme cases, while protecting the valuable elements that the majority enjoy. We do not believe, however, that removing cover for people under 25 is an appropriate solution.

Alternatively, a number of programs that are being, or are soon to be, undertaken will deliver the appropriate outcomes if given time. ASFA has confidence that the *Insurance in Superannuation Voluntary Code of Practice*,¹⁴ along with a range of other initiatives that will reduce the incidence of

¹⁴ Available at: <https://www.superannuation.asn.au/policy/insurance-in-superannuation-voluntary-code-of-practice>.

duplicate accounts and hence duplicate insurances, will address the extreme cases of retirement balance erosion for younger members in particular.

The case for retaining current settings for members under 25

When considering the 'need' that a young person has for the insurance they are provided, typically only death cover is referenced. However, most packages of cover include death, terminal illness and permanent and temporary incapacity benefits. If an individual does not have a 'need' for death cover, they are very likely to have a need for other elements of cover if that circumstance arises. Additionally, the data on claims paid to younger members demonstrates that existing arrangements are delivering on their objective to manage both individual financial and broader systemic risk.

In drafting its final report we recommend the Commission give further consideration to the likely impact on retirement balances after removing insurance for younger members. More specifically, the Commission should examine the proposition that removing young people from risk pools would result in higher premiums overall, and would have a marginal (or even negative) impact on retirement balances. ASFA notes that research recently released by Rice Warner¹⁵ and KPMG¹⁶ questions the benefits of such a change due to these likely impacts. As a compromise, should it be determined that an age-based threshold for which superannuation funds can provide automatic insurance is necessary, ASFA proposes that this be set at age 21 to minimise unintended consequences.

¹⁵ Research commissioned by AIA (<http://www.aia.com.au/en/individual/about-aia/media-centre/press-releases/2018/consequences-for-young-active-members.html>).

¹⁶ KPMG 2018, *Insurance in Superannuation: The Impacts and Unintended Consequences of the Proposed Federal Budget Changes*, June (<https://assets.kpmg.com/content/dam/kpmg/au/pdf/2018/insurance-in-superannuation-impact-2018-federal-budget.pdf>).

DRAFT RECOMMENDATION 15: CEASE INSURANCE ON ACCOUNTS WITHOUT CONTRIBUTIONS

COMMISSION'S DRAFT RECOMMENDATION 15

The Australian Government should legislate to require trustees to cease all insurance cover on accounts where no contributions have been obtained for the past 13 months, unless they have obtained the express permission of the member to continue providing the insurance cover.

Not support

ASFA does not support ceasing insurance for all superannuation accounts that stop receiving contributions.

The existence of insurance being attached to an individual's superannuation account is well entrenched and there are significant risks associated with removing cover that members understand they have.

- The vast majority of individuals, regardless of contribution activity, remain eligible to claim on their insurances should the prescribed event occur. For death and TPD payments, duplicate policies are not offset against each other.
- Once a superannuation account is above the industry recognised low-balance threshold of \$6,000 it can sustain premium deductions (without reducing the balance). This is even more so the case for higher-balance, older-age members who are more likely to have only one account with one insurance package to protect them.
- The number of duplicate and inactive accounts – where issues of premiums eroding retirement savings are most significant – will continue to reduce.
- The cessation of contributions is not an indicator of the need that an individual may have for the insurance attached to their superannuation – women leaving the workforce for family reasons is a notable case in point.
- Behavioural economics suggests that individuals are unlikely to elect to opt-in to take up or retain cover.

It is unquestionable that insurance premiums continuing to be deducted from a member's superannuation account can have an impact on retirement savings. The impact will be exacerbated if such deductions continue over a long period of time. As such, ASFA agrees that it is appropriate for funds to cease insurance based on contribution inactivity in some circumstances.

As highlighted in the Commission's *Draft Findings 8.1 and 8.2*, multiple insurances and income protection that a member may not even be able to claim upon are the main culprits for "extreme cases" of retirement balance erosion. ASFA welcomes measures that will prevent extreme balance erosion and premiums being collected for insurances that are invalid. However, it is equally important not to remove valuable cover for those individuals who have only one package of insurance in superannuation.

The case for a revised insurance cessation arrangement

As for the opt-in proposals for members under 25, the government has already adopted this policy position and is attempting to legislate for its commencement.

Responding to the government's draft Bill, ASFA proposed that this policy be refined to reflect the like measure in the *Insurance in Superannuation Voluntary Code of Practice* (the Code).¹⁷

Section 4.25 of the Code requires funds to cease cover for income protection insurance 13 months from the date of the last contribution being received – regardless of the account balance. This recognises that for income protection there is a greater risk that the individual will be unable to claim on the policy when contributions are not being received.

For death and total and permanent disability insurances, the Code requires funds to cease cover when a contribution has not been received and the account balance is below \$6,000. Having a balance threshold for the cessation of insurance due to contribution inactivity provides a mechanism for protecting cover for those who are more likely to need it, and who also have a means to maintain premium payments.

ASFA's response also highlighted that women leaving the workforce to have children will be particularly vulnerable to having their insurances ceased at a time in their life that it is most important. HILDA data indicates that 60 per cent of women have a break from employment of more than 12 months, and 40 per cent have a break of more than 2 years around child birth.¹⁸

¹⁷ Available at: <https://www.superannuation.asn.au/policy/insurance-in-superannuation-voluntary-code-of-practice>.

¹⁸ Melbourne Institute 2017, *The Household Income and Labour Dynamics in Australia Survey: Selected Findings from Waves 1 to 15* (https://melbourneinstitute.unimelb.edu.au/_data/assets/pdf_file/0010/2437426/HILDA-SR-med-res.pdf).

DRAFT RECOMMENDATION 16: INSURANCE BALANCE EROSION TRADE-OFFS

COMMISSION'S DRAFT RECOMMENDATION 16

APRA should immediately require the trustees of all APRA regulated superannuation funds to articulate and quantify the balance erosion trade off determination they have made for their members in relation to group insurance, and make it available on their website annually.

As part of this, trustees should clearly articulate in their annual report why the level of default insurance premiums and cover chosen are in members' best interests. Trustees should also be required to provide on their websites a simple calculator that members can use to estimate how insurance premiums impact their balances at retirement.

Qualified support

ASFA notes that the draft recommendation is broadly consistent with the *Insurance in Superannuation Voluntary Code of Practice* (the Code).

ASFA broadly supports enhancing communications to members and improving the accessibility to relevant information to support greater engagement and consumer decision making. We note that further to any increased role that APRA may undertake if this draft recommendation were to be adopted, ASIC (as the consumer and markets regulator) would be required to be involved – especially with respect to disclosure requirements and the provision of calculators to members.

Considering that the Code includes sections that require funds to meet obligations very similar to this draft recommendation, ASFA proposes that the framework to consider the draft recommendation be the Code.

According to *Section 4.3* of the Code, funds are required to “publish an insurance strategy on its website”. To then comply with *Section 4.9*, this strategy would need to include “the basis for determining an affordable level of cover for members”. Additionally, the Code includes a premium capping mechanism to benchmark what is a reasonable premium amount for opt-out insurance – that is “1 per cent of an estimated level of salary for our membership generally, and/or for segments within the membership”.

Reporting on Code compliance is also a feature of the Code. ASFA considers that including statements in annual reports relating to why premiums and cover have been chosen is feasible, but possibly not the only relevant reporting mechanism.

The Code also includes a section relating to communicating with members to help them make informed decisions. In developing this section, consideration was given to funds developing a simple calculator that would show the impacts premiums may have on retirement outcomes. However, it was decided that it is too difficult for trustees to provide such a calculator on their websites due to the complexity of different insurance benefit designs – including occupation classifications, smoking status and plan/policy discounts.

Calculators are likely to be costly to develop and maintain. They might also be misleading and increase the likelihood of members opting out of insurance or reducing levels of cover when it is not in their 'best interest'.

DRAFT RECOMMENDATION 17: INSURANCE CODE TO BE A MYSUPER CONDITION

COMMISSION'S DRAFT RECOMMENDATION 17

Adoption of the Insurance in Superannuation Voluntary Code of Practice should be a mandatory requirement of funds to obtain or retain MySuper authorisation.

DRAFT RECOMMENDATION 18: INSURANCE CODE TASKFORCE

COMMISSION'S DRAFT RECOMMENDATION 18

The Australian Government should immediately establish a joint regulator taskforce to advance the *Insurance in Superannuation Voluntary Code of Practice* and maximise the benefits of the code in improving member outcomes. The taskforce should:

- monitor and report on adoption and implementation of the code by funds
- provide guidance on and monitor enhancements to strengthen the code, particularly implementation of standard definitions and moving to a short-form annual insurance statement for members
- advise the industry what further steps need to be taken for the code to meet ASIC's definition of an enforceable code of conduct.

The code owners should be given two years to strengthen the code and make it binding and enforceable on signatories before further regulatory intervention is considered.

The taskforce should annually report findings on industry progress on the code.

Both ASIC and APRA should be members of the taskforce, with ASIC taking the lead.

DRAFT RECOMMENDATION 19: INDEPENDENT REVIEW OF INSURANCE IN SUPER

COMMISSION'S DRAFT RECOMMENDATION 19

The Australian Government should commission a formal independent review of insurance in superannuation. This review should evaluate the effectiveness of initiatives to date, examine the costs and benefits of retaining current insurance arrangements on an opt out (as opposed to an opt in) basis, and consider if further regulatory intervention or policy change is required. The review should be initiated within four years from the completion of this inquiry report, or earlier if the strengthened code of practice is not made enforceable within two years.

Qualified support

ASFA is supportive of working with the regulators, and other relevant stakeholders to advance the *Insurance in Superannuation Voluntary Code of Practice* (the Code).

A two year timeframe to assess the effectiveness of the Code and to investigate alternative monitoring and reporting arrangements in collaboration with the regulators ASIC and APRA is sensible. During that time, the Code owners, including ASFA will be able to explore with ASFA members whether the Code should be a condition of a MySuper license or mandatory through some other mechanism.

ASFA also supports the commissioning of an independent review of insurance in superannuation within four years.

In terms of Code adoption, ASFA estimates that funds representing approximately 94 per cent of MySuper members have adopted the Code – so coverage across this sector is already widespread.

The industry has shown through the development of the Code that it has the ability to engage and collaborate with all relevant stakeholders, including the regulators, to improve the experience that superannuation fund members have with insurance in superannuation.

