SEPTEMBER 2018

Superannuation round response
Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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The Superannuation Consumers' Centre was formed in 2013 as a not-for-profit to advance and protect the interests of superannuation consumers. The SCC aims to educate, advocate on behalf of and directly assist superannuation consumers to improve the standard of living for people of retirement age.

57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 | Fax 02 9577 3377 | Email campaigns@choice.com.au | www.choice.com.au

The Australian Consumers' Association is a not-for-profit company limited by guarantee. ABN 72 000 281 925 ACN 000 281 925

CHOICE SUPERANNUATION CONSUMERS' Centre

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Introduction

CHOICE and the Superannuation Consumers' Centre (SCC) appreciate the opportunity to make a joint submission in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry on policy questions it has raised regarding the superannuation system.

The superannuation market is an area CHOICE has devoted significant time to, especially in recent years, to better understand the consumer experience. Similarly, the newly launched SCC has been established with the specific intent of advancing the interests of consumers in relation to superannuation.

Superannuation is a product which people regularly place as the most difficult purchasing decision to engage with,[1] yet it is one of the most important decisions they are likely to make in saving for retirement. Given this importance, consumer protections need to be of a very high standard to prevent harm.

The $2.7 trillion in people's retirement savings has led to the creation of a very well funded industry lobby. At times this has seen the interests of consumers sidelined in favour of the entrenched self-interest of industry. Industry has a role to play in reform, however without an adequately funded consumer voice sectoral interests will continue to dominate the policy and advocacy space, influencing both regulators and government.

The hearings revealed repeated instances of conflicts that ultimately tainted the decision making of trustees. Some point to the need for more targeted consumer protections, such as the banning of sales in bank branches, ending grandfathered commissions and significantly extending the scope of the best interests duty beyond the trustee.

In other areas, tinkering with the existing law is unlikely to go far enough. For example, the current default allocation system is seeing far too many people defaulted into chronically poor performing funds. Likewise the lack of protection for people leaving the default environment has seen many move to funds with significantly worse returns. This points to the need for large system changes in allocation methods and much higher standards for the sale of superannuation products. The Productivity Commission has produced a thorough analysis of the current system and made draft recommendations on how it can be fixed; we've pointed to these solutions in the submission where appropriate.

[1] CHOICE 2017, 'Consumer Pulse question – how complicated do you feel it is to find the product that best suits you in each of the following areas', 42% answered quite complicated or very complicated, making superannuation the second highest, behind health insurance, on a list of product categories covering major areas of consumer spending.

Finally, the hearings uncovered an uneasy fit in our current regulatory environment between conduct and prudential regulation. In a properly functioning market general deterrence for bad behaviour must form an active part of the regulator's toolkit. To date this has been lacking in the superannuation space, in large part replaced by a focus on long term prudential goals. We have recommended that ASIC be empowered to take on a much greater role in conduct regulation, so that the two regulators can focus on their relative strengths.

Summary of recommendations

Recommendation 1: That the Federal Government adequately fund consumer advocacy in superannuation.

Recommendation 2: That funds be forced to publicly disclose the cost and benefit analysis of marketing strategies and that ASIC have oversight and directions powers to clamp down on inappropriate spending.

Recommendation 3: That the Federal Government legislates to create the Productivity Commission's consumer centric model for default fund allocation.

Recommendation 4: That Federal Government ban the practice of trustees retaining payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money.

Recommendation 5: That the Federal Government ban sale of superannuation in bank branches until adequate consumer protections are put in place.

Recommendation 6: That the Federal Government legislates to create a 'better off' test in all superannuation sales channels.

Recommendation 7: That the Federal Government proceed with the proposed Member Outcomes Bill and that the regulations include specific requirements to report against the best interests duty in how a fund is catering to the needs of Indigenous and other at risk members (e.g. refugee communities) of its fund.

Recommendation 8: That the Federal Government provide sustainable, independent and adequate funding to a consumer organisation to continue superannuation outreach work in at risk communities.

Recommendation 9: That the Federal Government legislate to ensure funds are transparent about the risk factors that are taken into account in individual underwriting and that people be given an opportunity to question the basis on which these factors are applied.

Recommendation 10: Pending further evidence of consumer detriment, that the Federal Government establish an inquiry to investigate the value of introducing community rating for life insurance within superannuation in response to access and affordability issues for certain groups seeking life insurance.

Recommendation 11: That the Federal Government legislate to create automatic notifications to be sent to people informing them of their access to insurance and the value of account consolidation.

Recommendation 12: That the Federal Government legislate to allow trustees greater flexibility to recognise diverse family structures when determining beneficiaries.

Recommendation 13: That the Federal Government legislate to ensure shareholders of RSE licensees have an obligation to exercise their powers to appoint and remove directors in the best interests of members.

Recommendation 14: That the Federal Government legislate to remove the ability to charge grandfathered commissions and ongoing advice service fees from superannuation. In its place the payment for advice be restricted to the following:

- Financial advisers only being paid from a member's superannuation account for one-off advice or service in relation to superannuation.
- Allowing a person to enter into an arrangement to make ongoing payments for advice, but only through a person's bank account.

Recommendation 15: That the Federal Government legislates to extend the obligation to act in the best interests of members of a superannuation fund so that contravention of the obligation attracts a civil penalty.

Recommendation 16: That the Federal Government legislates to extend the best interests duty (and the civil penalty for breach) to shareholders of trustees and any related bodies corporate (within the meaning of the Corporations Act) of the trustee in respect of any conduct that will affect the interests of the members of the superannuation fund.

Recommendation 17: That the Federal Government amends consumer protections, such as the Member Outcomes Bill, to extend beyond MySuper products in order to lift standards across the sector as a whole.

Recommendation 18: That the Federal Government adopts the Productivity Commission's draft recommendation on MySuper authorisation, with a role for ASIC in performing authorisation functions, including revoking authorisation for chronically underperforming funds.

Recommendation 19: That the Federal Government adopts the Productivity Commission's draft recommendation to ensure people are defaulted only when first entering the workforce.

Recommendation 20: That the Federal Government make available long-term funding for an independent superannuation focussed consumer organisation.

Recommendation 21: That the Federal Government legislate to make ASIC responsible for conduct regulation under the SIS Act.

Advertising

825.1 Is political advertising consistent with the intention behind section 62 of the SIS Act? Is any amendment to the SIS Act warranted, and if so, why?

The core of the problem is a subjective one that cannot necessarily be solved by amendment to the law. The central thesis of the AustralianSuper evidence was that the default allocation system in Australia works well for the average fund member, therefore it was justified spending members' money to preserve this system.[2] The argument is premised on the fact that a person who is defaulted into an average industry fund would have better outcomes than if they were invested in an average retail fund.[3] However, there is a problem with this argument and it is a big one.

At the time Industry Super Australia (ISA) was finalising the "Fox and Henhouse" advertisement there was no legislative proposal or Bill being considered by the Federal Parliament. At best the advertisement was anticipating some change in the future. The most likely source of that change being the recommendations stemming from the Productivity Commission's (PC) in-depth independent assessment of competition and efficiency in the superannuation sector. Among its terms of reference is an assessment of the default allocation system.

Helpfully, this independent assessment and draft recommendations have since been made public, so we are free to judge if the ISA intervention was well founded. The PC report reconfirmed what ISA has been saying, that on average not-for-profit funds outperform for-profit funds.[4] However, it made another crucial funding, that 15% of default member accounts are in products that have chronically underperformed.[5] The impact for a typical full-time worker of being in one of these underperforming funds compared to a top ten fund is $375,000 in

[2] Royal Commission into Financial Services, 2018, 'Superannuation Closing Submissions', p.51
[3] Productivity Commission, 2018, 'Superannuation: Efficiency and Competitiveness Draft Report', p.110
[4] Productivity Commission, 2018, 'Superannuation: Efficiency and Competitiveness Draft Report', p.110
[5] Productivity Commission, 2018, 'Superannuation: Efficiency and Competitiveness Draft Report', p.13

retirement savings.[6] Despite this failing the current default allocation system does nothing to address the problem.

The PC's solution is a 'best in show' list, from which people entering the workforce could select their default superannuation fund.[7] The proposal would weed out poor performing funds, as these funds would no longer be propped up by an automatic flow of new default customers. For the first time the market would be subject to a base level of competition. Instead of leaving people to a complex market with 40,000 investment options, in which they are likely to make poor decisions, the PC has proposed an assisted decision making model. To avoid people being defaulted into underperformers, there would be a maximum of ten funds presented to people to choose from, all of which would be selected by an expert panel to ensure the best performing funds were included.

As with all big policy ideas there is disagreement over the finer details of the proposed system. However, the PC's proposal attempts to significantly improve the current allocation system without losing the positive elements it currently contains.

Public policy debates are a contest of ideas, often based on assumptions about the future. There is unlikely to be a legal test which can adequately confine the actions of superannuation funds who wish to engage in policy debates, nor would this necessarily be desirable. However, what is lacking in this sector is an adequate consumer voice to counter industry policy ideas when they come from a place of self-interest. Industry always has far greater resources in this regard and in the context of the $2.7 trillion worth of funds under management, they have access to significantly more resources than all other policy players, perhaps barring Government. Figures uncovered in a Senate inquiry show the main industry lobby groups alone have a combined annual budget of more than $42 million to fund their advocacy work, employing approximately 108 staff.[8] In contrast the newly launched Superannuation Consumers' Centre has no ongoing funding and a single staff member. This severely limits its ability to engage on an equal playing field in policy debates.

In other important service areas consumer organisations have been funded to address this problem. Telecommunications consumers are represented by the Australian Communications Consumer Action Network, energy consumers by Energy Consumers Australia and health consumers by the Consumers Health Forum.

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[6] Productivity Commission, 2018, 'Draft Report Overview – Superannuation: Assessing Efficiency and Competitiveness', p.14 [a typical full-time worker in an underperforming MySuper fund compared to a top 10 MySuper fund]

[7] Productivity Commission, 2018, 'Superannuation: Efficiency and Competitiveness Draft Report'

[8] Senate Economics Legislation Committee, 10th October 2017, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/SuperannuationNo1/Public_Hearings This does not include the Australian Banking Association or smaller lobby groups.

Rather than asking whether political advertising is consistent with the intention behind section 62 of the SIS Act, it is worth asking, what are the pre-conditions for a robust policy debate that ultimately delivers better outcomes for people's retirements. The current state is grossly weighted in the favour of industry; this has created a significant threat that policy will entrench the interests of the sector over those of consumers.

Recommendation 1: That the Federal Government adequately fund consumer advocacy in superannuation.

825.2 Is there identifiable detriment to consumers from advertising by super funds or particular advertising (such as Fox and Henhouse)? Is there identifiable benefit to consumers from advertising by super funds or particular advertising?

Superannuation funds' approach to advertising could be characterised in two main ways. Firstly, they advertise in order to directly grow or maintain members. Secondly, funds advertise in order to sway the political process. As discussed above, spending to sway the political process may be justified, but without a countervailing and adequately funded consumer voice the net result can entrench self-interest and be harmful to consumers.

