

18/03/2021

Mr Mark Fitt
Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr. Fitt,

AustralianSuper Submission on Treasury Laws Amendment (Your Future Your Super) Bill 2021

AustralianSuper welcomes the opportunity to provide a submission in relation to the *Treasury Laws Amendment (Your Future Your Super) Bill 2021* (the Bill).

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. Over 2.3 million Australians are members of AustralianSuper with over \$200bn in member assets under management. We are the custodians of the retirement savings of more than 10% of Australia's workforce.

Our sole focus is to use our size and scale to provide the best possible retirement outcomes for members and in doing so, always act in members' best financial interests. AustralianSuper is the number one performing superannuation fund in Australia over the last 5, 10 and 15 years,¹ and over the last 10 years has halved investment costs.

AustralianSuper believes that a world leading superannuation system must be robust, focused on retirement income, deliver good benefits, be sustainable and characterised by a high level of integrity. Importantly in a compulsory system, we believe that all funds should perform, as a minimum, at a reasonable level with strong performance being the norm.

We note the recent Retirement Income Review's conclusion that Australia's retirement income system is sustainable, effective and sound, and that this builds on the largely favourable conclusions made by the Productivity Commission. Both reports, whilst generally supportive of Australia's superannuation system, noted areas where the system could be improved.

The Your Future, Your Super package appears to be directed to achieving the following policy objectives:

- Reducing multiple accounts;
- Measuring performance to members in a consistent manner that assists in comparing fund performance, and, by extension, highlighting the best and worst performers;
- Providing performance information in an accessible and relatively easy-to-understand form; and
- Ensuring that superannuation funds spend and invest members' money such that their best financial interests are served.

AustralianSuper unambiguously supports these policy objectives. However, we believe that the measures in the Your Future, Your Super package would create some unintended outcomes contrary to the stated policy objectives.

¹ Based on the AustralianSuper Balanced investment option compared to the SuperRatings Fund Crediting Rate.

In addition, given the policy intent of this legislation is to provide Australians with appropriate information, transparency and protection, then the legislation should apply to all superannuation funds and products, so that all Australians' superannuation investments are protected.

The remainder of our submission proposes means we believe will address these issues.

Submission – Your Future, Your Super

This submission on the Your Future, Your Super package covers the following key areas:

1. Single default account ('stapling')
2. Addressing underperformance in superannuation
3. Best financial interests duty

1. Single Default Account ('Stapling')

AustralianSuper believes that new entrants to the superannuation system must be protected against being defaulted into an underperforming fund for the duration of their working lives. The advantage of once-only default (or stapling) must therefore be balanced with ensuring only the best performing superannuation funds, measured by long term net benefit, make up the pool of once-only default funds. Ensuring appropriate insurance arrangements for workers automatically defaulted into a stapled fund, in particular for those in high risk industries, is also important.

In its 2019 inquiry, the Productivity Commission concluded that one third of superannuation accounts in Australia (approximately 10 million) are unintended multiple accounts and that the fees and insurance charges associated with multiple accounts erode members' balances by \$2.6 billion per annum.

AustralianSuper's long held view is that it is important for the issues associated with multiple superannuation accounts be proactively addressed, so members do not pay excessive fees, do not 'lose track' of their superannuation accounts and can better plan for retirement by having full visibility of their superannuation savings. However, the provisions as drafted do not adequately address these challenges for two key reasons:

While the concept of a 'fund for life' is worthy, for the provisions to meet the stated intent, that fund must be a well-run, high performing fund. As a result, an inherent danger of the proposal to move to a system of 'first timer default' is that employees can be defaulted into a poor performing fund, leaving them with substandard financial outcomes over the duration of their working lives. We consider this risk to be consequential and avertable, such that the proposed provisions should be reconsidered.

The proposed Regulation making power does not provide adequate certainty that these matters will be addressed and therefore represents insufficient protection for Australian workers.

Given the focus of the measures on new job starters and those Australians changing jobs, it will take considerable time for the proposed changes to have the effect of reducing the number of multiple accounts. They also do nothing to address existing multiple accounts for Australian workers who are already employed and remain in their jobs, or who move employers and choose a new or existing fund and retain their old superannuation account. These workers will continue to pay the multiple fees and charges the measure is designed to address.

