



AUSTRALIAN INSTITUTE of
SUPERANNUATION TRUSTEES

Response to Productivity Commission Draft Report: *Superannuation: Assessing Efficiency and Competitiveness*

13 July 2018

AIST Submission to Productivity Commission

Response to Productivity Commission Draft Report: *Superannuation: Assessing Efficiency and Competitiveness*

AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary

In brief:

- AIST agrees that there is no place for long term underperforming funds in the default space. However, we believe enhancing the current Fair Work Commission default selection process and increased APRA scrutiny are the most efficient, appropriate, and importantly the least disruptive ways, to address this issue.
- The Productivity Commission should address the biggest problem of underperforming choice funds in the retail sector, which is a drag on the efficiency of the super sector. The 'best in show' default proposal does not address this.
- Multiple accounts, balance erosion by fees and underperforming funds are serious issues, which are already being addressed by the APRA Outcomes Assessment Test, new ATO services. This should be enhanced by legislation supporting direct fund-to-fund consolidation of lost super.
- The Insurance Code should be implemented and be the focus for lifting standards.
- Regulator benchmarking of fees and returns should be used to assess if funds are delivering fair value and address under-performing funds.

AIST welcomes the Productivity Commission's rigorous analysis of superannuation in the draft report. We share the Commission's view that a mandatory system, with access generally limited to retirement purposes, and taxpayer-funded concessions, needs to be subject to extensive scrutiny, higher standards, and better disclosure and comparability.

We also welcome the acknowledgement that net returns matter most for members' retirement outcomes and that default funds offered by profit-to-member funds have generally outperformed over the long-term.

However, and despite this, the Commission overwhelmingly focuses on proposals to re-engineer the default system and sidesteps consideration of measures to address the more serious problem of underperforming choice funds.

AIST challenges the draft recommendations for a new default selection system, with new entrants to the workforce to be defaulted into one of ten 'best in show' super funds chosen by a new expert panel. The recommendation to dismantle the default system that has generally delivered good performance is neither warranted nor necessary,

AIST agrees that the current default fund selection system can be improved upon and underperforming funds should be removed. There is no place for long-term underperforming

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funds in our default system. But these improvements can occur within the existing default framework, supported by other initiatives currently being implemented.

The existing Fair Work Commission process should be improved by the implementation of a quality filter and expert panel to remove the default status of long-term underperforming funds. This mechanism was previously recommended by the Productivity Commission and then adopted in legislation passed by Parliament. However, it has been stalled by the Government since 2014 and not implemented. The draft report does not contain a serious analysis of the 'as legislated' default model.

The wholesale dismantling of the current system carries risks to existing default members. The one fund-for-life from a best-in-show list could threaten high-performing funds that currently serve a specific industry very well. They do not seek to draw members from a wider pool and pursuing best-in-show status could undermine their insurance offerings and their ability to engage with a particular cohort of members.

Most worryingly, the recommendations ignore serious and systemic inefficiencies in the Choice sector, where the amount of funds under management is nearly twice that of MySuper.

While the report identifies serious issues with insurance, fee erosion and underperforming funds in MySuper, it does not suggest solutions for under-performing and high fee retail choice and legacy funds, despite the Commission finding that profit-to-member super funds systematically outperform for-profit super funds.

AIST believes standards in the choice sector must be raised by requiring the same high standards and levels of disclosure and reporting as apply to MySuper products. The Commission should recommend the benchmarking of fees, costs and return information so regulators can assess if a product is delivering fair value. This must be a pre-condition for the product dashboards recommended by the Commission to be effective.



The Commission's draft recommendations relating to fee capping and exit fees, insurance in super and inactive low-balance accounts/consolidation into active accounts have been partially pre-empted by the Government's Protecting Your Super package of legislation now before Federal Parliament.

New regulation (notably APRA's members' outcome test) will accelerate an already evident trend to industry consolidation in the profit-to-member sector and, in doing so, play a role in reducing multiple accounts and improving scale efficiencies. And the industry Insurance Code (AIST is a code-owner) should be implemented and be the focus for lifting standards.

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A summary of our responses to the draft recommendations is in a table in the following section of this submission.


Summary of responses to draft recommendations

Productivity Commission Draft Recommendation	AIST response	AIST recommendations and summary explanation of AIST response
Draft Recommendation 1: Defaulting only once for new workforce entrants	Disagree 	<p>AIST recommendations</p> <ul style="list-style-type: none"> The ‘as legislated’ but unimplemented default system should be implemented. <p>Summary response</p> <p>The proposal is an unnecessary and inferior replacement of the ‘as legislated’ but unimplemented default system.</p> <p>It will lead to increased member disengagement and does not remove underperforming choice funds from the system.</p> <p>The centralised online service is already substantially developed, and can support employee commencement, choice of fund, consolidation and reporting of the existing and ‘as legislated’ default allocation models.</p> <p>AIST supports the eventual replacement of paper forms by the online service.</p>
Draft Recommendation 2: ‘Best in show’ shortlist for new members	Disagree 	<p>AIST recommendations</p> <ul style="list-style-type: none"> The ‘as legislated’ but unimplemented default system should be implemented. The centralised online system should contain suitable member protection mechanisms to both safeguard members and enable members to properly compare and choose. <p>Summary response</p> <p>The proposal is an unnecessary and inferior replacement of the ‘as legislated’ but unimplemented default system.</p> <p>It will lead to increased member disengagement and does not remove underperforming choice funds from the system.</p>




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AIST supports the provision of consumer protection and comparable product information on the centralised online service.		
Draft Recommendation 3: Independent expert panel for 'best in show' selection	Disagree 	<p>AIST recommendations</p> <ul style="list-style-type: none"> • The 'as legislated' but unimplemented default system should be implemented. • Given the Government's inaction over 4 years, a review of the quality filter criteria and expert panel should be undertaken. • An examination of what data is needed to benchmark fees, costs and returns should be undertaken so that APRA is enabled to undertake such benchmarking. <p>Summary response</p> <p>The Commission has essentially adopted the same quality filter and expert panel as legislated for the Fair Work Commission but has not provided any justification for moving the default fund process from the FWC and the industrial environment.</p> <p>The expert panel should be properly resourced, supported by the regulators (and have two-way communication with them) and have access to quality data. An assessment should be made as to what data does APRA need in order to benchmark fees, costs and returns.</p> <p>A review of the quality filter criteria and expert panel as legislated for the FWC is warranted following four years of Government inaction.</p> <p>FWC default process should recommence immediately after the review. Underperforming funds listed in awards would be removed and issuers of all MySuper products would be able to apply for inclusion.</p>
Draft Recommendation 4: MySuper authorisation	Agree 	<p>AIST recommendations</p> <ul style="list-style-type: none"> • That legislation should allow APRA to apply the MySuper outcomes test to all APRA regulated

		<p>funds, while maintaining the focus on net returns.</p> <ul style="list-style-type: none"> • Further consultation should occur regarding the proposals. <p>Summary response</p> <p>AIST supports measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their MySuper product offerings, provided this assessment does not reduce the existing legislative focus on the pursuit of optimal net returns.</p> <p>Assessment of performance should be on long-term net returns of at least 10 years.</p> <p>AIST supports independent verification of an outcomes test assessment and annual reporting on switching.</p> <p>AIST supports the extension of the test to all APRA-regulated superannuation products. All funds should be required to meet these standards to keep their RSE licences.</p> <p>AIST supports regular, rigorous and independent reviews of this process.</p>
<p>Draft Recommendation 5: Regulation of trustee board directors</p>	<p>Agree</p> 	<p>AIST recommendations</p> <ul style="list-style-type: none"> • The higher standards of maintaining and publishing a board skills matrix as contained in the AIST Governance Code should be replicated in legislation. • Funds should be required to assess board performance at least annually, disclose the process, and seek third party evaluations. • Independent directors should not be mandated. <p>Summary response</p> <p>AIST is a lead advocate for higher governance standards and supports the higher standards of the AIST Governance Code being replicated in legislation and to apply to all fund trustees.</p>






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<p>The AIST Governance Code requires the publication of an annual skills matrix of boards.</p> <p>AIST supports external third-party evaluation of board performance.</p> <p>AIST supports funds being able to appoint up to one third independent directors without APRA approval.</p>		
Draft Recommendation 6: Reporting on merger activity	Agree 	AIST recommendations <ul style="list-style-type: none"> We agree with the Productivity Commission's recommendations, subject to premature disclosure not jeopardising the merger attempt.
Draft Recommendation 7: Capital gains tax relief for mergers	Agree 	AIST recommendations <ul style="list-style-type: none"> We agree with the Productivity Commission's recommendations. <p>Summary response</p> <p>AIST has advocated for this over many years.</p>
Draft Recommendation 8: Cleaning up lost accounts	Alternative proposed 	AIST recommendations <ul style="list-style-type: none"> Lost super accounts should be cleaned-up by mandated fund to fund transfers of lost super accounts into active accounts, and without a requirement for member consent. That the Productivity Commission should not make recommendations which would result in increased transfers of superannuation money into consolidated revenue. An analysis should be undertaken regarding the quantity and causes of unpaid super and identify solutions. <p>Summary response</p> <p>AIST supports the pro-active use of technology and improved ATO services to reunite lost and inactive super with members' active accounts.</p>





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		<p>AIST supports reducing the lost inactive threshold to two years.</p> <p>Lost super accounts should be cleaned up by mandated <i>fund-to-fund transfers</i> of lost super accounts into active accounts.</p> <p>The Commission should not make recommendations that result in increased transfers of superannuation into consolidated revenue.</p> <p>AIST supports the ability for members to explicitly signal that they want to remain in the original fund.</p> <p>All ERFs should be required to undertake account consolidations.</p>
Draft Recommendation 9: A member friendly dashboard for all products	<p>Agree</p> 	<p>AIST recommendations</p> <ul style="list-style-type: none"> • The requirement to have Choice dashboards should be legislated. • First, however, fixing the gaps in Choice disclosure and reporting should occur prior to Choice dashboards being implemented. • A review of product dashboards design and methodology should take place, with review including consumer testing. <p>Summary response</p> <p>AIST supports the use of dashboards to improve member engagement and improved superannuation literacy.</p> <p>However, they are not a universal panacea. Disclosure - however well done - does not reduce the need for high levels of consumer protections for all members.</p> <p>AIST supports a review of the MySuper dashboard (which must include consumer testing) and its extension to all super products.</p> <p>Dashboards require better, more comparable data.</p> <p>AIST supports the centralised publication of dashboards.</p>




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Draft Recommendation 10: Delivering dashboards to members	Agree 	AIST recommendations <ul style="list-style-type: none"> AIST agrees that dashboards be incorporated within the centralised online service.
Draft Recommendation 11: Guidance for pre-retirees	Agree 	AIST recommendations <ul style="list-style-type: none"> AIST agrees with the Productivity Commission's recommendations.
Draft Recommendation 12: Exit fees at cost recovery levels	Go further 	AIST recommendations <ul style="list-style-type: none"> The Government's Protecting your Super package be implemented, subject to indirect costs being included in the fee cap and that sell spreads be included in the ban on exit fees. <p>Summary response</p> <p>This recommendation does not go far enough and AIST supports the stronger measure of prohibiting all exit and switching fees immediately.</p>
Draft Recommendation 13: Disclosure of trailing commissions	Go further 	AIST recommendations <ul style="list-style-type: none"> All trailing commissions should be banned immediately. Funds which have charged previously grandfathered members should be required to advise those members that these payments are illegal. <p>Summary response</p> <p>This recommendation does not go far enough and AIST supports the stronger measure of prohibiting all trailing commissions immediately, with full disclosure to members still being charged.</p>
Draft Recommendation 14: Opt-in insurance for members under 25	Alternate proposal 	AIST recommendations <ul style="list-style-type: none"> Funds should be able to retain an ability to provide default cover to members aged between 21 and 24.

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Draft Recommendation 15: Cease insurance on accounts without contributions	Agree 	AIST recommendations <ul style="list-style-type: none"> • We agree with the Productivity Commission's recommendation, provided that: <ul style="list-style-type: none"> ○ It applies to members with an account balance of less than \$6,000. ○ Members receive appropriate communications. ○ Inactive members can elect to continue to receive insurance. ○ The period of inactivity is extended from 13 months to 16 months. ○ Extending the timeframe for inactivity from 13 to 16 months will allow trustees to better meet the needs of members on parental leave and consider SG payment cycles.
Draft Recommendation 16: Insurance balance erosion trade offs	Agree 	AIST recommendations <ul style="list-style-type: none"> • We agree with the Productivity Commission's recommendations. <p>Summary response</p> <p>Articulation of the insurance/balance erosion trade-off is already required under the SIS Act insurance covenants and SPS 520 but agree it can be improved and better communicated to members.</p>
Draft Recommendation 17: Insurance code to be a MySuper condition	Disagree 	AIST recommendations <ul style="list-style-type: none"> • That the Insurance Code should not be mandatory. <p>Summary response</p> <p>High take-up rates for the Insurance Code mean there is no need to make the Code mandatory.</p>
Draft Recommendation 18: Insurance code taskforce	Agree 	AIST recommendations <ul style="list-style-type: none"> • We agree that a joint regulator taskforce should be established.