In theory spending on marketing and sponsorship can be justified on the grounds that it helps grow the scale of a fund, which in turn delivers the benefits of economies of scale to all members. However, currently there is little public transparency and pressure applied to funds to justify marketing and sponsorship, or requirements to show its direct linkage to acquiring new members. As it stands there are very low rates of switching within superannuation. Those who do switch funds often do so involuntarily and are unlikely swayed by marketing or sponsorship. Research indicates that 50-80% of member switching is simply due to a change of jobs or an employer changing default funds.[9] The PC's recent member survey found that of (non-SMSF) members who voluntarily switched superannuation funds, only 12% had been 'persuaded by their fund's marketing or advice'.[10] This calls into question the return on investment decision by some funds to, for example, sponsor major football codes and run wall-to-wall advertising, including television advertisements, around sporting events. We are keen to see funds produce evidence on the cost-benefit to members of this type of spending.

A potential analogy can be drawn with advertising in the superannuation and energy sectors. As the energy sector was privatised, energy companies increased their spending on marketing, and

[9] Fear, J. and Pace, G., 2008, 'Choosing Not to Choose: Making Superannuation Work by Default', The Australia Institute and Industry Super Network, Sydney; Cooper, J. et al, 2010,' Super System Review Final Report - Part One: Overview and Recommendations, Final Report', Canberra
[10] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report' p.229

prices increased.[11] This 'unfortunate paradox' results in a situation where "retailers engage in a variety of customer acquisition and retention practices" that have the effect of driving up prices for consumers.[12]

We are supportive of the PC's recent recommendation for ASIC to maintain oversight and regularly review "fund advertising that is not directly focusing on gaining or retaining members".[13] However, superannuation funds should also publicly disclose the cost-benefit analysis of their marketing strategies.

Recommendation 2: That funds be forced to publicly disclose the cost and benefit analysis of marketing strategies and that ASIC have oversight and directions powers to clamp down on inappropriate spending.

Employer inducements

825.3 Is it appropriate, as a response to conduct of superannuation trustees that seeks to induce employers to select funds, or affect their decisions as to default funds, to make alterations to section 68A of the SIS Act to widen the prohibition?

The core problem is that employers have a role in selecting funds in the first place. There is significant risk and indeed direct evidence in the case of HostPlus which suggests "that performance of the fund, net benefits to members, and other product features are subsidiary considerations for employers in selecting a default fund, if they are considered at all."[14] This is not to say placing a duty on employers or widening the duty on trustees is the solution, rather the misalignment of interests between employees and employers is so great that employers should be removed from the decision making process altogether.

Currently, employer choice is constrained by lists of funds in modern awards and enterprise bargaining agreements. While this system has on average produced good outcomes for consumers, there are some 1.7 million default accounts currently invested in chronic underperformers.[15] The impact of this underperformance is devastating on the retirement

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[11] The Australia Institute, 2017, 'Electricity costs: preliminary costs showing how privitisation went seriously wrong'.
[12] Ben-David, R. 2018, 'The unfortunate paradox of retail energy prices', Essential Services Commission
[13] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report' p.42
[14] Royal Commission, 2018, 'Superannuation closing submissions', p.91
[15] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness' p.25

balance of an individual, for example a typical full-time worker in the median underperforming fund could end up with 36% less (or $375,000) at retirement compared to a member in the median top 10 default product.[16]

These poor member outcomes are a direct result of the current employer-centred system design. Many employers are not best placed to navigate the maze of decisions required to choose an appropriate fund for their workers. They will always be constrained by limits on time, expertise and good will in finding the right fund.

The picture is much worse for employees of small to medium businesses, many of whom don't have the time or likely the skills to dedicate to this extremely important task. There are some 7.3 million Australians employed by small to medium businesses.[17] Research undertaken by industry fund REST found that 42% of small to medium business employers spent less than five minutes selecting a default fund for their employees.[18] This is clearly inadequate and has led to far too many consumers ending up in underperforming funds.

Lastly, there is an inherent risk that some funds will offer benefits to influence employers' choices. Widening the prohibition on this behaviour under section 68A of the SIS Act may do little to curb the behaviour given, as the PC observed, it is "a problem that is both hard to observe and regulate".[19]

Theoretically widening the prohibition may have some small impact, but it cannot be relied upon to solve the problem the evidence before the Commission has highlighted. The real policy solution needs to target the core problem, over-reliance on employers to pick a suitable superannuation fund. Again, the structural fixes to the default allocation system proposed by the PC are a much better fit to the problems exposed.

Recommendation 3: That the Federal Government legislates to create the Productivity Commission's consumer centric model for default fund allocation.

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[16] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness' p.121
[17] Parliament of Australia, 2015, 'Statistical snapshot: small business employment contribution and workplace arrangements', available at: http://parlinfo.aph.gov.au/parlInfo/download/library/prspub/4230400/upload_binary/4230400.pdf;fileType=application/pdf
[18] REST, 2016, 'Bridge the gap', p.20
[19] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report', p.26

825.4 How wide should the prohibition be – should it extend to prohibiting providing benefits to employers for the purpose or with the intention of inducing the selection of the fund as the default fund for employees, or affecting the decision, or being likely to induce or affect?

825.5 Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?

To the extent that altering the legislation is useful, it should be worded in the broadest possible way. As already outlined, the difficulty in observing an employer inducement makes it extremely difficult to regulate. To ease the task of the regulator the standard should prohibit providing benefits to employers where it is likely to induce or affect their decision. The law should acknowledge the difficulty in proving intention in these actions and move to a standard which does not require such a bar.

As already noted this problem is inherent to the current allocation model and cannot be properly solved without removing employers from the decision making process.

825.6 Is it appropriate for the trustee of a superannuation funds to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money?

It is highly problematic for the trustee of a superannuation fund to retain payments from the responsible entity of a managed investment scheme where the payment is derived from the investment of members' money. This practice appears to be analogous to a trustee receiving a commission for investing member's money with a particular managed investment. On the evidence from ANZ this money is not given directly to members, but instead forms "one of the variables" used in pricing the product.[20] This practice creates a lack of transparency over the true cost of an investment and puts the trustee in a situation filled with the temptation for conflict.

Recommendation 4: That Federal Government ban the practice of trustees retaining payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of member' money.

[20] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.126

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Selling superannuation

825.7 Is it appropriate that superannuation be sold through bank branches? Is it reasonable to think that there is any prospect that this is likely to produce an outcome that is in the best interests of consumers?

Deciding where to invest superannuation is one of the biggest financial decisions a person can make. As the PC points out, a typical full-time worker in the median fund in the bottom quartile (in terms of investment performance) over their lifetime would retire with a balance 53 per cent (or $635 000) lower than if they were in the median top-quartile fund.[21] Therefore there is a huge financial risk in allowing open slather in the sale of superannuation products.

Few, if any, people are properly equipped to make an informed decision in a bank branch. Not only are people unable to compare to other options on the market, but the research indicates many have such poor financial literacy that even given all of the options they'd be unable to determine the value of one product compared to another. Close to 60% of members do not understand their fees and charges, and around 40% lack an understanding of basic investment options (such as growth, balanced and conservative).[22] And about 30% of Australians have rather low levels of financial literacy.[23] To unpack this further, 21.5% of people lack the ability to even perform calculations with whole numbers and common decimals, percents and fractions.[24] These are the very skills required to calculate fees and returns when comparing products.

Product complexity and poor consumer understanding is endemic to the financial services sector. A recurring theme in the hearings is that because people have a poor understanding they have placed their trust in financial institutions to sell them products based on need. This is not an unreasonable assumption given these financial institutions are often in a position to know the personal financial circumstances of an individual.

In the case of ANZ and the sale of its 'Retail Smart Choice Super' account in branches, this belief was only compounded given it was sold in the context of bank staff undertaking an 'A-Z Review' of the person's financial situation. Attempts by the bank to disclose that the personal financial understanding it had gained as part of the review would not be relied upon in selling

[21] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.10
[22] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.23
[23] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.23
[24] ABS, 2013, 'Programme for the International Assessment of Adult Competencies, Australia, 2011-12', available at:
http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/4228.0Main%20Features202011-12?opendocument&tabname=Summary&prodno=4228.0&issue=2011-12&num=&view=

the superannuation product was found to be inadequate.[25] Financial services regulation has leaned heavily on disclosure, despite its repeated failure as an adequate protection for people.

In the mortgage broker context, research by the Federal Trade Commission found that mortgage broker disclosure of commissions actually increased trust in a broker, when it should have led customers to be more critical about the advice.[26] Solutions which rely on disclosure are not likely to address the conflicts leading to poor consumer outcomes. There is a long history of ineffective disclosure in financial services that have done little to protect consumers but added significant regulatory cost.

Taking on board what we know about the failures of disclosure and the behavioural biases on human decision making, under existing law we can see no branch sale situation in which the best interest of a person is likely to be met.

Recommendation 5: That the Federal Government ban sale of superannuation in bank branches.

825.8 Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient? What is the nature of the "advice" that a customer of a bank receives when told by a bank branch staff member about the availability of a superannuation product offered by a bank?

Given the banking sector cannot simply 'disclose away' the issue of conflicted advice or 'information', we need better adapted consumer protections. The PC's modelling shows the practical difference between being in a good or poor performing fund is hundreds of thousands of dollars. This could be the difference between a retiree being comfortable or struggling to make ends meet. Therefore, the sale of superannuation needs to meet a very high bar.

The solution may sit in moving away from personal and general financial advice to a model that better acknowledges the limitations on informed decision making. This could be done through the inclusion of a 'better off' test to be applied before signing a person up to a new product. This would require an entity wishing to sell superannuation to make an assessment of the person's best existing fund against the fund proposed to be sold. The financial service provider would need to be able to demonstrate both to the person considering the purchase, and the regulator

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[25] Royal Commission, 2018, 'Superannuation closing submissions', p.129

[26] Lacko, J. and Pappalardo, J, 2004, 'The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment", Federal Trade Commission, available at: https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment

on request, that the person would be better off with the new product compared to their best existing product.

For people who do not have an existing product an additional layer of protection would be required to ensure they are not sold into a poor performing fund. This is a potential threat particularly for young people who have yet to enter the workforce and may be coming to the bank to establish a basic banking product. In line with the PC's proposal for a 'best in show' of top performing funds, a superannuation product seller would need to demonstrate that a person would be better off with its product compared to one on the 'best in show' list.

Although this model would need further work to define exactly how the 'better off' test could be satisfied, it represents a significant step up from the ability to sell products under the fraught general advice model.

Recommendation 6: That the Federal Government legislates to create a 'better off' test in all superannuation sales channels.

Indigenous engagement

825.9 Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members?

Much positive work has been done by Indigenous advocates to build flexibility into the legislation and AUSTRAC guidance so that it can better cater to the needs of all people, including Aboriginal and Torres Strait Islander people.[27] The current system features a risk based test, with a safe harbour protection for funds that adhere to the guidance. This allows a fund to accept alternative forms of identification where people who would otherwise face difficulty in accessing financial services.[28]

The law is well adapted, however we are concerned that many superannuation funds are still failing to meet the needs of Aboriginal and Torres Strait Islander members.

(i) If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground?

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[27] The First Nations Foundation and other indigenous advocates in the financial services space were consulted in the development of this section of the submission.
[28] AUSTRAC, 2018, 'Aboriginal and/or Torres Strait Islander People', available at: http://www.austrac.gov.au/aboriginal-andor-torres-strait-islander-people

While the legislation and guidance is well adapted to flexible use, in practice few funds are meeting the needs of members by making use of the flexibility.

