

13 July 2018

Attention: Karen Chester, Deputy Chair
Superannuation
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne VIC 3000

Dear Ms Chester,

AustralianSuper's submission in response to the Productivity Commission Draft Report 'Superannuation: Assessing Efficiency and Competitiveness'

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. The best interests of the fund's 2.2 million members drive all our decisions. Our sole purpose is to help members achieve their best possible retirement outcome.

AustralianSuper acknowledges the significant work of the Productivity Commission (PC) throughout this inquiry. We note the research, consultation and analysis the PC has undertaken and the construction of investment benchmark portfolios and cameo analysis.

The most important, and yet the most understated, finding in the PC's report is that the majority of superannuation fund members are in strong performing funds:

- The default segment generated average net returns of approximately 7% pa over the 12 years to 2016.
- In the decade to 2017, 32 MySuper products with 9.1 million accounts and \$375 billion in assets performed above the Commission's own benchmark (BP2).
- Of these funds, the top 10 MySuper products generated a median return of 5.7% a year. These 10 products account for over 50% of all default accounts, more than 6 million member accounts and over \$225 billion in assets. All these funds are profit to member funds.

The report also found that the system suffers two fundamental flaws: entrenched underperformance of some superannuation funds affecting a minority (though material number) of fund members, and an excessive number of unintended multiple accounts. AustralianSuper agrees that these are fundamental problems in the superannuation system and must be urgently addressed.

AustralianSuper proposes an alternative model to specifically address both problems.

1) Mandatory performance filter for MySuper authorisation.

AustralianSuper believes any change to the current default system must stop people defaulting into poor performing funds or it will have failed. It is a failing of the current MySuper system that poor performing products can obtain and retain a license to receive default members.

AustralianSuper commends the work of the PC in the construction of investment benchmark portfolios (BP1 and BP2) to assess the system's relative and absolute investment performance, agnostic of asset allocation. The PC's benchmarking work is a clear measure of whether funds are adding value against market performance and is a definitive tool to identify where there is long-term underperformance in the system.

AustralianSuper applies the use of a standardised, passive benchmark to assess value add. BP1 is a consistent and accessible reference point for measuring whether funds have added value to members. We believe BP1 should be considered the 'Member Value Benchmark', to be measured over rolling 10 year periods to allow for investment cycles.

AustralianSuper proposes that:

- 1) The Member Value Benchmark (BP1) be implemented as a mandatory performance filter for MySuper authorisation.
- 2) The Member Value Benchmark (BP1) table should be published.
- 3) MySuper products must meet the Member Value Benchmark to become and remain eligible for MySuper authorisation.
- 4) MySuper products that underperform the Member Value Benchmark should have their MySuper authorisation cancelled by APRA and be subject to a prudential transition process, which may include Successor Fund Transfer (SFT) and merger arrangements, within a defined timeframe.
- 5) Cancelled MySuper products should be required to send a Significant Event Notice (SEN) to all employers who use that MySuper option as a default fund and all default members of that product.
- 6) Cancelled MySuper products would not be eligible to receive new default members or superannuation guarantee monies.

This proposal would:

- Ensure members are only defaulting into funds that have a demonstrated history of adding value.
- Expedite the exit of underperforming funds.
- Avoid sub-optimal market concentration.
- Remove the need for an independent expert panel.
- Remove the subjectivity, cost, complexity and contestability that could arise from the current proposal.

2) 'Best in Show' per Industry Award

The inclusion of superannuation in awards and collective agreements has consistently delivered better outcomes for members. It also facilitates the negotiation of improved superannuation conditions and assists effective prosecution of non/underpayment of superannuation entitlements and

AustralianSuper believes that the diverse needs of the Australian workforce cannot optimally be met by only 10 default products across the entire superannuation system.

We agree that behavioural economics suggests that limiting the number of options facilitates better decision making. Consequently, AustralianSuper recognises that employers and members will benefit from a shortlist of up to 10 products per Award.

To ensure better member outcomes, AustralianSuper recommends that only MySuper options that have met a performance filter, the Member Value Benchmark, should be eligible to be included in the relevant Award and Agreements. This eliminates the 'unlucky lottery' of defaulting into a poor performing fund. It also increases competition by funds for the market without homogenising the performance of players in the market due to index-hugging behaviours.

AustralianSuper proposes that:

Each Award list up to 10 MySuper default options for employees covered by that Award.

The process to establish this list would be:

- 1) FWC seek submissions from relevant parties and superannuation funds to be considered as a default product in Award/s.
- 2) To be eligible to be named in an Award the MySuper product must meet the Member Value Benchmark (performance filter).
- 3) The FWC may consider other factors, such as insurance design, in determining the final list, noting that to be eligible the MySuper product must meet the Member Value Benchmark and funds should be ranked according to performance.

The workplace parties will then choose a MySuper option from the relevant Award as the default fund.