It should be noted by the Commission that the Code owners ASFA, AIST and FSC, have (since the release of the Code in late 2017) been focussing their efforts on supporting members to adopt and implement the Code. The Code owners, along with a wide range of funds, insurers and administrators, remain heavily involved in the transition to full compliance (by no later than 30 June 2021).

Code monitoring, reporting and enforcement

In *Section 4* of the Code there is a range of compliance, monitoring and reporting obligations. Additionally the Code owners “will commission formal independent reviews of the Code as appropriate”. The Code owners will also “consult with relevant regulators, External Dispute Resolution bodies, consumer and industry representatives and other stakeholders to develop the Code on an ongoing basis”.

Parallel to supporting ASFA members implementing the Code, we will be exploring with members whether the Code should be a condition of a MySuper licence or mandatory through some mechanism. The Code owners have also committed to progress a range of standardisation measures across the industry through future work efforts. These efforts are likely to involve advocating for some legislative change to facilitate the required changes.

Independent review of insurance in superannuation

The Insurance in Superannuation Working Group (ISWG) that developed the Code gave deep consideration to the time that would be required to transition the industry to an improved framework. Thus, we consider it would be appropriate for the recommended independent review to be undertaken after the transition period.

The Commission's *Draft Finding 8.3* indicates that the fiscal effects of insurance in superannuation are complex and the net effects uncertain. Additionally, the Commission claims that existing estimates overestimate net fiscal benefits due to a lack of consideration of the impact of balance erosion on Age pension eligibility. The Commission references estimates from KPMG and Rice Warner reports.

ASFA has also considered these reports. We are satisfied that when both the qualitative and quantitative aspects of current settings are assessed, overall net benefits are positive at this time. We further note the modelling undertaken by the Commission reflects only the impact of premiums on retirement balances for individuals. The cameos "do not take into account any offsetting benefits to members, such as a successful claim on their insurance, or the peace of mind from insurance, even when no claim is made".¹⁹ A fuller analysis is required to determine value for individuals and net fiscal benefits.

ASFA has also undertaken its own research into the benefits that individuals derive from insurance through superannuation: *The Experience of Individuals with Insurance through Superannuation*.²⁰ This paper highlights the purpose of insurance in super – "to cover the future service period between an event such as disablement or death and retirement age". Analysis of claims data indicates that over a working life of around 40 years:

- a fund member on average has a 25 per cent chance of having an income protection benefit being paid to them in the context of a temporary disability or medical condition
- around five per cent of fund members over a working life will claim a total and permanent disability (TPD) benefit
- around five per cent of fund members will have an insurance policy death benefit paid to the fund member's beneficiary or beneficiaries, or to the individual in the form of a terminal condition payment.

A future independent review must adopt a cost-benefit approach, not a cost-only methodology.

¹⁹ Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 333 (word version).

²⁰ ASFA 2017, *The Experience of Individuals with Insurance through Superannuation*, September (https://www.superannuation.asn.au/ArticleDocuments/359/1709_Insurance_through_superannuation.pdf.aspx?Embed=Y).

DRAFT RECOMMENDATION 20: AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

COMMISSION'S DRAFT RECOMMENDATION 20

APRA should (in addition to draft recommendations 4 and 16):

- require all APRA-regulated superannuation funds to conduct formal due diligence of their outsourcing arrangements, at least every three years, to ensure the arrangements provide value for money. Each fund should provide a copy of the assessment to APRA (including the fees paid and the comparator fees)
- report annually to the Council of Financial Regulators on the progress stemming from the application of the MySuper scale test (and then the outcomes test, once legislated) in bringing about fund mergers
- undertake a systematic assessment of the costs to funds of the thousands of legacy products in the superannuation system. If the evidence demonstrates that they represent a significant cost in accumulation, APRA should further refine trustees' obligations for member transfers so these products can be rationalised
- embed product-level reporting within its reporting framework as soon as practicable (no later than 18 months) to enhance visibility of actual member outcomes across all APRA-regulated funds and to bring reporting for the choice segment into line with the MySuper segment. APRA should also expedite efforts to address inconsistencies in reporting practices.

Qualified support

ASFA broadly supports the elements of the recommendation, but the details require careful consideration. Any proposed regulatory requirements should be assessed to ensure they would achieve their intended purpose and not merely impose an additional compliance cost and burden on industry.

Due diligence of outsourcing arrangements

Given the scale and complexity of modern superannuation funds, outsourcing of some key functions is necessary to ensure trustees are able to access expertise and economies of scale, and to ensure that risks are effectively managed.

While ASFA considers it appropriate that trustees undertake a regular review of their outsourcing arrangements, we are concerned that this draft recommendation has the potential to significantly increase the cost and regulatory burden associated with outsourcing. The draft recommendation would effectively require trustees to undertake a three-yearly tender for all outsourcing arrangements, regardless of their scale, value or potential impact on the trustee's operations.

In contrast, the regulatory requirements set out in APRA's *Prudential Standard SPS 231 Outsourcing* apply only to the outsourcing of a 'material business activity' by a registrable superannuation entity (RSE) licensee. A 'material business activity' is one that has the potential, if disrupted, to have a significant impact on the RSE licensee's business operations, its ability to manage risks effectively, the interests, or reasonable expectations, of beneficiaries or the financial position of the RSE licensee, any of its RSEs or its connected entities.

ASFA considers that the Commissions' recommendation for a three-yearly due diligence process

should apply only in relation to outsourcing of a material business activity.

Annual reporting by APRA on effectiveness of the MySuper scale test and outcomes test in bringing about fund mergers

ASFA has some concerns about the scope and likely operation of the outcomes test, including whether there is a genuine need for the test to be applied annually (as outlined in ASFA's 2017 submissions to Treasury and the Senate Economics Legislation Committee).²¹

It is important to ensure that regulatory requirements are assessed to ensure they are achieving their intended purpose and not merely imposing an additional compliance cost and burden on industry. Accordingly, we would welcome regular reporting by APRA to the Council of Financial Regulators on the effectiveness of the MySuper scale test and the proposed outcomes test.

Legacy products: Assessment of the cost and potential reforms to facilitate rationalisation

ASFA agrees that legacy products have the potential to disadvantage both consumers and providers, primarily because of higher costs but also because of the difficulties in maintaining adequate operational and service standards. Legacy products can create barriers to exit and thereby introduce further structural inefficiencies at a system level. The lack of an easily accessible mechanism to rationalise legacy products has led to a proliferation of such products.

While the *Superannuation Industry (Supervision) Act 1993* (SIS Act) provides for the closure of an entire fund — using either the 'successor fund transfer' (SFT) or fund amalgamation provisions — these mechanisms are not designed for product rationalisation. In fact, because the SFT mechanism requires the new fund to provide 'equivalent rights in respect of benefits', it has to some extent led to the replication of the features of a legacy product in the successor fund. As acknowledged by the Commission, APRA's *Prudential Practice Guide SPG 227 Successor Fund Transfers and Wind-ups*, published last July, clarifies its expectations in relation to the 'equivalent rights' test with a view to removing (perceived) barriers to SFTs. It is, however, somewhat premature to judge the effectiveness of this guidance in encouraging funds to address the legacy product issue.

In ASFA's view, an additional mechanism may be required to ensure the effective rationalisation of legacy products. We note that throughout 2007 to 2010, Treasury undertook considerable work with a view to developing proposals for product rationalisation of superannuation products, managed investment schemes and life insurance products. Despite an extensive consultation process,²² the proposals did not translate into regulatory reform. One likely reason for this is that the inability to rationalise products is, in many instances, due not to statutory restrictions, but to existing contractual arrangements or documents such as trust deeds or insurance policies.

²¹ See:

https://www.superannuation.asn.au/ArticleDocuments/427/201722_Treasury_Superannuation_Guarantee-salary_sacrifice_integrity_measures.pdf.aspx?Embed=Y and
https://www.superannuation.asn.au/ArticleDocuments/427/201728_Treasury_improved_outcomes.pdf.aspx?Embed=Y

²² The Treasury, *Product Rationalisation*, Issues Paper, June 2007 and *Product Rationalisation of Managed Investment Schemes and Life Insurance Products*, Proposals Paper, December 2009.

ASFA supports an assessment of the costs to funds of legacy products, to provide an evidence base to inform potential reform. We would also welcome refinement of trustees' obligations for member transfers to facilitate the rationalisation of legacy products where it is in the interests of fund members to do so. However, it must be recognised that the reasons for a fund retaining a legacy product may vary, and there may be cases where the closure of a legacy product cannot be justified on the basis of the costs involved. It is unlikely that the issue of legacy products will be able to be addressed through a single, simple solution.

As well as addressing issues related to existing legacy products, it is also important that care is taken to minimise the risk of legacy products arising as a result of current and future product development. For example, we note that at a time when the industry is being encouraged to consolidate funds, there is a material risk that the short-term demand for the comprehensive income product in retirement (CIPR) will be low. In the medium term, this may add to the current problem of legacy products.

APRA to introduce product-level reporting, and addressing reporting inconsistencies

ASFA acknowledges that an absence of product-level data outside the MySuper framework makes it difficult for government, regulators and others to assess the efficiency and performance of the superannuation system as a whole, and for consumers to assess the appropriateness of 'choice' product offerings. The draft report succinctly outlines, in *Section 10.4*, some of the challenges stakeholders face in making product-level assessments without adequate data.

ASFA agrees that where inconsistencies in reporting practices are identified, these should be addressed. However, the data reporting regime is already extensive and represents a considerable cost and compliance burden for trustees. Prior to any expansion of that regime, ASFA considers it important that APRA provides clarity of what additional data it will require trustees to report, and the benefits expected to flow from this in terms of improved supervisory outcomes. To ensure consistency in reporting it is critical that standard definitions of new reporting items are agreed and implemented. More broadly, as noted ASFA's response to *Draft Recommendation 22*, reform is required to harmonise the current reporting requirements and standards of government agencies.

In ASFA's view, implementing a significant expansion of data reporting of this nature within the 18-month timeframe suggested by the Commission is likely to prove extremely challenging, both for trustees and for APRA. We also note that any changes to the data reporting regime will need to be managed carefully in light of the proposed replacement of the current Direct to APRA (D2A) reporting system, to avoid unnecessarily complicating that transition.

ASFA is also of the view that the issues of product-level data *reporting and disclosure* are intrinsically related and must not be considered in isolation. ASFA has consistently questioned the utility of the current product dashboards as a tool to help consumers understand and assess superannuation products, and we note that the Commission has made a number of draft recommendations regarding improved product disclosure requirements (see ASFA's responses to *Draft Recommendations 9 and 10*). It is critical that APRA and ASIC work together – and in close consultation with industry and consumers – to develop any proposed changes to the disclosure and reporting regimes.