The theme of poor self-regulation is one that runs throughout the financial services sector, but which is particularly endemic to superannuation. Superannuation has a myriad of funds and a series of extremely well-funded peak bodies to represent a range of interests in the sector. Within this costly and diffuse structure is a distinct lack of responsibility for basic pro-consumer measures, such as those outlined in the AUSTRAC guidance. In other sectors we have seen examples of a large cross section of industry actively helping customers with verification issues and working with government to streamline requirements.[29] Unfortunately we have not seen widespread adoption by superannuation funds or their peaks.

(ii) If those procedures are not appropriate, what should be changed?

Two main solutions are needed to address this problem; explicit requirements on superannuation funds to ensure they are meeting the needs of their members and greater resourcing for 'hands-on' assistance in at risk communities (e.g. Indigenous and refugee communities).

At a high level the proposed Member Outcomes Bill[30] could be adapted to require funds to report on their processes and staff education practices that assist people with verification issues. One simple way of demonstrating this would be for funds to have escalation processes for anyone with verification issues, so that they can be connected with staff members that have a better understanding of the alternative types of identification which can be used.

Recommendation 7: That the Federal Government proceed with the proposed Member Outcomes Bill and that the regulations include specific requirements to report against the best interests duty in how a fund is catering to the needs of Indigenous and other at risk members (e.g. refugee communities) of its fund.

Practically, this approach needs to be supported by adequate resourcing for community outreach programs in at risk communities to provide direct assistance with identity verification as well as other assistance and education activities. We are aware of recent work by ASIC in the

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[29] For example the telecommunications sector: https://www.acma.gov.au/Industry/Telco/Carriers-and-service-providers/Obligations/new-rules-streamline-identity-checking

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

Anangu Pitjantjatjara Yankunytjatjara (APY) lands which assisted 500 people, who didn't have 100 points of identification, to take control of their superannuation.[31] Similarly, the First Nations Foundation has reunited thousands of people with their superannuation through its 'Big Super Day Out' program right across the country.[32]

Without a holistic approach to resourcing ongoing community outreach and assistance, these endeavours can be limited and piecemeal. We see a strong need for a consumer organisation with a direct assistance function to help address this shortfall.

Recommendation 8: That the Federal Government provide sustainable, independent and adequate funding to a consumer organisation to continue superannuation outreach work in at risk communities.

825.10 Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?

There are ample examples demonstrating why it is valuable to identify Aboriginal or Torres Strait Islander people for service delivery organisations like superannuation funds. Twenty years ago the health, education and justice sectors all began identifying Indigenous Australians; as a result these providers are able to deliver much more targeted responses to issues identified. For example, the health testing protocols for Indigenous people now include diabetes and glaucoma tests, which have led to greater prevention and better health outcomes.[33]

The same level of identification by superannuation funds could lead to better targeting for assisting with identity verification issues, right through to sound policy approaches to early release of superannuation and taking account of broader kinship structures when considering beneficiaries.

The one caveat to this approach is how this identification will impact on access and affordability of insurance products within superannuation. A degree of risk based pricing already exists

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[31] ASIC, 2018, 'ASIC leads super industry on outreach trip to the APY Lands', available at: https://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-155mr-asic-leads-super-industry-on-outreach-trip-to-the-apy-lands/

[32] First Nations Foundation, 2018, 'Super Big Day Out', available at: http://www.fnf.org.au/big-super-day-out.html

[33] RACGP, 2018, 'National guide to a preventive health assessment for Aboriginal and Torres Strait Islander people. Third edition'

within these products, for example people categorised as 'blue collar' or 'smokers' tend to pay higher premiums due to the increased risk. On average Indigenous Australians have a lower life expectancy than the general population. For example, the most recent reports estimated Indigenous life expectancy to be 10.6 years lower than that of the non-Indigenous population for males (69.1 years compared with 79.7) and 9.5 years for females (73.7 compared with 83.1).[34] Given these are matters of fact it is unclear if anti-discrimination laws would be effective in preventing Indigenous people from being charged higher life insurance premiums.

It would be counterproductive to a number of broader policy goals if Indigenous identification data was used as a basis for increasing premiums. In the group insurance environment, insurers may be less likely to increase premiums for Indigenous Australians because of the reputational damage they would likely suffer and the greater ease with which risk can be shared across the cohort. However, personally underwritten policies within superannuation, for example when someone takes out extra cover, could be open to abuse.

Currently there is a lack of transparency in underwriting practices, which mean people are often unaware of what risk factors might go into determining a premium or exclusions from cover. They are also afforded no capacity to question the basis on which premiums are determined, instead they may be crudely categorised based on the fact they are Indigenous, rather than their personal circumstances. This is a significant problem in insurance which is not isolated to Indigenous people, people who have diagnosed mental health conditions are confronted with an array of exclusions when taking out and claiming against insurance policies.[35]

We see the solution, at least in part, as requiring insurers to be transparent about the factors they take into account in determining risk. This would put a person in a much stronger position to provide countervailing evidence of their individual risk or take their business to another insurer that doesn't rely on crude measures of risk.

This is an area that needs to be closely monitored to ensure different groups in society are not financially excluded based on factors outside of their control. It is likely that improved transparency will not go far enough and that broader measures, such as a community rating

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[34] Australian Institute of Health and Welfare, 2018, 'Deaths in Australia', available at: https://www.aihw.gov.au/reports/life-expectancy-death/deaths/contents/life-expectancy
[35] PIAC, 2018, 'Examples of travel and income protection insurance policies with blanket mental health exclusions', available at: https://www.piac.asn.au/examples-of-insurance-policies-with-blanket-mental-health-exclusions/

may be needed. Community rating is commonly used in the context of health insurance to ensure insurers cannot vary rates based on health status or claims history. There is a strong policy case for this in health insurance, where without cover some people may suffer significantly worse health outcomes. The economic impact on people who are not able to work due to disability is similarly detrimental and without access to affordable life insurance may suffer significant hardship.

Recommendation 9: That the Federal Government legislate to ensure funds are transparent about the risk factors that are taken into account in individual underwriting and that people be given an opportunity to question the basis on which these factors are applied.

Recommendation 10: Pending further evidence of consumer detriment, that the Federal Government establish an inquiry to investigate the value of introducing community rating for life insurance within superannuation in response to access and affordability issues for certain groups seeking life insurance.

825.11 Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?

Superannuation's primary objective should always be to provide income in retirement, however there is a sound case and exemptions built into existing law to allow access to superannuation early on the basis of severe financial hardship. We understand that some state run funds are currently limited in their ability to make use of early release. We see a sound basis for these barriers to be removed and to bring these funds in line with the rest of the superannuation sector.

825.12 Should the lower life expectancy of Aboriginal and Torres Strait Islander people be taken into account in the decision-making processes of superannuation funds when considering how to administer or release the funds of Aboriginal and Torres Strait Islander people? If so, how?

As a general principle the lower life expectancy of Aboriginal and Torres Strait Islander people would be better resolved at the cause, for example improving health outcomes for these groups. There is a significant risk that a crudely applied early release policy could lead to worse outcomes for Indigenous people. For example, due to the impact of compound interest and

higher accrued balances later in life, people stand to benefit most by keeping their superannuation invested for longer.

However, more could be done to help people understand their eligibility for insurance within superannuation. There should be automatic triggers built into the system to inform people at times they are more likely to need to claim on insurance. For example, a lack of contributions after 12 months is generally a good sign that a person has either left employment, perhaps due to death or disability or that they've moved jobs and established a new superannuation fund. Either way it is an important trigger point to inform people that they have insurance they may be able to claim against, or that they can avoid paying for extra insurance by consolidating their accounts.

Recommendation 11: That the Federal Government legislate to create automatic notifications to be sent to people informing them of their access to insurance and the value of account consolidation.

825.13 Should the categories of person permitted by legislation to be the subject of a binding nomination be changed to reflect Aboriginal and Torres Strait Islander kinship structures? If so, how should the categories be broadened?

Indigenous kinship practices include informal adoptions and caring for a much larger immediate family than is typical in western families. As a result, trustees should be given greater flexibility under the law to recognise other cultures and their family structures. For example, customary adoption in Torres Strait Islander communities is not typically 'formalised' under the law but adopted members are seen as equals to other family members.[36] Widening the definition will allow trustees to more closely reflect the real world kinship practices of all people.

Recommendation 12: That the Federal Government legislate to allow trustees greater flexibility to recognise diverse family structures when determining beneficiaries.

[36] The First Nations Foundation and other indigenous advocates in the financial services space were consulted in the development of this section of the submission.

Discretion to appoint and remove directors

825.14 Is it appropriate for shareholders of RSE Licensees to retain a broad discretion to appoint and remove directors? Or should there be an obligation imposed on shareholders to exercise such powers in the best interests of the members?

The debate over board governance is a fraught one, too often caught up in ideological beliefs rather than evidence based research. Trustee boards should be structured towards and focused on meeting the needs of their members. It is essential that trustee boards have a strong mix of skills, experience, and knowledge. Regular external third-party evaluation of board performance and the use of a skills matrix to assist in the appointment of board directors would strengthen governance across the sector.[37]

Many for-profit funds are struggling to manage conflicts due to the appointment of directors who are affiliated to related businesses within the group. Meanwhile, poor governance has seen some not-for-profit sub-scale funds failing to merge and realise the benefits of scale. The partisan nature of policy debates within the superannuation sector has meant there has been a failure to make ground on either of these issues, with consumers ultimately losing out due to the impasse.

Governance practices could be greatly improved by obliging shareholders to exercise their powers to appoint and remove directors in the best interests of members. This would help focus attention on appointing people with the right mix of skills, experience and knowledge, rather than those who come from a particular representative group or those with potential conflicts.

Recommendation 13: That the Federal Government legislate to ensure shareholders of RSE licensees have an obligation to exercise their powers to appoint and remove directors in the best interests of members.

Relationship between trustees and financial advisers

825.15 Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?

[37] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report' p.54

We expressed concern at the time of the Future of Financial Advice (FoFA) reforms that allowing grandfathered commissions would lead to the exact problems that were uncovered during the hearings. It is long overdue that grandfathered commissions and ongoing service fees be removed.

The FoFA reforms were predicated on a clear understanding that commission-based payments led to conflicted advice, therefore, advisers giving advice not in the best interests of their clients. Exemptions were fought for by industry to ease the shock of moving to a business model with fewer conflicts. One of these exemptions allowed advisers to continue to earn commissions on agreements entered into prior to the FoFA reforms coming into effect. The original intent of grandfathering was to "facilitate a smooth transition to the new regime for industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable."[38] Counter to this intent, it is clear from the evidence in this round of hearings that members of industry have sought to prolong the existence of conflicted remuneration by taking steps to evergreen conflicted remuneration or attempt to reclassify it as a 'service fee' despite no real service being offered. Without legislative intervention is it likely many funds will attempt to keep these practices in place.

825.16 Are there possible detrimental effects on the provision of high quality financial advice by such changes? If it is said that there are such detrimental effects, then the detriments and the reasons for the detriments should be precisely identified.

For example, if it is said that it is unlikely that consumers will be willing to pay for the true value of financial advice then, amongst other things, it ought to be explained how the "true value" of financial advice is to be determined, why consumers will pay for the true value of other services but not for financial advice and why it is not sufficient to allow consumers to make an informed choice as to the specific price that is to be paid for a specific service.