This proposal would:

- Stop people being defaulted into poor performing funds.
- Ensure superannuation funds can continue to provide a tailored offering to members based on the characteristics of the industry they work in.
- Retain an employer's ability to specify a default fund, from the list in the relevant Award, and in turn have greater access to workplace superannuation education and support.

3) Once only default.

AustralianSuper acknowledges that the current arrangement of having a new default fund each time employment changes is costly to members and the system. We are concerned about the regressive nature of multiple accounts and agree that more must be done to reduce current and future account proliferation.

AustralianSuper supports 'once only default' unless an Enterprise Bargaining Agreement (EBA) specifies otherwise.

Nothing in this proposal will impede member choice of fund.

This proposal would:

- Result in the majority of working Australians defaulting once and subsequently reducing the creation of multiple accounts.
- Enable workplace parties to negotiate superannuation clauses to meet the needs of their workforce.

4) Protecting choice members from poor performance.

We believe urgent action is required to address the plethora of choice products that deliver inexcusably poor long-term net performance.

Whilst AustralianSuper strongly believes a mandatory performance filter should be applied to default products, we call on the Commission to consider definitive action on poor performing choice products. AustralianSuper would welcome the Commission's leadership on tackling poor performing choice products, specifically initiatives to reduce the likelihood of consumers making decisions that would adversely impact their retirement outcomes.

AustralianSuper's detailed response to the Commission's recommendations and information requests are provided in attachments A and B.

We would welcome the opportunity to discuss this further with you, please do not hesitate to contact Kelly Shay on 08 9218 4038 or Louise du Pre-Alba on 03 8648 3847 in the first instance.

Yours sincerely,

PAUL SCHRODER
Group Executive
Product, Brand & Reputation

Attachment 'A' AustralianSuper's response to Productivity Commission Recommendations

1. DEFAULTING ONLY ONCE FOR NEW WORKFORCE ENTRANTS

Default superannuation accounts should only be created for members who are new to the workforce or do not already have a superannuation account (and do not nominate a fund of their own). To facilitate this, the Australian Government and the ATO should continue work towards establishing a centralised online service for members, employers and the Government that builds on the existing functionality of myGov and Single Touch Payroll. The service should:

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

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

AustralianSuper supports 'once only default' subject to:

- A performance filter being implemented to stop people from defaulting into poor performing funds
- The ability for workplace parties to negotiate superannuation clauses to meet the specific needs of their workforce.

2. 'BEST IN SHOW' SHORTLIST FOR NEW MEMBERS

A single shortlist of up to 10 superannuation products should be presented to all members who are new to the workforce (or do not have a superannuation account) from which they can choose a product. Clear and comparable information on the key features of each shortlisted product should also be presented. Members should not be prevented from choosing any other fund (including an SMSF). Any member who fails to make a choice within 60 days should be defaulted to one of the products on the shortlist, selected via sequential allocation. The ATO should embed the shortlist and accompanying information into the centralised online service.

AustralianSuper believes that the diverse needs of the Australian workforce cannot optimally be met by only 10 default products across the entire superannuation system. Funds have a responsibility to develop investment options, insurance arrangements, products and services that reflect the needs of their membership.

AustralianSuper cautions that the Commission's top ten default products would result in a market concentration to only 10 funds, homogenise the superannuation landscape, and may result in behaviour that may not be in the interests of superannuation fund members.

We are concerned that the sequential allocation of default members to a rotating set of MySuper options would lead to increased disengagement. This would be further exacerbated by decreased access to workplace education and support by superannuation funds.

Consistent with behavioural economics, AustralianSuper does recognise that employers and members would benefit from a shortlist of up to 10 MySuper products to choose from however we believe this should be a short list of up to 10 MySuper products per Award.

We believe a list of 10 high performing MySuper options per Award would benefit consumers, employers, funds and the economy. We believe it would meet the Commission's objective of increased competition for the market while being efficient and effective.

AustralianSuper believes there is a strong case for superannuation to remain part of the workplace relations framework. The inclusion of superannuation in industrial agreements solidifies the negotiation of improved superannuation entitlements and assists effective prosecution of non/underpayment of superannuation obligations.

3. INDEPENDENT EXPERT PANEL FOR 'BEST IN SHOW' SELECTION

The Australian Government should establish an independent expert panel to run a competitive process for listing superannuation products on the online shortlist. This panel should select from products submitted by funds that meet a clear set of criteria (established beforehand by the panel) and are judged to deliver the best outcomes for members, with a high weighting placed on investment strategy and performance. The panel should have flexibility to select up to 10 products, with the exact number at the discretion of the panel based on the merit of each product and what is most tractable for members, while maintaining a competitive dynamic between funds for inclusion. The panel should be comprised of independent experts who are appointed through a robust selection process and held accountable to Government through adequate reporting and oversight. The process should be repeated, and the panel reconstituted, every four years.

We believe an independent expert panel for 'Best in Show' selection is not achievable. It is unclear how a panel can be assembled that is both eminent, independent, and suitably qualified to judge and select a top 10 of default investment options. Using performance data is more reliable.