DRAFT RECOMMENDATION 21: AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

COMMISSION'S DRAFT RECOMMENDATION 21

ASIC should (in addition to draft recommendation 9):

- proactively set and enforce standards for the meaningful disclosure of information to members on superannuation products and insurance policies (in addition to product dashboards). Information should be simple, comparable and easy for members to understand
- require all superannuation funds to publicly disclose to current and prospective members the proportion of costs paid to service providers that are associated with related-party outsourcing arrangements
- proactively investigate (questionable) cases where mergers between superannuation funds stalled or did not proceed
- review exit and switching fees faced by existing members, with a focus on whether these fees are related to the underlying performance of the product, and whether they unreasonably impede members moving to products that better meet their needs.

Qualified support

ASFA broadly supports the elements of the recommendation, but the details require careful consideration. Any proposed regulatory requirements should be assessed to ensure they would achieve their intended purpose and not merely impose an additional compliance cost and burden on industry.

Set and enforce standards for the meaningful disclosure of information to members

ASFA supports transparent, consistent, and comparable disclosure of meaningful information to members. However, it is imperative that any regulatory requirements ensure that disclosure is relevant to members and to the nature of the products.

Setting disclosure requirements for superannuation funds has largely been the province of the government through legislation. While there may be a role for ASIC to play in setting disclosure requirements, ASFA urges that this be done in consultation with the superannuation industry and subject to rigorous consumer testing.

Require public disclosure of the proportion of costs paid to associated service providers

ASFA supports requiring funds to disclose to members the proportion of costs associated with related-party outsourcing arrangements.

As noted in ASFA's response to *Draft Recommendation 20*, requiring funds to conduct formal due diligence of their outsourcing arrangements generally would not be warranted and would represent an unnecessary expense – although regular reviews of service providers are appropriate.

Investigate (questionable) cases where mergers did not proceed

ASFA supports the investigation of questionable failed mergers, although we query whether this should be performed by ASIC or by APRA. Reporting to the Council of Financial Regulators on fund

mergers is not warranted.

ASFA notes that *Draft Recommendation 6* proposes that Boards be required to disclose to APRA (at the time) the reasons why a merger did not proceed. ASFA broadly supports *Draft Recommendation 6* – if the merger proposal was received by the trustee (rather than instigated) and not progressed, an ‘if not, why not’ position could be provided to APRA citing the key reasons why the proposal was not progressed.

Review exit and switching fees faced by existing members

Investigation of switching fees should only be instigated where there is evidence that they are materially higher than cost recovery. ASFA supports a total exit fee ban for existing and future products, with exemptions for partial benefit transfers and family law payments (see ASFA’s response to *Draft Recommendation 12*).

DRAFT RECOMMENDATION 22: SUPERANNUATION DATA WORKING GROUP

COMMISSION'S DRAFT RECOMMENDATION 22

The Australian Government should establish a superannuation data working group, comprised of APRA, ASIC, the ATO, the ABS and the Commonwealth Treasury (with Treasury taking the lead). This group should:

- identify ways to improve the consistency and scope of data collection and release across the system, with a focus on member outcomes
- evaluate the costs and benefits of reporting changes, including strategies for implementation
- identify areas where legislative or regulatory change may be necessary to support better data collection
- report annually to the Council of Financial Regulators on its progress, and on the data analytics capabilities of each regulator.

Qualified support

ASFA supports a coordinated approach to data collection and supports a centralised governance structure in some form. Any such governing or consultative body should include representatives from relevant government agencies as well as industry.

ASFA considers that this is an urgent reform. It would not only help to minimise duplication and other inefficiencies, but also strengthen information security protections – currently weakened by the patchwork approach to data collection.

ASFA considers that the regulatory burden is heavy for RSE licensees. The superannuation sector has recently been subjected to significant regulatory change and reporting requirements.

The regulatory and reporting impact of any new requirements should be kept to a minimum through the use of existing resources where possible. Careful, transparent consideration of the cost and impact of further regulation and reporting requirements on fund members is necessary. This should occur via the issuance of a regulatory impact statement, prior to implementation of any proposal.

The current reporting requirements and standards vary from agency to agency and there are examples of the same information being required in different formats by different agencies. For some time ASFA has been arguing that reporting requirements should be made as consistent as possible across all government agencies, and any new reporting requirements should take account of data that is already available.

ASFA considers the best way to ensure consistency and efficiency in data collection is for the government to adopt a centralised approach to data collection. This coordinated approach to data collection and exchange could be achieved by the establishment of a body made up of senior representatives from the industry and all relevant government agencies which collect industry data (such as the ATO, ASIC, the ABS, APRA) and other agencies with IT expertise (such as the Department of Finance and the Digital Transformation Agency).

An alternative approach would be to establish a central data collection agency, which would collect and distribute data to any government agency that required it, and through which all government

agencies would submit any additional reporting requirements.

We are also of the view that the existing patchwork reporting framework between various government agencies represents a security risk to the government and fund members. Alignment between the different agencies that currently collect, manage and in some instances send data would greatly assist in dealing with cyber security threats in a coordinated way.

E. DRAFT FINDINGS

DRAFT FINDING 2.1

COMMISSION'S DRAFT FINDING 2.1

APRA-regulated funds have delivered investment returns to members over the past two decades (net of all fees and taxes) of 5.7 per cent a year, on average. The majority of members and assets in the system are in products that have performed reasonably well. But there is significant variation in performance within and across segments of the system which is not fully explained by differences in asset allocation. Not-for-profit funds, as a group, have systematically outperformed for-profit funds. While retail funds dominate the 'tail' of underperformance, industry and corporate funds also reside in the tail.

ASFA has some comments about the performance of the Australian superannuation system. Separately, ASFA has some comments about the Commission's methodology for benchmarking investment performance, and how the Commission has interpreted and presented its benchmarking analysis.

The performance of the Australian system

The fact that APRA-regulated funds have delivered investment returns to members over the past two decades (net of all fees and taxes) of 5.7 per cent a year, on average, demonstrates the strength of the superannuation system. For a member on average income (using the Commission's assumptions), net returns of 5.7 per cent over a working life would lead to a balance at retirement of around \$640,000. According to the ASFA retirement standard, this is around the balance required to fund a comfortable standard of living in retirement for a couple – which would be a great outcome for members.

The performance of the Australian system compares favourably with the performance of systems in other OECD countries. Based on recently-published OECD figures, the Australian system has recorded the fifth-highest real net investment returns for the period from 2006 to 2016 (among the 21 OECD countries for which there is a complete data set).²³

The Commission's approach to benchmarking

In the draft report, the Commission benchmarks investment returns in two ways:

- against a reference portfolio that represents the average asset allocation of the particular cohort under consideration (which the Commission uses for benchmarking MySuper products).
- against a reference portfolio where asset allocation is tailored to funds/products within the particular cohort.

²³ OECD 2017, *Pension Markets in Focus*, No.14, and ASFA calculations.

As ASFA has noted in previous submissions, benchmarking using reference portfolios has advantages, but also has limitations.

- *Average asset allocation benchmark*: funds/products will (to some extent) under and over-perform relative to the average asset allocation benchmark according to their particular asset allocation (as well as other factors).
- *Tailored asset allocation benchmark*: conceptually, benchmarking in this way can be interpreted as determining the *efficiency* by which a particular fund/product generates investment returns. However, this approach is not particularly suited for benchmarking performance between funds/products with different asset allocations on a risk-return basis (for example, a cash-only product and an equities-only product may both score well against their respective tailored benchmarks).

Some of the general limitations with the benchmarking approach are outlined below.

Risk-adjusted returns

The Commission's benchmarking methodology does not explicitly account for risk. The Commission's benchmarking analysis assumes that risk will 'wash out' over the duration of the relevant assessment period.

For example, the Commission's benchmarking of MySuper (and precursor default) products is undertaken over a ten-year period, where product returns are benchmarked against a reference portfolio that represents the average asset allocation of all MySuper products. Ten years is only slightly longer than a typically business cycle (twenty years would be better, although ASFA notes the significant data limitations).

In the absence of longer time series, ideally returns should be adjusted for risk. In earlier stages of its review process, the Commission noted some of the standard methods used to adjust returns for risk (Stage 1 draft report).²⁴ Although there is no universal agreement on how best to adjust returns for risk, this would not preclude the Commission from undertaking such analysis for the final report.

Ex post versus expected returns

Both benchmarking approaches compare *ex post* returns (for example, *ex post* returns of a fund/product relative to those of a cohort). A key limitation of *ex post* benchmarking is that it does not account for expected returns – that is, how *ex post* investment performance compares with investment objectives.

Within the superannuation system, there is a wide range of investment objectives – reflected in the discrete asset allocations of products and investment options (that can vary over time). In this regard, it is worth noting the differences between major segments of the superannuation industry.

- A MySuper member's investment strategy is determined by his/her fund.

²⁴ Productivity Commission 2018, *How to Assess the Competitiveness and Efficiency of the Superannuation System: Draft Report*, Canberra, pages 111-112.

- In contrast, a choice member's investment strategy depends on his/her specific objectives and risk appetite (as is the case for self-managed superannuation funds, or SMSFs), which may take account of investments outside superannuation.
- Typically, investment strategies differ between accumulation and retirement phases.

It should be noted that a comparison of *ex post* investment performance with investment objectives can only be undertaken at the product (or option) level – it is not possible to aggregate discrete investment objectives to obtain an investment objective for the system.

Investment governance arrangements

Both benchmarking approaches are backward looking. They are based on historical investment performance – which is not necessarily indicative of likely future performance.

For a fund's products/options, a forward-looking assessment could look at the quality of investment governance arrangements. The quality of a fund's investment processes and procedures can indicate how effective a fund will be in reviewing and changing investment/risk management decisions where this is warranted.

In this regard, ASFA notes the Commission's broader assessment framework (as set out in the final report for Stage 1 of the Commission's review) includes an indicator of 'quality of investment committee and investment governance processes'.²⁵

The Commission's approach to benchmarking the system

The Commission has assessed superannuation fund returns at a system level – although the results are difficult to interpret.

The Commission benchmarks system-wide returns against a benchmark reflecting the system-wide average asset allocation. As noted above, conceptually, this can be interpreted as the efficiency by which the collective (*ex post*) asset allocations of all funds in the system generate investment returns.

In communicating the results, the Commission should note that this approach cannot shed light on the extent to which actual investment performance compares with investment objectives – this, as noted above, can only be undertaken at the product/option level.