There should be no detrimental effects on the provision of high quality financial advice by removing grandfathered commissions and ongoing service fees from superannuation. Being forced to justify value of the service is long overdue in financial advice. Demonstrating value to a customer is one of the most basic requirements of operating a business and something to which virtually every other product on the market is subject.

The concerns expressed by some retail groups as to the impact of switching off these fees are highly problematic, at times contradictory and certainly against their best interests duty to members. For example, the belief that if the fees were turned off financial advisers would remove members from a fund, despite those same advisers having a best interests duty to the

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[38] Treasury, 2018, 'Key reforms in the regulation of financial advice', p.8

member is highly concerning. This appeared to be the concern even where those advisers were part of the same retail group as the superannuation fund. Believing that if a fee were removed employees of your retail group would potentially breach the law is a frightening justification for maintaining a fee. It displays a direct preference for the interests of the financial adviser over the interests of members.

Counsel Assisting presented a better model for how financial advice could be paid for in the future, including:[39]

- Financial advisers only being paid from a member's superannuation account for one-off advice or service in relation to superannuation.
- Allowing a person to enter into an arrangement to make ongoing payments for advice, but only through a person's bank account.

As Counsel Assisting points out, this would greatly improve transparency over fees paid and would likely prompt people to end payments where they no longer believed they were getting value for money.[40] This has a number of follow on benefits, such as eliminating account erosion and removing temptation from trustees and financial advisers.

Recommendation 14: That the Federal Government legislates to remove the ability to charge grandfathered commissions and ongoing advice service fees from superannuation. In its place the payment for advice is restricted to the following:

- Financial advisers only being paid from a member's superannuation account for one-off advice or service in relation to superannuation.
- Allowing a person to enter into an arrangement to make ongoing payments for advice, but only through a person's bank account.

Managing conflicts

825.17 Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties. For example, where a trustee is a dual-regulated entity, that would seem to raise an inherent conflict of interest, or the potential of a conflict of interest.

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[39] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.203
[40] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.203

There are structures that raise inherent problems which on the evidence make conflicts impossible to manage. During the hearings it was revealed that APRA has had long-standing concerns over the dual-regulated entity IOOF.[41] IOOF Investment Management Limited (IIML) is the trustee of superannuation funds and the responsible entity for a number of managed investment schemes. In 2015, APRA found that IOOF's governance structure had resulted in a lack of focus by boards on individual APRA-regulated entities and that some decisions appeared to favour the interests of shareholders over the beneficiaries of superannuation funds.[42]

For example, IOOF has structured its superannuation funds to invest through related party managed investment schemes, which in turn invests that money with an external managed investment scheme. In return IOOF receives a fee from the external entity, purportedly for providing a service. To the extent to which IOOF provided a service and was reimbursed for associated costs, the remainder of the fee is not passed back to members of the superannuation fund. This merry-go-round of member money and fees lacks transparency and seems well designed to extract fees from members rather than add any significant value.

These structures also appear to be subject to inherent conflicts of interest as they favour using related entities where it is unclear what extra value these entities add for members.

Are there other structures such as investment of funds in insurance policies issued by related party insurers or the integration of a superannuation trustee into an advice business that also raise inherent problems? Is it possible to say that these conflicts are ever manageable?

The evidence of Colonial First State (CFS) in the hearings showed that it had conducted an independent benchmarking review of its insurance offering, which at the time was provided by a related entity, CommInsure.[43] The benchmarking showed the group insurance product performed poorly when compared to the market. Among other things, its risk categories were between 19-132% more expensive than the market median. When asked why CFS stuck with the related entity insurer despite the added cost to members, the response was that CFS thought it would be better off negotiating with CommInsure as the incumbent rather than selecting a new insurer.

This conclusion by CFS defies logic. Introducing competition into a market for a service has a tendency to either push down prices, improve a product or result in a combination of the two, for both the incumbent and rivals. By not even going to market to negotiate a better deal the trustee

[41] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.53
[42] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.54
[43] Financial Services Royal Commission, 2018, 'Superannuation closing submissions', p.102

clearly failed its members and acted in a manner which placed the interests of a related entity over its fund members.

Given the repeated examples turned up during the hearings of this kind of behaviour it is extremely difficult to see how these conflicts are ever manageable.

There is an inherent conflict of interest at the heart of for-profit superannuation funds, in which the retail group attempts to balance the competing interests of their shareholders and their members. This is known as the *'principal-principal conflict'*.[44]

The profit motive of for-profit funds creates a conflict between the retail group's obligations to shareholders under the *Corporations Act*, and the trustee's duty to beneficiaries (members) under the *Superannuation Industry (Supervision) Act*. There is much talk about having measures in place to 'manage' these conflicts. Steps can be taken, such as the appointment of independent directors and transparency around conflicts, but ultimately there are two objectives which are at odds with one another.

Theoretically organisations with a profit motive need to respond to customer needs in order to maintain this profit. Customer friendly innovations and efficiencies are often driven by this obligation to build market share and extract profit. In some markets, with highly engaged, active consumers, competition helps ensure the fruit of these innovations and efficiencies are shared between consumers and the business. Usually this takes the form of better quality products and lower prices. Unfortunately, superannuation is not one of these markets.

A combination of factors, such as highly complex and opaque products, a proliferation of over 40,000 investment options and a product with a value that is often not realised until retirement, constrain competition in superannuation. Under these conditions for-profit businesses are not under the same pressure to share the value they create with customers. As a result, they are poorly positioned to manage the conflicts between the retail group's obligations to shareholders and the trustee's obligation to members of the superannuation fund.

The result of this poor management of conflicts is laid bare in the Productivity Commission's analysis of long term fund performance. For-profit retail funds on average significantly

[44] Sy, W. 2008, 'Pension governance in Australia: an anatomy and an interpretation', *Rotman International Journal of Pension Management,* vol. 1, no.1, p.36

underperformed against their benchmark, while not-for-profits outperformed their benchmark.[45] The actual return performance of the for-profit sector was just 4.9% per annum over the last 12 years, compared to 6.8% in the not-for-profit sector. Being stuck in an underperforming fund would see a person hundreds of thousands of dollars worse off in retirement.

In some cases the ability of for-profit superannuation funds to act independently is greatly diminished by the high number of directors affiliated with other arms of the business.

> "*on average, 78 per cent of retail fund trustee directors are affiliated, where 34 per cent of these trustee directors are either executives or employees of a related entity within the service provider group, and the remaining 44 per cent are directors of a related entity within the service provider group*."[46]

The impact of these split loyalties is clearly on display in the underperformance of some funds. It lends credence to the need for more stringent definitions of what is an independent director.[47]

The problem of for-profit fund accountability to consumer interests bleeds into life insurance within superannuation. As a for-profit component of a superannuation product, which is already poorly understood and lacking member beneficial competition, life insurance in superannuation is ripe for a thorough analysis of any conflicts driving arrangements, competition and efficiency in how it is delivered. As an industry it sucks out more than $9.5 billion annually from members' savings and delivers just $5 billion back in benefits.[48] As a legislated default product offered on an opt-out basis, life insurance in superannuation is not subject to normal market pressures, again this can mean there is inadequate pressure to contain excess profitability.

Importantly, the PC's work did find, although on a smaller scale, some not-for-profit funds underperforming. As mentioned throughout the submission we see a need to resolve these problems through reforms to the default allocation system.

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[45] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview', p.9
[46] Liu, K. and Ooi, E. 2018, 'The impact of related-party outsourcing and trustee director affiliation on investment performance of superannuation funds'.
[47] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview'.
[48] APRA, 2018, 'Statistics – quarterly superannuation performance – March 2018', available at: https://www.apra.gov.au/publications/quarterly-superannuation-performance-statistics

825.18 If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable?

Structural reform is one way to deal with these problems, however it has limitations. Ultimately we need to build a superannuation system which is capable of improving members outcomes in retirement. As demonstrated above, the inherent conflicts in some of these retail groups are demonstrated in the poor product offerings they ultimately deliver to people. Building improved allocation systems and protecting people from being sold poor quality products will go a long way to forcing overpriced poor performing products out of the market, without the need for full scale structural separation.

That said, the inherent conflicts in particular structures, such as dual-regulated entities, appear so unmanageable that legislative intervention may be required.

825.19 Would it be preferable to extend the obligation to act in the best interests of members of a superannuation fund so that:

(i) contravention of the obligation attracts a civil penalty; and

Given some of the limitations on structural separation, a civil penalty regime for breaches of the best interests duty and a regulator willing to use the power would go a long way to resolving these problems.

Without an adequate disincentive we are likely to continue to see the best interests of members placed second to the profit motive of the group. Importantly a civil penalty regime needs to at least match any benefit extracted from members where a duty to act in their best interests has been breached. Indeed, it should go beyond simple disgorgement of benefit, so that there is a large disincentive to engaging in any of the problematic behaviour identified in the hearings.

Complementary to a civil penalty regime we need a conduct regulator with the right mandate to act and drive improved compliance through the active pursuit of civil penalties where wrongdoing has occurred.

Recommendation 15: That the Federal Government legislates to extend the obligation to act in the best interests of members of a superannuation fund so that contravention of the obligation attracts a civil penalty.

(ii) the obligation (and the civil penalty for breach) extends to shareholders of trustees and any related bodies corporate (within the meaning of the Corporations Act) of the trustee in respect of any conduct that will affect the interests of the members of the superannuation fund?

Importantly, the obligation needs to extend to shareholders of trustees and any related bodies corporate of the trustee in respect of any conduct that will affect the interests of members of the superannuation fund. It was clear from the evidence that some retail groups appeared to be structured in order to prevent a trustee from being aware of decisions and conduct in other parts of the group that detrimentally affected the interests of members.

Extending the obligation to the broader group would simply reflect the reality of how decision making is occurring in these structures. Obligations should be placed wherever decisions are being made that have the potential to impact fund members.

These proposed changes would greatly diminish these inherent conflicts. Instead the broader group would have a clear obligation to the best interests of the member. To the extent that a business could no longer reconcile its duty to members and its obligations to broader parts of the business, it may decide it would be better to divest itself of its superannuation fund or vice versa. This would be a good thing and potentially lead to much needed consolidation of the superannuation industry.

Recommendation 16: That the Federal Government legislates to extend the best interests duty (and the civil penalty for breach) to shareholders of trustees and any related bodies corporate (within the meaning of the Corporations Act) of the trustee in respect of any conduct that will affect the interests of the members of the superannuation fund.

825.20 Are there unforeseen consequences of such a legislative intervention that would make it undesirable to strengthen the SIS Act in this way?

We see this as a well-adapted policy response to the biggest internal conflict impacting members' outcomes in superannuation.

System changes

825.21 Is one way of addressing and discouraging misconduct on the part of superannuation trustees to seek to encourage improvements to outcomes for members whose contributions are made to MySuper products or is the link too tenuous to justify recommending any system changes to the default system?

The strength of any system can be undone by differences in protection of some products compared to others. This simply creates an incentive to bypass consumer protections, and undermines the intent of the legislation. Implicit within the current MySuper system is an assumption that a higher level of protection is required for default members who don't

adequately engage. The extent to which MySuper is achieving this goal has been questioned and a roadmap for improvements is laid out in the PC's review of the system.

There is also an assumption that those outside of the MySuper environment have ended up there due to an informed choice and therefore a lower standard of protection is required. This assumption is highly questionable given the way the choice segment of the market has developed. In a well-functioning market consumers are empowered with perfect knowledge of the options available to them.