AustralianSuper believes the implementation of a "Best in Show" top 10 in the manner described, together with its consequences for unsuccessful funds, will also provide incentives for funds to act in ways that may not be in the interests of superannuation fund members including:

- Short termism over each four year block, including "window dressing" to manage performance leading into tender dates.
- "Herding" behaviour by those MySuper options selected into the 'Best in Show', around a particular asset allocation or strategy, in order to retain position within the top 10.
- Increased risk-taking or alternative strategies by funds nudging the bottom of the top 10 list.
- Product providers running multiple extreme portfolio strategies, so that one will have very high performance and one very low, the goal of having one of those selected in the next tender.

4. MYSUPER AUTHORISATION

The Australian Government should legislate to allow APRA to apply the MySuper outcomes test. Authorisation rules for MySuper should be further strengthened to require funds to:

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

Funds that fail to meet these conditions — or persistently underperform (for five or more years) an investment benchmark tailored to their asset allocation by a material margin, as determined by APRA — should have their MySuper authorisation revoked. After implementation, the Australian Government should commission an independent review, every five years, of the effectiveness of the MySuper authorisation rules (including the outcomes test) at meeting their objectives.

AustralianSuper is supportive of proposals to enhance the existing MySuper authorisation, to require funds to obtain independent verification of their outcomes test assessment, comparison against other products in the market, and determination of whether members' best interests are being promoted, at least every three years. We support the proposal that funds report to APRA annually on how many of their MySuper members switched to a higher fee choice product within the same fund.

AustralianSuper believes MySuper authorisation should be further enhanced by the implementation of a performance filter (Member Value Benchmark) as outlined in our submission. We support use of a single consistent benchmark (BP1) and determine underperformance by reference to this.

5. REGULATION OF TRUSTEE BOARD DIRECTORS

The Australian Government should legislate to:

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

This recommendation is broadly consistent with AustralianSuper current practice. AustralianSuper supports the proposals outlined in the Fraser Report and the AIST Governance Code.

6. REPORTING ON MERGER ACTIVITY

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

AustralianSuper supports this recommendation.

7. CAPITAL GAINS TAX RELIEF FOR MERGERS

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

AustralianSuper supports this recommendation.

8. CLEANING UP LOST ACCOUNTS

The Australian Government should legislate to:

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

AustralianSuper supports this recommendation and notes the crossover with the "Protecting Your Super" package.

AustralianSuper acknowledges the role of ERF's, particularly AusFund, in proactively reuniting members with their lost accounts. AustralianSuper supports the rollover of accounts from Eligible Rollover Funds to the ATO.

AustralianSuper is concerned that this recommendation does not consider account balance as a factor. We question whether this is in the best interests of members with larger account balances who should achieve higher earnings in the superannuation system than with the ATO.

9. A MEMBER FRIENDLY DASHBOARD FOR ALL PRODUCTS

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

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

AustralianSuper generally supports these initiatives and provides additional suggestions under recommendation 10.

10. DELIVERING DASHBOARDS TO MEMBERS

The Australian Government should require the ATO to present the relevant (single page) product dashboard on a member's existing account(s) on its centralised online service. The Government should also require all superannuation funds to actively provide their members with superannuation product dashboards when a member requests to switch from a MySuper product to a choice product within the fund. This should include:

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

AustralianSuper supports the use of the product dashboard for MySuper products as a consumer decision-making tool. We note that the product dashboard is subject to disclosure requirements that are administered by ASIC as the disclosure regulator in superannuation.

AustralianSuper has no objection to the product dashboard for any investment option being placed on the member's existing 'account'(s) on its centralised online service.

AustralianSuper notes that those people who do not change jobs or superannuation funds will not access this information on the centralised online service.

Presently, superannuation funds are required to include these product dashboards on superannuation fund websites. We suggest that trustees of MySuper products be legally required to send members the product dashboards when they consider switching as follows:

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

AustralianSuper suggests that the product dashboard regime be finalised and confirmed to apply to choice products as soon as possible.

We suggest that all product dashboards for investment options be placed on ASIC's MoneySmart website for ease of comparison, and that every member who contacts a superannuation fund to switch to products outside of the superannuation fund be provided a hyperlink reference to product dashboards shown on the ASIC MoneySmart website.

11. GUIDANCE FOR PRE RETIREES

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

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

AustralianSuper agrees with the premise that more can be done to help Australians as they approach retirement and broadly supports measures that will assist pre-retirees in obtaining help and advice services. No harm would come of requiring the ATO to guide all superannuation members to either of the suggested sites, however, we suggest that this is a role that superannuation funds should undertake, some of whom currently reference such websites.

Directing members as they approach retirement back to their fund is likely to have more success as funds will be better-placed to harness behavioural economics techniques and data technologies to prompt, nudge, help and guide members towards retirement with actionable steps.