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Summary response		
Code monitoring and reporting by a joint regulator taskforce is supported, and another reason why the Code does not need to be mandatory.		
Draft Recommendation 19: Independent review of insurance in super	Agree 	AIST recommendations <ul style="list-style-type: none"> We agree with the Productivity Commission's recommendations.
Draft Recommendation 20: Australian Prudential Regulation Authority	Agree 	AIST recommendations <ul style="list-style-type: none"> We agree with the Productivity Commission's recommendations, provided that: <ul style="list-style-type: none"> There is a consultation process with industry to ensure information is provided in a consistent way. APRA provides a report on how the information is used. There is alignment with member outcomes test requirements. Details of the requirements are designed so as not to be unduly onerous on funds. APRA should also be required to demonstrate how each of the steps being taken further to these requirements is progresses the overall interests of members and the superannuation system.
Draft Recommendation 21: Australian Securities and Investments Commission	Agree 	AIST recommendations <ul style="list-style-type: none"> We agree with the Productivity Commission's recommendations, provided that: <ul style="list-style-type: none"> They are not at the expense of high standards of consumer protections and undue reliance is not placed on dashboards. Issues of comparability, benchmarking and the avoidance of carve-outs must be resolved as a pre-condition to

improved benchmarking and – as a result – consumer protection.		
Draft Recommendation 22: Superannuation data working group	Agree 	AIST recommendations <ul style="list-style-type: none"> • We agree with the Productivity Commission’s recommendations, provided that: <ul style="list-style-type: none"> ○ There is a consultation process with industry to ensure data collection and reporting objectives are discussed; and ○ Information is provided in a consistent manner, the regulators provide a report on how the information is used, and the details of the requirements are designed so as not to be unduly onerous on funds. • The regulators should also be required to demonstrate how each of the steps being taken further to these requirements is progresses the overall interests of members and the superannuation system.

Chapter 2 – Investment performance

AIST KEY POINTS:

- **AIST agrees that long-term net returns are the most relevant member outcomes.**
- **Benchmarking of fees, costs and returns is needed to better protect consumers and allow analysis of the superannuation system, and the Commission's benchmarked portfolios are an important step forward.**
- **The poorer performing choice sector requires the most regulatory and legislative attention.**

AIST agrees that long-term net returns are critical to members' retirement outcomes and note the finding that profit-to-member funds as a group have outperformed the for-profit funds. We strongly support the focus on member outcomes.

AIST's recommended solutions to enabling a proper assessment of the superannuation system are:

- System objectives which have key performance indicators suitable for assessing progress and are capable of being monitored.
- Specification of what is needed to benchmark fees, costs and net returns. Benchmarking then needs to be implemented through improved collection and analysis of data by APRA.
- Gaps in the current legislative framework need to be filled.

It is important that any assessment of investment performance, fees and costs is seen within the context of superannuation not being viewed only as a competitive system driven by choice. Superannuation in Australia is mandatory and as such, members of superannuation funds and other taxpayers need the comfort of knowing that the system is being properly analysed, regulated, supervised, and actively reported upon.

Whether these fees and costs are currently delivering fair value to net returns is uncertain. What we do know is that MySuper products overall has delivered far better results to members and that choice products generally underdeliver. We also know that there are systemic legislative carveouts regarding choice products and other products and services (e.g. commissions and general advice and over the counter) from the disclosure and reporting obligations.

AIST applauds the Productivity Commission for its work on developing several benchmarked portfolios to assess long-term investment performance. AIST has consistently advocated to the Productivity Commission, APRA, ASIC and Treasury that benchmarking of fees, costs and net returns is a vital but missing element of analysing the superannuation system.

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AIST strongly recommends that the Productivity Commission focus on fixing areas where the substantive problems lie.

2.1 How is the system being assessed?

While AIST is not commenting on the Commission's benchmarks in detail, we note that they do illustrate the lack of transparent and comparable data. For example:

- Investment costs both across or within asset classes are not disclosed or reported in a comparable way. Examples include differences between MySuper or choice, whether the investment is in listed or direct property, or whether the investment is in a non-platform or platform superannuation product;
- *Regulatory Guide 97: Fees and Cost Disclosure* treats the fees and costs of various asset classes and sectors differently. SuperRatings¹ has stated that 'disclosure mechanisms by Platforms and Superannuation Funds can be very different, while the disclosure processes with regards to property costs can also vary. For example, the same property held jointly by a REIT and a Superannuation Fund directly, could have materially different disclosed costs. This could result in a superannuation fund having to disclose fees associated with the holding of that asset, at a multiple two to three times the level disclosed by the REIT, despite the actual costs being materially the same (or less); and
- Administration costs are disclosed in different ways.

The vital question is what data is needed to benchmark the performance of the various asset classes within the superannuation system including what taxonomies need to be settled?

AIST believes that the role of benchmarking should be managed at regulator level and set within the legislative framework. Without this information, it is difficult to see how system efficiency, the APRA member outcomes test, or the proposed ASIC product design and intervention powers can be implemented or assessed. Such data could also be used to identify where conflicts of interest have had an impact on member outcomes.

2.2 How has the system performed?

AIST agrees that, without a set of transparent and comparable data, it is difficult to properly assess the product performance. AIST agrees with the Productivity Commission and the SMSF Association that SMSFs do not suit everyone. We believe that SMSFs should be reporting

¹ SuperRatings (2018). *Australian Institute of Superannuation Trustees Fee and Performance Analysis*. June 2018. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/yal75ayt> [Accessed 9 Jul. 2018].

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adequate data against which to assess their performance, especially since their underperformance impacts on the sustainability of the taxpayer funded age pension.

2.3 How have options and asset classes performed?

AIST agrees that the results support the view that many members are doing relatively well in the superannuation system if they are in a diversified investment option.

Benchmarking the system requires a review of taxonomies used. As the Productivity Commission appreciates, such analysis is based on how 'growth' or 'defensive' assets are categorized in Product Disclosure Statements.

2.4 How have different segments performed?

Default and choice segments

AIST strongly disagrees with the Productivity Commission's comment that in many ways, the choice segment is inherently different to the default segment. The Productivity Commission states this is the case because on the demand side, members are more likely to have exercised choice and on the supply side, the products on offer are more heterogeneous.

While the performance of the choice products in the for-profit sector is 'inherently different' through substantially higher fees and general underperformance, it is partly funded through taxpayer concessions and should be delivering sound, comparable and transparent outcomes for members.

There is also little evidence as to how members choose. AIST's advocacy regarding the need to set data needed to benchmark as well as closing legislative gaps eroding the regulatory framework should apply to all superannuation options. If this does not happen, then there is a greater demand on the age pension.

Investing all choice money in MySuper for 10 years

One of the prime drivers of superannuation value has been the 5% return provided above inflation for 25 years or more by MySuper products and their predecessors, balanced funds.

In contrast to the view that members who choose to invest their superannuation assets outside MySuper products should achieve a better outcome as they are tailoring their investment decisions to their personal circumstances and financial goals, an analysis undertaken by RiceWarner for AIST shows that this is not generally the case.

Their analysis shows that higher returns and lower fees of MySuper products could continue to have a material impact on the superannuation market over the next 10 years. RiceWarner's modelling shows that, if all members of APRA regulated funds had fees and returns consistent

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with the average MySuper product, superannuation assets would be \$52.5 billion higher (in today's dollars) in 10 years' time (compared to their baseline projections).

Assets in choice compared with MySuper

We agree that simply looking at averages mask a diverse range of products and fund types.

The Productivity Commission suggests that the assets in choice are evenly split between for-profit funds and profit-to-member funds. AIST does not agree that this is the case, based on the following data. This shows that the profit-to-member sector has approximately half the value in choice products of the for-profit sector.

That there are variances in such significant data further highlights the need to examine what data is needed to properly benchmark and otherwise assess the system.

The table below shows estimated MySuper and choice assets at 30 June 2017:

Market segment	Pre-Retirement			Retirement	Total	
	Choice	MySuper		Choice	All	MySuper
	(\$m)	(\$m)	(%)	(\$m)	(\$m)	(%)
Not-for-Profit Funds						
Corporate Funds	44,490	21,125	32.2	10,576	76,191	27.7
Industry Funds	159,713	349,826	68.7	63,189	572,727	61.1
Public Sector Funds	167,511	120,232	41.8	57,703	345,445	34.8
Subtotal	371,714	491,183	56.9	131,467	994,364	49.4
Commercial Funds						
Employer Master Trusts	57,506			-	160,991	
Personal Superannuation	249,885	103,482	24.9	-	249,885	16.4
Eligible Rollover Funds	4,400			-	4,400	
Commercial Post Retirement Products	-	-	-	216,298	216,298	-
Subtotal	311,791	103,482	24.9	216,298	631,572	16.4
Self-Managed Super Funds						
Self-Managed Super Funds	217,507	-	-	481,118	698,625	-
Subtotal	217,507	-	-	481,118	698,625	-
Total superannuation market	901,012	594,666	39.8	828,883	2,324,561*	25.6

*Excludes unallocated reserves.

Source: Rice Warner's 2017 Superannuation Market Projections

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For-profit and profit-to-member funds – a systematic performance divide

In the MySuper sector, where disclosure and reporting to APRA is more aligned than in choice, profit-to-member funds outperform.

For-profit funds have been also afforded many and ongoing carveouts to their disclosure and reporting to APRA requirements. We have summarised these in past submissions². They include differences in disclosure both within and between asset classes, thereby affecting the lack of comparability both within MySuper and choice. These significant carveouts raise the question as to the quantum of costs which have and continue to be hidden from members (minimising their net returns), regulators, and those keen to analyse the system.

Differences in performance may be attributed to several factors including governance structural differences and different investment styles and asset allocations. Structural differences in governance can have an impact on raising fees in the for-profit sector. We will examine this in our comments about fees.

The profit-to-member sector outperforms the for-profit funds in relation to each style of option, except Secure, and for certain periods in International Shares and Property³.

The table below shows median returns for choice product Balanced investment options (60-76% in growth assets):

	1-year	3-years (p.a.)	5-years (p.a.)	7-years (p.a.)	10-years (p.a.)
Profit-to-member median	10.45%	7.91%	9.96%	8.65%	5.45%
Retail master trust median	9.05%	6.82%	9.01%	7.66%	4.34%
All Fund Median	9.55%	7.13%	9.34%	8.09%	5.03%

² Most notably AIST (2017). *Senate Inquiry into consumer protection in the banking, insurance and financial services sector*. AIST Submission, 7 March 2017. [online] Canberra: Senate Standing Committees on Economics, chapter 3. Available at: <https://tinyurl.com/y83a28xk> [Accessed 13 Jul. 2018].

³ SuperRatings (2018). Report as cited previously in this submission. “Secure”, “Balanced”, “International Shares” and “Property” are examples of investment option categories used throughout the report, and have been capitalised to reflect SuperRatings’ system of categorisation.

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The table below shows median fees across sectors for choice Balanced investment options (between 60% and 76% in growth assets):

Sector	Member Administration Fee	Asset-based Administration Fee	Investment Management Fee	Indirect Cost Ratio
Profit-to-member median	\$78.00	0.15%	0.48%	0.32%
Retail master trust median	\$78.00	0.54%	0.58%	0.16%
All Fund	\$78.00	0.27%	0.55%	0.19%

The following table compares Balanced option fees across the two sectors based upon a range of account balances, to understand the impact of member and asset-based fee differentials:

Sector	\$5,000	\$50,000	\$250,000
NFP	\$124.00	\$598.00	\$2,663.40
RMT	\$166.47	\$846.50	\$3,720.02
All Fund	\$140.20	\$724.00	\$3,200.50
Retail Master Trust / Profit-to-member	134%	142%	140%

2.5 What is the variation in performance within the system and segments

AIST agrees that funds delivering poor long-term returns should not be part of the system.

We repeat our concerns that currently, there is no agreed way to benchmark fees, costs and returns and that the legislative framework has been persistently eroded in favour of bank and retail superannuation funds. This legislative erosion is systemic and that it exists has been documented by AIST to APRA, ASIC, Treasury, and the Productivity Commission.

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Given that there are many competing priorities, AIST strongly contends that it is the poorer performing choice sector which needs the most attention, both in terms of regulatory and legislative focus.

Chapter 3 – Fees and costs

AIST KEY POINTS:

- **Legislative carveouts, gaps and inconsistencies need fixing so that the system may be benchmarked and that members may properly compare outcomes.**
- **There is a wide variation in fees and costs, with the for-profit funds generally underperforming and having between 117-182% more expensive choice products than profit-to-member funds.**

AIST queries the Productivity Commission’s comment that fees are driven by market dynamics, especially since the Commission goes on to note that on average, funds that charge higher fees do not deliver better net returns to their members over time. There is something other than market dynamics which is driving fees, and AIST contends that it is the culture and remuneration incentives within for-profit funds as evidenced by higher fees and poorer returns.