The choice market has over 40,000 options, meaning consumers are left with what is commonly referred to as a 'confusopoly'[49] in which they are severely limited in their ability to assess options and pick one that is best for them. Most damning is the PC's modelling, which found:

> "*underperformance appears to be more pronounced for the 11 million members who have chosen their own products within APRA-regulated funds*"[50]

The modelling showed 40% of assets in choice products have underperformed market benchmarks by at least 0.25% over the long-term.[51] This is not the hallmark of a market that has been well served by light touch consumer protections.

It is clear that future recommendations, such as the 'Member Outcomes Bill' currently before parliament need to go beyond improving outcomes for default MySuper products and hold choice products to a much higher standard.

Recommendation 17: That the Federal Government amends consumer protections, such as the Member Outcomes Bill, to extend beyond MySuper products in order to lift standards across the sector as a whole.

825.22 Is it appropriate, as a response to misconduct of superannuation trustees, to apply an additional filter to MySuper authorisations so as to require outcome assessments? If so, what are the general parameters for such a system change and who is appropriate to apply the test?

We are supportive of the draft recommendation made by the PC in relation to MySuper authorisations:

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[49] Kalayci, K. 2016, 'Confusopoly: competition and obfuscation in markets', Experimental Economics, vol. 19, no. 2, pp. 299–316
[50] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report', p.14
[51] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report' p.14

CHOICE SUPERANNUATION CONSUMERS' Centre

> Productivity Commission DRAFT RECOMMENDATION 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.

However, as outlined later in the submission we have some concerns over APRA's capacity to reconcile its prudential function and the functions outlined in the recommendation above. We see a strong case for ASIC, as the conduct regulator, to perform authorisation functions, including revoking MySuper authorisation where funds are chronically underperforming.

We also see scope for the regulator to use its existing powers to specifically look at the issues related to inappropriate fund erosion caused by life insurance products. Trustees should be required 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. In addition, ASIC should take appropriate regulatory action where there are failures on the part of trustees to appropriately weigh this trade-off.

Recommendation 18: That the Federal Government adopts the Productivity Commission's draft recommendation on MySuper authorisation, with a role for ASIC in performing authorisation functions, including revoking authorisation for chronically underperforming funds.

825.23 Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation accounts of a person, to introduce some form of "stapling" so that a person's account for receipt of default

contributions is linked to the person and travels with the person when she or he changes job? Is this is a practical method of addressing this type of conduct noting that it is not suggested to be misconduct?

The problem of multiple superannuation accounts is well understood and highly detrimental to people's retirement balances, yet astoundingly has not been dealt with. The PC estimates over a third of all superannuation accounts are 'unintended multiples'.[52] These accounts drain $1.9 billion a year in excess insurance premiums and $690 million in excess administration fees. A typical full-time worker is $51,000 worse off in retirement, with the impact even greater for those on lower incomes.

Linking an account for default fund payment to a person is a sound policy measure and a process for achieving this, combined with an improved default allocation method, should be adopted.

Part of the industry has attempted to deal with this problem using existing powers.[53] The method involves transferring inactive funds under $6,000 to an Eligible Rollover Fund and then attempting to reunite these funds with an active fund. Some small measure of credit should be given to the participating funds for attempting to deal with this problem, albeit years after it was well understood to be causing consumer harm.

However, one must by sceptical of both the timing and execution of this plan. It comes on the back of a withering assessment of the superannuation sector by the PC and concerns a completely indefensible practice. In this context, industry funds are eager to protect the default system from which they currently benefit; despite the fact this system has largely been responsible for the creation of duplicate accounts.

The industry solution would not address the core problem that without intervention a new fund is created each time a person starts a new job. We are concerned that this industry proposal represents yet another antiquated approach to superannuation which will add cost, drive down engagement and ultimately deliver few benefits to consumers when compared to the PC's model.

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[52] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness – Draft Report', p.18

[53] Industry Super Australia, 2018, 'Industry funds to make account consolidation easy, member savings could top $100m per year', available via: http://www.industrysuperaustralia.com/media/media-releases/industry-funds-to-make-account-consolidation-super-easy-member-savings-could-top-100m-per-year/

The cost alone of the industry model makes it grossly inadequate as a modern way to manage superannuation. Due to normal movement in the workforce, people move funds at a frequency which would have disastrous impacts on their retirement savings. According to ABS labour mobility data, there were 2.2 million people who have been with their current employer for less than 12 months.[54] Assuming these trends continue, across the life of an average 18 year old entering the workforce today and retiring from all work at 75, they would have changed employers every six years and had almost 10 different employers in their lifetime.

In turn this would lead to nine different rollovers. The number of rollovers would impact a fund's investment strategy, requiring them to hold larger amounts of liquid assets to facilitate the timely movement of savings between funds. Liquid assets, such as cash, tend to have far lower returns than alternatives. This heavier loading into liquid assets would ultimately drive down the retirement incomes of people.

Selling in and out of asset classes also carries cost. Some funds recoup these costs directly through a buy/sell spread, and others share the cost across the entire membership. Either way it is a real cost which is incurred due to member movement in and out of investment options. The regular fund switching under the industry model would greatly increase the rate at which these costs would be incurred.

We should be driving for supported engagement so that people are empowered to take control of their superannuation at key moments in their lives and are helped to make good decisions. As a simple illustration, we want people to feel ownership of their fund when they first enter the workforce, by selecting from a list of high performing funds. A system of automatic rollover, where many would never exercise any choice, would drive down engagement and allow the underperformers to fester, unchecked and unquestioned.

This proposal also doesn't extend beyond the 18 participating industry funds, which leaves people in the entire retail sector and other non-participating funds languishing with duplicate accounts.

In the face of the damage already done to retirement savings by duplicate accounts this recommendation from industry is disappointing.

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[54] ABS, 2017, 'Participation, Job Search and Mobility, Australia, February 2017', available at: http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6226.0Main%20Features4February%202017?opendocument&tabname=Summary&prodno=6226.0&issue=February%202017&num=&view=

Recommendation 19: That the Federal Government adopts the Productivity Commission's draft recommendation to ensure people are defaulted only when first entering the workforce.

825.24 Are there other system changes that might be appropriately tailored responses to misconduct or conduct falling below community standards and expectations of superannuation trustees? If so, what are the general parameters for such a system change?

CHOICE has made thorough recommendations as to other system changes which should be adopted in response to misconduct or conduct falling below community standards and expectation of superannuation trustees in its response to the PC's Superannuation: Assessing Efficiency and Competitiveness Draft Report (appendix 1).

Deterrence and insight

825.25 What can be done to encourage the regulators to act promptly on misconduct or potential misconduct?

In other financial services markets (e.g. credit and insurance), there are consumer bodies funded to undertake case work, advocacy and education. Apart from the funding of a single part-time advocacy role within CHOICE, this is missing from the superannuation space. These consumer advocates have been particularly effective in assisting the regulators to act promptly on misconduct or potential misconduct.

Tellingly, the superannuation round of Royal Commission hearings did not have the strong case study focus of other rounds. This is in large part because, unlike in credit and insurance, superannuation has no consumer organisation funded to provide direct assistance. As a result, this important nexus of case work and advocacy was missing from the round. These functions of policy advocacy and case work, along with education can form a virtuous circle, identifying and solving problems on both an individual and systemic basis.

Regulators can perform elements of consumer protection, but without a strong voice advocating solely for the interest of members, the space can be crowded out by the views of industry. This is particularly true for consultations into complex issues initiated by regulators. As already outlined there is currently an imbalance in policy staffing, a recent parliamentary inquiry uncovered that the major industry lobby groups spent a combined $42 million p.a, employing

108 staff, with more than 20 dedicated to superannuation policy and research.[55] The funding for this came directly from the retirement savings of consumers, yet not a cent was dedicated to a truly independent consumer advocate.

Australia needs a consumer group that can focus on the highly technical area of superannuation and represent consumer interests. The concept of a Superannuation Consumers' Centre (SCC), was first raised by CHOICE as a contribution to the Cooper review.Work has been done since this time to develop a strong business case for an organisation that would directly assist consumers, advocate for reform and educate people about the system. It was established in 2013, but without any funding was unable to act on its purpose. In August 2018 the SCC received $2.5 million in funding stemming from community benefit payments from ANZ and CBA for the mis-sale of superannuation products and has hired its first staff member.

While this seed funding is welcome and will lead to a lot of positive member outcomes in the short term, it is one off. An adequately funded SCC would be a valuable steward in ensuring long-term, that the superannuation system is efficient, competitive, and truly works for the interests of members. Ideally, the organisation would work alongside a regulator that focuses on and champions member interests.

Specifically, an SCC would be well placed to deliver original research into consumer needs and experience with the superannuation system, advocacy for consumers and a series of consumer education and empowerment initiatives. This combination of direct assistance and policy, research and advocacy projects would directly help consumers to better understand their superannuation and make the case for improving the system in their interests.

Given the vast size of the superannuation sector, it is essential that we have an SCC to promote the long-term interests of members. This is common practice in other consumer sectors. Unless there is a strong organisation dedicated to representing consumers in debates about superannuation, we'll continue to see industry groups dominate discussion and conflate their interests with the interests of their members.

Funding for similar consumer advocates is commonplace across other key services. For example, the Australian Communications Consumer Action Network, in communications,

[55] Senate Economics Legislation Committee, 10th October 2017, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/SuperannuationNo1/Public_Hearings This does not include the Australian Banking Association or smaller lobby groups.

Energy Consumers Australia, in the energy sector and the Consumers Health Forum, in the health sector.

Recommendation 20: That the Federal Government make available long-term funding for an independent superannuation focussed consumer organisation.

825.26 Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct?

Clearly there is a role for both strong prudential and conduct regulation within the superannuation space, however these two functions at times conflict. By its own admission APRA's approach to prudential regulation tends towards working with industry to improve standards, often behind the scenes. The reason for this approach was explained to be that public action against a trustee could "make the problem that we were trying to address worse", and could be "destabilising" for the trustee and impact the members of the fund.[56] The fear was that public action could lead to members withdrawing from a fund in a short space of time, causing adverse outcomes to fund members.

In other contexts, a loss of market share would send a powerful message to a business to cease the behaviour that led to the loss. It would also send a strong message to other businesses not to engage in similar behaviour. This is one of the primary benefits of a properly functioning market. To protect a business from this kind of public scrutiny and hope it responds to behind the scenes cajoling can lead to perverse outcomes.

The Commission heard evidence that CFS had breached the law 15,000 times between January 2014 and mid-April 2014 in relation to transitioning accounts to MySuper products.[57] CFS informed APRA several months after the initial breach and refused to act on APRA's guidance to expedite a remedy to the situation. CFS continued to commit further breaches until August 2016, more than two years later, yet APRA took no further action. In this case it is clear that APRA's approach of behind the scenes convincing could have been augmented by a public deterrence to expose the poor conduct.

More generally, APRA has never commenced civil proceedings for breach of the sole purpose test, nor has it commenced any other court proceeding in the superannuation space in the past decade.[58] It was clear from the evidence that that there significant differences in the mindset of a prudential versus and conduct regulator and that the two cannot easily co-exist.