In addition, the provisions do not protect Australians from being defaulted into funds which are not subject to the new annual performance test, benchmarking provisions or comparison tool contained in the Bill. If these measures are designed to achieve the policy objective of ensuring Australians have relevant information and transparency, it seems contradictory to allow Australians to be defaulted into funds where such transparency and performance benchmarking is not applied.

Hawking

It is clear that a regulatory shift to 'first timer default' will incentivise superannuation funds to target new job entrants and younger Australians. It may encourage providers to sell members into products early, regardless of the suitability of the product for that member's life stage, the performance of the fund, suitability of insurance offer or the member's financial risk profile.

Providers may also be incentivised to use a 'Dollarmites' type approach aimed at securing members prior to them starting their first job. We note this activity was explicitly rejected by the Royal Commission into the Financial Services Industry. The provisions as drafted do not appear to contemplate protections for younger Australians from these practices, in addition to the risks outlined above of them being placed into an underperforming fund.

Employer impact

There is presently no automated way for employers to determine a new employee's 'stapled' fund. The employer will be required to take time and effort to search for the existing fund for each new employee joining their business. This is clearly an onerous task, whether for small business employers with limited administrative support, or large volume employers. As a result, there is the potential for negative impacts on system compliance.

In addition, there is no way for an employer to discern if the fund they are identifying on behalf of their employee is a high performing fund or an underperforming fund, or indeed an underperforming fund that may be closed to new members.

Regulation making power

In addition to our comments above regarding the minimum standards that should be applied to stapled funds, we note the Bill contains a regulation making power which will clarify how a 'tie breaker' will operate where a member may have two or more active funds. We note the guidance in the Explanatory Memorandum that these provisions are intended to operate similarly to existing tie breaker rules. However, given the importance of this measure to the retirement savings of Australian workers, we consider it important that any rules for determining which fund is the 'stapled' fund be reflected in legislation rather than regulation and that best performing funds (measured by net benefit) are prioritised in how the rules are drafted and their operation.

Recommendations

Based on our observations above, we make the following recommendations:

- i. In line with the Productivity Commission's recommended approach, new entrants to the superannuation systems should only be stapled to high-performing funds, determined on a net-benefit basis.
- ii. The proposed reforms be implemented alongside additional targeted measures to address the issues arising from existing multiple accounts. As part of these measures, protections should be in place to prevent consolidation from a high performing fund to a poor performing fund – especially if the poor performing fund is prohibited from accepting new members due to chronic under performance.
- iii. Funds or products that are not subject to benchmarking or available through the proposed comparison tool should not be available for stapling.
- iv. Protections against hawking and other activities rejected by the Royal Commission, which may lead to adverse outcomes, should be included in this tranche of legislation.
- v. Issues going to system compliance and the operation of 'tie breaker' rules should be clearly spelled out in the legislation for consideration by the Parliament.

2. Superannuation Fund Performance

As set out above, AustralianSuper believes that new entrants to the superannuation system must be protected against being defaulted into an underperforming fund for the duration of their working lives. The advantage of

once-only default (or stapling) must therefore be balanced with ensuring only the best performing superannuation funds, measured by long term net benefit, make up the pool of once-only default funds.

AustralianSuper notes the intent of these measures is to subject MySuper and Trustee Directed Products to annual performance tests and to prevent funds underperforming over two years from receiving new members. Given the compulsory nature of Australia's retirement system and the importance of funds acting in the best financial interests of members, we support measures that ensure only high performing funds receive Australians' superannuation contributions.

To operate as intended, the key outcomes of these provisions must therefore be to improve net performance across the full range of superannuation funds and products, and to ensure members have the opportunity to move to better performing funds, where the performance that is measured accurately reflects the overall cost and benefit to the member.

As a result, we consider the provisions as drafted do not meet the stated policy aim for three reasons:

- The scope of the provisions is too narrow, excluding many relevant funds and products;
- The test for performance is too narrow, as it is focused on 'net investment performance' only rather than 'net benefit' to members;
- The chosen benchmark approach risks funds gaming the system or otherwise adopting investment approaches contrary to members' best financial interests over the longer term.