12. EXIT FEES AT COST RECOVERY LEVELS

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

Current MySuper requirements limit exit fees to a 'cost recovery' basis. The government has proposed the removal of exit fees under the 'Protecting Your Super' legislation. It is of concern to AustralianSuper that this package does nothing to limit the imposition of buy/sell spreads or switching fees in superannuation, which should also be only made on a 'cost recovery' basis.

The concept of "cost recovery" for switching fees is complex for superannuation, in particular where investments are made in related-party products, because the underlying related-party products can charge switching fees or buy/sell spreads which include a profit margin, passing these on at "cost recovery" levels to a fund may still include a profit margin. We suggest therefore, that "cost recovery" be considered on an arms-length basis and be subject to a comparability requirement.

AustralianSuper has expressed concern in consultation with the ASIC RG97 expert review on this point, and suggested that fee and cost disclosure to superannuation fund members should be extended to illustrate the "Cost of Moving".

13. DISCLOSURE OF TRAILING COMMISSIONS

The Australian Government should require superannuation funds to clearly inform, on an annual basis, all members who are subject to trailing financial adviser commissions. This information should include the amount of commissions paid and a notice that trailing commissions are now illegal for new members. All funds should publicly disclose the extent of trailing commissions and number of affected members in their annual reports and provide this information to ASIC.

AustralianSuper supports the separate disclosure of all trailing commissions at the superannuation fund level in addition to financial adviser disclosure.

14. OPT IN INSURANCE FOR MEMBERS UNDER 25

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

AustralianSuper supports this recommendation.

15. CEASE INSURANCE ON ACCOUNTS WITHOUT CONTRIBUTIONS

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

AustralianSuper supports changes to insurance in relation to inactive accounts for 13 months or more, so that insurance is not held if not directed by the member.

16. INSURANCE BALANCE EROSION TRADE OFFS

APRA should immediately require the trustees of all APRA regulated superannuation funds to articulate and quantify the balance erosion trade off determination they have made for their members in relation to group insurance, and make it available on their website annually. As part of this, trustees should clearly articulate in their annual report why the level of default insurance premiums and cover chosen are in members' best interests. Trustees should also be required to provide on their websites a simple calculator that members can use to estimate how insurance premiums impact their balances at retirement.

AustralianSuper supports these changes. They are broadly in line with the requirements of the Insurance in Superannuation Code of Practice and will improve confidence that members have in the levels of automatic insurance provided.

17. INSURANCE CODE TO BE A MYSUPER CONDITION

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

AustralianSuper supports this recommendation.

18 INSURANCE CODE TASKFORCE

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

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

The code owners should be given two years to strengthen the code and make it binding and enforceable on signatories before further regulatory intervention is considered. The taskforce should annually report findings on industry progress on the code. Both ASIC and APRA should be members of the taskforce, with ASIC taking the lead.

AustralianSuper supports this proposal in principle. However, there should be close dialogue between the joint regulator taskforce and the code owners to ensure alignment of desired outcomes. In addition, the enhanced Code of Practice should be given at least two years to operate before any assessment is made of its effectiveness. We also draw your attention to legal opinion obtained which limits making a voluntary code binding on superannuation trustees as it fetters their discretion. Perhaps this issue requires legislative consideration instead.

19. INDEPENDENT REVIEW OF INSURANCE IN SUPER

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

AustralianSuper supports this recommendation, however, we believe that current initiatives should be allowed to flow through the system and be monitored for effectiveness before a review commences. We note that if the 'Protecting Your Super' package is implemented it will directly affect the offering of insurance within superannuation, and also should be given time to function before such a review is conducted.

20. AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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

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

AustralianSuper supports this recommendation, noting:

- We suggest that guidance should be provided by APRA regarding the format of assessments so that meaningful comparisons and insights can be analysed.
- Our enhanced MySuper authorisation proposal deals with the issues of scale and mergers issue directly.
- We agree that product level reporting for choice products should be brought into line with the MySuper segment as soon as possible.

21. AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

ASIC should (in addition to draft recommendation 9):

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

AustralianSuper supports this recommendation and notes the following:

- Disclosure can have limitations in terms of consumer protection – it needs to be aligned with behavioural economics thinking on consumer decision-making.
- A uniform approach to the definition of "related party" should be prescribed for all funds.
- Where mergers between funds did not proceed, we suggest that this governance issue be considered by APRA instead of ASIC.
- Refer our comments on recommendation 12 on exit and switching fees being subject to cost recovery limitations.

22. SUPERANNUATION DATA WORKING GROUP

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

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

AustralianSuper supports this recommendation.

Attachment 'B' AustralianSuper's response to Information requests from the Productivity Commission

Information Request 2.1

Are the assumptions underpinning the Commission's benchmark portfolios sound? If not, how should they be revised, and what evidence would support any revisions?

