



ASIC

Australian Securities & Investments Commission

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Superannuation
Productivity Commission
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Dear Sir/Madam

Review of the Efficiency and Competitiveness of the Superannuation System

I refer to the issues paper released by the Productivity Commission (the Commission) in July 2017 (Issues paper) as part of stage 3 of the above review.

The Australian Securities and Investments Commission (ASIC) made a broad initial submission in May 2016 in relation to stage 1 of the review with respect to the development of criteria to assess the efficiency and competitiveness of the superannuation system. ASIC also made a submission in November 2016 in relation to stage 2 of the review with respect to alternative models for allocating default fund members to superannuation products. We appreciate the opportunity to provide a submission in relation to the stage 3 Issues paper.

As noted in our previous submissions ASIC's role primarily concerns the relationship between product providers and individual consumers. Promoting confident and informed investors and financial consumers, and fair and efficient markets in the financial system, are strategic priorities of ASIC.

We undertake to influence the behaviour of, or hold to account, trustees and those advising in relation to superannuation. In addition, ASIC also endeavours to promote financial literacy about superannuation. ASIC's MoneySmart includes detailed information for consumers about choosing a superannuation fund and retirement income planning. ASIC also provides calculators to assist with superannuation and retirement decision-making. Some trustees refer their members to our website.

While ASIC is committed to increasing consumer understanding about superannuation, we recognise the practical reality that many persons are disengaged participants in the superannuation system. For these people, product design features that apply in place of a member's own choices can be very important.

On 30 June this year, ASIC released its Report 529 *Member Experience of Superannuation* (REP 529), which looked at ways consumers can be vulnerable in the superannuation system due to a lack of engagement. REP 529 identified insurance within superannuation as a key area where

there are vulnerabilities for disengaged members, including where members change employers and as a consequence, cover changes or ceases.

This submission will focus on the three aspects of the superannuation system highlighted in the terms of reference for stage 3 of the review and in relation to which ASIC has undertaken work. Much of the work we are doing now has its origins in the findings of REP 529.

Default Funds

ASIC has made comments about the role of employers in the superannuation system in our earlier submissions. We expect to publish a public report of the results and findings from work exploring the role of employers in the superannuation system in the first half of 2018.

In a \$2.3 trillion superannuation system, nearly \$600 billion is in MySuper products. This suggests that employers in Australia have a significant impact on the retirement outcomes. Employers make a decision about the superannuation funds to which the employer will contribute in the absence of choice by an employee (default funds).

Over the course of 2017, we have been conducting a project focusing on trustees and others interaction with employers when an employer is making decisions about default super funds for their employees. Ultimately, we are interested in how this decision impacts the end consumer. We are focussing on the following areas:

- advice given to employers;
- disclosure material given to employers by trustees and others;
- benefits and services offered or provided to employers by trustees and others; and
- the role of other third parties, such as payroll providers, corporate tender consultants, clearing houses and other advisors in the superannuation system who interact with employers.

We have served a notice on 47 trustees, asking questions about these key areas and have followed up with notices on a smaller number of trustees to explore the information we have received to date. Our second round of work is seeking to understand:

- the nature of the advice provided and how this is paid for (80% of our initial sample of trustees indicated that they provided advice to employers);
- the quality of the additional disclosure provided by employers by trustees, including whether these disclosures are misleading (77% of our initial sample of trustees indicated that disclosure other than just a PDS was provided to employers); and
- the value of benefits provided to employers, with a view to obtaining more insight about the influence this has on decisions about default funds (our initial sample of trustees found that the most popular benefits are free educational materials for employers (33%) as well as free tickets to sporting events or corporate hospitality (24%).

While not the primary focus of the project, in seeking further information about benefits we may need to consider the application of the inducement prohibition in s68A of the *Superannuation Industry (Supervision) Act 1993*.

We expect our formal enquiries to be completed by the end of 2017. Given the importance of employers in the superannuation system, we think the way employers are treated by trustees and others is a serious matter. Where trustees fail to meet their legal obligations in their dealings with employers, we will consider whether regulatory action is appropriate.

Insurance in superannuation

According to research this year from Rice Warner¹, the superannuation industry is the leading provider of death and total & permanent disability insurance in Australia, accounting for more than 70% of all life cover. On this basis, insurance in superannuation is a key area of interest for ASIC. We want to ensure that such a critical component of the superannuation system is meeting the needs and expectations of consumers.

Over 2017 we have been conducting a surveillance project about insurance and questions about insurance arrangements were included in the 47 notices served on trustees mentioned above.

This project follows up the initial findings in relation to insurance in superannuation as part of ASIC's work noted in REP 529.

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| Disclosure about insurance cover | <ul style="list-style-type: none">• Disclosure about insurance cover in superannuation is sometimes inadequate, with inconsistencies between policy documents, PDSs, and other disclosure material from the trustee. In some cases, exclusions from cover could be more clearly articulated. |
| Changes to or cessation of cover | <ul style="list-style-type: none">• Some trustees are providing inadequate notification of changes to, or cessation of, insurance cover, and are relying on disclosure made in PDSs about the circumstances when cover will change or stop. |
| Default transfer arrangements | <ul style="list-style-type: none">• Some trustees are defaulting members as 'smokers' or 'blue collar workers' for insurance purposes when moving members between divisions of funds. |

The project is further examining some of the issues raised in REP 529, including:

- disclosure;
- complaints and claims handling; and
- incentives, culture and conflicts.