AIST agrees that there are inconsistencies with how fees and costs are reported, but that this problem requires fixing through remedies other than only regulator endeavours. A mix of solutions is needed, including:

- Legislative change to close the disclosure and reporting gaps between profit-to-member funds and for-profit funds.
- Identifying and implementing what is needed to benchmark fees, costs and returns.
- Establishment of a data framework against which all regulator requests for data and what may be reported back to industry can be assessed.

Just as one example, there is even inconsistency as to what is a ‘fee’ given that currently, funds can elect that fees be instead treated as indirect costs. AIST is awaiting the outcome of the RG 97 fee and cost disclosure review being undertaken by Darren McShane and has made many submissions regarding the lack of transparency, consistency, or a level playing field.

3.1 Trends in fees and costs

AIST can neither agree or disagree with the comment that the costs of Australian superannuation funds are amongst some of the highest in the OECD. This is mainly because fees and costs cannot be meaningfully compared even within Australia.

As for comparing Australia’s fees internationally, the objectives for each system and the regulatory environments differ greatly across jurisdictions. The RBA submission to the Financial System

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Inquiry⁴ also points out the limitations of comparing the costs of Australia's system to international comparisons. It notes that any comparisons must recognise:

- The objective of universal coverage necessarily results in many more small accounts than would exist in a less comprehensive system;
- The Australian system provides participants more choice than is present in most other jurisdictions: The fragmentation of the system resulted from the decision in 1993 to employ private market participants to administer the monies mandated by the Superannuation Guarantee;
- There are material differences in the tightness of regulatory settings in different jurisdictions; and
- Many of the systems to which the Australian system is compared are comprised predominantly of defined benefit schemes.

The RBA submission notes that the first four factors above are the result of policy decisions taken by government and are outside the control of market participants, while the fifth, the prevalence of DC schemes over DB schemes, makes the Australian system appear to be costlier, but only because the costs in other jurisdictions are understated. AIST endorses these distinctions between the Australian superannuation system and schemes in other parts of the world and submits that true international comparisons are complicated as a result.

Exit and switching fees

Since the release of the draft Report, the Government has introduced the *Treasury Laws Amendment (Protecting Your Superannuation) Bill* 2018 into Parliament. AIST supports measures in this Bill to ban exit fees regardless of the account balance. AIST sought that sell spreads should also be included in the prohibition, as otherwise what comprises an exit fee may be gamed. This advocacy has not yet been reflected in the Bill.

There is a wide fee variation across segments

We query the basis for the Productivity Commission saying that for-profit funds may have become more responsive to member needs. The median for-profit fees in the choice sector on a \$50,000 account balance are between 117% to 282% more expensive than in a profit-to-member fund, depending on which type of option.

⁴ Cited in Herbert Smith Freehills (2018). *Financial System Inquiry Costs in Superannuation*. 14 August 2014. [online] Sydney. Available at: <https://tinyurl.com/y76mgm46> [Accessed 9 Jul. 2018].

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A recent report commissioned by AIST⁵ shows that using median fees in the choice sector, someone with \$50,000 in a bank-owned and retail super fund Balanced option could be paying \$248.50 per annum more in fees – and if they had \$250,000, it could be \$1,056.62 extra each year compared with a profit-to-member fund. The bank-owned and retail super fund returns are generally lower.

Retirement fees have come down faster than accumulation fees

We dispute the Productivity Commission's comment that fees in the retirement phase can reflect (among other things) greater levels of member engagement, tailored products and advice as members begin to draw down their balances and that retirement products generally incur higher administration costs than accumulation products.

All retirement moneys – if in an APRA regulated fund – are in choice products. The for-profit level of fees and general underperformance compared with profit-to-member funds in the choice sector show a distinct lack of member engagement and the impact of poor advice. We can provide a breakdown by each main investment option type if the Productivity Commission would like this information.

Investment management costs have trended down

AIST agrees that there is a variation in how costly it is to invest in particular asset classes. This issue is exacerbated by the impact of RG97, where there is inconsistent treatment of how costs are disclosed depending upon the asset class and also how products are treated. (e.g. there is a variation between platform superannuation and non-platform superannuation).

⁵ SuperRatings (2018). Report as cited previously in this submission.

Chapter 4 – Are members’ needs being met?

AIST KEY POINTS:

- The superannuation system is generally delivering well.
- Superannuation is supported by both members and taxpayers.
- While there are public policy initiatives designed to assist product improvement, more work needs to be done at system analysis and benchmarking level in order to better protect members and taxpayers.
- More work is also needed in the retirement phase. AIST strongly supports development of retirement income frameworks by trustees.

Notwithstanding the chronic underperformance of the choice sector, the performance and sustainability of Australia’s super system ranks highly against other countries. We point to two key evidence points:

- The Melbourne Mercer Global Pension Index ranks Australia third of 30 countries.
- The AIST-Mercer Super Tracker, which examines whether Australia is delivering against ten stated objectives for the Australian system, ranks the system as delivering 68/100.

We restate our earlier comments that the focus of the Productivity Commission should be on those areas which are not (based on evidence) delivering, e.g. the choice sector.

Members’ needs are ultimately about receiving the best retirement outcome for them. As the International Organisation of Pension Supervisors notes⁶, members make few decisions in pension systems and accordingly need protection. AIST has provided suggested solutions above, including the benchmarking of fees, costs and returns.

We query the manner in which superannuation is viewed. Superannuation is a public good, supported by both members and taxpayers and, accordingly, more is needed to protect members and, ultimately, taxpayers. However, it is not an economic “search good”: Members cannot be expected to assess, for example, the impact that conflicts of interest have on the potential to achieve their best possible retirement income. While AIST strongly supports public policy initiatives which are aimed at improving products – such as the member outcome test and the

⁶ Stewart, F. and Ashcroft, J. (2010). Managing and Supervising Risks in Defined Contribution Pension Systems. *International Organization of Pension Supervisors Working Paper No. 12*. Available at SSRN. [online] Available at: <https://tinyurl.com/y8wm2pus> [Accessed 9 Jul. 2018].

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product design and distribution proposals – these are at product level, and more work needs to be done at system analysis level.

4.1 Do members *believe* they are being well served?

Member satisfaction is an element of system success but, ultimately, the system needs to protect members. AIST notes that it has been unable to find any research which correlates the level of satisfaction with the outcome of any choice the member has made, including an SMSF. It is clear that the for-profit “choice” sector has not generally delivered to members, even if they believe they are being well served.

4.2 Is there product proliferation and does it matter?

AIST strongly believes that product proliferation does matter, especially as the benchmarking of performance and fees are not currently possible and choice products are afforded many legislative disclosure and reporting carveouts.

With over 40,000 investment options, AIST contends that this makes it extremely difficult to benchmark the outcomes which members are receiving from so many options. Clearly, this is not serving members well.

Legacy products are a further problem since they do not disclose nor report key data. Once again, members are in products the outcome of which cannot be benchmarked.

4.3 Are products meeting people’s needs in the transition to retirement? Life cycle products

AIST commissioned RiceWarner⁷ to examine lifecycle products. The main findings were that in general:

- For-profit funds utilise lifecycle products rather than profit-to-member funds.
- There is a risk of cross-subsidisation across the membership base.
- If a lifecycle product was used in a profit-to-member fund, de-risking occurs at a later age and produces a better member outcome.

4.4 Variety is needed in the drawdown phase

AIST agrees that more weight needs to be given to the decumulation phase and shares the Commission’s misgivings about the mandating of a ‘MyRetirement’ default.

⁷ Rice Warner (2016). *Lifecycle MySuper Product Fees*. 28 October 2016. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y926sdpw> [Accessed 9 Jul. 2018].

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AIST has long advocated⁸ the need for a retirement income strategy. We have recently repeated this advocacy in our response to the Retirement Income Covenant Position Paper. Our response may be summarized as follows:

- AIST continues to advocate for a retirement incomes framework, based on trustees assessing member needs;
- Having (or not having) a 'MyRetirement' default should be a matter for the trustees, considering member characteristics and needs;
- AIST disagrees with the definition of a CIPR proposed in the Retirement Income Covenant Position Paper as it stipulates the types of products which must be included;
- Specific and informed member consent would be required for a member to take up the default;
- A longevity product may not be in members' best interests;
- We agree with the Productivity Commission that complex products which limit members' consumer rights must be examined by members with the assistance of financial advice, since there can be no single product which meets member needs; and
- Retirement product disclosure requires review both in terms of choice product disclosure and the disclosure of pooled longevity products.

4.5 Innovation and quality improvement in the system

AIST agrees that products should be designed taking members' needs and data into account. Tailoring of products is important.

The issue of data management does not just relate to the data which superannuation funds capture. AIST has consistently advocated for the development of a data framework, which could include what data is needed to benchmark fees, costs, and returns; how will data be shared by the regulator; how will any new calls for data by the regulator be assessed; and what data pool insights might the ATO share so that greater data pools are available to assess member needs.

⁸ AIST (2018). *Response to Retirement Income Covenant Position Paper*. 15 June 2018, AIST Submission to Treasury. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/yaec9ptg> [Accessed 9 Jul. 2018].

Chapter 5 – Member engagement

AIST KEY POINTS:

- **No member is able make a fully-informed decision about their super given legislative gaps and exemptions, and a lack of benchmarking fees, costs and returns at system level.**

AIST reiterates that in a mandated superannuation system partly funded by taxpayer concessions and within which members make few decisions, members should be properly protected through regulator assessment of whether they are getting fair value, and through having a regulatory framework which is sound. Currently, members do not have this safety net.

Superannuation is not an economic search good, driven by consumers making regular decisions about the price and quality of a product. We underpin our advocacy that the regulatory framework is not currently sound, given the numerous carveouts and inconsistencies. Even the most highly engaged member is not in a position where they can make a completely sound decision.

AIST agrees that where a member turns to disclosure documents, they should be such that a member can compare and understand them. A layered approach to disclosure should be considered and could include detailed information needed to benchmark the system being sent to the regulators, aggregated fee and cost information at member level (as is being rolled out in the UK), and more detailed information for the member if requested including revised product dashboards which need to be suitably member tested.

5.1 How engaged are superannuation members?

Engagement can comprise both active and passive activity. Some of our member funds have noted that both younger and older members show genuine interest in the funds through registering to log on to their account, calling the contact centre, and even sending substantive feedback via member surveys.

Superannuation is not like a bank account that is transaction-oriented. It is more analogous to health or other insurances – people know they have them or are on the right track, check in once a year or when there is an ‘event’. However, it is more practicable for funds to engage with members at workplaces when the majority of members are in the one fund. This would not be the case if members are assigned to funds on a numerical basis.

AIST will be conducting research regarding how members go about the process of choosing funds, and what they consider.

5.2 Are active members and member intermediaries able to exert material competitive pressure?

AIST neither agrees nor disagrees that the demand side pressure in superannuation is weak. Critically, members need suitable protection and analysis undertaken by the regulators, the outcomes of which help drive competition. The implementation of MySuper is a good example of this. Prior to MySuper, profit-to-member fund fees were lower than for-profit funds and returns were better. Once the for-profit funds had finally transferred accrued funds to MySuper, the MySuper regulator focus and legislative framework helped drive down for-profit retail fees.

Exit and other costs are not a large barrier to switching or engaging

Critically, and as the Productivity Commission has noted, exit fees from legacy products are not known. Exclusion of responsibility to disclosure to legacy product members is but one of the many legislative carveouts which requires closing.

AIST notes that since the draft Productivity Commission's report was released, a Bill to ban exit fees has been introduced into Parliament.

Chapter 6 – Erosion of member balances

AIST KEY POINTS:

- **The problem of duplicate accounts should be tackled in tandem with measures to curb unpaid super, including Single Touch Payroll, real-time fund reporting to the ATO, improved arrears collection and payslip reporting requirements.**
- **Automated solutions to reduce the creation and incidence of multiple accounts should be have been implemented as planned from 2014 and should be facilitated now.**
- **Lost super accounts can be cleaned-up by mandated fund-to-fund transfers of lost super accounts into active accounts, and all ERFs should be required to undertake consolidations.**
- **All trailing commissions should be banned immediately.**
- **The Productivity Commission should not make recommendations which would result in increased transfers of superannuation money into consolidated revenue.**
- **AIST supports reducing the lost inactive threshold to two years.**
- **All ERFs should be required to undertake account consolidation.**
- **An analysis should be undertaken regarding the quantity and causes of unpaid super and identify solutions.**

AIST agrees that the unnecessary erosion of member balances is a serious problem for the superannuation system that requires urgent attention by government, ATO and the super industry.