The assumptions are broadly sound, but there are a number of changes to the approach we would suggest:

- The same benchmark for all investment options should be used, grouped by a comparable level of risk, and should be simple and largely unchanged over time. The report currently focuses on comparing segments (for profit/not-for-profit; industry/retail/corporate) to their individualised benchmarks. We don't believe different segments of the market should be given tailored benchmarks (and an opportunity to claim they have beaten their benchmark). We recommend using BP1 for all investment options. BP1 is a more representative portfolio across all market segments.
- Comparison at the System level (total fund level) does not reflect an individual member's experience. We recommend a product level comparison between products with a broadly comparable risk profile. Both MySuper and Choice products should be required to publish basic performance information – to allow for incumbent funds to be compared to new menus presented to members on change of employment.
- A separate fund level comparison should be retained as an additional measure that doesn't reflect member experience but provides guidance as to the average outcomes of members. This simpler metric can be informative as to the structure of the fund – and the take-up of offerings by members (e.g. take-up of higher cost Choice options versus lower cost MySuper products).
- The indexes the report used for constructing the two benchmarks are generally representative of the asset classes considering issues of index accessibility, transparency and availability (for 12 years).

Our key recommendations/observations on index choices are:

- The draft splits listed property as a separate asset class. Note there is an overlap between the chosen Listed Equity benchmarks and Listed Property benchmarks. The look through weight of REITS may be overstated in the benchmarks. The report should address or acknowledge this potential overstatement.
- The benchmark for International Equity is Developed markets only. In our experience, most funds would have invested some portion of international equity in emerging markets. We recommend using MSCI ACWI Ex Aust.
- Broadening the consideration for international unlisted assets. Given the report is mainly based on long term, it is suitable to consider using listed markets indexes plus an illiquidity premium. The current benchmarks for unlisted international property and unlisted international infrastructure are Australian indices.
- Currency hedging: Consider using all hedged benchmarks and determine the average hedging ratio at the option level, rather than having different hedging ratio for each benchmarks. We cannot ascertain the overall hedging ratio with the data provided in this report.
- Asset Allocation data used to construct the benchmarks is not available in the report for us to provide feedback. We reviewed the methodology, and agree with the general approach of using the average of the pool as the benchmark asset allocation and the assumptions the commission have made to overcome data issues. Benchmarks should not be revised based on individual active fund asset allocations – otherwise the performance impact of asset allocation decisions (which can be significant – positive or negative) will not be reflected.
- Tax: The draft used actual tax paid at the fund level as the tax rate for benchmarks. The actual option returns submitted are based on tax liability accrued. Actual tax paid is generally lower than tax accrued, hence overstates the outperformance of the options. Pension members (non-tax payers) are also included in fund level data. Actual tax paid is more volatile than tax accrued for a given year, hence increase the volatility for the benchmarks. We recommend using a long term average estimated tax rate.
- Risk: Some consideration for risk in performance in benchmarking is worthwhile. Agreeing a measure and methodology is very difficult, so we would recommend grouping default options by bands of % risk assets or equity risk, which provides scope for funds to measure returns based a reasonable risk appetite. We suggest comparison of returns on a risk adjusted basis, e.g. active beta/volatility or tracking error. The intuitive advantage of using this is the ability to assess how true to label an option is/has been, and also how successful their investment process has been given their exposure to growth assets.

Information Request 2.2

Aside from administration fees, asset allocation and tax, what other factors might explain differences in investment performance against benchmark portfolios of the superannuation system, as well as segments such as for profit and not for profit? What evidence is available to test the influence of such factors?

Fees, profit margins, operational costs of interposed vehicles, and operational inefficiencies directly detract from investment performance. The impact of these – in particular within the for-profit versus not-for-profit sector – have been identified through the benchmarking process.

Other factors include:

- Actual asset allocation will have differed from the passive BP1 or BP2 at any given time, which may add or detract value.
- Security selection decisions which lead to out/underperformance of underlying portfolios against benchmarks.
- Costs which are hidden in returns. E.g. low returning cash pools.

To test these influences, we suggest further grouping funds according to:

- Investment style, such as: active/passive managed, internally/externally managed. Those mentioned above are already implicitly reflected in the findings due to their impact on investment fees. Also if data quality permits, % invested in illiquid assets.
- Size of the fund (reflected in the findings) – though the impact differs between market segments (for profit v not for profit).
- Risk taken: compare returns on a risk adjusted basis for investment options, this also helps to minimize any error caused by mislabelling of assets during asset allocation submission. We also suggest looking at pre-tax volatility of the returns.
- Use the same after fee after tax benchmark for both the “for profit” and “not for profit” market segments: Although the draft report already has findings that suggest not for profit funds outperform their benchmarks more so than the for profit segments, it may be valuable to compare both to the same benchmark. This may assist to identify the factors are driving the results.
- We also suggest looking at rankings for default options vs non default options to see if the funds have a consistent approach across their options. We suspect some funds focus on their default fund and do not pay much attention to their other investment options.

Finally, in terms of evidence and analysis, we note that poor response rates to surveys limit meaningful assessments. Discretionary provision of data results favourable information biases. To enable meaningful assessments and performance comparisons to be made, we suggest that funds should be compelled to provide information required for assessment of the efficacy of their investment program, as part of an enhanced MySuper licence process.

