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Submission to Productivity Commission
Superannuation: Assessing Efficiency and Competitiveness
Draft Report

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By authority of the NFAW Social Policy Committee

Submission to Superannuation: Assessing Efficiency and Competitiveness: Draft Report

This submission is being made by The National Foundation for Australian Women (NFAW).

NFAW is dedicated to promoting and protecting the interests of Australian women, including intellectual, cultural, political, social, economic, legal, industrial and domestic spheres, and ensuring that the aims and ideals of the women's movement and its collective wisdom are handed on to new generations of women. NFAW is a feminist organisation, independent of party politics and working in partnership with other women's organisations, including the National Women's Alliances Equality Rights Alliance and economic Security 4 Women. These organisations include those committed to increasing support for women in Australia as well as those with a special interest in women's history.

NFAW is concerned about the financial security of women, and the role of superannuation in achieving that security. To that end we have made a number of submissions to previous Parliamentary and Treasury enquiries into the superannuation system and to the Senate Inquiry into the Financial Security of Women in Retirement.

The superannuation guarantee is a key pillar of the retirement system, and for many women it is the primary source of their retirement savings. Women are overrepresented among lower paid, part-time and casual employees. These are among the groups of workers most likely to be affected by the erosion of superannuation balances due to inefficiencies in the superannuation system.

We have read the most recent report, and would like to comment on some of the recommendations and issues raised in the report.

Draft Recommendation 1: Multiple Accounts:

The data presented in the report is consistent with what we are being told by our various stakeholders, that there is a proliferation of accounts held by people who are members of default funds. There are a number of reasons for this proliferation, including the status of default funds in industrial agreements and a lack of understanding of the system by workers entering the superannuation system.

The connection between a particular industry and a fund is now largely irrelevant as public offer funds will generally accept members from outside a particular industry. The status of default funds in industrial agreements is historical, originating from the employer fund model under which employers and employees both engaged with the fund. This then extended out to the establishment of industry based schemes to facilitate portability.

Generally we are in favour of removing the default fund provisions in industrial agreements. We note the reservations expressed by some industry funds that their investment and insurance offerings are preferable for their members on account of their better knowledge of members' circumstances. This may be justified where a default fund is outperforming the market, but there are cases where it is not.

However, we note that there are circumstances where membership of a particular fund provides additional benefits due to historical arrangements that are incorporated in industrial agreements,

for example employer contributions that are higher than the Superannuation Guarantee. We make no comment on these arrangements per se, however removing the default status of funds in such cases will need to ensure that employees are fully informed of the consequences, and/or not disadvantaged, by not taking membership in that fund.

Draft Recommendations 2 & 3: “Best In Show”

The ability to readily compare funds and identify whether a fund is performing at an acceptable level is important, however developing a “Best In Show” list could be counterproductive.

Funds that are nominated and appear on that list will have a market advantage that will persist beyond the four-yearly review period. A default member captured by a fund on the list is likely to remain with that fund – particularly as the measures to reduce the multiplicity of funds are implemented. This concentrates membership and funds under management in a small number of funds.

We suggest that the “Best In Show” model, based on principles of behavioural economics, should be tested before deciding whether to adopt it, for example through the use of randomised control trials.

If a “Best In Show” model is adopted, we agree that the list must be reviewed regularly, based on performance data from both the default and the choice funds. We suggest that beyond the requirement for no conflicts of interest among the board nominating funds, the Commission should consider mandating that board members comprise a range of backgrounds, with gender balance and representing employer and employee interests. It would be appropriate for the Governor of the Reserve Bank to chair the panel.

The product that is compared for the default fund is a no-frills MySuper product. These funds are designed to meet specified base level standards, and will not have features that can be found in the Choice funds. If a person makes a decision based on the performance of the default fund it becomes a much more difficult decision to assess the benefits of a Choice product in a different fund. In the assessment of the default funds, there should also be an assessment of features that are available in the Choice products: for example can a person subsequently move into an ethical investment product.

Draft Recommendation 4: MySuper Authorisation

We acknowledge that there are wide disparities in the performance of funds; and that industry funds, while generally better, are not always among the highest performing funds. Additional reporting requirements for MySuper accreditation will aid in transparency. However the cost of additional audit requirements, which will be passed on through fees, must be taken into account before mandating additional regulatory requirements.

The effect of revoking a MySuper authorisation will need to include consideration of the options available for members of that fund: will the authorisation be grandfathered for those members, or will the members be required to rollover into better performing funds or choice options? Taking into account that MySuper accounts are intended to service members that are less engaged with their

superannuation, the options available when the fund authorisation is revoked must be carefully presented.