AIST has been proposing policy responses to address this since at least the Super System review in 2010. We have also been involved in various activities aimed at reducing the problem, especially with the ATO. Notwithstanding this, the problem remains large, with small account balance members the most affected.

The abolition of member benefit protection, high levels of unpaid super, increasing insurance premiums, unimplemented policy solutions, inadequate ATO powers, and insufficient attention by the industry have all contributed to the problem.

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While we generally agree that “much (but not all unnecessary balance erosion is beyond funds’ control”⁹, the pursuit of unpaid super by super funds is an area where activity by funds can make a difference, and this is addressed in the later section on arrears collection.

6.1 Multiple accounts

AIST agrees with the Commission’s estimates of the number and cost of unintended multiple accounts, their profile and their impact on retirement savings. We also agree with the observation that the incidence of multiple accounts has been falling. We argue later in this section that the incidence would be materially lower had the government implemented measures it announced back in 2011.

Regulatory lag

AIST does not agree that the existing default fund selection system is the overwhelming structural cause of multiple accounts, although we accept that it is a contributing factor. Rather we argue that deficiencies in data collection, sharing, matching and consolidation since the inception of the ‘universal’ superannuation system is the biggest offender:

- Before SuperStream, the quality of data meant identifying duplicate accounts within a fund – let alone between funds – was extremely difficult and subject to regulatory constraints.
- Regulatory assistance to address multiple accounts has been incremental. For example, funds were only able to use TFNs for the purpose of facilitating the consolidation of multiple accounts within a fund since 2011. A further example relates to AUSfund, which we cover below.
- SuperStream is new and replaces manual processes which have already resulted in errors. These will take time to fix.

AIST submits the Commission should further explore and support existing and nascent measures rather than dismissing them as making ‘slow progress’.

Industry initiatives

The profit-to-member industry has taken steps through AUSfund to address multiple accounts over many years. However, despite noteworthy results, these measures have not been applied across the board and have been frustrated by regulatory constraints.

⁹ Productivity Commission (2018). *Superannuation: Assessing Efficiency and Competitiveness*. Productivity Commission Draft Report, April 2018. [online] Canberra: Commonwealth of Australia, p.245. Available at: <https://tinyurl.com/ycmuoojg> [Accessed 9 Jul. 2018].

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Over the period 2001 to 2013, AUSfund's cross-fund matching activities resulted in the consolidation of 830,000 accounts into members' active accounts, the location and provision of valid addresses for AUSfund members and the members of funds working with them.

This was curtailed from 2013 to 2016 following ASIC concern about their regulatory foundation. These concerns were overcome by regulatory changes in 2016, and AUSfund cross-fund matching activities resumed this year.

AUSfund recently reported¹⁰ that its 2017-18 cross fund matching programme had successfully matched 108,000 accounts and 54,400 accounts could be immediately repatriated to eligible active accounts.

This provides another example of the regulatory obstacles that have hindered the use of tools to could address the problem of multiple accounts.

Defaulting once proposal

The Commission identifies¹¹ a range of initiatives and tools to support consolidation of accounts. What each of the identified tools has in common is that they are voluntary. The Commission then goes on to recommend that the online choice form should be made a requirement for all new employees¹².

AIST agrees that the online choice form should be presented to all new employees (not just new entrants to the workforce) as a means of increasing their engagement with their super.

However, we do not agree that individuals should be forced to choose between competing funds. In an efficiently operating system (such as the 'as legislated' changes to the Fair Work Commission model), the best decision might be to make no decision and accept the default option. This should not be structurally prevented or discouraged.

AIST has been actively involved with the ATO in the development of the online choice form, and supports its rollout, and its eventual replacement of the paper-based standard choice form. The online form has been developed in the context of the existing default fund selection process and will assist with the efficient operation of this system. It also explicitly encourages the

¹⁰ Meehan, N. (2018) 'FW: AIST submission to productivity commission', email to David Haynes, 25 June 2018.

¹¹ Productivity Commission (2018). Draft report, as cited previously in this submission, p.245.

¹² We also note that the voluntary quotation principle applying to the use of TFNs means that people cannot be forced to give their TFN (or even have one).

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consolidation of accounts, and AIST supports the further strengthening of the form to encourage and facilitate consolidation.

The savings identified by the Commission through use of the form to consolidate accounts and prevent unnecessary duplication of accounts would equally apply to use of the form in the context of the existing default fund selection process. This is another instance where AIST submits that the Commission should concentrate on fixing the problem through enhanced implementation of an existing and emerging solution, rather than changing the whole default system to achieve the same result.

Previous policy proposals

The Stronger Super reforms of 2011-12 included proposals for improving SG compliance. On 21 September 2011, the then government announced:

...new processes for locating and consolidating multiple member accounts that will see lost and inactive accounts with balances under \$1,000, and accounts in eligible rollover funds consolidated into the member's current active account (unless the member opts out)¹³.

The processes to be implemented by the government were developed as part of the Stronger Super consultation process by the SuperStream Working Group. That is, they were developed in consultation with the super industry and other relevant parties, including employers, administrators and payroll providers.

While the Commission has found that the implementation of SuperStream has been overwhelmingly beneficial¹⁴ the draft report is silent on the adverse impact of the non-implementation of some SuperStream measures, including those the subject of government announcements. Had these policies been implemented, the problem of multiple accounts would have been largely fixed by today.

The new arrangements were intended to be introduced in a staged process. The final stage of implementation would have taken place four years ago and would have seen auto-consolidation of lost and inactive accounts (two years without contributions or rollover) with a balance of less than \$1,000 and accounts in eligible rollover fund from January 2014 as well as similar changes to the

¹³ Australian Government (2011). Stronger Super. Information Pack 21 September 2011. [online] Canberra: Commonwealth of Australia. Available at: <https://tinyurl.com/ya6jwp7g> [Accessed 9 Jul. 2018].

¹⁴ Productivity Commission (2018). Draft report, as cited previously in this submission, p.56.

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enrolment process for new employees from July-December 2014. The threshold was proposed to increase to \$10,000, subject to a review by Treasury, ATP and APRA.

Instead of implementing this process to resolve the problem of multiple accounts, in August 2013 the former government announced it would increase instead progressively increased the threshold for transferring inactive accounts from funds to the ATO from \$2000 to \$4000 by December 2015 and to \$6000 by December 2016. (This followed an earlier change on December 2012 when the previous threshold of \$200 was increased to \$2,000). This measure was legislated and subsequently many hundreds of million dollars of members' account balances were transferred to consolidated revenue.

There has been some significant progress made on multiple accounts and unclaimed super. Over the past four financial years (1 July 2013 – 30 June 2017) lost and inactive accounts up to \$6,000, with about 1.68 million accounts to the value of \$8.12 billion having been consolidated, transferred or claimed by fund members as a result of the system reforms introduced and implemented by the ATO and the super industry ¹⁵.

However, and as the Commission emphasises, there is much more work to be done, and this must include moving members' money away from the ATO and into their active accounts. As at 31 January 2018, the ATO held 5.38 million unclaimed super money accounts with a value of \$3.83 billion. They also held 313,000 super holding accounts (SHA) worth \$111 million ¹⁶.

6.2 Delayed and unpaid SG contributions

The Commission has focussed on two major structural problems. AIST strongly urges the Commission to more seriously address the critically important issue of unpaid Superannuation Guarantee payments. That there is insufficient focus on this is evidenced through there being 192 references to multiple accounts in the draft report, compared with only 29 to unpaid super.

Summaries in the draft report highlight unintended multiple accounts as the most outstanding driver of balance erosion despite the report itself stating that unpaid super is a bigger problem:

- Figure 6.1 shows that unpaid SG caused by an 'inefficient compliance regime' is of greater magnitude than multiple accounts.

¹⁵ O'Halloran, J. (2018). *Journey through reform for ATO and APRA superannuation funds*. Speech to the Conference of Major Superannuation Funds, Brisbane QLD, 14 March 2018. Available at: <https://tinyurl.com/y7sjkd7l> [Accessed 9 Jul. 2018].

¹⁶ O'Halloran, J. (2018). Speech as cited previously in this submission.

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- Figure 6.13 also shows that unpaid SG payments can have a significant impact on retirement balances.
- The Commission itself relies on the “most conservative”¹⁷ ATO estimates of \$2.85 billion annually of unpaid super in figure 6.1 and \$2.6 billion in the text on page 247 and in the draft findings. Other commentators have calculated that the cost to consumers is much higher than this and could be as high as \$3.6 billion annually.¹⁸

Despite the Commission acknowledging that it is difficult to calculate the extent of the unpaid super problem, there is no finding or recommendation calling for further research and analysis of the size of the problem, its causes, manifestation and how it should be further resolved. Rather there appears to be an acceptance that a range of current government and ATO initiatives will fix the problem.

An important aspect of the new Single Touch Payroll, transaction-based reporting and the ATO’s increased SG compliance powers initiatives is the way they transfer effective responsibility for unclaimed super from the individual to the ATO. Historically, there has been too much reliance on individuals noticing and acting on underpayment of super: compliance activity relating to delayed SG payments is still often prompted by an employee complaint to the ATO, their super fund or their union of unpaid contributions.

However, our experience with such initiatives is that they are not necessarily as quick or as successful as planned, nor are they always fully implemented – as evidenced by the fate of the Stronger Super initiatives referenced earlier.

The Commission also incorrectly defines unpaid super as arising only “when an employer fails to meet this obligation altogether¹⁹.” This understates the size and nature of the problem and underscores the lack of serious attention given by the Commission to this problem.

The tactics used by some unscrupulous employers in evading their SG obligation can be less binary than just paid/not paid. Some employers only pay for some periods of employment and not others; some employers incorrectly categorise employees as contractors; others short-pay entitlements; while other significantly delay the making of payments. Some employers may even

¹⁷ Productivity Commission (2018). Draft report, as cited previously in this submission, p.264.

¹⁸ Industry Super Australia and Cbus (2017). *Overdue: Time for Action on Unpaid Super*. ISA/Cbus Report December 2016. [online] Melbourne: Industry Super Australia, p.3. Available at: <https://tinyurl.com/yaco4h1r> [Accessed 13 Jul. 2018].

¹⁹ Productivity Commission (2018). Draft report, as cited previously in this submission, p.261.

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artificially structure employment arrangements so that some of their employees fall below the \$450 monthly threshold for SG payments.

Arrears collection

Many profit-to-member super funds have active programs to improve SG compliance by employers. This includes education and communications material to assist and support employers to understand and comply with their obligations.

In addition, many super funds have an active arrears process to identify and follow-up with employers who have not made the payments in a timely matter. Having been involved in this process for many years, funds are familiar with the different ways (such as those sketched out above) in which some employers avoid their obligations. Typically, these processes have a success rate of more than 95%.

This is a clear example of steps that funds can and do take to reduce balance erosion. As well as demonstrating that there are positive steps funds can take, AIST also submits that a comprehensive program of arrears collection is something all processes of default fund selection process should consider. A well-working arrears collection process improves member outcomes, demonstrates administrative efficiency and can improve employer engagement.

Payslip reporting

Another unimplemented measure from the Stronger Super reforms concerns payslip reporting. If an employee is actually, and accurately advised of the superannuation payments made on their behalf, they are more likely to know when payments have not been made.

Under measures passed by Parliament and scheduled for implementation from 1 July 2013, employers were required to report actual superannuation contributions paid rather than just accrued contributions on employee payslips.

Although this legislation was passed, no regulations were ever made to specify reporting requirements, and the legislation was repealed. This is a further example of solutions being developed by government with industry support to address unpaid super but not proceeded with.

AIST has been involved with many measures to address unpaid super and continues to encourage strong and systemic steps to be taken in response.

Member benefit protection

Eligible Rollover Funds

AIST generally agrees with the criticisms of ERFs made in the draft report, although we argue that the ERF used by profit-to-member funds (AUSfund) is the exception to the rule.

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The draft report states that, “Originally, ERFs were envisaged as developing the necessary expertise to reunite accounts with members, while administering balances at very low cost”²⁰. Unfortunately, there is not and has never been a requirement for an ERF to operate on this basis.

AIST submits that, rather than recommending the abolition of ERFs, ERFs should be required to have low fees, a single diversified investment strategy and an implemented mandate to reunite their members with their active super accounts.

Recent legislative changes now allow ERFs to undertake auto-consolidation on a limited basis, but AIST submits that they should be required to undertake this activity as a condition of their registration as an ERF. Fulfilment of this requirement should be monitored and enforced by APRA.

Regulators should also take steps to improve the effectiveness of ERFs generally and acknowledge that present settings unnecessarily limit ERF effectiveness. Changes could include extending the activity timeframe period for auto-consolidation to 24 months (currently 12 months), adding ERFs to the prescribed organisations list for access to a copy of the electoral roll and permitting transfers from the ATO to ERFs.