Information Request 4.1

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

AustralianSuper recommends removal of lifecycle products from the MySuper authorisation process, so that they are not available for default selection in superannuation.

AustralianSuper does not expect that many lifecycle MySuper products will survive a robust and performance-based MySuper process. Higher fees charged by lifecycle products will lead to difficulties in meeting the Member Value Benchmark.

AustralianSuper has undertaken extensive research into lifecycle investment strategies for our default members. Our key conclusion was that reducing the exposure to growth-related investments, as many lifecycle strategies propose, is

undertaken too early, and should largely be left to (or beyond) retirement, or when a member exercises an investment choice.

AustralianSuper's approach was based on the following key observations about our members:

- The amount of savings for most of our default members are modest. Therefore, the biggest risk AustralianSuper aims to manage on members' behalf is the risk of not sufficiently growing their savings;
- Reducing the volatility of a members investment balance leading into retirement, whilst intuitively appealing, would have a significant impact on the growth of their savings. If members were invested in a lower returning strategy over a sustained period, they would have to either drastically increase their contributions or accept a significantly lower retirement outcome;
- Most of AustralianSuper's pension members rely heavily on the Government Aged pension for their retirement income (99% of current pension members receive a part or full aged pension). Therefore, superannuation is often only a small component of their total retirement income;
- The income demands of most of AustralianSuper's pension members are modest, with the most common withdrawal rate being the minimum required under the Government's rules for an account-based pension;
- Increasing life expectancies means that members are living longer, and their investment horizons are lengthening.

AustralianSuper considers the most appropriate way to manage "sequencing risk" is to redeem progressively during retirement. We have found that the ability of lifecycle products to reduce "sequencing risk" are often overstated, and best applies to the phase when a member is drawing down a large amount of their savings. We have found that many lifecycle strategies simply bring forward the sequencing risk date to the point at which growth assets are sold and other assets are purchased.

In addition, AustralianSuper believes that the combination of higher fees and lower returns has been, on average across the industry, largely detrimental for members. Given the costs of managing asset classes such as cash and fixed income are generally lower, AustralianSuper would expect that lifecycle funds which have de-risked their members would be substantially cheaper than their non-lifecycle equivalents.

Finally, we note also that there is a distinct difficulty for consumers to compare these products against other MySuper or choice investment options.

Information Request 7.1

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

The main types of costs involved in fund mergers relate to:

- Cost of transition in administration environment.
- Cost of transition in investments environment, including custody costs.
- Cost of general execution (e.g. management, communications and consultancy).

The quantum of the costs vary in line with the complexity of the fund. Whilst smaller funds can be less complex, it is not often the case. There is a requirement for trustees to ensure equivalency for members in a merger transition, and complexity can arise in the ability to meet the requirements of any legacy arrangements in the merging fund.

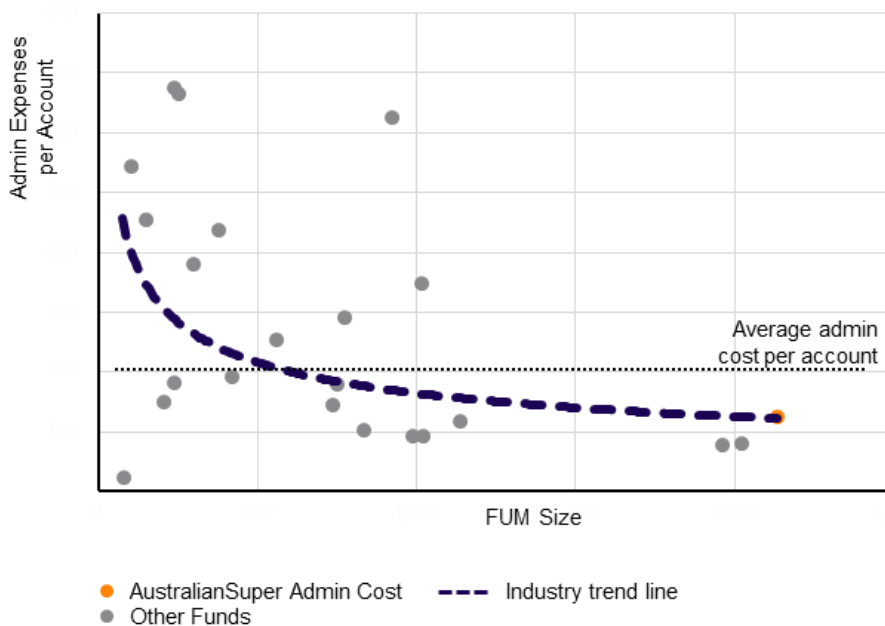
Information Request 7.2

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

There is compelling evidence that cost efficiency is correlated to scale. AustralianSuper has strongly demonstrated in its history that scale has delivered efficiency gains in the form of lower costs.