[56] Financial Services Royal Commission, 2018, 'Closing submissions, p.189
[57] Financial Services Royal Commission, 2018, 'Closing submissions', p.190
[58] Financial Services Royal Commission, 2018, 'Closing submissions', p.188

By contrast ASIC gave evidence that general deterrence was a particularly important tool to prevent misconduct.[59] It saw litigation as part of the solution, but also the use of an enforceable undertaking where this might provide an additional or positive alternative to going to court. All of these options bring with them a degree of general deterrence, which on the evidence is severely lacking in the superannuation space.

825.27 Given that what we are fundamentally concerned with is conduct that in subtle but ongoing ways negatively affects the retirement outcomes of consumers, are either of the regulators best placed to carry the responsibility to protect consumers should the balance between them be restructured or significantly altered?

As explained above, we see a strong need for general deterrence in superannuation. It's a feature of any properly functioning market that a business should face some public scrutiny for poor conduct. Given the concern expressed by APRA in performing this function, we see a strong need for conduct powers under the SIS Act to pass to ASIC.

Based on its record, ASIC has been far more likely to take public enforcement action. Indeed, it is better structured to do so, with what we understand is a significantly bigger enforcement team than is present at APRA. Through the hearings it also expressed a strong willingness to act on the reports of misconduct if it were better equipped to do so.

Recommendation 21: That the Federal Government legislates to make ASIC responsible for conduct regulation under the SIS Act.

[59] Financial Services Royal Commission, 2018, 'Closing submissions', p.195

JULY 2018

SUPERANNUATION: ASSESSING EFFICIENCY AND COMPETITIVENESS DRAFT REPORT

CHOICE submission to the Productivity Commission

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia‟s largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE‟s campaign work visit www.choice.com.au/campaigns and to support our campaigns, sign up at www.choice.com.au/campaignsupporter

57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 | **Fax** 02 9577 3377 | **Email** campaigns@choice.com.au | www.choice.com.au

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CHOICE

Introduction

CHOICE would like to thank the Productivity Commission for its comprehensive draft report into the efficiency and competitiveness of superannuation. Enacting these proposals will turn superannuation from an opaque, frightening experience for consumers to something people can confidently engage with, or where they will not be materially worse off where they cannot. We have focussed our response on the areas that we see will provide the greatest benefit to consumers, particularly account allocation, and propose a few areas we encourage the Productivity Commission to examine further for the Final Report.

The Draft Report puts forward recommendations that will help people immediately and leave them with more money in retirement. It puts consumers at the heart of the superannuation system by recommending changes to support people to make high-quality decisions about their money in retirement.

Reform to direct people away from underperforming funds and remove multiple accounts has to occur to retain consumer trust in the superannuation system and to make sure more people have more of their money in retirement. From CHOICE"s perspective these reforms are relatively simple and common-sense solutions. We do not believe they are as radical as some in the industry make them out to be.

CHOICE regularly hears from people frustrated or worse, defeated, by the current system. People talk to us about the thousands of dollars lost to duplicate accounts due to absurd system design issues. This frustration compounds as people get closer to retirement with people feeling they have been punished for decisions made unbeknownst to them decades earlier.

CHOICE strongly supports the merits based „best in show" proposal in the Draft Report. This allocation process will allow people to choose their own product, but it controls the choices available so that any fund chosen should be high-performing. While linking the allocation process to the industrial relations systems may have made sense decades ago, it now fails to fully support people that change jobs, industries and increasingly hold multiple jobs.

Consumers can and should be able to choose their superannuation fund, but they need support to do so. Supported consumer choice puts the right person in the driver's seat from day one: the person who"s paying into the fund and whose quality of retirement rests on getting the right fund.

We don‟t believe the naysayers that say 17 year olds should not be trusted to make decisions about superannuation. These arguments do a great disservice to young people. A system that starts with consumer choice starts a process of engagement that should continue for life. We will never have a large group of people actively engaged with their superannuation unless we give them greater support and control over that very first decision in saving for the future.

There are three areas where we think the Productivity Commission could go further for the Final Report.

First, on trailing commissions covered in recommendation 13. We support greater disclosure; at minimum consumers deserve to know what they‟re being charged for any service. However, this really is a bare minimum. A far better outcome would be to ban trailing commissions altogether.

Secondly, the Insurance in Superannuation Voluntary Code of Practice is in need of urgent reform. CHOICE sat on the working group for this Code. Our experience was that the industry stripped the Code of its enforceability and removed many of the protections designed to end the erosion of accounts, particularly for young people. Our view is that at this point the industry is incapable of meaningful reform. We agree there should be a regulator-led taskforce to improve the Code, but stress that this should be done in consultation with consumer groups. We also see a strong need to adopt the co-regulatory proposals in the ASIC Enforcement Review and thereby enhance the role of the regulator in code development, monitoring and enforcement.

Finally, we encourage the Productivity Commission to explore options to give consumers a greater voice in debates about the superannuation system. We need a strong voice for superannuation fund members. The superannuation industry covers 15 million Australians who collectively own $2.6 trillion in assets. We need an independent and well-funded body that represents the interests of superannuation members.

CHOICE

Summary of recommendations

- **Recommendation 1:** That the ATO consumer test the best methods for ongoing engagement with superannuation at key times.
- **Recommendation 2:** That the Federal Government establish an inquiry into how to adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.
- **Recommendation 3:** That life cycle products no longer be allowed as part of MySuper.
    - Alternatively, that the design principles be enhanced for lifecycle products and that they be reported against as part of the proposed MySuper outcomes test.
- **Recommendation 4:** To allow consumers to tailor insurance products to their needs, bundling of insurance products should be banned.
- **Recommendation 5:** That long term funding be made available for an independent Superannuation Consumer Centre.
- **Recommendation 6:** That the Productivity Commission not endorse the automatic rollover proposal put forward by some in the industry sector.
- **Recommendation 7:** That the Federal Government introduce legislation to ban grandfathered commissions.
- **Recommendation 8:** That the Federal Government adopt the proposed co-regulatory model from the ASIC Enforcement Review to greatly enhance standards in self-regulation.

Protecting existing members

The creation of a „best in show" shortlist of up to 10 superannuation products would drive significantly better consumer outcomes. Using this approach, the Productivity Commission"s research found over 95 per cent of respondents who received a recommended shortlist of four to eight funds made a choice.[1]

CHOICE"s research also found that shortcuts to answers on superannuation, located in a central space where consumers already came, would be the most likely to drive engagement.[2] Consumers can handle and want more support and choice when it comes to superannuation.

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[1] Productivity Commission, 2018, „Draft report: Superannuation: Assessing Efficiency and Competitiveness", p.444
[2] Pollinate, 2016, „Project Superpower – informing a strategy to engage people with their superannuation", Research commissioned by CHOICE, p.32, available at: https://www.choice.com.au/money/financial-planning-and-investing/superannuation/articles/why-consumers-avoid-thinking-about-super-20161024

We have found that when people are equipped with the right information, they can move from being confused and disengaged, to informed and motivated. In our 2016 research, young people told us that they weren"t engaged because the current system is not user-friendly.[3] People wanted a short-cut to the correct answer, not to be drowned in information by every single option. This strongly indicates that the best in show option could help all consumers but, best of all, support those who are currently worst-served by the current system.

The best in show measure will drive new workforce entrants into a far superior fund than they might otherwise end up in in the current system. Placing a best in show list on the MyGov platform is the ideal outcome.

We also need to ensure existing members are not left behind, as the Productivity Commission found:

> *"While dispersion of product-level fees has decreased over the past decade, there remains a persistent „tail" of relatively high-fee (mainly for-profit) choice products with total fees exceeding 1.5 per cent of assets each year. This tail comprises about 14 per cent of member accounts and 15 per cent of system assets."*[4]

For existing members the Productivity Commission has proposed that members would have access to the best in show list for switching and consolidating, and be able to join those funds as well as benefit from greater protections through enhancing MySuper standards. These measures are all well adapted to the needs of existing members.

However, to benefit from the best in show list people, particularly the 14% stuck in high fee legacy products, need to be made aware that it is available, at targeted times. We agree that the Australian Tax Office (ATO) has a role in nudging people towards engagement with their superannuation. The best way to achieve this needs to be consumer tested, but at a minimum we would expect the ATO would prompt people to compare the net long term performance of their existing fund with those on the best in show list. People could be prompted to make these checks around tax time when they are already assessing their finances.

We also see a strong need to assist people in making good decisions if contemplating leaving the default environment. This should include measures such as an obligation on a gaining

[4] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview" draft finding 3.2

superannuation fund to actively encourage people to compare the fund against the best in show list before proceeding with a transfer.

- **Recommendation 1:** That the ATO consumer test the best methods for ongoing engagement with superannuation at key times.

Explaining differences in investment performance

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?

There is an inherent conflict of interest at the heart of for-profit superannuation companies who have to balance the competing interests of their shareholders and their members. This is known as the „*principal-principal conflict*‟, where:

> *"retail trustee directors may be in a situation where they have to decide whether company shareholder profits or whether pension fund member benefits should have priority in the direction of executive action"*[5]

The profit motive of for-profit funds creates a conflict between a director‟s obligations to shareholders under the *Corporations Act*, and their beneficiaries (members) under the *Superannuation Industry (Supervision) Act*. There is much talk about having measures in place to „manage‟ these conflicts. Steps can be taken, such as the appointment of independent directors and transparency around conflicts, but ultimately there are two objectives which are at odds with one another.

Theoretically organisations with a profit motive need to respond to customer needs in order to maintain this profit. Customer friendly innovations and efficiencies are often driven by this obligation to build market share and extract profit. In some markets, with highly engaged, active consumers, competition helps ensure the fruit of these innovations and efficiencies are shared

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[5] Sy, W. 2008, „Pension governance in Australia: an anatomy and an interpretation‟, *Rotman International Journal of Pension Management,* vol. 1, no.1, p.36

between consumers and the business. Usually this takes the form of better quality products and lower prices. Unfortunately, superannuation is not one of these markets.

A combination of factors, such as highly complex and opaque products, a proliferation of over 40,000 investment options and a product with a value that is often not realised until retirement, constrain competition in superannuation. Under these conditions for-profit businesses are not under the same pressure to share the value they create with customers. As a result, they are poorly positioned to manage the conflicts between their obligations to shareholders and to members of a superannuation fund.

The result of this poor management of conflicts is laid bare in the Productivity Commission‟s analysis of long term fund performance. For-profit retail funds on average significantly underperformed against their benchmark, while not-for-profits outperformed their benchmark.[6] The actual return performance of the for-profit sector was just 4.9% per annum over the last 12 years, compared to 6.8% in the not-for-profit sector. For a person stuck in an underperforming fund these differences would potentially see them hundreds of thousands of dollars worse off in retirement.

CHOICE acknowledges recent research that found that while some superannuation funds had independent directors, the majority of those „independent" directors were affiliated with another segment of the business.

> "*on average, 78 per cent of retail fund trustee directors are affiliated, where 34 per cent of these trustee directors are either executives or employees of a related entity within the service provider group, and the remaining 44 per cent are directors of a related entity within the service provider group*."[7]

The impact of these split loyalties is clearly on display in the underperformance of some funds. It lends credence to the need for more stringent definitions of what is an independent director. It also makes it all the more important that the Productivity Commission‟s recommendations be adopted in full to apply increased competitive pressure on the for-profit sector in order to lift it out of its current state of underperformance.