Undue erosion

Trailing commissions

AIST agrees with the Commission’s concerns about erosion arising from grandfathered commissions. However, we disagree with the draft recommendation. New trailing commissions in relation to superannuation have been illegal in advice packages since 1 July 2013, and it is entirely inadequate to simply recommend that effective members be more clearly advised about the payments.

AIST submits that all grandfathered trailing commissions should be banned immediately.

Tax management

AIST agrees with the Commission that there is a need for more research into optimising tax management by super funds, and that tax optimization expectations should be more clearly articulated and monitored. We submit that this approach is a necessary part of focusing on net returns to members.

²⁰ Productivity Commission (2018). Draft report, as cited previously in this submission, p.255.

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Draft recommendation 8 – Cleaning up lost accounts

AIST supports 'cleaning up lost accounts' but does not support the draft process recommended by the Commission as it is not in members' best interests

In the alternative, AIST supports the reporting of lost member information to the ATO, and for the ATO to use this information to support the transfer of these accounts into members' active accounts. This process should be as quick and efficient as possible, and AIST submits that there is a better process to achieve this outcome than the wholesale transfer of lost account balances to the ATO. The transfer of lost inactive accounts to the ATO has mainly resulted in the ATO becoming a repository of much more unclaimed super than any ERF.

This alternate approach uses functionality that the Commission positively commented on and which the Commission is aware is being implemented by the ATO and super funds.

Funds are required to report account transactions to the ATO on a near real-time basis as part of MATS reporting from April 2019 and are reporting account attribution details from later in 2018 as part of MAAS reporting; this transaction-based reporting incorporates and replaces previous Lost Member Reporting.

From this information, and data held by the ATO, the ATO can determine if the account owner has an active account. This information can be used to trigger a report to the fund with lost members identifying these members and include a direction to transfer the account to the relevant active account. There would be no requirement for monies to be sent to the ATO. The transfers would move directly from a lost account to an active account in the same name.

The turnaround time for this process avoids unnecessary double-handling, is efficient and leverages off an emerging functionality. It would be faster and more efficient than that proposed by the Commission and would retain monies in the superannuation system.

AIST submits that this process can be given certainty by making both the ATO and super funds accountable for the process. This process should include legislated timelines for the ATO reports to be actioned by funds (i.e., by transferring the lost super balances to the appropriate active account).

AIST will provide further details of this proposal in a supplementary submission.

Chapter 7 – Market structure, contestability and behaviour

AIST KEY POINTS

- Continued scrutiny should be applied to outsourced service arrangements.
- Poor legacy and choice products should be examined and addressed by the Commission, and if not in the best interests of members, removed from the marketplace.
- The default market is contestable within the Fair Work Commission process particularly if the legislated, but stalled Fair Work Commission process can proceed.
- Serious conflicts of interest can arise within vertically integrated business structures, and regulators must do more to collect data and examine arrangements that may not be in the best interests of members.
- The role that third parties play in the distribution of financial products, particularly choice products, must be examined by the Commission.

Outsourcing

Both profit-to-member and retail trustees engage related party service providers. It is essential to understand the impact that these arrangements have on the retirement benefit of members in terms of fees. Previous research in 2010²¹ found retail related-party service providers tend to charge higher fees than their independent counterparts.

We believe continued scrutiny should be applied to these arrangements, to ensure conflicts of interest are managed to ensure that members are not disadvantaged because of engaging related parties to provide a service or product.

Competition in choice and default

The large number of mostly for-profit choice products drives poor member outcomes because:

- Long-term net performance of choice products is, on average worse than the performance of the system overall;

²¹ Liu, K. and Arnold, B. (2010). Australian Superannuation Outsourcing: Fees, Related Parties and Concentrated Markets. *23rd Australasian Finance and Banking Conference 2010 Paper*. Available at SSRN. [online] Available at: <https://tinyurl.com/y8vrqr3p> [Accessed 9 Jul. 2018].

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- Fees are higher in choice products compared to MySuper products²²;
- There are costs associating with ‘switching’ behaviour, which is borne by members; and
- There is poor comparability between products in the choice segment

A significant amount of superannuation assets is also in legacy products. There is evidence that members in legacy products pay substantially higher fees than those in MySuper products.²³

There is no requirement to produce a shorter Product Disclosure Statement (PDS) for legacy products, which makes it difficult for members in legacy products to compare performance, fees, and costs of the product compared to other products. This information asymmetry highlights the need for greater scrutiny. Research by Rainmaker also revealed that from 2014-2017 the retail sector delayed in transitioning members from legacy products to MySuper options: The cost of this transition delay amounts to \$800 million in extra fees being paid by retail MySuper members over the four years up until 2017.

This suggests that legacy products can have higher fees than MySuper, and thus need appropriate scrutiny. Legacy and choice products should be examined by the Commission, and if not in the best interests of members, removed from the marketplace. Amending the legislative outcomes test to cover choice and legacy products is recommended to address these poorly performing products.

Barriers to entry

The Commission found that in the default segment there are high barriers to entry, and there is little competition for the default market.²⁴ We reject this observation and restate our position that the default market is contestable within the Fair Work Commission process particularly if the legislated but stalled Fair Work Commission process can proceed.

Vertical integration

Within ‘vertically integrated’ systems, there is a risk that trustees can make decisions that are in the interests of other parties, such as shareholders, rather than members.

²² SuperRatings (2017). Report as cited previously in this submission.

²³ Rainmaker (2016). *Cost to retail fund members of delaying their MySuper transition*. Research Note October 2016, prepared for Industry Super Australia (ISA). [online] Melbourne: Industry Super Australia. Available at: <https://tinyurl.com/yaxydzt8> [Accessed 9 Jul. 2018].

²⁴ Productivity Commission (2018). Draft report, as cited previously in this submission, p.296.

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Retail trustees have obligations to both shareholders and members, as such may be swayed to provide business to a related party (the profits of which will ultimately go to the shareholders) on potentially uncompetitive terms (such as higher fees). Research by APRA in 2010 details that this has occurred.²⁵

Because outsourcing decisions have the potential to detrimentally affect a member's retirement savings there needs to be:

- effective management and disclosure of conflicts of interest
- disclosure of the fees and costs associated with outsourcing
- where there are concerns about the use of related parties, for regulators to take appropriate action.
- monitoring, reporting and supervisory activity by APRA of related-party outsourcing arrangements to ensure trustee directors are meeting their legal obligations act in members best interests.
- Additional research to assess the current impact of related-party transactions on fees
- Greater data collection, to enable a meaningful evaluation of related party transactions

Distribution channels for choice products

The role that third parties play in the distribution of financial products, particularly choice products, must be examined by the Commission.

While the Commission has recommended a new default allocation model, other distribution models by which superannuation funds acquire members will remain.

Currently, the main distribution channel being financial advice. ASIC's recent report into the financial advice provided by the five biggest vertically integrated financial institutions revealed that:

- Advisers appeared to favour in-house products as approximately 80% of products on the firm's approved product list (APL) were external and 20% were internal yet 86% of funds were invested into in-house products.²⁶
- in 75% of the advice files reviewed the advisers did not demonstrate compliance with the duty to act in the best interests of their clients.

²⁵ Liu, K. and Arnold, B. (2010). Research paper as cited previously in this submission.

²⁶ ASIC (2018). *18-019MR ASIC reports on how large financial institutions manage conflicts of interest in financial advice*. [online] Available at: <https://tinyurl.com/ybqf3hkn> [Accessed 9 Jul. 2018].

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- 10% of the advice reviewed was likely to leave the customer in a significantly worse financial position.
- In addition to the adviser distribution channel, retail superannuation funds attempt to influence the allocation of members into products by entering workplaces and directly marketing to members.

Some retail superannuation funds also enter arrangements with a payroll provider for the fund to be listed on the provider's 'choice of fund' section page within an onboarding program provided by the payroll provider to employers. This warrants further scrutiny, particularly because 68A of the *Superannuation Industry (Supervision) Act 1993 (Cth)* (SIS Act) which deals with conduct relating to fund membership does not appear to capture this conduct because it relates to conduct between trustees and employers (not trustees and other third parties).

The commission should examine and these relationships and consider the role that regulators can play in managing this conduct.

Chapter 8 – Insurance

AIST KEY POINTS:

- Funds should be able to retain an ability to provide default cover to members aged between 21 and 24.
- AIST supports cessation of insurance on low-balance accounts inactive for more than 16 months, provided members receive appropriate communications, and inactive members can elect to continue to receive insurance.
- High take up rates for the Insurance Code mean there is no need to make the Code mandatory.

Draft Recommendation 14 - opt in insurance for members under 25

AIST supports special insurance arrangements for younger members, including the provision of insurance on an opt-in basis for members below a specified age.

However, funds should be able to set the commencement age for insurance cover depending on the needs of members and to best meet members interests. Specifically, funds should be able to provide default cover to members aged between 21 and 24, while all cover for members below 21 should be on an opt-in basis. In all instances, opt-out insurance should apply to all younger members when they reach the age threshold.

This is the subject of detailed consideration in section 4.10 of the *Insurance in Superannuation Code of Practice* (“the Code”).

In response to these requirements, funds subscribing to the Code are reviewing the needs of their members and are making changes accordingly. This is a work in progress. However, it is clear that different membership cohorts will have different needs.

AustralianSuper, for example, has made changes to its insurance benefit structure so that insurance is not held in new accounts for under 25 year olds. Default cover for these members commences when they either turn 25 or elect to receive cover. As was stated by AustralianSuper in the public hearings on the draft report, this change recognises that very few claims for these younger members were paid to dependents.

However, building industry super fund, Cbus reflects its members’ needs and typical life circumstances and defines young members differently from other funds. By the time its members reach 21, many have been in the workforce for 3-4 years and often have dependents. As

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mentioned by Cbus in the public hearings, most death claims made in relation to Cbus members over the age of 21 years are paid to their dependents.

Unlike the Code, the Commission's draft recommendation does not give trustees the capacity to consider the particular needs of their younger members and allow them to tailor their insurance offerings accordingly.

While it is much more likely that young people in Australia under the age of 21 will not have dependants or mortgages, the circumstances of people in their twenties is likely to be more varied and reflected in different ways in different funds. Accordingly, trustees should have discretion in relation to default cover for members aged between 21 and 24, and AIST submits that this should be recognised by the Commission.

Draft Recommendation 15: Cease insurance on accounts without contributions

AIST supports insurance cover ceasing being removed from an account on low balance accounts where no contributions have been obtained for the past 16 months, unless the member has expressly sought cover, consistent with the Insurance in Superannuation Voluntary Code of Practice.

Under the Code, default members with income protection cover, would generally have their cover cease 13 months from the date of their last contribution, unless the member advises that they wish to keep this cover. For default members with death and TPD cover, cessation applies to 13 month inactive members with a balance of less than \$6,000. AIST submits that these are the appropriate formulas for the cessation of cover.

AIST submits that the process for cessation should include further consumer protections about ongoing requirements to advise members, reflecting communications provisions of in section 4 of the Insurance Code.

The 13 months in the Code exists within the context of an 'if not, why not' provision. In the absence of that provision, there needs to be some clear protection for women returning from 12 month's maternity leave (bearing in mind that they may not receive their first super contribution until almost 4 months after their return. Hence, our support for cessation after 16 months in the context of this submission.

Draft Recommendation 16: Insurance balance erosion trade offs

AIST supports the Commission's recommendation that funds should be required to articulate and quantify the balance erosion trade off determination they have made for their members in relation to group insurance.

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This is similar to the existing requirements imposed on fund trustees by the general and specific insurance covenants of section 52 of the SIS Act.

In particular, s.52(7)(b) requires trustees to consider the cost to beneficiaries of offering insurance and s.52(7)(c) only permits them to offer insurance if the cost of the insurance does not inappropriately erode retirement savings.

APRA *Prudential Standard SPS 520 Insurance in Superannuation*²⁷ further establishes insurance requirements for funds and explicitly requires a fund's insurance management framework to include those required under section 52(7).

AIST supports the requirement for this statement to be more explicitly stated in SPS 250 and for it to be made available on fund websites.

A statement about the trade-off should also be accompanied by a simple explanation of the benefits of insurance in super and include reference to the unfortunately large number of people who make a death, TPD or income protection claim against their policy. As the commission itself acknowledges, TPD cover contributes to retirement income in that it insures against the risk a member's accumulation phase is cut short.²⁸

Draft Recommendation 17: Insurance code to be a MySuper condition.

AIST does not support adoption of the Insurance Code being a mandatory requirement of funds to obtain or retain MySuper authorisation. Approximately 92% of MySuper members will be covered by the Code.

41 AIST members – covering the overwhelming majority of the estimated 6 million plus profit-to-member super fund members – have stated their intention to adopt the Code, and are in the process of publishing a statement about this on their websites. Subscribing funds are in the process of preparing transition plans.

Draft Recommendation 18: Insurance code taskforce

AIST welcomes increased regulator involvement in the Insurance Code in the form of a Joint Regulator Taskforce.