The graph below shows that Administration costs per member account are likely to be much lower if the size of the fund is larger.

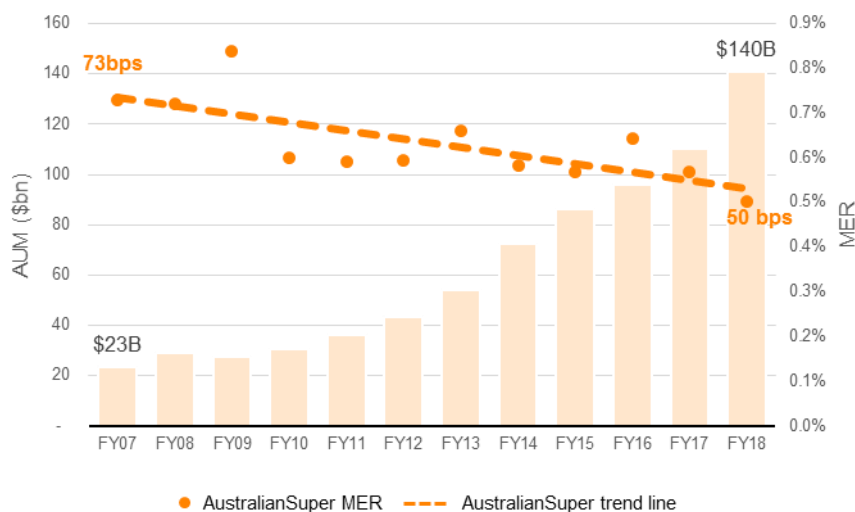
FUM Size vs Admin Costs⁽¹⁾



1

The following graph illustrates that investment management costs have reduced as AustralianSuper has grown in funds under management.

AustralianSuper's MER⁽²⁾



2

¹ Grattan Institute 2015, APRA Super Fund Level Publications, analysis by Port Jackson Partners.

² Investment Costs measured by the Member Expense Ratio (MER) for Balanced Option, based on internal data from Investments Operations (30 June 2018)

The evidence by which these cost savings are passed on to members are clear. Firstly, we are a profit-for-members fund and all profits are returned to members. Secondly, our administration fee of \$1.50 per week has been unchanged since it was first introduced in 2009. Thirdly, AustralianSuper has passed onto members all benefits of the reduced investment management fee.

Consistent with draft findings 7.1 and 7.2, the future competitive landscape will force superannuation funds to face a balancing act. Operating costs will increase as a result of the industry shift towards a more retail environment, but expectations of scale benefits being passed through to members will remain.

Information Request 8.1

What is the case for bundling life and total and permanent disability insurance together, as is done by some superannuation funds? Are there funds that offer these separately, and if so, do many members of these funds elect to have one type of cover but not the other?

AustralianSuper does not believe that bundling death and TPD cover is appropriate for its members. There is no case for additional legislative or regulatory restrictions on product design as we are required to consider the best interests of members when designing product rules for our fund.

AustralianSuper allows members to have death cover, TPD cover, both or no insurance. In addition, Terminal Illness benefit is paid at the greater of the death and TPD cover levels chosen by the member (or provided by default). The table below shows the number of AustralianSuper members with different combinations of products demonstrating a variety of combinations are sought and provided.

| Benefits provided | Number of insured members | % of total |
|-------------------|---------------------------|---------------|
| Death + TPD + IP | 782,000 | 58.2% |
| Death + TPD | 484,000 | 36.0% |
| Death + IP | 13,000 | 1.0% |
| TPD + IP | 3,000 | 0.2% |
| Death Only | 53,000 | 3.9% |
| TPD Only | 3,000 | 0.2% |
| IP Only | 6,000 | 0.5% |
| TOTAL | 1,344,000 | 100.0% |

AustralianSuper believes that the MySuper provisions should be changed to support the unbundling of Death and TPD and that the provision of opt-out TPD no longer be mandatory where opt-out income protection is provided.

MySuper legislation requires the trustee to offer Death and TPD cover on an opt-out basis whereas the trustee may determine whether to provide income protection on an opt-out basis, an opt-in basis or not at all. This has encouraged the bundling of Death and TPD to minimise cost and discourage opt-out Income Protection (temporary incapacity), even if that would have been more appropriate for the membership. In most circumstances, income protection provides better protection for members than TPD as it provides cover in all circumstances when the member cannot work due to illness or injury, not just for those whose condition is so severe that it renders them permanently disabled. TPD then needs only to be provided as a top-up for more severe illnesses or injuries.

Income Protection usually provides an additional benefit to cover the Superannuation Guarantee contributions which makes it more fit for purpose in supporting retirement incomes.

AustralianSuper does not support the regulation of product design but suggests that the conditions for release of benefits in the event of disability (temporary or permanent incapacity) be harmonized and focused on:

- Providing income.
- Replacing reasonable superannuation contributions that would have been made if the member had been fully employed.
- Funding additional expenses the member might face as a result of their disability, including the provision of rehabilitation and retraining.