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[6] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview", p.9
[7] Liu, K. and Ooi, E. 2018, „The impact of related-party outsourcing and trustee director affiliation on investment performance of superannuation funds"

The risk remains that any watering down of the core recommendations, say through expansion of the short-list or gaming of the system to get members to leave high performing defaults, could leave us with funds that consistently underperform. The Federal Government must vigilantly guard against this when developing legislation to enact the Productivity Commission"s regulations.

It also lends significant weight to the Productivity Commission"s recommendation for a broader review of life insurance within superannuation. As a for-profit component of a superannuation product, which is already poorly understood and lacking member beneficial competition, life insurance in superannuation is ripe for a thorough analysis of any conflicts driving arrangements, competition and efficiency in how it is delivered. Separate from life insurance, this analysis needs to take its starting point as looking at how to best adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.

Importantly, the Productivity Commission"s work did find, although on a smaller scale, some not-for-profit funds underperforming against the benchmark. The outcome for someone stuck in an under-performing not-for-profit fund is the same for someone stuck in an under-performing for-profit fund: they are left with significantly less in retirement. Reform is equally required to address this problem. In these cases, it is important to look into the factors which led to underperformance, such as the lack of independent directors. Having independent voices on a board is extremely valuable to an organisation, particularly when making decisions over merger proposals, where a fund is chronically underperforming due to a lack of scale.

- **Recommendation 2:** That the Federal Government establish an inquiry into how to adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.

Creating world-class competition in superannuation fees

Australian superannuation fees are high by international standards and not-for-profit fees are stagnant despite decreases in the for-profit sector, albeit from a high base. While fees alone are not the most important factor in a well-functioning superannuation system, they are far easier to control and predict than returns, so analysing how to create fee competition, without sacrificing net returns is worthwhile. As the Productivity Commission found:

> *Superannuation fees in Australia are higher than those observed in many other OECD countries. In aggregate, total fees — for administration and investment*

> *management services, and in both accumulation and retirement — have been trending down as a proportion of assets, from 1.3 per cent in 2010 to 1.1 per cent in 2016. Fees have fallen markedly for retail funds, albeit they remain higher (at least for choice products) than the (largely unchanged) fees for industry funds.*[8]

The fact that industry fund fees have stagnated, a sector typically made up of defaults, is a key indicator that there is a lack of competition in the default market. This stagnancy indicates the for-profit dominated choice sector has failed to apply pressure to the industry funds and there has been little rivalry within the industry funds on fees.

With so many default funds listed and people barred from choice in some industries, it is not surprising that fee competition is small to non-existent in the existing default system. The solutions sit in the Productivity Commission‟s recommendations to not just create competition in the market but to create competition for the default market through the best in show shortlist.

Without this important change the default market will continue to flat line and we will never see what competitive superannuation funds, particularly the not-for-profit sector, are capable of delivering consistent high-quality outcomes for people‟s retirements.

The expectation and reality gap on life cycle products

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?

In terms of product design, there are obligations on trustees to weigh members‟ needs in developing investment strategy.[9] Trustees can decide whether to use a „standard balanced option‟ or a „life cycle option‟ for investment in MySuper products. Life cycle options tend to alter the level of assets held in „growth assets‟, gradually decreasing as you age. This is to control for „sequencing risk‟ or the risk that a consumer‟s investments will be subject to a significant market

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[8] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview‟, Draft finding 3.2

[9] Australian Prudential Regulation Authority, *Prudential Standard 530 Investment Governance,* July 2013. Available at: http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-530-Investment-Governance-July-2013.pdf.

drop shortly before retirement. Many consumers experienced such a drop during the Global Financial Crisis (GFC).

By contrast, a balanced option is a fixed investment mix that does not change with age. The difference in target market for these two products primarily comes down to managing „longevity risk‟, or how long a consumer may live. For example, a trustee for a fund with members with lower life expectancy may reasonably decide it is in those members‟ best interests to develop a life cycle product which decreases risk as retirement age nears. By contrast, a fund whose members have a higher life expectancy may reasonably decide it is in members‟ best interests to stay in a higher risk investment option until retirement as they are likely to live and perhaps work well beyond retirement age.

In theory, depending on your expected longevity, one product may be more suitable than the other.

While the theory is clear, there are deep problems with how these life cycle options have developed in practice. Analysis conducted by Rice Warner shows that many of these products may not be living up to consumer expectations. After reviewing products available on the market the analysis showed that building more conservative (lower risk) investment portfolios at too early an age would see a reduction in member retirement benefits.[10] For example, the research found life cycle products began aggressively de-risking an investment product at age 45. People in this category tend to be 20 years or more from retirement and depending on longevity may continue to invest their funds for an additional 20 years throughout retirement. Therefore 45 is likely far too early for de-risking an investment and according to the Rice Warner modelling will not lead to the best retirement outcomes for people in life cycle products.

From a consumer‟s perspective the idea that a product will be tailored to their life stage is an appealing prospect. However on the evidence someone in a life cycle product would on average be worse off at retirement. The approach also relies on superannuation funds holding high-quality data about the needs of their current members (not just trends for past or older members. It remains unclear to CHOICE if funds hold this information in order to adequately tailor a life cycle product. CHOICE recommends removing life cycle products from the MySuper system. Alternatively, the design principles to which they must adhere need to be enhanced. These design principles should force a fund to be transparent about product structure and

[10] Rice Warner, *Lifecycle MySuper Product Fees*, 2016. Available at: http://www.aist.asn.au/media/860083/lifecycle_mysuper_product_fees.pdf

provide evidence of member longevity estimates and modelling against expected „balanced" investment outcomes to justify any age based de-risking.

This could be linked to the proposed MySuper outcomes test, which would enable APRA to de-authorise poorly performing products.

- **Recommendation 3:** That life cycle products no longer be allowed as part of MySuper. Alternatively, that the design principles be enhanced for lifecycle products and that they be reported against as part of the proposed MySuper outcomes test.

Bundling creates confusion

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?

The research makes it clear that bundling adds greatly to the cost and difficulty in consumer decision making. Behavioural economics recognises that consumers have limits on the amount of information they can take in; are affected by presentation; tend to be poor at anticipating the future; and are more concerned about losses than gains.[11] Given life insurance is often complex and the benefits are in the future if at all, consumers can be particularly poor at assessing their needs in relation to an insurance policy.

These issues can be compounded by the fact that life insurance in superannuation is a bundled product, let alone some products also bundling death and total and permanent disability (TPD). From a behavioural perspective, bundling, which can result in complex pricing, increases the costs of searching for the preferred choice, and ultimately impacts someone"s ability to make an informed decision.[12] This is due to the need for consumers to obtain information and learn about the various quantities, quality and price combinations offered by a range of suppliers. Studies have shown that consumers make systematic errors when assessing the worth of bundled

[11] Office of Fair Trading, 2010, „What does Behavioural Economics mean for Competition Policy?", March 2010, p. 5
[12] Papandrea, F., Stoeckl, N., Daly, A., 2003, „Bundling in the Australian telecommunications industry", *Australian Economic Review* 36 (1), 41-54.

goods and/or services.[13] These errors may advantage producers at the expense of consumers.[14]

Ultimately people should be given the freedom to tailor a life insurance offer to their needs. Increasingly people are part of dual income households and may not have financial obligations beyond rent and other living expenses. In the event of the death of one member of this household, from a purely economic perspective, they would be much better placed to deal with the loss than someone in a household reliant on a single income. These people should be given the option of reducing their insurance spend by removing death cover and keeping TPD, which they may still find valuable.

- **Recommendation 4:** To allow consumers to tailor insurance products to their needs, bundling of insurance products should be banned.

The (lack of) case for default income protection

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?

As an opt-out product the case for income protection is tenuous at best. For the following groups of people it adds significant cost without necessarily delivering any additional benefit:

- People paying for more than one policy due to duplicate accounts;
- People with intermittent work;
- People in the lowest income quintile;
- People casually employed; and
- People who have taken time out of paid employment, for example to raise children.

We are not aware of any fund making any attempt to ensure groups that cannot benefit from this insurance are not inadvertently paying for cover. Superannuation funds either appear to have poor data on member needs or are unresponsive to this data. For example, an extended period of no superannuation guarantee payment would be indicative of someone not being in

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[13] Heeler, R.M., Nguyen, A., Buff, C., 2007, „Bundles = discount? Revisiting complex theories of bundle effects", *Journal of Product and Brand Management* 16 (7), 492-500.
[14] Estelami, H., 1999, „Consumer savings in complementary product bundles", *Journal of Marketing Theory and Practice*, 7(3), pp. 107-114.

paid employment and unable to claim against an income protection policy. We would expect that a fund acting in the best interest of its member would ensure it made contact to understand the situation and see if the insurance provided by default was appropriate. Better yet, given the cost and limited circumstances in which a claim can be made, checking could be done at sign up to see if an income protection product in suitable in the first place.

Many arguments for its existence seem to rely on its high successful claim rates, with ASIC research finding it had one of the lowest decline rates at 7%.[15] The justification being that, because it was being claimed and paid it was beneficial. This fails to consider the cost on retirement savings weighed against the actual insurance need of a person. At claim time an argument can be made that every type of insurance that can be claimed upon is needed. Certainly, any consumer upon discovering they may be eligible to make a claim would want to make one. However, insurance is a hedging product and its need should be weighed against its cost prior to an event which may lead to a claim.

Depending on product structure this high successful claim rate for income protection is also reflected in its cost. In some funds the default income protection premiums can be as high as $767 a year compared to $362.96 for both death and TPD.[16]

The industry funded research into life insurance in superannuation by KPMG even directed funds to consider what benefit offering both TPD and income protection offered members. Recommending funds:

> *"Consider the rationale and cost of providing both a lump sum and an income replacement on disablement. Are Death, TPD and IP cover all necessary for default group insurance cover or should funds consider offering TPD and IP interchangeably to best suit their demographic."*[17]

It is clear that some funds have already done this analysis and decided against offering income protection by default. According to APRA data 31% of funds contain income protection compared to 76% for death and 65% for TPD.[18]

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[15] ASIC, 2016, „Report 498: Life insurance claims: An industry review", p.7
[16] Based on a 36 year old with default cover in the REST superannuation fund. Available at: https://www.rest.com.au/NEW-Document-l brary/Guides/Member/RES0254_REST_Super-Insurance-Guide-FA_WEBSAFE.PDF
[17] KPMG, 2017, „Review of default group insurance in superannuation", available at: https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/default-group-insurance-superannuation-review.pdf
[18] Annual MySuper Statistics June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 6 – MySuper Products.

In purely income replacement terms, other social security payments may more than cover the needs of people on low incomes. For this demographic income protection is a poorly targeted product. Again superannuation funds do not appear to be adequately considering the needs of some segments of their membership. Instead funds have focussed on developing products for the „average member" which may be totally inappropriate for some cohorts. As mentioned, we see a strong need for a broader piece of work to develop a more efficient and effective way to provide for people who are impacted by disability.

Superannuation Consumer Centre

The superannuation industry covers 15 million Australians who collectively own $2.6 trillion in assets, which for many will be relied upon to cover cost of living expenses for the last 20 or so years of their lives. Yet there is currently no single funded consumer voice to ensure their interests are advocated in major policy debates. To date CHOICE has funded, through its subscription model, a part-time role to ensure there is a voice in these crucial discussions.