Further, this benchmarking approach does not take account of the benefits to members of risk management decisions made by individual funds to reduce the volatility of investment returns. This has value for members, including by reducing sequencing risk. It is worth noting that separate analysis in the draft report (in *Technical Supplement 4*) finds that the volatility of fund returns are less than the volatility of the Commission's benchmark portfolios.

²⁵ Productivity Commission 2018, *How to Assess the Competitiveness and Efficiency of the Superannuation System: Final Report*, Canberra, pages 177.

Comments on other aspects of the Commission’s benchmarking

For some of its benchmarking exercises, the Commission uses short time periods (three years for MySuper products). ASFA advises against benchmarking returns over short time periods – notwithstanding the fact that data for certain funds/product may be limited. Benchmarking returns on this basis can lead to erroneous conclusions. This is exemplified by the Commission’s analysis of the returns of MySuper products and precursor default products over 3 and 10 years. Markedly different conclusions can be drawn from the two sets of analysis.

DRAFT FINDING 2.3

COMMISSION’S DRAFT FINDING 2.3

There is wide variation in performance in the default segment that is not fully explained by differences in asset allocation. About 1.7 million member accounts and \$62 billion in assets are in MySuper products that underperformed conservative benchmarks over the 10 years to 2017. This suggests that many members are currently being defaulted into underperforming products and could be doing better.

If all members in these underperforming products received the median return from a top-10 MySuper product, they would collectively be \$1.3 billion a year better off. Being in an underperforming product means that, on retirement, a typical worker (starting work today) is projected to have a balance 36 per cent lower (or \$375 000 less to retire with).

ASFA has some comments about the Commission’s methodology for benchmarking the performance of MySuper products, and how the Commission has interpreted and presented its benchmarking analysis.

To benchmark performance of MySuper products, the Commission uses the average asset allocation of MySuper products. The average asset allocation benchmark is simple and transparent. However, as noted in ASFA’s response to *Draft Finding 2.1*, this approach has some limitations that should be articulated when presenting the analysis.

By construction, use of the average asset allocation benchmark will ensure there always will be underperforming products. In particular, products will (to some extent) under and over-perform relative to the average asset allocation benchmark according to particular asset allocations (as well as other factors).

A ‘standard’ asset allocation

The draft report suggests there is a standard asset allocation that MySuper products should adopt. The draft report states that “a simple balanced portfolio is likely to maximise lifetime returns”.²⁶

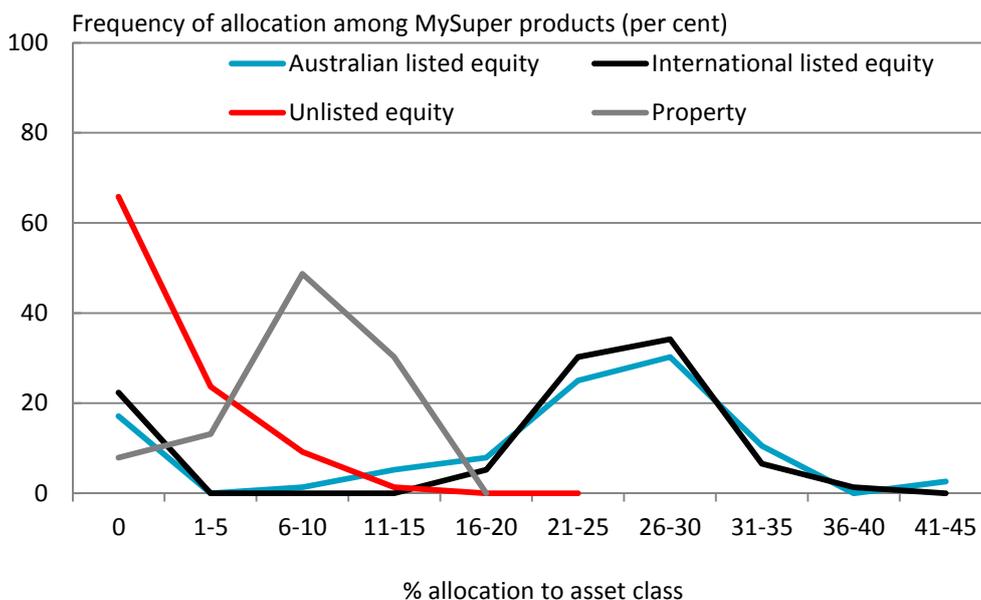
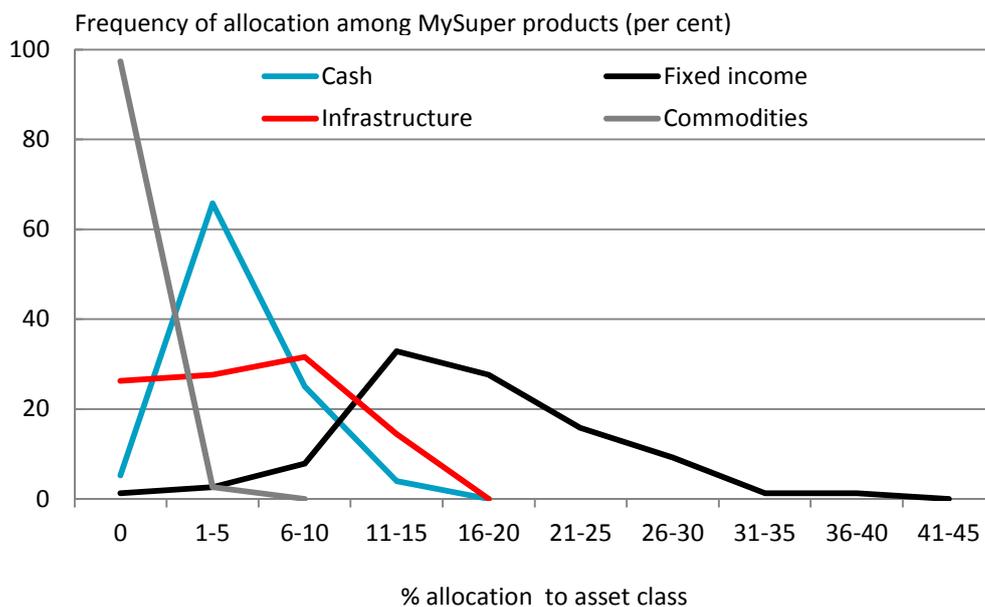
There is no question that *ex post*, one can determine what the optimal asset allocation would have been over a particular time period (this of course would vary during a particular time period). However, fund trustees are presented with a fundamentally different problem: under conditions of

²⁶ Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 122 (word version).

uncertainty, the set of asset allocation and risk management decisions that will most likely meet investment objectives (for a given risk tolerance).

In this context, it is unsurprising that asset allocations differ markedly across MySuper products – even with respect to the cohort of non-lifecycle products. For each of the major asset classes, allocations among MySuper products is very broad at any point in time – Histograms 1 and 2 show the frequency (in per cent terms) of allocations for each asset class for non-lifecycle MySuper products.

Histograms 1 and 2: Frequency of allocations for each major asset class (June 2017)
For non-lifecycle MySuper products



Source: APRA and ASFA calculations

The presence of lifecycle products adds an additional layer of complexity to the picture. By design, lifecycle products have larger allocations to defensive assets for older members (thus the average asset allocation for a lifecycle product will typically be more defensive than for a non-lifecycle product).

This highlights an important point that is relevant to benchmarking. In assessing and benchmarking returns, the Commission should be aware that in terms of investment outcomes, particular stages of the economic/financial cycle favour specific assets over others, and by extension, specific asset allocations.

The Commission's average asset allocation benchmarking approach means that products will (to some extent) under and over-perform relative to the benchmark depending on the length of the assessment period and the particular stages of economic/financial cycles that are captured in the assessment period.

Benchmarking MySuper products

As noted in ASFA's response to *Draft Finding 2.1*, the Commission's average asset benchmarking approach assumes that risk will 'wash out' over the duration of the relevant assessment period. However, ten years (which covers MySuper products and their precursor default products) is arguably too short a period (ASFA notes the significant data limitations in this regard).

In the absence of longer time series, ideally returns should be adjusted for risk. In earlier stages of its review process, the Commission noted some of the standard methods used to adjust returns for risk (Stage 1 draft report).²⁷ Although there is no universal agreement on how best to adjust returns for risk, this would not preclude the Commission from undertaking such analysis for the final report.

Outcomes of benchmarking

According to the Commission's benchmarking, 26 of 66 MySuper products underperform the benchmark. Setting aside ASFA's above comments, ASFA has some comments about the Commission's analysis – in particular, the sensitivity of measured underperformance to assumptions.

Sensitivity to tax rates

The draft report assumes fund-level tax rates apply to MySuper products. This would tend to under-state the tax rates relevant for MySuper products.

Fund-level assets include both accumulation phase and retirement phase assets. Members who are in the retirement phase are subject to lower tax rates than accumulation phase members (untaxed investment income generally and treatment of imputation credits). This tends to drag down reported fund-level tax rates.

The Commission's own analysis (in *Technical Supplement 4*) uses a 5 per cent tax rate for MySuper products, which is equivalent to around 25 basis points off the benchmark. This reduces the number of 'underperforming' products from 26 to 15 – or around 10 per cent of assets. An assumed

²⁷ Productivity Commission 2018, *How to Assess the Competitiveness and Efficiency of the Superannuation System: Draft Report*, Canberra, pages 111-112.

8 per cent tax rate is equivalent to around 45 basis points, which would reduce the number of ‘underperforming’ products to around 12 products.

Assumption for underperformance threshold

The Commission defines underperformance as 25 basis points below a benchmark return. There is no clear theoretical basis for this figure, and so no explanation as to why the threshold for underperformance should not be lower – say, 50 basis points.

This would reduce further the number of ‘underperforming’ products to around 10 products.

Effect of asset allocation and risk

As noted above, the diversity of asset allocations among MySuper products means that the Commission should consider adjusting returns for risk as part of its benchmarking analysis. If this is undertaken, then the apparent dispersion of performance would likely reduce.

It would also provide a more meaningful assessment of the ‘tail’ of underperforming products.

DRAFT FINDING 3.1

COMMISSION’S DRAFT FINDING 3.1

Despite regulator endeavour, there remain significant gaps and inconsistencies in how funds report data on fees and costs. This harms members by making fee comparability difficult at best, and thus renders cost based competition largely elusive.

This is an area that is fraught with confusion and misconceptions.

This extends to fundamental definitions, such as the critical difference between a cost and a fee, as well as the difference between exit fees and switching fees and between buy/sell spreads and bid/ask spreads, just to name a few. This is exacerbated by conceptual difficulties with the appropriate treatment of fees and costs – in particular indirect investment costs, which are already reflected in the disclosure of net investment returns.