ASIC considers that better overall industry performance in relation to these aspects will support and enhance the valuable role played by insurance coverage in superannuation. Insurance within superannuation can help those people who may not otherwise provide for themselves in the event of illness or injury yet insurance needs to be administered in a way that minimises the risk that member's superannuation balances will be unnecessarily eroded.

ASIC has undertaken an analysis of the data received from trustees to date. Unfortunately some of the adverse member outcomes we identified in our Report 523 were present in the data we have received to date.

¹ See Rice Warner, *The role of insurance in superannuation*, 9 August 2017: <http://www.ricewarner.com/the-role-of-insurance-in-superannuation/>

So far, results indicate that:

- approximately 10% of trustees still use smoker defaults, and approximately 10% of trustees use defaults in relation to blue collar workers. One trustee used both of these defaults.
- There were also a small number of trustees (6%) who only told a member about the circumstances when cover may cease in the PDS. That is, they gave no further warning that cover might be about to stop closer to the time when cover might cease.
- It also appears that rebates are provided to around 20% of trustees by insurers, and around 20% of trustees reported receiving other benefits from insurers such as corporate hospitality.
- 70% of claims were accepted in full during the time period of our notice and approximately 30% of complaints received by trustees related to insurance issues (36% of insurance related complaints related to TPD).

Notices have been served on a smaller number of trustees to follow up on the data we have received to date. These notices are seeking information about the process of selecting insurers by trustees, the defaults transfer arrangements used by trustees, complaints handling processes trustees have in place, and disclosures made to members about all of these matters.

We are also following up the small number of trustees who did not directly notify members prior to insurance cover ceasing, to seek improvements to their disclosure practices.

We note the Government has recently tasked APRA with making it easier for consumers to opt-out of automatic life and disability insurance policies provided through superannuation.² ASIC supports more user-friendly arrangements in this regard. We think it would also help a member to engage with the insurance in super more generally, and this could include increasing or decreasing their level of insurance cover.

We also have considered the need for more comparable information about insurance to be made available to assist in member engagement with insurance in superannuation. In this respect we note that the current arrangements for product dashboard disclosure for superannuation products do not include information about any insurance component of the product.³

Disclosing fees, costs and net returns

In Report 398 *Fee and costs disclosure: Superannuation and managed investment products* ASIC identified a range of issues with fee and costs disclosure in the superannuation industry. The issues that appeared to be more common and have a bigger impact on the accuracy and comparability of fee and cost disclosure were:

Fees in underlying investments

- Inconsistency in the treatment of management costs associated with investing funds through external investment structures, such as where funds are invested into a fund-of-fund structure that has its own fees and costs mechanism.

² Minister for Revenue and Financial Services, Press release *Reforms to give consumers more power at the heart of a stronger superannuation system*, 24 July 2017.

³ Section 1017BA of the Corporations Act 2001.

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| Data quality | <ul style="list-style-type: none"> • The quality of fee and cost data provided by investment managers to trustees of superannuation funds about underlying investment vehicles varied significantly. |
| Management costs | <ul style="list-style-type: none"> • Under-reporting of management costs, eg by mis-characterising management costs as transactional costs, affecting the accuracy of the indirect cost ratio as a key comparative measure. |
| Performance fees | <ul style="list-style-type: none"> • Different practices in the disclosure of net performance fees including disclosure based on the fees paid in the last financial or calendar year, disclosing the range of performance fees that may be paid depending on the performance outcome. |
| Tax treatment | <ul style="list-style-type: none"> • Inconsistency of practice in relation to the requirement to present fees and costs in a PDS gross of income tax (but includes goods and services tax (GST) and any applicable stamp duty) and net of any applicable reduced input tax credits. |

ASIC has been taking steps to address these issues, by issuing instruments modifying the law and an updated Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97) following consultation with the managed funds and superannuation industries.

ASIC has recently issued a media release outlining some changes to our approach to fee and cost disclosure: see 17-369MR *ASIC updates work on fee transparency for super and managed investment schemes*. As part of ASIC's ongoing commitment to fee and cost disclosure, we have:

- extended beyond 30 September our facilitative compliance approach to fee and cost disclosure; and
- announced we will work with an external expert to conduct a review of the fees and costs disclosure under RG 97 to ensure that it is best meeting in practice the objective of greater transparency for consumers.

ASIC recognises that accurate fee and cost disclosure is complex to implement, and that this implementation takes time. ASIC will continue to work with industry to make sure that disclosure works for consumers.

We also recognise that from an investor's perspective, fees and costs are not the only factor to consider. Asset allocation, investment objective strategy and risk are also important, as is the availability of member services like advice and online accessibility.

ASIC also considers that developing a standard risk measure in the presentation of superannuation investment options across the industry will be another area of important work.

Recent legislative proposals

Finally, we note the legislative reforms proposed by Government in relation to fund accountability in the *Treasury Legislation Amendment (Improving Accountability and Member Outcomes Measures No. 1) Bill 2017*. While many of the initiatives outlined in the Bill are primarily matters for APRA, ASIC is generally supportive of measures that improve accountability, help protect member interests and promote member engagement, including annual

member meeting reforms and portfolio holdings disclosure. We are committed to working with APRA and Government to implement these accountability measures.

Contact

Thank you once again for the opportunity to make a submission to the Commission. We would be happy to meet with the Commission to discuss any of the issues noted in this letter. If you have any queries, please contact Alex Purvis, Senior Manager, Investment Managers and Superannuation

Yours faithfully

Jane Eccleston
Senior Executive Leader
Investment Managers and Superannuation