As the focus should be on improving member outcomes, we agree that ASIC should take the lead.

²⁷ Superannuation (prudential standard) determination No. 5 of 2012, *Prudential Standard SPS 250 Insurance in Superannuation*.

²⁸ Productivity Commission (2018). Draft report, as cited previously in this submission, p.312.

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The Commission's draft recommendation that the taskforce should monitor and report on adoption and implementation of the code by funds is another reason why there is no pressing need for the Code to become mandatory. This is a 'co-regulatory' approach that harnesses the co-operative and productive initiatives of the superannuation industry to the independence, rigor and authority of the regulators to deliver consumer benefits.

As a code-owner, AIST would welcome the regulators' guidance about enhancements to strengthen the code, particularly implementation of standard definitions and moving to a short form annual insurance statement for members. These are both matters under consideration by the code-owners for the next stage of the Insurance Code.

The Code is another mechanism for improving standards in superannuation, and AIST anticipates that APRA would approach funds about compliance with the overall code and its specific provisions on an 'if not, why not' basis.

AIST also agrees that the taskforce should annually report findings on industry progress on the code, and further suggest that it report on joint-industry-regulator initiatives to improve consumer outcomes.

Information request 8.2: What is the value for money case for income protection being provided on an opt-out basis in MySuper products?

In designing the most appropriate insurance offering for their members, some AIST members have determined that member needs are best served by the inclusion of income protection insurance in their MySuper product.

AIST supports funds being able to maintain income protection insurance on this basis.

Income protection plays an important role in assisting members to return to work following injury or illness, thus supporting the rehabilitation process.

Income protection allows support for members to work in a staged approach as well as assistance through active rehabilitation, wellness programs and other support services. This helps the member remain socially and work connected, which in turn has mental health benefits. It also means that they are contributing to the economy as taxpayers.

Income protection also plays an important social role, reducing pressure on the social security and healthcare systems.

Chapter 9 – Fund governance

AIST KEY POINTS

- The AIST Governance Code addresses a significant number of the concerns identified by the Commission.
- While we agree that the appointment of skilled directors is very important, the Commission should also address the ongoing professional development of existing directors.
- We do not agree that having one-third independent directors is best practice.
- The effective management, regulation and reporting of conflicts of interest is essential.

9.1 Introduction

AIST is committed to the promoting best practice governance practices in the superannuation industry. AIST established a dedicated Governance Department in 2010, and has since delivered on several key governance projects, including:

- Governance Toolkits: The nine toolkits contain functional tools such as diagrams, decision trees, flowcharts and checklists, to assist Trustees with understanding and applying their legal obligations, regulatory guidance and AIST governance guidelines.²⁹
- Fund Governance Framework for not-for-profit funds: First developed in 2011, the framework is designed to complement trustees' legal obligations and are designed specifically for representative trustees. They provide guidelines on a variety of governance issues
- AIST Governance Code: released in 2017.

²⁹ AIST (2018). *Governance Toolkits*. [online] aist.asn.au . Available at: <https://tinyurl.com/yb336qt5> [Accessed 9 Jul. 2018].

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AIST governance code

The Governance Code³⁰ – and accompanying Guidance³¹ – is designed to position profit-to-member funds at the leading edge of governance practices. The Code has 21 requirements that exceed existing legal and APRA regulatory requirements.

The code is mandatory for all Australian AIST member funds from 1 July 2018.

The AIST Code covers:

- Director skills, experience, qualifications, training, induction³²;
- Board renewal and appointment³³;
- Board performance evaluation³⁴;
- Diversity³⁵;
- Member engagement³⁶;
- Remuneration³⁷;
- Enhanced disclosure and transparency³⁸;
- Financial integrity³⁹; and

³⁰ AIST (2017). *AIST Governance Code*. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y8rz5rr3> [Accessed 9 Jul. 2018]. AIST (2017). Governance Code, as cited in a previous footnote.

³¹ AIST (2017/2017a). *AIST Governance Code Guidance*, Version 1.1, June 2018. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/ybd6aaol> [Accessed 9 Jul. 2018].

³² AIST (2017). Governance Code as cited earlier in this submission, paragraphs 1.1; 2.1; 2.2; 2.5; 2.7.

³³ AIST (2017). Governance Code as cited earlier in this submission, paragraphs 1.1; 2.1; 2.5; 2.7.

³⁴ AIST (2017). Governance Code as cited earlier in this submission, paragraph 1.5.

³⁵ AIST (2017). Governance Code as cited earlier in this submission, paragraph 1.4.

³⁶ AIST (2017). Governance Code as cited earlier in this submission, paragraph 5.1.

³⁷ AIST (2017). Governance Code as cited earlier in this submission, paragraph 7.1.

³⁸ AIST (2017). Governance Code as cited earlier in this submission, paragraphs 1.5; 1.6; 2.1; 2.2; 2.3; 3.1; 4.2.

³⁹ AIST (2017). Governance Code as cited earlier in this submission, paragraph 4.1.

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- Real, potential and perceived conflicts of interest⁴⁰.

Several comments, findings and recommendations made by the Commission in the draft report are directly addressed by the AIST Governance Code.

9.2 Board composition and assessment

AIST agrees that skills are essential and that it falls to the board to ensure that the necessary skill requirements are met. There is always room to improve the skills and experience of trustee boards, indeed there is no 'limit' to how skilled or experienced a board could be.

AIST has long been a champion of developing trustee director skillsets. Advocacy over several years have been, in part, focused on director skills and as highlighted by the following work:

- AIST Governance Code
- Fund Trustee Framework
- Provision of training to trustees

The AIST Governance Code

The Code contains 5 requirements relating to director skills, experience and knowledge.

Code requirement	Relationship to trustee skills
1.1 A profit-to-member superannuation Board must conduct all appropriate enquiries to ensure that nominees have the appropriate skills and experience before appointing a person as a trustee director. For the appointment of representative directors in particular, this includes engagement with sponsoring organisations.	<p>This requires positive engagement by the board with sponsoring organisations and other entities to ensure nominees have the required skills and experience.</p> <p>The obligation to actively engage with sponsoring organisations reflects leading practice⁴¹ and assists in ensuring that directors that are appointed are appropriate and suitably skilled.</p>
2.1 The Board of a profit-to-member superannuation fund must have a committee responsible for Board renewal that has at least three members. The committee must have a	<p>The Board renewal committee would ordinarily consider nominee skills and experiences and their alignment with the boards' needs.</p>

⁴⁰ AIST (2017). Governance Code as cited earlier in this submission, paragraphs 1.3; 2.3; 2.6; 4.2.

⁴¹ Rowell, H. (2018). *Board Governance Thematic Review*. Letter to All Trustees, 17 May 2018. [online] Sydney: Australian Prudential Regulation Authority. Available at: <https://tinyurl.com/y752u6fz> [Accessed 9 Jul. 2018].

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<p>charter that is disclosed, and it should meet at least annually. For each reporting period the fund must disclose the members of the Board renewal committee and attendance records for any meetings during that period</p>	
<p>2.2 A profit-to-member superannuation fund must maintain a matrix showing the skills, relevant experience and diversity the Board currently has and acknowledge gaps it is looking to fill in order to effectively fulfil its strategic plan. It must disclose annually a representation of the existing collective skills, experience and diversity of the Board.</p>	<p>Maintaining a skills matrix enables identification of the board's collective skills, experience and knowledge as well as gaps that must be addressed.</p>
<p>2.5 The Chair of a profit-to-member superannuation fund Board must be appointed by the Board and must satisfy all the requirements of skill and experience identified in the fund's skills matrix for the role of Chair.</p>	<p>The Chair leads the board and steers discussion and therefore requires a specific skillset. This requirement ensures that the skillset is met.</p>
<p>2.7 A profit-to-member fund must have an induction program for new trustee directors and provide appropriate ongoing professional development and training opportunities to continuously enhance their skills and knowledge.</p>	<p>Having an induction program helps ensure that newly appointed directors have the required skills, and that existing skills are identified, and a program of ongoing improvement is developed.</p> <p>It is important that directors continue to solidify their skills as they continue serving boards, as well as acquiring any new skills as identified by the board.</p>

Concerns articulated in the commission's draft finding 9.1 are met by the AIST Governance Code which requires boards to:

- Conduct inquiries to ensure nominees have the required skills and experience.
- Have a board renewal committee – which would ordinarily consider nominee skills and experience.
- Maintain a skills matrix, which allows easy identification of any 'missing' skills that could be addressed through board appointments (or further director training).

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Notwithstanding the focus on the *appointment* of directors with requisite skills, it is important to note that:

- Directors in the profit-to-member sector already have significant skills, experience and knowledge; and
- The acquisition of skills is not confined to the appointment stage.

Ongoing professional development.

The acquisition of skills is not confined to the appointment stage. The focus of the commission on the *appointment of skilled directors* is important, but the Commission should also examine the building of *skilled directors* that have already been appointed to funds.

Directors enhance their skills over time as they continue to serve on boards.

The value of independent directors

AIST rejects the Commission's view that best practice corporate governance includes a critical mass of independent directors. Moreover, AIST has long argued that it is inappropriate to mandate independent directors., especially when representative directors are independent of executive management and, in this regard, satisfy the broad corporate definition of the term independence. However, we note that non-representative directors can bring skills to board decision making and believe funds should be given the flexibility to appoint up-to one third independent directors.

The governance model requiring one-third independent directors should not be imposed on funds. Superfunds are autonomous and are best placed to make decisions in the best interests of their members. The SIS Act should be modified to allow equal representation boards to appoint up to one-third independent directors to their boards, thereby allowing them to retain equal representation across the remaining two-thirds.

The draft report identified the out-performance of the profit-to-member sector and their absence of shareholders (thus removing the potential for a conflict of interest) as being key arguments against the mandating of independent directors.⁴²

AIST supports these two arguments and has referenced details of this outperformance elsewhere in this submission. This genuine and measurable outperformance results in members retiring with more money at retirement. There is no empirical evidence, and none referenced by the Commission, that the current model is failing or that mandating independence would be

⁴² Productivity Commission (2018). Draft report, as cited previously in this submission, p.362.

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beneficial. The draft report does not present any evidence that mandating independent directors would improve governance.

Super funds are a major contributor to the Australian economy, with the profit-to-member superannuation sector representing more than \$1.2 trillion dollars in funds under management. There is the real possibility that changes to board composition will mean changes to the culture of these large financial institutions and a potential disruption to fund activities. This is simply unjustifiable without any evidence for the need for such reform or an articulated benefit to the members being presented.

Barriers to the appointment of independent directors

We agree with the commission's observation that barriers in the SIS Act to the appointment of independent directors should be removed.

We recognise there are limitations in the *Superannuation Industry (Supervision) Act 1993* which allows equal representation fund boards to only appoint one independent director to their board in addition to the representative directors.

Recognising the autonomy of superannuation fund entities, and their right to make decisions in the best interests of their members, we recommend that the SIS Act be amended to allow equal representation boards to appoint up to one-third independent directors to their boards.

This measure is beneficial because it allows funds to retain equal representation across the remaining two-thirds, which plays a pivotal role in good governance and it leaves the organisation flexibility to determine their own governance model.

External assessment of Board skills

Superannuation fund boards should regularly evaluate the performance of the board and of individual directors. This is a requirement set out in SPS510. SPG510 sets out APRA's expectation that the board's performance is assessed by an external party at least every three years.⁴³

These evaluations enable board to identify any areas for improvement and to take appropriate action, such as undertaking additional training. We support the productivity commission's views that funds should have, and disclose a process:

⁴³ APRA (2016). *Prudential Practice Guide SPG 510 - Governance*. November 2016. [online] Canberra: Australian Prudential Regulation Authority. Available at: <https://tinyurl.com/y7we3ss3> [Accessed 9 Jul. 2018].

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- To assess the performance of the board and individual directors at least annually⁴⁴ (the requirement to assess already required by SPS510 and the AIST Governance Code also requires an assessment and disclosure of this)
- To seek external third-party evaluation of the boards performance.⁴⁵

Conflicts of Interest

AIST agrees that the effective management of conflicts of interest is essential.⁴⁶

The regulatory framework for the identification, disclosure and management of perceived or actual conflicts of interest is extensive. Various legislative provisions in the *Superannuation Industry (Supervision) Act 1993*, *Corporations Act 2001* and *Corporations Regulations 2001*.

Prudential standards also require funds to manage or prevent conflicts of interest, including SPS 521, SPS 231 and SPS 510.

Notwithstanding these requirements, related-party transactions continue to be a concern, particularly within the retail sector. Our recommendations for addressing this are set out at section X of this submission.

Merger activity

Whether a merger is in the best interests of members is a decision that should be left to the trustee, as it is in the best position to assess the benefits and risks and understanding whether members will be better off because of a proposed merger.