The disclosure of fees and costs is overlaid by a prescriptive regulatory regime that has struggled to deal with the variety of trustee and fund structures; the different types of investments structures; differences between asset and asset classes and the (legitimate) variety of ways costs and fees can be determined and allocated in practice. Overall there is a lack of clarity as to the precise disclosure outcome that would be useful to members, including the disclosure of indirect investment costs.

There is an argument that the effect of indirect management costs is reported – as it is net, as opposed to gross, returns that are reported. The effect of the indirect investment costs has been taken into account prior to the determining of the net investment return credit to members, and that in this context members are able to compare the different net returns, both against each other and against a benchmark. In fact, to the extent emphasis is placed on comparison based on indirect investment costs and net returns, this represents an element of ‘double-counting’, as the amount of the indirect investment costs is already taken into account in determining the net investment return.

Where a fund has invested at arm's length in a particular investment there is little visibility of the indirect investment costs and it is debatable the extent to which any benefits derived by members from receiving disclosure with respect to them exceeds the costs incurred in obtaining and collating them. From a member perspective, it can be argued that disclosure of the net investment returns is the critical information. Where the investment is not at arm's length the indirect costs should be known to the trustee and, given the relationship between the trustee and the investment, it would be appropriate to disclose the indirect investment costs.

DRAFT FINDING 3.2

COMMISSION'S DRAFT FINDING 3.2

Superannuation fees in Australia are higher than those observed in many other OECD countries. In aggregate, total fees — for administration and investment management services, and in both accumulation and retirement — have been trending down as a proportion of assets, from 1.3 per cent in 2010 to 1.1 per cent in 2016. Fees have fallen markedly for retail funds, albeit they remain higher (at least for choice products) than the (largely unchanged) fees for industry funds.

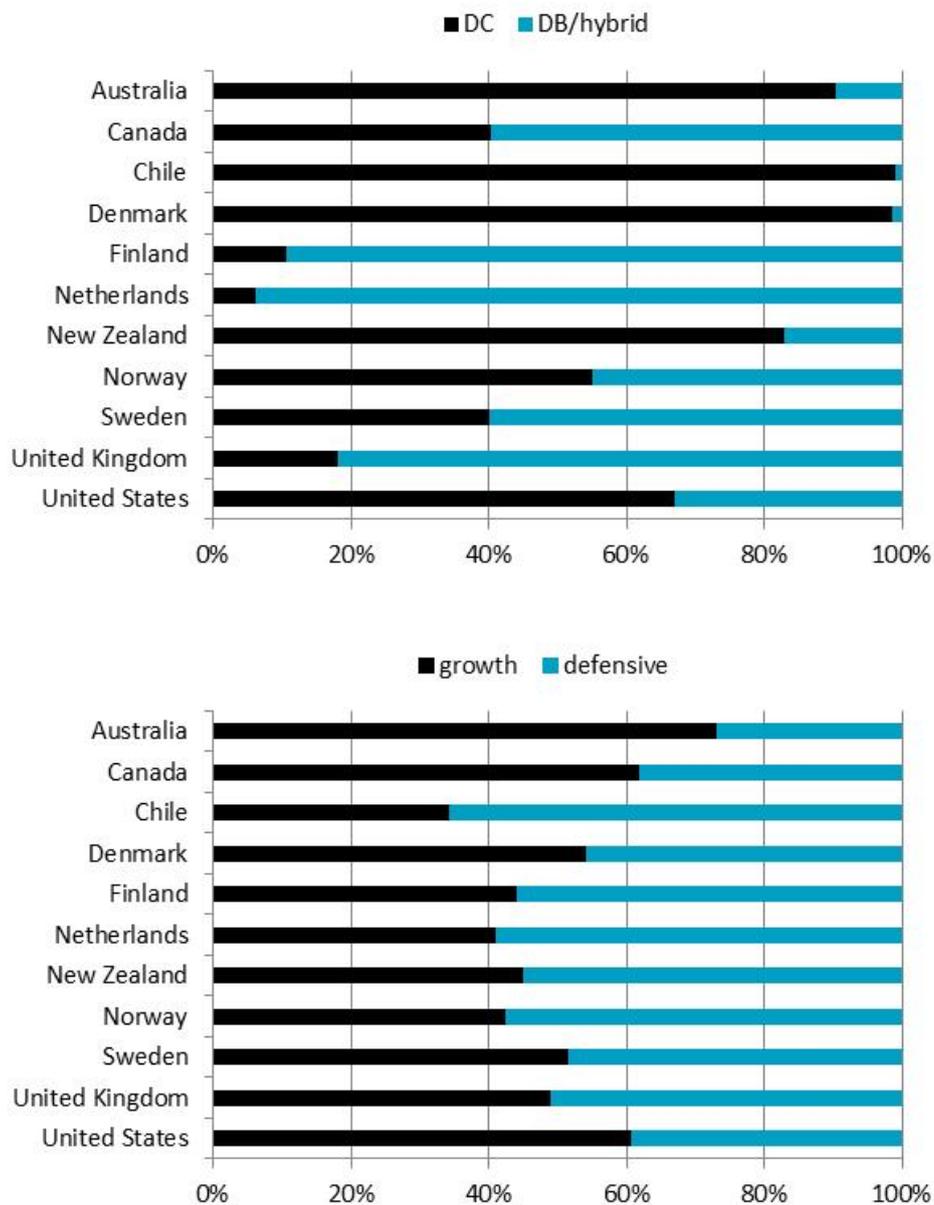
Among APRA-regulated funds, the MySuper and SuperStream reforms have likely acted to reduce fees (including some likely competitive spillover to choice products), albeit this is difficult to attribute directly given growth in average fund scale and the impact of other fee drivers.

While dispersion of product-level fees has decreased over the past decade, there remains a persistent 'tail' of relatively high-fee (mainly for-profit) choice products with total fees exceeding 1.5 per cent of assets each year. This tail comprises about 14 per cent of member accounts and 15 per cent of system assets.

With respect to international comparisons of fees, not only is there little consistency internationally on the types of fees that funds charge and what fees funds report, there are also significant structural differences between systems that affect funds' administrative and operating costs (which are reflected in fees).

There are markedly different cost structures between a private pension system which is dominated by single employer-sponsored defined benefit funds, mostly invested in bonds and fixed interest; and a system which has multi-employer sponsored defined contribution funds with a high allocation to equities and unlisted assets (such as in Australia). The significant variation internationally with respect to scheme type and asset allocation (Charts 1 and 2) makes clear the difficulties of comparing private pension systems.

Charts 1 and 2: Scheme type and asset allocation, by country



Source: OECD, Mercer and ASFA calculations.

Features of the Australian system that need to be taken into account

The Australian system has a relatively high allocation to growth assets. At the fund level, investment strategies that have a relatively high exposure to growth assets are typically more expensive to manage than strategies that are weighted more towards defensive assets such as bonds. However, growth strategies tend to deliver higher returns over long time horizons (exposure to growth assets also provides diversification benefits).

Cross-country measures of net returns can account for differences in investment expenses, although the data require careful interpretation. Figures from the OECD show that Australia ranks 5th out of

21 OECD countries for average returns since 2005, when accounting for both investment expenses and inflation.²⁸ This is despite equities underperforming relative to bonds globally over this period,²⁹ which favoured systems dominated by defined benefit schemes (that tend to invest more in defensive assets).

As well as investment services, Australian funds also provide a variety of services to members that are not always and sometimes only rarely provided to members of pension funds in other countries.

A case in point is the provision of advice services. Quality advice is particularly important in a defined contribution system, where member decisions at the point of retirement can have material and irreversible effects on their retirement income. In countries where most assets are in defined benefit funds (where benefit design is fixed), there may be little or no financial advice provided to fund members.

Legislative and taxation arrangements have a significant impact on fund costs, and Australia's regulatory regime for superannuation is highly prescriptive and has been subject to significant change over recent years.

Fees in defined contribution systems

Overall, superannuation fund fees in Australia are in line with those of comparable systems overseas – that is, systems with a high proportion of defined contribution schemes.

Rice Warner recently noted that average fees for Australian superannuation funds have declined from 1.3 to 1.0 per cent of assets over the past decade.³⁰ The bulk of MySuper products have fees under 1.0 per cent of assets,³¹ and the average fees for MySuper products is around 0.8 per cent.³²

- In New Zealand, the average fee for Kiwisaver accounts with an asset allocation equivalent to the average allocation for MySuper products is just over 1.0 per cent of assets.³³
- In Chile, the average fee for defined contribution funds with a similar asset allocation to MySuper products is around 1.1 per cent of assets.³⁴
- In Denmark, for the largest private providers of occupational defined contribution schemes the average annual cost (which incorporates administrative and investment costs) is around 0.8 per cent of assets for members in the accumulation phase.³⁵

²⁸ OECD 2017, *Pension Markets in Focus*.

²⁹ Shane Oliver 2017, *Are shares offering enough of a risk premium over bonds? What about rising bond yields?*, AMP Capital, 3 May.

³⁰ Rice Warner 2017, *Superannuation Fees: How Low Can We Go?*, and separate unpublished data from Rice Warner (<http://www.ricewarner.com/superannuation-fees-how-low-can-we-go/>).

³¹ APRA, *Quarterly MySuper Statistics*, March 2018.

³² Unpublished Rice Warner data.

³³ Derived from fund data (<https://www.canstar.co.nz/kiwisaver/kiwisaver-fees/>).

³⁴ ASFA 2017, *The Chilean pension tender model* (https://www.superannuation.asn.au/ArticleDocuments/359/ASFA_Chilean_tender_model_paper.pdf.aspx?Embed=Y).

³⁵ Derived from fund data (<http://faktaompension.dk#!/resultatside>).

DRAFT FINDING 2.2

COMMISSION'S DRAFT FINDING 2.2

The SMSF segment has broadly tracked the long-term investment performance of the APRA-regulated segment on average, but many smaller SMSFs (those with balances under \$1 million) have delivered materially lower returns on average than larger SMSFs. The difference between returns from the smallest SMSFs (with less than \$50 000) and the largest (with over \$2 million) exceeds 10 percentage points a year.