With the introduction of MySuper, the role of default funds has intensified to capture members who may later move across to a Choice product¹; yet now aspects of the default settings in MySuper products are leading to concerns that the simplified system has not led to behavioural change. We note that the outcomes of the MySuper changes have not met expectations, and agree that a comprehensive review is warranted.

Draft Recommendation 5: Regulation of Trustee Board Directors

There is legislation currently before the Parliament regarding the composition of trustee boards: Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017. NFAW made a submission in respect of this legislation (attached) which highlights director education as the primary requirement for board competency, rather than any minimum requirement for director independence. In addition, directors should bring a range of skills sets and backgrounds, so as to reflect the broader population. Boards should be gender balanced. The focus upon mandating director independence also gives rise to the issue around determining what is 'independent' when directors sit on multiple boards, as they often do. This is another reason why the education of directors is a preferable as the primary competency.

Draft Recommendations 6 & 7: Merger Activity

Fund consolidation is desirable generally, but we agree that the regulator should have a role in permitting or blocking mergers. This will become particularly important if the Best-in Show model is adopted as the market will become more concentrated.

We agree that the current CGT relief on superannuation fund mergers should be continued.

Draft Recommendation 8: Cleaning Up Lost Accounts

We note the proposals in the 2018-19 Commonwealth Budget to facilitate the amalgamation of multiple funds where a fund is inactive. We are in favour of this measure and the application of Single Touch Payroll and other data-matching resources available to the ATO to reduce unwanted duplication of fund membership. Specifically, when a new employee commences work they should receive a notification reminding them of any existing superannuation account and given the option of nominating that account to receive their Superannuation Guarantee contributions.

At the same time, policy needs to ensure that there is no adverse effect on people who are temporarily out of the paid workforce, where a lack of engagement could be read as account inactivity. Data matching systems could be brought to bear to monitor this.

¹ Productivity Commission. (2016) *How to Assess the Competitiveness and Efficiency of the Superannuation System*, Canberra: Productivity Commission: at p200

Draft Recommendations 9 & 10: Member Dashboards

While we agree that all products should have a greater level of transparency, simply making the information available will not of itself produce behavioural changes like ‘rational’ choices around best performing funds. The MoneySmart website is a useful tool, however people need to be capable of accessing the information that is available, to actually log on and do so, and to then be prepared to act on that information. There needs to be an appropriate balance between addressing the lack of financial literacy and nudge practices that may be counterproductive.

Specifically, the use of MyGov as the central portal to information about superannuation requires an element of trust in the system. This may happen as more government services are moved across to MyGov, but currently many people do not access MyGov on a regular basis; and many people have had bad experiences with the tool. For taxation requirements, Australia still has a very high reliance on the use of tax agents to prepare tax returns and many people would not be accessing MyGov as part of that process. If MyGov is to be used as the primary information channel, it needs to be supplemented with other communication systems, such as the Tax Agent lodgement systems.

Draft Recommendation 11: Guidance for Pre-Retirees

When designing choice architecture, the literature shows that target populations of nudges need to be segmented to be effective². We note the 2018-19 Budget proposal “More Choices for a Longer Life — jobs and skills for mature age Australians” which includes advice on remaining in the workforce. This program should also include basic financial skills to ensure that people understand their superannuation in the pre-retirement phase of their working life.

Draft Recommendations 12 & 13: Fees and Trailing Commissions:

We agree that fees and trailing commissions should be fully disclosed to members and that fees should be limited to cost-recovery levels. We support the measure in the 2018-19 Budget to ban exit fees, and to limit administration fees on accounts with a balance of less than \$6,000.

Draft Recommendations 14 – 19: Insurance Arrangements

We note that the *Budget Papers 2018-19* have proposed the introduction of opt-out insurance for people under 25, with balances under \$6,000 or with dormant accounts. The data shows that insurance products may be poorly designed, and cross subsidies arise in the costing of policies, with a long-term effect on superannuation balances.

In the 2018-19 *Gender Lens on the Budget* (NFAW, 2018) we noted that:

Women stand to be the beneficiaries of measures contained in the Protecting Your Super Package that are directed at low balance superannuation members, on account of women’s lower average wages and lower superannuation balances. Specifically, these are the measure to consolidate accounts; to limit fees on accounts with balances of less than

² See overview of the literature in the tax context by Nicholas Biddle and Lilia Holzinger, “Behavioural Insights of Tax Compliance: an Overview of Recent Conceptual and Empirical Approaches,” Tax and Transfer Policy Institute Working Paper 8/2016, October.