The commission asks the rhetorical question of why more funds have not merged.⁴⁷

Impediments to mergers include:

Tax liability and CGT relief

The capital gains tax (CGT) relief on mergers fund transfers is due to expire on 1 July 2020. The temporary nature of the relief means that funds entering merger discussions now may be

⁴⁴ Productivity Commission (2018). Draft report, as cited previously in this submission, p.365.

⁴⁵ Productivity Commission (2018). Draft report, as cited previously in this submission, p.365.

⁴⁶ Productivity Commission (2018). Draft report, as cited previously in this submission, p.365.

⁴⁷ Productivity Commission (2018). Draft report, as cited previously in this submission, p.374.

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deterred from proceeding with the merger because of the impact the CGT provisions may have on their members.

AIST supports the Productivity Commission's draft recommendation 7, for the government to legislate to make CGT relief for fund merges permanent.⁴⁸ AIST has long called for the relief to be made permanent and are pleased to see that productivity commission make this recommendation.

Making the CGT relief permanent may contribute to merger activity and will ensure that members are not worse off because of the merger by removing the detrimental financial impact of the merger. It is in the best interests of members in the merged entity that their retirement savings are not accessed to pay tax liability that, but for the merger, they would not be called on to pay.

Culture

The role that culture plays in mergers should not be overlooked as a potential barrier or difficulty to be managed.

There is significant academic discourse on the role that culture plays in mergers, while analysis varies, there is a body of evidence that clashing organisational cultures decreases an organisation's performance.^{49 50}

Having the right organisational culture is integral to the ability for an organisation to deliver on its business strategy. This is because the culture of an organisation directly affects how employees:

- Approach and complete their work;
- Engage with others in the business; and
- interact with fund members.

Bringing together two different cultures can be challenging and can be a live consideration for entities that are considering merger activity.

⁴⁸ Productivity Commission (2018). Draft report, as cited previously in this submission, Draft Recommendation 7.

⁴⁹ Barker, A. (2012). *The role of culture in post-merger performance*. Postgraduate. [online] University of Pretoria, p.35. Available at: <https://tinyurl.com/y8xmkej> [Accessed 9 Jul. 2018].

⁵⁰ Teerinkangas, S. and Very, P. (2012). Chapter 16: Culture in M&A – A critical synthesis and steps forward. In: D. Faulkner, S. Teerinkangas and R. Joseph, ed., *Handbook of Mergers and Acquisitions*, 1st ed. [online] Oxford: Oxford University, p.13. Available at: <https://tinyurl.com/y96qsgff> [Accessed 9 Jul. 2018].

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Different membership bases

Many superannuation funds have different membership bases which can be challenging to bring together. Consider the example of funds that represent distinct Australian states and territories. It is a live consideration for merging funds to consider how to effectively unite members who live in different states.

Assets

A merger of two funds results in the bringing together of two investment portfolios and asset bases. It is important that the two merging funds have regard to how the assets within each portfolio are valued, and whether the assets were acquired after robust due diligence processes and will be a benefit, rather than a burden to members.

There is also the issue of being able to retain historical investment returns for comparability purposes. This is crucial and directly affects a ‘best in show’ comparison where it is likely that one of the criterion will be net returns for say 10 years. Retaining the historical return data of most relevance to members is essential. The risk that no figures at all will be referenced for years prior to a merger must not be entertained.

If the investment strategy has to be changed because of the size of the fund, this can also be material to a merger and whether it will be in the interests of both sets of members.

Merger disclosure

The commission made the draft recommendation that APRA regulated funds be required to disclose to APRA:⁵¹

- When they enter a Memorandum of Understanding with another fund in relation to a merger attempt;
- APRA regulated funds disclose to APRA reasons why a merger did not proceed.

Notwithstanding the complexity surrounding mergers, we support this proposal on the condition that ongoing merger discussions are not jeopardized because of the disclosure. It would not be in the best interests of members for information surrounding the merger to be disclosed prior to the Memorandum of Understanding.

Going forward, we expect the introduction of new regulation, notably APRA’s member outcomes test, to accelerate the trend to industry consolidation that is already evident.

⁵¹ Productivity Commission (2018). Draft report, as cited previously in this submission, p.60.

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Chapter 10 – System Governance

AIST KEY POINTS

- ***Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* should be amended to enhance protection for members in choice products and allow for more meaningful data collection.**
- **A coordinated regulatory approach is essential for effective regulation.**

Introduction

We agree with the Commission's observation that the *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* contains important proposals and would improve member outcomes if legislated.⁵² In 2017 in a submission to Treasury⁵³ on the exposure draft bill we outlined our support for measures and provided suggestions which, if adopted, would improve the package so it can deliver greater benefit to members. In 2018 in a submission to APRA⁵⁴, we provided detailed recommendations which would greatly strengthen the proposals outlined in the *Strengthening Superannuation Outcomes* discussion paper. These recommendations cover three critical issues which we have consistently raised, including within this submission:

- The superannuation system currently cannot be meaningfully benchmarked. This arises from differences in fee, cost and return disclosure. AIST believes it is difficult to properly assess 'outcomes' in these circumstances. The proposals refer to RSEs developing benchmarks and APRA's expectations that RSEs would refer to external sources of information.
- There are various disclosure gaps which erode the regulatory framework and do not deliver a level playing field. These gaps make it difficult to properly undertake an outcomes test.

⁵² Productivity Commission (2018). Draft report, as cited previously in this submission, pp.387; 389 and at Draft Finding 10.1.

⁵³ AIST (2017). *Improving Accountability and Member Outcomes in Superannuation*. AIST Submission. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y76t8lsc> [Accessed 9 Jul. 2018].

⁵⁴ AIST (2018). *Strengthening Member Outcomes*. AIST Submission [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y9lk9sdf> [Accessed 9 Jul. 2018].

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- Regulatory alignment. In this case, we need clarity regarding how the proposals will interact with the proposed design and distribution obligations and product intervention powers (a Treasury consultation).

Annual MySuper outcomes assessment

To ensure that retirement outcomes for MySuper members are maximised it is vital that an assessment of long term net returns be maintained as the main factor that should be considered in the assessment. The assessment of net returns should not be supplanted, or diluted, a range of additional factors.

The outcomes assessment should apply to MySuper and choice products. This is essential, particularly considering the Commission's own findings that:

- The MySuper sector has on average outperformed the choice sector over the long term.
- There is unhealthy competition in the choice segment which has more than 40,000 products.⁵⁵
- Retail and choice products have higher fees than MySuper⁵⁶
- Average balance for choice accounts are over twice that of MySuper⁵⁷
- choice has \$1 trillion in assets, versus \$595 billion for MySuper.⁵⁸

Choice

AIST continues to voice its concerns that the Choice sector is continually being 'let off the hook' in terms of both reporting and disclosure, with a resultant underperformance in optimizing members' retirement savings.

In our 2017 in a submission to Treasury⁵⁹ on the exposure draft bill, we drew attention to the following deficiencies regarding the proposed application of the outcomes assessment:

⁵⁵ Productivity Commission (2018). Draft report, as cited previously in this submission, p.2.

⁵⁶ Productivity Commission (2018). Draft report, as cited previously in this submission, p.16.

⁵⁷ Productivity Commission (2018). Draft report, as cited previously in this submission, p.74.

⁵⁸ Productivity Commission (2018). Draft report, as cited previously in this submission, p.74.; we note that this is MySuper, not default.

⁵⁹ AIST (2017). *Improving Accountability and Member Outcomes in Superannuation*. AIST Submission. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y76t8lsc> [Accessed 9 Jul. 2018].

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- MySuper products have delivered outcomes to members and while greater scrutiny of the MySuper part of the system is appropriate, it should not be at the expense of focusing on Choice aspects within the superannuation system.
- The outcomes assessment does not apply equally between MySuper and Choice products and the provisions in the Bill should be reviewed to ensure that they apply equally to all superannuation products, in order that best practice and standards can be delivered across the industry.
- The MySuper outcomes assessment should be made in writing and publicly available. The same should apply to Choice.

In our 2018 submission to APRA⁶⁰, on their member outcomes test proposals ('the proposals'), we raised the following issues regarding Choice:

- We supported the inclusion of Choice products.
- We sought clarity as to how the assessments would work in practice. For example, would it apply to each Choice product and all legacy products.
- We sought clarity regarding how assessments were to be undertaken. For example, if at 'fund level', this would not capture poorly performing choice products.
- We requested information as to how these proposals would interact with the exposure draft Bill (if enacted).

Our concerns remain, given that the exposure draft Bill has not been passed, and further consultations have not occurred regarding the proposals.

Enhanced expense reporting

We strongly support the collection and analysis of data which would help APRA review the impact of related party costs, as well as the delivery of fair value to members. We support the development of a robust data collection and use framework. Such a framework could greatly assist with the prioritisation of, and the assessment of the need for, the collection of any new data.

APRA must conduct another in-depth assessment of the impacts of related party costs, like the assessment performed in 2010.

⁶⁰ AIST (2018). Strengthening Member Outcomes. AIST Submission [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/y9lk9sdf> [Accessed 9 Jul. 2018].

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Existing issues regarding APRA reporting must be resolved. These include the implementation of Regulatory Guide 97, Disclosing fees and costs in PDSs and periodic statements, as well as the alignment of MySuper and choice reporting

Respective roles of APRA and ASIC

While AIST acknowledges that there is the Council of Financial Regulators, and that considerable work has been done regarding regulator performance frameworks, we agree with the Productivity Commission's view that it is timely to revisit the respective roles of APRA and ASIC. Additionally, given the increasing role of the ATO within superannuation through single touch payroll and the development of myGov, AIST strongly recommends that this role also be reviewed concurrently.

We both note and support the OECD's *The Governance of Regulators 2014*⁶¹, which encourages countries to "Develop a consistent policy covering the role and functions of regulatory agencies in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence." AIST believes that a role functions policy encompassing a review of both APRA, ASIC and the ATO would be most beneficial, especially given the ever-increasing size and complexity of the superannuation system.

Frequency and pace of policy change

We agree with draft finding 10.5 that the frequency and rate of policy change can create pressure for scheme participants, and that major regulatory reforms (such as MySuper and SuperStream) have been effective.⁶²

To promote the effectiveness, and outcomes of policy reform, Government and regulators should take a coordinated approach. There are several instances where concurrent policy reform processes have taken place that have substantially dealt with the same subject matter or issue.

For example, the Productivity Commission was asked to review of the competitiveness and efficiency of the Australian superannuation system. This process led the Commission to make recommendations about how unintended multiple accounts can be dealt with. Simultaneously, the Federal Government, as part of the Protecting Your Super Package, consulted on and is seeking to implement measures that promote account consolidation and remove the prevalence

⁶¹ OECD (2014). *The Governance of Regulators*. OECD Best Practice Principles for Regulatory Policy. [online] Paris: OECD Publishing. Available at: <https://tinyurl.com/yb9qt7v2> [Accessed 13 Jul. 2018].

⁶² Productivity Commission (2018). Draft report, as cited previously in this submission, p.411.

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of multiple accounts. These are two separate reform processes and the process would be smoother, and ultimately better if there was coordination of reform processes.

A second example is where the Federal Government introduced legislation that would replace the MySuper scale test with a broader 'outcomes test'. Shortly after the legislation was introduced, APRA developed a new draft prudential standard that required RSE licensees to conduct a similar 'outcomes assessment' for their products. The two separate reform processes, despite having similar objectives, will potentially have significantly different outcomes. Again, it would be preferable for there to be greater coordination on policy reform processes so that, rather than two separate processes operating in tandem, there can be a fuller, more holistic approach.

The policy process and implementation of new measures can be a costly exercise, a cost that is ultimately borne by members.

Chapter 12 – Competing for default members

AIST KEY POINTS:

- The Commission has essentially adopted the same quality filter and expert panel as legislated for the Fair Work Commission but has not provided any justification for moving the default fund process from the FWC and the industrial environment.
- The expert panel should be properly resourced, supported by the regulators (and have two-way communication with them) and have access to quality data.
- A review of the quality filter criteria and expert panel as legislated for the FWC is warranted following four years of Government inaction.
- FWC default process should be recommenced immediately following the review, with a view to remove any underperforming funds listed in awards.

12.1 How does the current default system perform?

In both 2012⁶³ and 2017-18, the Productivity Commission has found that default superannuation arrangements for employees who derive their default superannuation product in accordance with modern awards provided market stability, and net returns of default funds have generally exceeded those of non-default funds.

In 2012, the Commission recommended a set of factors to be considered by an Expert Panel of the Fair Work Commission as a second stage ‘quality filter’ when selecting default products for modern awards. In 2018, the Commission’s draft recommendation is to completely decouple the default fund allocation from industrial relations but to maintain the quality filter and an expert panel.

The explanation given in the draft report for this position is that the Commission asserts there is a minority of underperforming products listed amongst the majority of overperforming products in modern awards.

AIST continues to support an approach that embeds default fund selection within the industrial relations system and ensures high standards of consumer protection.