DRAFT FINDING 3.3

COMMISSION'S DRAFT FINDING 3.3

Reported costs for SMSFs have increased over recent years and, for those with over \$1 million in assets, are broadly comparable with APRA-regulated funds as a percentage of member account balances. By contrast, costs for low-balance SMSFs are particularly high, and significantly more so than APRA-regulated funds. These high costs are the primary cause of the poor net returns experienced by small SMSFs on average. However, the number of new SMSFs with very low balances (under \$100 000) has fallen from 35 per cent of new establishments in 2010 to 23 per cent in 2016.

DRAFT FINDING 10.4

COMMISSION'S DRAFT FINDING 10.4

The relatively small number of SMSFs with some form of limited-recourse borrowing arrangement (about 7 per cent and representing 4 per cent of SMSF assets) means such borrowing is at present unlikely to pose a material systemic risk. However, active monitoring (along with public reporting and discussion by the Council of Financial Regulators) is clearly warranted to ensure that SMSF borrowing does not have the potential to generate systemic risks in the future.

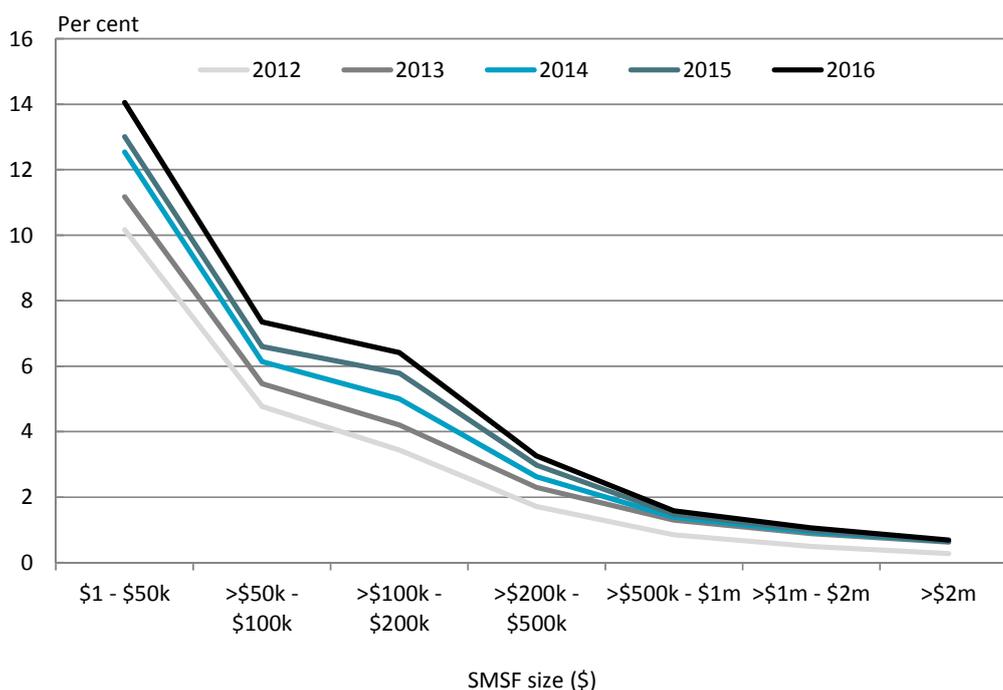
Operating costs of SMSFs

ASFA broadly agrees with the Commission's draft findings concerning SMSFs.

In general, there is an inverse relationship between SMSF expenses – as a per cent of assets – and fund size. An SMSF's expense ratio is total expenses relative to total assets, and includes administrative, operating and investment expenses. According to ATO data, SMSFs with \$50,000 or less in assets had an average expense ratio of 14.05 per cent in 2015-16. This compares with an average expense ratio of 1.58 per cent for SMSFs with assets between \$500,000 and \$1m, and 1.06 per cent for SMSFs with assets between \$1m and \$2m.³⁶

Further, ATO data show that SMSF expenses – as a per cent of assets – have increased each year from 2011-12 to 2015-16 (Chart 3). This reflects increases for administrative, operating and investment expenses (as a per cent of assets). The increase in expenses is particularly stark for lower-balance SMSFs.

³⁶ ATO, *Self-managed super funds: a statistical overview 2015–2016*.

Chart 3: SMSF expense ratio, by fund size and year

Source: ATO and ASFA calculations.

Notwithstanding the difficulties in comparing expense data between SMSFs and APRA-regulated funds, the above data suggest that expenses (as a per cent of assets) of SMSFs and APRA-regulated funds are broadly comparable for SMSFs with assets over \$1 million in assets.

- For APRA-regulated funds, total product fees generally range between 0.5 and 1.5 per cent of assets, where the dispersion in product fees can reflect differences in the range and type of products and services provided to members (as noted by the Commission in the draft report).³⁷

SMSFs with assets in excess of \$1 million represent a small minority of SMSFs and SMSF members. In 2015-16, only around 16 per cent of SMSF members, or around 170,000 individuals, were in a SMSF that had a balance of \$1 million or more.³⁸

It is also worth acknowledging that the SMSF sector's share of system assets and members has declined slightly over the last few years. The largest annual growth in the number of SMSFs (13 per cent) occurred in 2007. This coincided with the introduction of the Government's Superannuation Simplification measures which, in effect, encouraged the making of large non-concessional contributions of up to \$1 million during a limited transitional period. Since then, growth in the number of SMSFs has been at pre-2007 rates – with growth in recent years slowing to between 4 and 5 per cent.³⁹

³⁷ Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 150 (word version).

³⁸ ATO, *Self-managed super funds: a statistical overview 2015–2016*.

³⁹ APRA, *Annual Superannuation Bulletin*, June 2018.

Leverage in SMSFs

ASFA supports prohibiting direct leverage in superannuation, including in SMSFs.

An increase in overall leverage in superannuation accounts in an environment where asset prices are high and interest rates low has the potential to disrupt the economy if a sudden market adjustment were to occur. An example, which is quite relevant today, would be a correction in residential property prices alongside an increase in interest rates.

The superannuation system must be designed in a way that does not contribute to the risk of financial system instability. Although the primary objectives of the superannuation system do not include providing stability in financial markets, it is important that the superannuation system does not allow significant exposures to particular risks that may work against overall financial system stability.

- During the Global Financial Crisis, the generally unleveraged nature of the superannuation pool and its naturally longer investment horizon enabled superannuation funds to play a stabilising role in the financial system.

With respect to SMSFs, investment in assets supported by limited recourse borrowing arrangements (LRBAs) has increased strongly in recent years, up by almost 70 per cent in two years. The proportion of SMSFs that have LRBAs is still small (6.9 per cent as at June 2016), however those SMSFs that use LRBAs typically have 50 per cent or more of the fund assets in the LRBA-supported assets.⁴⁰

It would be appropriate for regulators to monitor and assess leverage in SMSFs to ensure that SMSF borrowing does not have the potential to generate systemic risks. This could include stress-testing to determine whether there are systemic risks associated with leverage and asset concentration in the SMSF sector, and assessment of the linkages between SMSFs and the rest of the superannuation system (and the broader financial system), and how a disruption could be transmitted through those linkages.

DRAFT FINDING 4.2

COMMISSION'S DRAFT FINDING 4.2

Many members find it hard to make comparisons between the large numbers of superannuation products available. The substantial proliferation of investment options in the choice segment (some 40 000) complicates decision making and increases member fees, without boosting net returns.

A 'no frills' product with low fees that is allocated to a balanced (or balanced growth) portfolio is likely to meet the retirement needs of most Australians during the accumulation phase. A better designed and modernised default allocation could act as a trusted benchmark for better member decision making across the entire system.

There is a material difference between a fund/product and an investment option. While there may be 40,000 investment options there are far fewer funds/products.

⁴⁰ ATO, *Self-managed super funds: a statistical overview* (various years).

Member comparison and choice occurs at two separate levels:

- a comparison/choice between funds/products
- followed by a comparison/choice between investment options.

ASFA considers that MySuper is an appropriate ‘no frills’ product with low fees that is allocated to a balanced (or balanced growth) portfolio.

DRAFT FINDING 4.3

COMMISSION’S DRAFT FINDING 4.3

The inclusion in MySuper of life-cycle products is questionable given the foregone returns they pose for many members’ balances (with some foregoing higher returns by adjusting asset allocation as early as 30 years of age). Life-cycle products comprise around 30 per cent of all MySuper accounts, but are mostly suited to members who want to ‘lock in’ a lump sum for some immediate purchase after retirement. For other members, maintaining a balanced portfolio before and after retirement would maximise retirement and lifetime income. Life-cycle products are better suited to the choice segment.

While the draft report questions the inclusion in MySuper of lifecycle products, the offering of lifecycle products, including by way of default, is very common around the world.

The relative attractiveness of such products depends on a variety of factors, including the volatility of investment markets and the attitude of fund members to investment risk and the volatility of returns.

It should also be noted that there are considerable variations between lifecycle products, both by age cohort and between different funds. Some of the MySuper products included in the Commission’s analysis have only a very modest lifecycle component, moving to slightly less exposure to growth assets in the period just prior to traditional retirement age.

Many countries have a history of private pension benefits having investment risk and volatility substantially reduced or eliminated at the time of retirement with the purchase of life pensions or annuities. Such policies and practices assume even greater investment risk aversion by individuals than is implicit in the design of lifecycle superannuation products.

DRAFT FINDING 4.4

COMMISSION’S DRAFT FINDING 4.4

A ‘MyRetirement’ default is not warranted. The diversity in household preferences, incomes, and other assets when approaching, and in, retirement means there is no single retirement product that can meet members’ needs. The most important task remaining is to improve the quality of financial advice to guide members among the various complex products, especially where members may decide to make the mostly irreversible decision to take up a longevity (risk pooled) income product.

ASFA agrees that a compulsory ‘MyRetirement’ default is not warranted.

While it is reasonable and arguably necessary for the trustees of each fund to develop a retirement

income strategy, it should be up to each fund to determine their strategy based on the characteristics of their membership. Funds should not be required to offer a specific product or class of retirement income products.

The accumulation phase is materially different to the retirement phase.

- In the accumulation phase there is a common objective of maximising savings for a reasonable/appropriate level of risk.
- In the retirement phase:
 - the circumstances, needs and objectives of individuals, which determine drawdown needs, will vary greatly
 - the effect of drawdowns is substantially different from that of contributions
 - there is a greater range, and uncertainty, regarding the likely time periods over which drawdowns will occur.
- Unlike MySuper – where the consequences of being in an unsuitable product are reduced net returns, which can be remediated by rolling-over to another product – the consequence of being in an unsuitable retirement product, with a longevity component, can include the inability to exit the product, with the attendant loss of access to capital/reduced death benefits.
- Unlike MySuper, retirement products with a longevity component are likely to be offered in an ‘opt-in’ regime, where members apply for a product, as opposed to a ‘default’ regime’.