\$6,000; and to ban exit fees and opt-in life insurance for accounts with balances of less than \$6,000. (NFAW 2018; p 75)

However, we do have some concerns about the design of an opt-out measure. Life insurance can form a significant part of a death benefit payable to a person's dependants, and the absence of a death benefit will make a difference to the financial circumstances of the family. If a person opts-out of life insurance, there needs to be a review mechanism that prompts them to review this decision regularly, based on their circumstances at the date of review: this is particularly important for younger members as their life circumstances evolve. Further, the consequences to death benefit nominees of opting out of life insurance needs to be fully explained to members. It would seem appropriate for a review to be linked to the cycle of review for a binding death nomination.

It is also important that a person who opts out under this mechanism does not face additional hurdles, financial or procedural, if they subsequently apply for life cover.

We also note the development of the *Insurance in Superannuation Voluntary Code of Practice*, which sets standards for the provision of insurance products in superannuation. The Code addresses the needs of different categories of members, including younger members, members with low and infrequent contributions and older members. These categories of membership will benefit from specific attention in the design and cost of insurance.

We agree with the proposal that MySuper authorisation should require the fund to become a signatory to the Code, but note that there will need to be oversight of compliance with the code.

Specifically, we note the measures that signatories to the Code will take where contributions cease, which will require a person to proactively respond to requests for continuation of cover. We note that measures to cease cover will take effect after 13 months without contributions (subject to a 60 day reinstatement period), with life insurance subject to a \$6,000 balance requirement. There are several categories of members that this could apply to, including a new parent who has elected not to return to the workforce. Although income protection insurance is likely to be inappropriate for these members, the member may still need life cover.

If the Productivity Commission were to recommend a measure along these lines, it is important that members are given the opportunity to retain cover. This could include reviewing the member's superannuation history to see whether they have in fact joined another fund that may provide cover.

Draft Recommendations 20 - 22: Regulatory Agencies

Emerging evidence from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry shows that major reforms are required to bring regulatory agencies together to protect the interests of consumers. We support the creation of a joint taskforce comprised of APRA, ASIC, the ATO, Treasury and the ABS that has an overall purpose of improving member outcomes. Foremost among the roles of the taskforce would be joint data development and data sharing, as well as identifying areas for reform and evaluating changes to the system.

Summary Comments

NFAW has been engaged in the public debate on the equity of the retirement system, but efficiency is an important element of a well-functioning system. This work on the efficiency of the superannuation system is timely, and is of great importance to the economic security of women in retirement.

Overall:

- We agree that behavioural economics and technology can be used to ensure that members are more aware of their superannuation accounts, and to reduce the number of members in multiple default funds.
- We believe that the “Best-in-Show” proposal will result in a contraction of the number of superannuation funds operating, which will limit competition in the market.
- We agree with proposals that will reduce the fees on superannuation accounts.
- However we recommend that proposals regarding opt-out insurance within superannuation be designed in a way that ensures that opt-out decisions are reviewed periodically in line with changes in a person’s circumstances.
- We thank the superannuation industry for developing the *Insurance in Superannuation Voluntary Code of Practice*, and support proposals to ensure that it is adopted more widely.



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Submission to Senate Economics References Committee

Inquiry into the 2017 superannuation bills:

Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017

Prepared by Associate Professor Helen Hodgson, Curtin Law School

Submission to Objective of Superannuation

This submission is being made on behalf of The National Foundation for Australian Women (NFAW).

NFAW is dedicated to promoting and protecting the interests of Australian women, including intellectual, cultural, political, social, economic, legal, industrial and domestic spheres, and ensuring that the aims and ideals of the women's movement and its collective wisdom are handed on to new generations of women. NFAW is a feminist organisation, independent of party politics and working in partnership with other women's organisations, including the National Women's Alliances Equality Rights Alliance and economic Security 4 Women. These organisations include those committed to increasing support for women in Australia as well as those with a special interest in women's history.

NFAW is concerned about the financial security of women, and the role of superannuation in achieving that security. To that end we have made a number of submissions to previous Parliamentary and Treasury enquiries into the superannuation system and to the Senate Inquiry into the Financial Security of Women in Retirement.

Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

As noted in the Explanatory memorandum for these Bills, the superannuation system has changed significantly since the Superannuation Industry Supervision Act (SISA) was introduced in 1993. At the time that the SISA was introduced, superannuation funds were still conceptualised as a joint arrangement between employees and employers; which resulted in the inclusion of the joint representation rules in Part 9 of the SISA. Portability of benefits, choice of fund rules and the increase in accumulation funds relative to defined benefit funds have changed this underlying dynamic of the superannuation system.

The proposed Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 replaces the current provisions in Part 9 of the SISA with the requirement that at least one third of trustees are independent trustees.