- Current TPD and Income Protection products already meet these requirements but new and innovative products should also be allowed to flourish. In fact, the more appropriate tailoring of products to needs may result in lower insurance costs.

Information Request 8.2

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

AustralianSuper strongly supports the provision of income protection on an opt-out basis. Our view is that income protection is often a more valuable and appropriate benefit than TPD. If the primary role of superannuation is to provide for income in retirement then the first priority should be to replace members' income and superannuation contributions if they are unable to work due to illness or injury.

The case for opt-out income protection is compelling:

- It is more aligned with the purpose of superannuation.
- It provides broader coverage for members.
- It is better understood by members, as evidenced by member research and lower complaints.

Critics of opt-out income protection often refer to product designs adopted by funds that are less generous than AustralianSuper's. AustralianSuper's income protection product provides broad, comprehensive coverage that does not suffer from many of the criticisms levelled at industry more broadly.

Current legislative/regulatory constraints around the provision of disability benefit in superannuation are impeding trustees in providing the most suitable insurance products for members. In particular, we suggest that the conditions for release of benefits in the event of disability (temporary or permanent incapacity) be harmonised and focus on:

- Providing income.
- Replacing reasonable superannuation contributions that would have been made if the member had been fully employed.
- Funding additional expenses the member might face as a result of their disability, including the provision of rehabilitation and retraining.

Current Income Protection (and TPD) products already meet these requirements but if appropriate legislative/regulatory changes could be made, new and innovative products would also be allowed to flourish. In fact, more appropriate tailoring of products to needs may result in lower insurance costs.

Suggested changes to the current SIS Act conditions for release

There is a broader issue with the current legislative settings that we would urge the Commission to consider.

The SIS Act draws a distinction between permanent incapacity and temporary incapacity, with different rules for providing benefits in each case. Tax law has adopted a similar distinction and imposed different tax treatments of the two types of benefit. As a result, product design in the market has coalesced around these two concepts, so TPD (permanent incapacity) and Income Protection (temporary incapacity) have remained virtually unchanged for more than 20 years, with few other products and little innovation.

If the primary role of superannuation is to provide for income in retirement then that may not be best served by the current product duopoly. Arguably, the first priority should be to replace members income and superannuation contributions if they are unable to work due to illness or injury - in that way they are more likely to achieve the retirement income they would have achieved if they had not been disabled. That, in turn, would lead to income based products with additional payments to fund rehabilitation and lifestyle modifications required as a result of the illness or injury concerned. Benefit payments may need to be uneven over time and exceed a member's pre disability income in some circumstances. Both these latter features would offend the current legislative/regulatory settings.

We suggest that consideration be given to defining a new concept of "disabled" which does not make a distinction between temporary and permanent incapacity, but allows funds to provide benefits of any amount provided the member is "disabled" at the time. Benefits would be restricted to providing income for the member while they are disabled, future SG contributions and reasonable additional expenses likely to be incurred by the member or their family as a result of their disability, including rehabilitation and retraining.

Information Request 10.1

Would a clearer division of responsibilities between APRA and ASIC (for superannuation) lead to better strategic conduct regulation and better regulator accountabilities? Is APRA best placed to specifically focus on ensuring high standards of system and fund performance, and ASIC to specifically focus on the conduct of trustees and the appropriateness of products (including for particular target markets)?

The division of responsibilities between APRA and ASIC is clear to AustralianSuper. We note that APRA and ASIC respond differently to conduct engaged in by superannuation funds, as they should, given their differing regulatory responsibilities.

ASIC more readily takes regulatory/enforcement action against superannuation funds where they engage in misconduct, but there are also enforcement consequences to breaches of the law that are within APRA's ambit. ASIC has recently been granted a competition responsibility regarding financial products – how ASIC proposes to administer this responsibility needs to be clearly explained prior to implementation of any changes to default superannuation, and needs to be relevant to any selection of default investment options as well as choice investment options.

We agree that APRA is best placed to focus on high standards of system and fund performance. APRA's focus on fund performance as a whole has allowed for the proliferation of underperforming MySuper investment options which needs to be addressed in a MySuper reauthorisation process. We suggest further consideration by APRA on how its approval processes around "trustees for hire" impacts the superannuation market and whether further regulatory overview of new products is required where they are offered by differing promoters with a comparatively passive trustee.

Information Request 12.1

Are there any material impediments to high performing non incumbent funds participating in a 'best in show' selection process? The Commission is particularly thinking about possible claims for participation by funds with no prior local track record but in principle claims, such as foreign funds or a government owned fund.

Provided that any new product can be appropriately compared and benchmarked, on cost, risk, performance and service, there is no reason the product cannot be offered in Australia. As with any new product, we should always be wary of manufactured track record – which is capable of having been subject to "ex-post" optimisation. It is also important that any participant provides the same protections and is subject to the same trustee obligations – i.e. is required to obtain and operate under a RSE license.

This concludes our response.