There is considerable risk in ‘mass-customising’ a retirement product.

In the accumulation phase the target is to maximise returns for a level of risk reasonably appropriate for the members. By way of contrast, in retirement, every member’s financial circumstances, needs and objectives will vary significantly. Furthermore – and importantly – these largely will be unknown to the provider.

Providers will face considerable difficulty in designing an appropriate single, ‘mass customised’, retirement product – especially given restrictions on access to capital – that will meet the proposed income efficiency tests and be suitable for their members. It is unclear how a provider could determine that a retirement product would be appropriate for most members, in particular where there are a number of significant – unknown – personal circumstances which affect this, including assets/income; debts/liabilities; health and family longevity; social security entitlements and dependants.

A range of options are available to funds to assist members meet their retirement income objectives, including by providing information and education, personal financial advice and by having available either directly or indirectly retirement income products potentially appropriate for members of the fund.

DRAFT FINDING 4.5

COMMISSION'S DRAFT FINDING 4.5

Superannuation funds make insufficient use of their own (or imputed) data to develop and price products (including insurance). This is particularly problematic for designing products for the retirement and transition to retirement stages, because this is when different strategies have the biggest payoffs for members.

Superannuation funds make use of their own (or imputed) data in the context of:

- the amount of data provided in regard to fund members, with limited or even incorrect data provided by employers when an employer-sponsored member is enrolled
- any specific underwriting processes when a fund member seeks cover that differs from the default cover
- the balance between providing group insurance cover on a simple, uniform basis and underwriting of risks at an individual level
- the cost effectiveness and relevance of data for product development and other purposes.

As well, by definition, when personal financial advice is provided to an individual, the fund (or adviser) makes use of a range of personal information provided by the fund member. Increasingly funds provide or facilitate the provision of personal financial advice, particularly when a fund member is approaching retirement or is making other important financial decisions involving their superannuation.

It should be left to superannuation funds to decide what data they might seek to collect and how to use and analyse that data. The views of providers of data analytic services are not objective evidence of whether or not funds are making sufficient use of data to develop and price products.

INFORMATION REQUEST 4.1

COMMISSION'S INFORMATION REQUEST 4.1

Should life-cycle products continue to be allowed as part of MySuper? If so, do they require re-design to better cater for the varying circumstances of members nearing retirement, and how should this be achieved? What information is needed on members to develop a product better suited to managing sequencing risk?

ASFA considers that lifecycle products should not be prohibited from qualifying as MySuper products. If the products meet the general requirements for MySuper, including any stricter requirements that are introduced following the final report from the Commission, then there is no reason to prohibit them.

It should be up to the trustees of each fund to determine the best product design for the general circumstances of the members of the fund.

The design of specific lifecycle products would also be relevant to the evaluation of products should an expert panel be established for that task.

DRAFT FINDING 5.1

COMMISSION'S DRAFT FINDING 5.1

Across a range of indicators, member engagement remains low on average, though it is not realistic or desirable for members to be engaged all the time. Engagement tends to be higher among those approaching retirement, those with higher balances and owners of SMSFs. Engagement is lowest for the young and those with relatively low balances.

While many Australians have good broad knowledge of the superannuation system, many lack the detailed understanding necessary for effective engagement. Low financial literacy is observed among a sizable minority (about 30 per cent) of members.

ASFA has a strong commitment to the improvement of financial literacy and capability among superannuation fund members as a means of increasing engagement and enhancing members' ability to make financial decisions that suit their needs and circumstances.

ASFA maintains a superannuation information website called Super Guru whose aim is to provide Australians of all stages of life with independent information to help them understand and maximise their superannuation. ASFA is also a partner and strong supporter of ASIC's MONEYSMART initiative and participates in the ASIC Community of Practice discussions with the purpose of improving Australians' financial awareness and engagement.

ASFA supports the use of plain English in the financial services industry as a way to make this information more accessible and useful to superannuation fund members.

DRAFT FINDING 5.2

COMMISSION'S DRAFT FINDING 5.2

Demand-side pressure in the superannuation system is relatively weak.

- Most members in the accumulation phase let the default segment make decisions for them, at least when they enter the workforce.
- A significant minority of members (an estimated 1 million) are barred from exercising choice even if they wanted to.
- Fund and investment switching rates are modest, suggesting that active members (or their intermediaries) have not exerted material competitive pressure on funds.

Proposed legislative changes to prohibit restrictive clauses in workplace agreements on members' choice of fund are much needed.

A relatively low level of switching between funds does not necessarily mean that a member is either disengaged or in a fund that it is not suitable for them.

Many fund members exercise choice of fund in order that employer contributions from a new employer are paid into their existing fund.

Remaining with a fund can be evidence that a fund is very suitable for the member. On the other hand, high rates of switching can indicate that a fund is not suitable for many of its members. As

well, the Commission's draft recommendation relating to members being defaulted upon entering the workforce (*Draft Recommendation 1*), where the default fund follows the member from job to job, presupposes a low incidence of choice of fund.

There are sound reasons why it is not appropriate to allow members of defined benefit funds to exercise choice of fund. To do so would allow adverse selection against the fund, with members who have reached their maximum defined benefit then able to direct future contributions to an accumulation account in another fund.

DRAFT FINDING 5.3

COMMISSION'S DRAFT FINDING 5.3

While there is no shortage of information available to members, it is often overwhelming and complex. Dashboards should be a prime mechanism to allow for product comparison and need to be salient, simple and accessible to be effective — but most are not.

This finding is linked to *Draft Recommendations 9 and 10*.

It is important to note that both the content and the form of MySuper product dashboards are prescribed.

The Commission has clearly identified that there is not a need for more information, just better information, as even the current level is overwhelming. On this basis, it is doubtful that more granular reporting of costs and fees will be of any value to members, but instead may contribute to their confusion.

Revisions to the dashboard measures, and comprehensive consumer testing, are required to enhance the meaningfulness of dashboards to members. There is a need to ensure that dashboard requirements are clear – to ensure dashboards are accurate and consistent, and so enable consumers to use them as a basis for comparison between products and options.

ASFA agrees that product dashboards are a work in progress and that improvements need to be made to the prescription of the contents and format.

DRAFT FINDING 6.1

COMMISSION'S DRAFT FINDING 6.1

Several proposed policy changes will promote Superannuation Guarantee payment compliance:

- Single Touch Payroll being extended to small employers (with less than 20 employees) from 1 July 2019
- funds being required to report contributions to the ATO at least monthly
- the ATO having stronger powers to penalise non-compliant employers and recover unpaid contributions.

ASFA is committed to measures and policies that reflect and support the core role of the superannuation system in providing adequate retirement outcomes for all Australians. Compulsory superannuation plays an integral role in this and accordingly we strongly welcome the measures

identified by the Commission, which are currently before the Parliament in the *Treasury Laws Amendment (2018 Measures No. 4) Bill 2018*.

The measures will strengthen the options available to the Commissioner of Taxation to secure compliance with employers' superannuation guarantee (SG) obligations and improve the timeliness and granularity of the information received by the Australian Taxation Office (ATO) from employers and funds about the making and receipt of superannuation contributions. In ASFA's view, the measures represent a positive step toward ensuring that Australian workers receive their legislated superannuation entitlements.

ASFA notes that the effectiveness of the measures will ultimately depend on the extent to which the ATO is prepared — and resourced — to implement enhanced compliance monitoring and enforcement activities. In this respect, we welcomed the announcement, in the *2017-18 Mid-Year Economic and Fiscal Outlook*, of additional funding to support the extension of Single Touch Payroll reporting and to address SG non-compliance. In particular, we note that it will be necessary for the ATO to develop sophisticated data analytics and engagement tools to identify unpaid SG and implement enhanced monitoring processes.

DRAFT FINDING 6.2

COMMISSION'S DRAFT FINDING 6.2

The superannuation system, primarily due to its policy settings, does not minimise the unnecessary and undesirable erosion of member balances. This erosion is substantial in size and regressive in impact.

Unintended multiple accounts (one in three of all accounts) are the most egregious driver, directly costing members nearly \$2.6 billion a year in excess insurance premiums and administration fees. For an individual member holding just one unintended multiple account throughout their working life, the projected reduction in their balance at retirement is 6 per cent (or \$51 000).

Superannuation Guarantee non-compliance is hard to estimate, but may be costing members about \$2.8 billion a year.

At least 2 per cent of all member accounts (about 636 000) are subject to (grandfathered) trailing adviser commissions. These commissions may cost members in excess of \$214 million a year.

Recent policy initiatives have improved the situation, but current policy settings are inevitably making slow progress by treating the symptoms and not the structural cause.

ASFA supports measures designed to reduce the number of inadvertent duplicate accounts including giving the ATO increased powers to consolidate inactive member accounts with active ones.

ASFA welcomed the government's recent reforms designed to increase employer SG compliance and the additional funding for an ATO taskforce.

DRAFT FINDING 7.1

COMMISSION'S DRAFT FINDING 7.1

The market structure of the superannuation system (as distinct from its policy and regulatory settings) is conducive to rivalry. At the retail level, there are many funds and products. At the wholesale level, while there is concentration in some service provider markets for outsourcing (like administration), a growing ability for larger funds in particular to insource all, or parts, of their service requirements adds to competitive pressure in the system.

As ASFA has noted previously in its submissions to the Productivity Commission, market concentration in most parts of the superannuation sector is at relatively low levels by generally accepted standards.⁴¹

Where there are any areas of market concentration, larger funds have the ability to insource, or contemplate insourcing, their service requirements. Actual or potential insourcing adds to competitive pressures within the superannuation industry.

DRAFT FINDING 7.2

COMMISSION'S DRAFT FINDING 7.2

At the system level, fund-level regulation is a significant cost of entry and there are structural features of the system on the supply and demand side that are likely to create challenges for new entrants (including gaining scale by attracting members). However, these are not necessarily prohibitive or even high barriers to entry.

In the default segment, there are high regulatory barriers to new fund entry, due to policy and regulatory settings that limit access to the market (including difficulty being listed in a modern award). There is also an absence of competition for the default market. Conversely, the choice segment is largely contestable.

While the costs of exit are unlikely to deter new fund entry, barriers to fund mergers are continuing to frustrate much needed consolidation in the system, at great cost to members.

ASFA agrees that, at the system level, fund-level regulation is a significant cost of entry and that, in the default segment, there are high regulatory barriers to new fund entry due to policy and regulatory settings that limit access to the market.