Scope

As drafted, the performance measures apply only to a limited cohort of funds and products, that is MySuper and Trustee Directed Products. This means that \$881 billion in Single Asset Class Products owned by 8.4 million members will fall outside the remit of the provisions. As a result, the proposed measures do not provide Australians with a complete picture of fund and product performance, to enable them to make informed choices regarding the fund which best suits their circumstances.

We understand that some may argue the provisions have limited application because APRA does not collect sufficient data on the choice products that it regulates to enable them to be included. We note that if the stated policy objective is to be met then the provisions should be applied consistently across the sector. It is within APRA's remit to collect that information from funds that offer choice products and within the Parliament's power to legislate that the data be provided. As such there is no apparent reason why the provisions cannot be applied consistently in the interests of Australians.

Net benefit

We consider Australia's superannuation system must place 'net benefit' to members as a highest order priority. A 'net benefit' test measures actual returns members receive into their accounts. It is more reflective of the lived experience of members and is therefore in their best financial interests. Instead, the Bill proposes a 'net investment return' measure, which ignores the impact of administration fees on member balances.

It is instructive that the Cooper Review and the Productivity Commission both recognised the critical nature of administration fees when considering benefits received by members, and both advocated for them to be included in performance measures.

Benchmarking

Superannuation investment must adopt a long-term posture to deliver returns in members' best financial interests over their working lives. The regulatory system should support longer term decisions and innovation by Trustees

where this can add value (with appropriate controls) to ensure Australians' can maximise their retirement savings in their best financial interests.

We believe every superannuation fund should be able to demonstrate to members and the public at large the net benefit the fund has created. AustralianSuper's high performance over many years and lowering costs demonstrate that active management does deliver a net benefit to members.

At a minimum, we note administration fees are currently not included in the proposed benchmarking test. This means members' real financial interests (the quantum of savings in their accounts) is not benchmarked. We consider this to be a significant failing and not in members' best financial interests.

Demonstrating and measuring 'net benefit' could be achieved by a number of measures, including comparing products of similar objectives/risk profiles, or by benchmarking individual products. AustralianSuper is comfortable that the benchmarking approach will help to identify materially underperforming funds. However, the focus on active performance only renders this approach unsuitable for fund ranking purposes where ranking by net benefit within cohorts of similar products may be more appropriate.

We are also concerned that the proposed strategic asset allocation (SAA) benchmark approach could have several adverse consequences for members of superannuation funds including:

- Funds may anchor their strategy to the stated benchmark, restricting the investment approach. For example, with unlisted assets and specifically infrastructure, the proposed FTSE listed infrastructure benchmark has little Australian infrastructure, and could encourage funds not to invest in projects which would otherwise support the Australian economy;
- Funds may seek to game the benchmarking in an attempt to demonstrate 'outperformance' on the proposed benchmarked test. For example, by setting an SAA for benchmark which is easier to outperform;
- The measure does not adequately capture the value-add that a fund may be generating from asset allocation decisions by Trustees.

Recommendations

Based on these observations above, we make the following recommendations:

- i. All APRA regulated superannuation products should be subject to performance benchmarking and annual performance assessment, not just MySuper and Trustee Directed Products.
- ii. In line with the Productivity Commission's recommended approach, and to ensure members' best financial interests are met, fund performance should be assessed against a 'net benefit' measure (including administration fees) rather than 'net investment' return.
- iii. The Government and or regulatory authorities should adopt a more interventionist approach to underperforming funds in the interests of their members.
- iv. Consider amendments to the benchmarking approach for assessing underperformance to ensure long-term performance is incentivized, to ensure performance is fairly assessed and potential gaming minimised and to better capture the effect of asset allocation decisions.

3. Best Financial Interests Duty - Superannuation accountability and transparency

AustralianSuper always seeks to comply with our Trustee obligations to act in members' best interests. Indeed, our approach is to not only comply with our obligations, but ensure our conduct reflects that of an industry leader. As the custodians of the retirement savings of over 2.3 million Australians, we do not see a difference between the concept of acting in members' best interests and acting in members' best financial interests.