Regulators can perform elements of consumer protection, but without a strong voice advocating solely for the interest of members, the space can be crowded out by the views of industry. This is particularly true for consultations into complex issues initiated by regulators. To give a sense of the size of the current imbalance in policy staffing, a recent parliamentary inquiry uncovered that the major industry lobby groups spent a combined $25.8 million, employing 100 staff, with more than 20 dedicated to superannuation policy and research.[19] The funding for this came directly from the retirement savings of consumers, yet not a cent was dedicated to a truly independent consumer advocate.

Australia needs a consumer group that can focus on the highly technical area of superannuation and represent their interest. The concept of a Super Consumer Centre, or SCC, was first raised by CHOICE as a contribution to the Cooper review. Work has been done since this time to develop a strong business case for an organisation that would directly assist consumers, advocate for reform and educate people about the system.

The SCC would be a valuable steward in ensuring long-term, that the superannuation system is efficient, competitive, and truly works for the interests of members. Ideally, the organisation would work alongside of a regulator that focuses on and champions member interests. It would

[19] Senate Economics Legislation Committee, 10th October 2017. https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/SuperannuationNo1/Public_Hearings this does not include the Australian Banking Association or smaller lobby groups

be useful in ensuring that the member focused work of the Productivity Commission is followed through and enacted beyond this inquiry.

Specifically, an SCC would be well placed to deliver original research into consumer needs and experience with the superannuation system, advocacy for consumers and a series of consumer education and empowerment initiatives. This combination of direct assistance and policy, research and advocacy projects to would directly help consumers to better understand their superannuation and make the case for improving the system in their interests.

Given the vast size of the superannuation sector, it is essential that we have a SCC to promote the long-term interests of members. This is common practice in other consumer sectors. Unless there is a strong organisation dedicated to representing consumers in debates about superannuation, we�What continue to see industry groups dominate discussion and conflate their interests with the interests of their members.

Funding for similar consumer advocates is commonplace across other key services. For example the Australian Communications Consumer Action Network, in communications, Energy Consumers Australia, in the energy sector and the Consumers Health Forum, in the health sector. Typically these are funded through a small levy on industry. Their work includes direct education to consumers, policy expertise, research and advocacy in important policy debates.

- **Recommendation 5:** That long term funding be made available for an independent Superannuation Consumer Centre.

Automatic rollovers

At the hearings, an automatic rollover approach was discussed by some industry members, whereby members would see their balance move to a new superannuation fund each time they changed jobs or industries. This was posed as an alternative to the Productivity Commission‟s recommendation that people have a single fund which was linked to them rather than their place of employment. CHOICE is concerned that this industry proposal represents yet another antiquated approach to superannuation which will add cost, drive down engagement and ultimately deliver few additional benefits to consumers when compared to the Productivity Commission‟s model.

The cost alone of the industry model makes it grossly inadequate as a modern way to manage superannuation. Due to normal movement in the workforce, people would be chopping and changing funds at a frequency which would have disastrous impacts on their retirement savings.

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According to ABS labour mobility data there were 2.2 million people who have been with their current employer for less than 12 months.[20] Assuming these trends continue, across the life of an average 18 year old entering the workforce today and retiring from all work at 75, they would have changed employers every six years and had almost 10 different employers in their lifetime.

In turn this would lead to nine different rollovers. The number of rollovers would impact a fund‟s investment strategy, requiring them to hold larger amounts of liquid assets to facilitate the timely movement of savings between funds. Liquid assets, such as cash, tend to have far lower returns than alternatives. This heavier loading into liquid assets would ultimately drive down the retirement incomes of people.

Selling in and out of asset classes also carries cost. Some funds recoup these costs directly through a buy/sell spread, and others share the cost across the entire membership. Either way it is a real cost which is incurred due to member movement in and out of investment options. The industry model would greatly increase the rate at which these costs would be incurred. As an example, one major default fund charges a buy/sell spread of up to 0.47%, if a male with an average balance at age 55 were to change jobs under the industry plan they would be charged up to $1,114.[21] Depending on the fund and balance, that person could be forced to pay a similar amount for each job move. This desire to keep superannuation within the industrial relations system at all costs is clearly detrimental to consumers and leads to poorly thought through policy proposals.

This proposal would also play havoc with people‟s insurance coverage. Constant switching has the potential to impact people‟s coverage and could lead to lapses or gaps in cover. In some instances people consciously increase, decrease, add and remove different types of cover based on their needs. There is no system to carry forward this tailoring as people are bounced around the superannuation system under the industry‟s proposal. Insurance also differs dramatically from fund to fund, for example, some offer income protection, some don‟t, some offer TPD cover which is much easier to claim against compared to other policies. This could lead to a person being left without cover they thought they had, or paying for more cover than they intended.

[20] ABS, 2017, „Participation, Job Search and Mobility, Australia, February 2017", available at: http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6226.0Main%20Features4February%202017?opendocument&tabname=Summary&prodno=6226.0&issue=February%202017&num=&view=

[21] Based on a 55 year old male having an average balance of $237,022 moving from REST to a new fund.

Sectors of the industry have tied themselves in knots attempting to show that low engagement in the current system has actually led to better consumer outcomes. The fact is assisting consumers to positively engage with superannuation would help them avoid some of the worst traps in the system and allow the market to operate where it can. The relatively high fees, chronic underperformers, inappropriate insurance and high levels of duplicate accounts are all emblematic of a system which shuns any attempt to encourage positive member engagement.

CHOICE has consistently maintained that we should be driving for supported engagement so that people are empowered to take control of their superannuation at key moments in their lives and are helped to make good decisions. As a simple illustration, we want people to feel ownership of their fund when they first enter the workforce, by selecting from a list of high performing funds. The system as proposed by the Productivity Commission would see these decisions lead to a culling of the chronic underperformers from the system. A system of automatic rollover, where many would never exercise any choice, would drive down engagement and allow the underperformers to fester, unchecked and unquestioned.

In the face of the damage already done to retirement savings by duplicate accounts this recommendation from industry is disappointing.

- **Recommendation 6:** That the Productivity Commission not endorse the automatic rollover proposal put forward by some in the industry sector.

Ending grandfathered trail commissions

As part of recommendation 13 the Productivity Commission has proposed greater disclosure around ongoing trail commissions. The intent is to inform consumers of the cost and that they are no longer legal for new members. At minimum, consumers deserve to know what they're being charged for any service. However, the better outcome would be to phase out trailing commissions all together.

The Future of Financial Advice (FoFA) reforms were predicated on a clear understanding that commission-based payments led to conflicted advice, i.e., advisers giving advice not in the best interests of their clients. Exemptions were fought for by industry to ease the shock of moving to a business model with fewer conflicts. One of these exemptions allowed advisers to continue to earn commissions on agreements entered into prior to the FoFA reforms coming into effect. The original intent of grandfathering was to “facilitate a smooth transition to the new regime for

industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable."[22] Counter to this intent, it is clear from the evidence from the Royal Commission hearings on financial advice which found members of industry have sought to prolong the existence of conflicted remuneration by taking steps to evergreen conflicted remuneration rather than remove it entirely.

The evidence which came to light during the hearings showed financial advice licensees have systemically prioritised maintaining grandfathered commissions over acting in the best interest of their customers. Including:

- Evidence that a subsidiary of ANZ, RI Advice, purchased advisers without undertaking appropriate due diligence, before the 1 July 2013 FOFA deadline, to ensure that they received ongoing grandfathered commissions.[23] This included offering $150,000 to one financial planner, despite the fact he had failed his initial competency exam, continued to provide consistently poor advice, and received his first complaint just three months after joining ANZ.[24]

- Evidence that AMP management made a concerted effort to structure their business to allow „orphan" clients to continue to be charged grandfathered commission, even though their clients changed advisers.[25]

- Evidence that even five years after the passing of FoFA, 60-70% of fees that AMP pays to its advisers are commissions, rather than fees-for-service.[26]

- Evidence that Commonwealth Financial Planning Limited (CFPL) has made no efforts to „dial down" grandfathered commissions to zero, and that the CFPL views grandfathered commission as simply providing "some relief" to their bottom line.[27]

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[22] Treasury, 2018, „Key reforms in the regulation of financial advice", p.8
[23] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 20th April 2018, p.1527
[24] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 20th April 2018, p.1492
[25] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 17th April 2018, p.1138
[26] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 17th April 2018, p.1153
[27] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 19th April 2018, p.1345

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These examples are not isolated incidents. They exist on an industry-wide level. Financial service licensees have systematically endeavoured to profit from existing pre-FoFA customers. This behaviour falls well below community standards and expectations. It has been unequivocally shown that commissions distort the quality of financial advice offered to consumers, and grandfathered commissions are no exception. The current exemption has helped to foster the attitude that advisers are justified in continuing to reap these commissions. Industry members have sought to exploit this exemption and it is past time to close it down.

Should grandfathered commissions cease?

Industry has been given ample time to adjust to a new business model with fewer conflicts, yet large elements of it have failed to make the move and seem intent on squeezing every last cent from this tainted advice. Consumers stuck in these arrangements will continue to be slugged with large commission-inflated fees for products that are likely not in their best interests. Attitude change will not come from within, with players like AMP denying it should be up on criminal charges for misleading the regulator over the independence of the report it commissioned into the fee for no service breaches of the law.[28] Change will only come from a legislated ban on grandfathered commissions.

Ending grandfathered commissions will also serve as a catalyst for advisers to offer new advice to consumers who may currently be acting on conflicted advice. Turning off these conflicted revenue streams will force advisers to work for future income by offering advice to these clients which meets the best interest test.

- **Recommendation 7:** That the Federal Government introduce legislation to ban grandfathered commissions.

Insurance in superannuation code taskforce

CHOICE is also concerned that the Insurance in Superannuation Voluntary Code of Practice still falls well short of community expectations, not just in its lack of enforceability, but in the fact that it is filled with carve outs and loopholes. CHOICE sat on the working group for this Code and gave extensive feedback on its many failings. We endorse the Productivity Commission"s recommendation that an insurance code taskforce be immediately established. However, our view is that the industry is incapable of meaningful reform and that the regulators, in

[28] SMH, 2018, „AMP 'strenuously denies' it should face criminal charges", 4/5/2018, available at: https://www.smh.com.au/business/banking-and-finance/amp-denies-it-doctored-independent-report-20180504-p4zdcz.html

consultation with consumer groups, advise the industry on what further steps need to be taken for the code to meet ASIC"s definition of an enforceable code of conduct under Regulatory Guide 183. We agree that action should occur immediately to lift standards and make requirements

We also see the current self-regulatory process as deeply flawed and in need of overhaul. The lack of regulator involvement in code development, oversight and ultimately enforcement has allowed the superannuation and financial services sector in general get away with developing meek codes that do little to lift standards. The evidence of this can be seen in the numerous examples of self-regulatory failure in the Banking Royal Commission as well as industry failure in relation to the Insurance in Superannuation Voluntary Code of Practice.

We repeatedly see the need for legislative reform to fix industry inaction, the most recent of which is the *Protecting Your Superannuation Package Bill 2018*, which was introduced to correct the failing in relation to the Code. Without solutions such as the co-regulatory model, proposed in the ASIC Enforcement Review industry will continue to let self-interest get in the way of meaningful consumer protection. This would see a far greater role for the regulator in development, monitoring and compliance and ultimately deliver far more responsive codes which actually lift consumer standards.

- **Recommendation 8:** That the Federal Government adopt the proposed co-regulatory model from the ASIC Enforcement Review to greatly enhance standards in self-regulation.