- Legal and regulatory barriers arise from licensing and market entry conditions, while market barriers include (lack of) economies of scale, customer inertia and characteristics such as the SuperStream payment processes and interactions.
- ASFA agrees there are barriers to fund mergers that frustrate consolidation in the system, including the absence of enduring CGT relief and on occasion the difficulty in ensuring 'equivalent rights' to the transferring members, especially with respect to insurance.
- The direct and indirect costs of fund-level regulation also have significant implications for the cost structure of funds that are active in the market.
- ASFA does not agree that there is an absence of competition for the default market.

⁴¹ For example, the ASFA submission to the draft report for Stage 1:
https://www.superannuation.asn.au/ArticleDocuments/265/ASFA_PC_Draft_Report_final.pdf.aspx?Embed=Y.

The proposals in the draft report for default funds to be limited to those chosen by an expert panel with the number of default funds limited to a set number of ‘best in show’ funds would introduce new barriers to entry in the default area. A new fund would have little or no chance of being able to qualify as ‘best in show’.

The proposals if adopted would also have implications for existing funds that are not successful in being chosen by the expert panel as a default fund. They would be deprived of default contributions and would have decreased liquidity and scale, making it difficult to compete with chosen default funds (which would have stronger cash inflows and greater scale).

ASFA supports the proposition that ‘[t]he regulatory framework and regulatory activity should be calibrated to encourage mergers that are in the best interests of members’.⁴²

We also support the Commission’s view and understanding of the benefits of scale that can be achieved through outsourcing to service providers, especially given the investment required in systems and processes to support the increasing legislative burden on funds. Outsourcing also enables funds to access the expertise of specialist providers.

DRAFT FINDING 7.3

COMMISSION’S DRAFT FINDING 7.3

There are signs of unhealthy competition in both the choice and default segments of the superannuation system.

While the choice segment is largely contestable, competition has not always translated to better outcomes for members, and product proliferation (some 40 000 investment options is unhealthy choice) and poor comparability is symptomatic of unhealthy competition.

In the default segment, the risk of employer inducements (of no benefit to members) remain a concern and can work against the interests of members.

Multiple investment options in some wrap and master trust arrangements reflect, amongst other things, a need to deal with approved product lists which vary between different financial planning firms. They generally are not presented to retail members as a menu from which they must choose on an individual, unassisted basis.

DRAFT FINDING 7.4

COMMISSION’S DRAFT FINDING 7.4

There is a high propensity for funds in the system (particularly retail funds) to report using associate service providers — a form of vertical integration. While vertical integration is not in itself a problem, it does raise a potential conflict of interest which needs to be addressed by confident regulators and with greater transparency through disclosure and reporting.

⁴² Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report*, Canberra, page 303 (word version).

Existing prudential and other regulation require all funds to deal appropriately with any actual or potential conflicts of interest.

INFORMATION REQUEST 7.1

COMMISSION'S INFORMATION REQUEST 7.1

What are the main types and quantum of costs involved in fund mergers? How do these vary depending on the size of funds involved?.

As an initial observation, the 'one-off' costs of a fund merger should be offset against the benefits that are likely to be realised by the merger. The business case and cost/benefit analysis should be formally estimated and assessed with the assistance of professional advisors, and the costs amortised as an element of the long-term strategic and accretive benefits of the merger (including to fund members).

Some of the main types of costs involved in implementing a fund merger, after the initial due diligence, are largely administrative/operational and include:

- data transition and reconciliation
- business rules (benefits and insurance) configuration and testing
- application testing
- communications to members.

Defined benefit funds are typically more complicated, and therefore more expensive, when measured by on a dollars per member basis.

Integrating the investments also can represent a very significant cost, especially if this involves selling and replacing assets, and may have significant taxation costs as well. ASFA supports permanent CGT relief to minimise the potentially significant taxation costs (as per *Draft Recommendation 7*).

INFORMATION REQUEST 7.2

COMMISSION'S INFORMATION REQUEST 7.2

What evidence is there that funds are passing through economies of scale to members in the form of lower fees, or to members through other channels? Why has the pass-through of scale benefits occurred as it has?

A range of factors have affected the cost levels of superannuation funds and the related fees that are charged to fund members.

Upward cost pressures have come from the increased direct and indirect costs of regulation. A number of funds have also moved to a higher allocation to unlisted investments, where costs are higher.

Enhancements have also been made by many funds to the services provided to members, including increased provision of information and advice through a variety of channels and enhanced website

and mobile app capabilities.

As the Commission has noted, average fees have tended to decrease over time. Economies of scale and associated lower costs have contributed to this.

DRAFT FINDING 10.1

COMMISSION'S DRAFT FINDING 10.1

The package of reforms contained in the Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 would improve member outcomes if legislated.

In particular, the proposed MySuper outcomes test should better enable APRA to de-authorise poorly performing products and better promote fund consolidation. Giving APRA more power to deal with ownership changes of superannuation funds would also help.

ASFA supports a number, but not all, of the measures in the 'outcomes' package of reforms.

In particular, better enabling APRA to de-authorise poorly-performing products and giving APRA more awareness of ownership changes should help to protect fund members.

On the other hand, ASFA considers some of the measures, such as the extension of APRA's powers to make directions to RSE licensees, could be better targeted. Other measures, such as the outcomes test/assessment and the annual members' meeting, require a rigorous cost/benefit analysis.

DRAFT FINDING 10.3

COMMISSION'S DRAFT FINDING 10.3

The formation of the new Australian Financial Complaints Authority should be a positive reform for members, provided it is adequately resourced to deal with the level of complaints received.

While recognising the policy intent behind moving toward a 'one stop shop' approach to external dispute resolution (EDR) for the financial services industry, ASFA did not agree with the view reached by the Ramsay Review that the SCT model was 'broken'.

In ASFA's view, the SCT has — within its historic and current funding and operational constraints — served the industry and consumers well. ASFA has for many years called for action to address those constraints. In particular, our submissions to the Ramsay Review also highlighted the need to improve the SCT's operations and performance, via adequate funding and resourcing and enhancements to its governance structure and operating procedures.

While still of the view that an enhanced SCT would be superior to a generic EDR scheme, ASFA has remained an active contributor to the processes leading to the establishment of the Australian Financial Complaints Authority (AFCA) and its preparation to begin hearing complaints from 1 November 2018.

The ability of AFCA to deliver improved complaints handling outcomes for consumers will be dependent on several factors. These include the effectiveness for superannuation of the new hybrid

model (a membership-based ombudsman scheme overlaid with specific legislative powers for superannuation complaints). One factor that will be absolutely critical to AFCA's success will be the extent to which its flexible approach to complaints resolution is supported by sufficient resourcing and expertise to effectively manage complex superannuation complaints.

Under its mandatory legislative requirements, the operations of the AFCA scheme will be funded by its member firms⁴³ — including APRA-regulated superannuation funds. The operator of the AFCA scheme is also required to ensure the scheme provides for resolution of complaints in a way that is efficient and timely⁴⁴. Importantly, ASIC has the power to direct the scheme operator to take measures to ensure that the operations of the AFCA scheme are sufficiently financed.⁴⁵

This framework undoubtedly provides AFCA with a level of control over its funding that was not available to the SCT. This should have a direct impact on AFCA's ability to resource its operations appropriately to ensure efficient resolution of complaints.

However, in ASFA's view close monitoring of AFCA's funding levels will be required. The cost of operating AFCA is imposed directly on its member firms, and it is not permissible for a consumer to be charged any fee in relation to a complaint heard by AFCA. Nonetheless, it must be recognised that all consumers who are customers, members and/or beneficiaries of an AFCA member firm are likely to contribute indirectly toward AFCA's funding.

Accordingly, it is important that AFCA's funding model is carefully calibrated to ensure its resourcing is adequate, but not excessive. This is a matter in which ASFA will take an active interest.

DRAFT FINDING 12.3

COMMISSION'S DRAFT FINDING 12.3

Although a sovereign monopoly default fund would be well placed to realise economies of scale for default members, such a model would run counter to the (desirable) absence of an actual or implied government guarantee in the Australian superannuation system and would fail to harness the benefits stemming from a competitive process. It would also supplant member engagement.

ASFA agrees that a sovereign monopoly default fund would be detrimental to the long-term interests of default members. The Future Fund (the FF) has been put forward, by some, as a potential monopoly provider.

The FF effectively operates as the Australian Government's wholesale investment manager and is responsible for managing various pools of funds under investment mandates determined through legislation.

To perform the role of a sovereign monopoly provider, the FF – assuming that it would need to be set up as a fund regulated under the SIS Act to maintain critical prudential safeguards – would need to establish a governance framework to enable it to operate in a superannuation context. This would include application to APRA for an RSE licence, appointment of a trustee board, application for

⁴³ *Corporations Act 2001*, subsection 1051(2)(b).

⁴⁴ *Corporations Act 2001*, subsection 1051(4)(b).

⁴⁵ *Corporations Act 2001*, section 1052BA.

MySuper authorisation, establishment of an appropriate compliance and operational risk framework, and monitoring and reporting to APRA and the ATO. Even exempt public sector superannuation schemes are required to comply with the spirit of the SIS legislation in relation to MySuper whereas the FF, given its separate focus, is not well placed to perform this role.

The FF also would have to develop significant operational infrastructure. For example, the FF does not have the administrative capabilities enabling it to receive and allocate member contributions, unitise holdings, deliver appropriate insurance arrangements and provide regular reporting to fund members and regulators.

Given its purpose, the FF does not offer insurance (unlike MySuper products). Consistent with current regulatory requirements, the FF would be required to arrange suitable default insurance (for which they currently lack the required capability).

Finally, the purpose of the FF is to manage money to meet public liabilities or other specific public purposes. Superannuation money is exclusively private and owned by individual fund members. Broadening the role and scope of the FF in such a fashion would heighten political risk for the FF, the government and superannuation fund members. It also would risk heightening market or member perceptions that savings are underwritten by the government.

F. CONCLUSION

The Commission's draft report provides a comprehensive assessment of the superannuation system which, if implemented, has the potential to materially transform the industry.

While it is certainly the case the system needs to continue to evolve to meet the needs of consumers, and reform will play a role, it is important to be clear about what the evidence is telling us regarding the nature and extent of underperformance in the system.

The Commission's analysis clearly shows that the default system has performed well overall, and for the vast majority of default members.

However, the Commission has identified a range of products that are underperforming. ASFA is concerned about underperformance and the impact on consumers, and supports strong actions to target habitual underperformance. This would include reforms to 'clear-up the tail' of underperforming MySuper products and facilitate an orderly transformation of the system.