However, we have identified a number of concerns with the proposed 'best financial interests' test as set out in the Bill. For the avoidance of doubt, AustralianSuper is not arguing against a 'best financial interests' test on behalf of members, but rather the provisions as currently drafted.

Our concerns include:

Scope

We hold concerns about the types of expenditure that are provided as examples of 'core' and 'discretionary' and the complete exclusion of dividend payments to shareholders of retail funds (discussed further below).

We consider the strategic management of any superannuation fund to be within the remit of Directors or Trustees and note all funds are already subject to overriding obligations to act in members' best interests.

Different funds will adopt their own strategic settings and should be measured on their outcomes and performance in members' best financial interests. For example, in response to the evolving nature of the superannuation system from default to choice, some funds may choose to directly target particular cohorts of potential members, while others may choose to rely on their existing default structures. Each will have a different cost structure and expenditure profile associated with their strategy. To attempt to regulate which approach is better under the auspices of members' best financial interests fails to acknowledge this difference and that each fund will nevertheless be governed by the existing best interests test.

Additional concerns raised by the provisions as currently drafted include the classification of 'financial advice' as 'discretionary' expenditure. AustralianSuper seeks to be a trustworthy guide for members and we consider providing advice and information to members as squarely aligned to meeting members' best financial interests.

Materiality

We note that the legislation provides no guidance in relation to the level of expenditure covered by the provisions. Whilst AustralianSuper supports measures to ensure funds act in members' best financial interests, the test as drafted provides no difference between records that should be generated for minor expenditure or significant investment of member funds. Given the reverse onus discussed below, we would encourage the Government to set out more clearly where they consider expenditure is material enough to require additional documentation.

For completeness, we consider the indicative compliance cost provided in the Regulatory Impact Statement to be significantly understated. Our initial assessment of compliance costs for our Fund alone means that the overall industry costs will be well in excess of the Treasury estimate, therefore an appropriate assessment and RIS need to be conducted.

AustralianSuper (and all funds) will need to invest significantly to meet any increased regulatory requirements associated with the materiality and record keeping provisions. This of course is a cost that will be borne by fund members.

Reverse onus

The provisions contain a reverse evidentiary onus of proof, which is highly unusual for provisions of this nature and is not currently reflected in existing 'members best interests' test. It is an approach used in a small number of areas (for example terrorism offences). It is unclear from the explanatory material why a reverse onus is necessary to protect members' interests and why the Government considers the current system Regulators ill-equipped to enforce the proposed financial best interests test using the existing evidentiary model.

Regulation making power

The Bill provides for a Regulation making power that would allow the Parliament to prohibit expenditure that would otherwise be in members' best financial interests. It also provides for specific record-keeping obligations supporting payments a strict liability offence. We understand that this seemingly bizarre provision is actually intended to ensure that when superannuation funds spend money, that the products or services they are paying for are in fact provided. If this is the sole purpose of the provision it should be more clearly stated as such.

Of particular concern to us is that Regulations may prohibit or restrict Trustees from making certain investments on behalf of members, even if they are in the best financial interests of members. The exercise of such a power directly contradicts existing law and prudential standards.

Section 52 of the *Superannuation Industry (Supervision) Act 1993* (SIS) and prudential standards made under that Act (e.g. APRA Prudential Standard SPS 530) dictate that the formulation of investment strategy and selection of specific investments is the sole responsibility of the Trustee of the fund. Further, APRA regulated superannuation fund Trustees already have a fiduciary duty to act in members' best (financial) interests.

This includes that Trustees are responsible for determining an appropriate level of diversification for each investment strategy.

The notion that excluding assets from a Trustee's investment universe will improve outcomes is flawed. Further, that such a decision would be made by Parliament via Regulation, to apply to all Trustees regardless of their investment strategy or members' investment choices, is not in members' interests.

The legislation also does not provide for any transitional provisions to ensure members' existing investments aren't adversely impacted as a result of the implementation of the provisions.

The potential impacts of such a restriction are quite broad. For example:

- A restriction could be in direct conflict with the investment choices made by a member.
- The provisions may contradict or constrain a Trustee's investment strategy for an investment option. This could result in the following outcomes:
 - The Trustee being unable to invest in attractively priced assets that would help meet investment return objectives, denying members the chance of better returns;
 - The Trustee being unable to effectively diversify the portfolio against risks, as required under existing law/prudential standards, exposing members to greater risks of loss;
 - If existing assets are owned by funds that are subsequently prohibited, it could result in the forced sale of assets, which would also expose members to loss of capital.