We note that this provision will apply to all RSE licensees, and will override existing provisions in the trust deeds of registered superannuation entities. However the effect is will be greater in the not-for-profit sector. Notably, the June 2016 APRA Annual Statistics show that of the 44 RSE Trustees that are not required to have equal representation, only two are classified as not for profit licensees. Conversely, of the 36 that require equal representation under the governing rules and the 45 that are required to have equal representation under the legislation only one in each category is a for profit licensee³. For profit funds are more likely to have independent directors than not for profit RSEs by virtue of the relevant FSI and ASX requirements.

Both the Cooper Review⁴ and the Murray Inquiry⁵ recommended that the structure of RSE licensees should require independent directors. Cooper recommended one third of directors be independent, and Murray recommended that a majority of directors should be independent. We note, however

³ APRA (2017) *Annual Fund-Level Superannuation Statistics* June 2016, Table 1; Commonwealth of Australia <http://www.apra.gov.au/Super/Publications/Pages/superannuation-fund-level-publications.aspx>

⁴ Cooper et al (2010) *Super System Review: Final Report* 2010, Commonwealth of Australia <https://treasury.gov.au/publication/super-system-review-final-report/>

⁵ Murray et al (2014); *Financial System Inquiry* Dec 2014 <http://fsi.gov.au/publications/final-report/>

that the Murray inquiry acknowledged that the joint representation model continues to be appropriate for defined benefit schemes with a single employer sponsor⁶.

In contrast to these reviews, the Fraser Review⁷ found that there was insufficient evidence to substantiate the view that that increasing the number of independent directors would improve the governance of not for profit RSEs.

However both reviews also recommended that the requirements to address potential conflicts of interest should be strengthened, with the Cooper Review recommending a “fit and proper person” test and mandatory on-going educational requirements. We note that APRA has issued prudential standards in respect these matters, however they fall some way short of mandatory requirements. Prudential Standard on Governance, SPS 510,⁸ which took effect from 1 July 2017, does not establish any requirements regarding the independence of directors. Prudential standards SPS 520⁹ and SPS 521¹⁰ require the Board to establish processes to ensure that the person is a fit and proper person, including holding relevant qualifications and experience; and to ensure that appropriate processes are in place to manage potential conflicts of interest.

The technical requirements for independence appear to be adequate, being based on

- a 5% interest in the share capital of the RSE; or
- being a director or executive office of a large employer-sponsor (500 or more employees); employer sponsor organisation or a member organisation with representation under the deed.

Although the criteria are reasonable, the effect of the criteria can only be determined by examination of the deed for each affected RSE licensee. To the extent that several member or employer organisations may be represented on the board of a superannuation fund, the effect of the exclusions could significantly limit the field of independent directors, and reduce the limited pool of individuals currently qualified to act as independent directors. In June 2016 of the 1,071 RSE directors, there were 74 directors recorded as independent. There were also 69 director with multiple directorships, although this groups was not reported by representation¹¹. These number have been stable over the three years since 2014.

⁶ Above at p 135

⁷ Fraser, B; (2016) *Board Governance of Not for Profit Superannuation Funds* 16 Feb 2017, <http://www.industrysuperaustralia.com/assets/Reports/Board-Governance-of-NFP-Superannuation-Funds.pdf>

⁸ Superannuation (prudential standard) determination No. 1 of 2016 Prudential Standard SPS 510 Governance

⁹ Superannuation (prudential standard) determination No. 4 of 2013 Prudential Standard SPS 520 Fit and Proper

¹⁰ Superannuation (prudential standard) determination No. 7 of 2012 Prudential Standard SPS 521 Conflicts of Interest

¹¹ APRA (2017) *Statistics: Annual Superannuation Bulletin* June 2016

<http://www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx>

Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017

One of the matters raised in the Fraser Report¹² is the need for funds to communicate clearly with members. To the extent that this Bill improves the flow of information, the Bill should be supported.

MySuper is a growth segment of the superannuation market. By virtue of the default status of these funds, it is appropriate that MySuper funds are monitored closely. However, there is a balance that must be struck between monitoring the performance of MySuper funds and overregulation, particularly when the cost of further regulation will add to fees.

We note that many superannuation funds already implement measures similar to those that are required in this Bill, including internal monitoring and benchmarking of the performance of MySuper funds.

Accordingly:

1. We are not convinced that requiring independent directors on the Boards of superannuation funds will improve accountability.
2. It would be more effective to require mandatory educational and conflict of interest measures to improve the skills of Directors of RSEs.
3. The independent director requirements could reduce the pool of directors eligible to serve on RSE boards.
4. Measures that require superannuation funds to communicate more effectively with members should be supported
5. Increasing the level of regulation of MySuper funds should take account of the likelihood that additional costs will be passed on through increased fees.

¹² Above n 5