⁶³ Productivity Commission (2012). *Default Superannuation Funds in Modern Awards*. Productivity Commission Inquiry Report, No. 60, 5 October 2012. [online] Canberra: Commonwealth of Australia. Available at: <https://tinyurl.com/y8zoaa49> [Accessed 9 Jul. 2018].

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Quality filter

Following their 2012 recommendations, the Government introduced a quality filter in the *Fair Work Act 2009*. Under section 156F of the Act, the Fair Work Commission is required to compile a 'Default Superannuation List' based on prescribed criteria.

The draft report does not list these criteria and does not assess their efficiency. Rather, it presents a modified version of the FWC criteria as being a suitable basis for determining the proposed list of 10 'best in show' funds.

The below table compares the FWC criteria and the Commission's modified version. The quality filter in the draft report is very similar to that legislated in 2012 for the FWC.

The most notable difference here is the lack of references to MySuper authorisation being first level criteria under their preferred approach to default fund allocation. However, the Commission elsewhere clarified that all funds to be considered as a best in show fund must first have MySuper authorisation⁶⁴.

FWC criteria	Draft report	Difference in Commission proposal
Appropriateness of the MySuper product's long-term investment return target and risk profile	Match between the product's long-term investment return target and risk profile for the types of members who typically default	Requires consideration of characteristics of defaulting members
Expected ability to deliver on the MySuper product's long-term investment return target, given its risk profile	The expected ability of the fund to deliver on the product's return target, given its history and risk profile	Requires consideration of past performance
Appropriateness of the fees and costs associated with the MySuper product, given: (i) its stated long-term investment return target and risk profile; and	Fees and costs, given the product's stated long-term investment return target and risk profile	Does not require consideration of additional services

⁶⁴ For example, at Productivity Commission (2018). Draft report, as cited previously in this submission, p.461.

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(ii) the quality and timeliness of services provided;		
Net returns on contributions invested in the MySuper product	Key focus of the selection process should be on a fund's likelihood of producing high net returns for members	Same but given higher priority
Whether the superannuation fund's governance practices are consistent with meeting the best interests of members of the fund, including whether there are mechanisms in place to deal with conflict of interest	Fund's governance practices, including mechanisms to deal with conflicts of interest	Does not require consideration of members best interests in relation to governance
Appropriateness of any insurance offered in relation to the MySuper product	Compliance with the Insurance in Superannuation Voluntary Code (chapter 8) (that is, it would not be enough to simply be a signatory to the Code). The merits of a product's insurance offering would not be a selection criterion, but funds should justify why the insurance offering was demonstrably in members' best interests	Requires Insurance Code compliance, and consideration of members best interest in relation to insurance.
Quality of advice given to a member of the superannuation fund relating to the member's existing interest in the fund and products offered by the fund;	Fund's intrafund advice offering and track record on innovation and identifying and meeting member needs (including design of superannuation products)	Same
Administrative efficiency of the superannuation fund	Administrative efficiency of the fund	Same
Any other matters the FWC considers relevant	Any other factors considered relevant	Same

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The changes to the quality filter suggested by the Commission are minor and may well have been considered by the FWC and Government if the ‘as legislated’ changes were allowed to continue from 2014 and had been reviewed in 2018.

The Commission has not provided any justification for removing the quality filter for default funds from the FWC. We also agree that, given the passage of time since the ‘as legislated’ model, it is now appropriate to review the criteria for the quality filter (and for periodic reviews to occur thereafter).

An efficient process for the recovering unpaid SG payments should be included in the administrative efficiency criteria. The criteria should also exclude products whose manufacturers engage in inappropriate cross-selling activities.

The Commission acknowledges the risk of upselling. AIST supports the recommendation that funds should notify ASIC and APRA about intra-fund switches from MySuper products.

Expert panel

The draft report seems to imply serious and unsubstantiated shortcomings in the structure and operation of the Fair Work Commission, both in relation to superannuation and financial services, and more generally. This is notwithstanding the Expert panel being the 2012 brainchild of the Productivity Commission.

The Commission criticises the FWC for being beholden to precedent without explaining how precedent would apply in the context of the legislated quality filter. It also claims that *the appointment process it is subject to is clearly of a partisan nature*⁶⁵, presumably because appointments were made by a Minister. Neither of these claims are substantiated, and are at odds with the statutory requirement for the FWC to be an independent tribunal.

As an alternative, the Commission suggests advertising for expert panel positions, with interviews conducted by a high-level selection panel (including a member capable of representing member interests⁶⁶), and appointments made by Cabinet. As an organisation committed to transparent processes, AIST would support this approach but argues that it can and should be applied within the context of the FWC. Both the existing and proposed processes ultimately rely on political decision-making.

⁶⁵ Productivity Commission (2018). Draft report, as cited previously in this submission, p.448.

⁶⁶ Productivity Commission (2018). Draft report, as cited previously in this submission, p.448.

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The Commission also questions the capacity of the FWC Expert Panel to apply the quality filter, stating instead “that appointment of experts whose accountability is to the shortlisting process rather than the objectives of the industrial relations system is essential”.⁶⁷ As the Expert Panel has never been allowed to undertake its statutory role, the Commission has no factual basis to come to this conclusion.

In fact, the Expert Panel on default funds is required to and does consist of full-time members of the FWC and part-time members who have knowledge of or experience in:

- finance
- investment management, or
- superannuation⁶⁸.

The Australian Government Actuary has expertise in the analysis and management of risk, especially long-term financial risk, but not necessarily investment markets. Their involvement in superannuation has more narrowly focused on assessments of the costing and financing of Australian Government defined benefit superannuation schemes.

The expert panel must however be properly resourced, supported by the regulators and have access to quality data. It should not be up to the expert panel to decide if the performance data they receive is accurate, up-to-date, comparable and benchmarked on a fund and asset class basis. APRA should be required to provide this information and to provide other support.

The expert panel should also be able to commission further research and make relevant requests to government agencies. For example, in considering the administrative efficiency of a fund, it should be able to ask the ATO for information about the data security of a particular fund in the Superannuation Transaction Network.

Listing of underperforming funds in modern awards

The issue of underperforming funds should be addressed through commencement of the FWC process.

Previous arrangements for the listing of default funds in awards did not explicitly contain a mechanism for ensuring that only the best performing funds were listed. However, and as result

⁶⁷ Productivity Commission (2018). Draft report, as cited previously in this submission, p.462.

⁶⁸ Fair Work Commission (2018). *Overview - Expert Panel on Default Funds*. [online] fwc.gov.au. Available at: <https://tinyurl.com/ybhpbav8d> [Accessed 9 Jul. 2018].

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of the Commission's previous review, the 'as legislated' changes to the default selection process in 2012 would ensure that only high performing super funds are listed.

AIST agrees with the Commission that consideration of past performance should be included in the quality filter.

12.2 Foundations for a modern default allocation system

AIST continues to disagree with the proposal that a 'fund for life' should be chosen by new entrants to the workforce. We believe it is in members best interests and healthy for the system for people to be encouraged to consider the appropriateness of their superannuation choices (or defaults) when they change jobs.

The average Australian changes jobs about every 6 years. This is an appropriate frequency for such a 'nudge'. Changing jobs is a significant life event and people are most likely to review their financial decisions and be receptive to thinking about their superannuation at this juncture. This may also result in them reviewing the appropriateness of their insurance cover and their superannuation investment option.

Not having such a nudge or making it less of the job-change process than it is now, is likely to decrease the level of member engagement.

Decoupling of MySuper products and industrial instruments

Superannuation funds tailor their communications to their membership. If UniSuper needed to recalibrate its message to speak to a much broader community, it is highly likely its level of engagement with its members would diminish substantially.

The problem of unpaid SG is clustered in specific occupations and funds that serve these occupations have well established and successful programs to recover members' money from their employers.

Investment strategies also reflect the characteristics of particular occupational groups.

Insurance is also highly tailored. Some funds have dependents at a younger age than the national average and serve members in high risk occupations including mining, emergency services and construction.

The common bond of working in an industry or a related occupational group is undervalued in this draft report (and its predecessor report) and is dismissed without due consideration or evidence.

12.3 How do alternate default approaches perform?

AIST does not support the Commission's preferred assisted employee choice model. AIST supports the version of assisted employer choice embodied in the FWC model, on the ground that employers would only be able to choose one of a small number of high quality products.

While employers do not have a regulatory obligation to act in their employees' best interests, our preferred FWC model mitigates this with transparent and accountable processes.

Government monopoly default provider

AIST agrees with the comments made by the Commission about the risks inherent in this model, especially political risk. A model that is susceptible to use by government for purposes not consistent with members best interest is undesirable.

Chapter 13 – Modernising the super system to work better for all members

AIST KEY POINTS:

- The best in show proposal is an inferior replacement of the legislated but unimplemented default system, and does not remove underperforming choice funds from the system.
- AIST supports measures that strengthen the obligation on superannuation trustees to consider the appropriateness of their MySuper product offerings, provided this assessment does not reduce the existing legislative focus on the pursuit of optimal net returns.
- AIST support independent verification of an outcomes test assessment and annual reporting on switching.
- AIST support the extension of the test to all APRA-regulated superannuation products.
- AIST support regular, rigorous and independent reviews of this process.
- AIST supports the establishment of a Superannuation Data Working Group.

Best in show shortlist

AIST agrees that there should be a systematic approach to minimise the creation of unnecessarily duplicated accounts. However, we reiterate our earlier comments disagreeing with the defaulting once proposal and arguing that the online choice form can be just as effectively tied to the FWC model as to the best in show proposal.

We support a simple choice environment, where people who do not choose are defaulted into good funds. However, the draft report does not meet its own criteria of ensuring people who exercise choice are able to do so simply and safely. The best in show proposal is more closely aligned to a default process than it is to choice processes. For example, all products of the proposed best in show list would be MySuper products, comply with the Insurance Code and meet the requirements of the modified quality filter.

This still means that there will be thousands of choice products that do not meet this threshold and that often underperform. The suggestion⁶⁹ that the best in show funds will be the exemplar that funds in the choice sector will be driven to follow is naïve. The higher standards and

⁶⁹ Productivity Commission (2018). Draft report, as cited previously in this submission, p.458.

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outcomes of MySuper products have raised the bar in relation to default super but have not resulted in a trickle-down effect of higher standards and outcomes in choice products.

The proposal for a shortlist of ten best in show funds is not demonstrably better than either the existing or the 'as legislated' default system.

The 'as legislated' model could be implemented tomorrow if the government stopped its four-year delay in the operation of the FWC model. This would immediately mitigate the risk of defaulting a member into a poorly performing fund. By being linked to new employee commencement and the award system, many more employees would have the benefit of the improved system at an earlier stage.

Elevate the threshold for MySuper

AIST supports measures that strengthen the obligation on superannuation trustees in relation to their MySuper product offerings, provided this does not reduce the existing legislative focus on the pursuit of optimal net returns.

We oppose any displacement or dilution of the requirement to pursue net returns for MySuper products. At least in relation to default fund selection the Commission shares this view. AIST supports elevated thresholds using a two-tiered outcomes assessment with a primary annual MySuper outcomes assessment based on net returns and a secondary annual MySuper outcomes assessments having regard to the sorts of factors identified by the Commission and in the proposed outcomes assessment legislation (provided the pursuit of these are not in conflict with the pursuit of net returns).

The Commission has also expressed its support for higher standards in the choice sector. We share this view and therefore support the extension of the standards required of MySuper products to all APRA-regulated superannuation products. While we agree that MySuper products should be held to the highest standards of accountability and transparency, we believe that this standard should apply equally across all parts of the superannuation system.

A fund's determinations in relation to the MySuper outcomes assessment should be made in writing and publicly available. The Commission should recommend that the Government make a consequential amendment to section 29QB of the SIS Act to include the determination as specific information required to be made publicly available.

Given the importance of this assessment (especially if it has a primary focus on net returns), we submit that it should be prescribed in legislation rather than regulations.

Superannuation data working group

There is a critical need for a more co-ordinated and consistent approach to superannuation data collection, quality and adequacy across Australian Government agencies. In AIST's experience, while there is a reasonable level of communication between agencies about data, this does not always translate into co-ordinated outcomes.

APRA is currently in the process of reviewing its superannuation prudential standards, including its reporting standards, and updating the channels through which super funds report to them. These projects do not seem to be co-ordinated within APRA and the opportunity to further streamline data collection does not appear to be taken.

The opportunity to explore better data collaboration and use with the ATO that these APRA projects present also do not appear to be taken. Much of the data provided to the ATO at an individual level is also provided to APRA at an aggregated level. By reviewing data collection, the areas of overlap could be identified and addressed, as could gaps in data collection.

For example, the collection of near real-time insurance information by the ATO could alleviate the insurance data deficits identified by APRA, and an opportunity to provide members with consolidated information about their insurance within super is being wasted. The collection of this information could also be used to facilitate account consolidation and ensure that members had appropriate insurance.

AIST therefore supports the superannuation data working group proposed by the Commission.