Dividend payments not in members' best financial interests

As set out above, we consider the proposed treatment of dividend payments by retail funds as 'out of scope of the best-financial interests test' as not reflecting the policy intent of the measure or members' best financial interests in any sense. Both the Productivity Commission and the Hayne Royal commission identified such payments as inconsistent with members' best interests. The Explanatory Materials accompanying the Bill fail to demonstrate how the estimated \$10 billion diverted from members' retirement savings annually can be in members' best financial interests.

Recommendations

We make the following recommendations in relation to the proposed best financial interests provisions:

- i. The provisions should be redrafted to recognise the nature of funds' expenditure will be determined by their overarching strategy and the test should be the outcomes or 'net performance' that is delivered to members. Funds should be held accountable for their expenditure on this basis and should be prepared to evidence the rationale for their expenditure accordingly.
- ii. To support compliance, the provisions should be redrafted to provide clarity regarding materiality and record keeping.
- iii. The provisions should apply to all superannuation funds, to ensure all Australians receive the benefit of the provisions.
- iv. Remove the Regulation making power allowing Parliament to prohibit or place conditions on payments and investments.
- v. The 'best financial interests' test must include dividend payments as well as all fees.
- vi. A regulatory impact statement should be conducted to determine the cost of compliance with the current Bill, given any increased compliance costs will be borne by fund members.

Summary of Recommendations

AustralianSuper's proposed recommendations, as set out above, are:

- In line with the Productivity Commission's recommended approach, new entrants to the superannuation systems should only be stapled to high-performing funds, determined on a net-benefit basis.
- The proposed reforms be implemented alongside additional targeted measures to address the issues arising from existing multiple accounts. As part of these measures, protections should be in place to prevent consolidation from a high performing fund to a poor performing fund – especially if the poor performing fund is prohibited from accepting new members due to chronic under performance.
- Funds or products that are not subject to benchmarking or available through the proposed comparison tool should not be available for stapling.
- Protections against hawking and other activities rejected by the Royal Commission, which may lead to adverse outcomes, should be included in this tranche of legislation.
- Issues going to system compliance and the operation of 'tie breaker' rules should be clearly spelled out in the legislation for consideration by the Parliament.
- All APRA regulated superannuation products should be subject to performance benchmarking and annual performance assessment, not just MySuper and Trustee Directed Products.
- In line with the Productivity Commission's recommended approach, and to ensure members' best financial interests are met, fund performance should be assessed against a 'net benefit' measure (including administration fees) rather than 'net investment' return.
- The Government and or regulatory authorities should adopt a more interventionist approach to underperforming funds in the interests of their members.
- Consider amendments to the benchmarking approach for assessing underperformance to ensure long-term performance is incentivized, to ensure performance is fairly assessed and potential gaming minimised and to better capture the effect of asset allocation decisions.
- The provisions should be redrafted to recognise the nature of funds' expenditure will be determined by their overarching strategy and the test should be the outcomes or 'net performance' that is delivered to members. Funds should be held accountable for their expenditure on this basis and should be prepared to evidence the rationale for their expenditure accordingly.
- To support compliance, the provisions should be redrafted to provide clarity regarding materiality and record keeping.
- The provisions should apply to all superannuation funds, to ensure all Australians receive the benefit of the provisions.
- Remove the Regulation making power allowing Parliament to prohibit or place conditions on payments and investments.

- The 'best financial interests' test must include dividend payments as well as all fees.
- A regulatory impact statement should be conducted to determine the cost of compliance with the current Bill, given any increased compliance costs will be borne by fund members.

Conclusion

We would be pleased to provide additional information or to discuss this submission in further detail. If that would be of assistance, please contact Louise du Pre-Alba, Strategic Policy Advocate (lduprealba@australiansuper.com).

Kind regards

A handwritten signature in blue ink, appearing to read 'Sarah', is placed on a light grey rectangular background.

Sarah Adams

Group Executive Strategy, Brand and Reputation