Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Overview of Key Regulatory Reforms in Superannuation

Background Paper 23

This paper was prepared by Treasury in response to a request made by the Royal Commission.

Australian Government

The Treasury

Financial Services Royal Commission

Request for information

Overview of key regulatory reforms in superannuation

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INTRODUCTION

Superannuation is an important sector of the financial system and a major pillar of Australia's retirement income system.

As the second largest sector of the financial system, superannuation provides a significant and growing source of funding for the economy and long-term capital formation. Superannuation's large pool of relatively stable and unleveraged assets adds depth and liquidity to financial markets and contributes positively to financial system stability.[1] Superannuation assets total $2.6 trillion (145 per cent of GDP).[2] Retail and industry public offer funds hold a relatively even split of these assets,[3] with large funds having a growing influence in domestic investment markets.

The superannuation sector supports Australians to save for their retirement, underpinned by compulsory contributions for employees. While compulsory superannuation was introduced to boost retirement incomes and reduce full or partial reliance on the Age Pension, over time, the system has grown as a wealth accumulation vehicle. Together with the Age Pension and other sources of savings, superannuation provides an increasingly important source of income in retirement as the system matures. Already, superannuation is the second-largest savings vehicle for Australian households (accounting for 17 per cent of household assets).[4]

Much of the framework of the superannuation system is a product of the incremental policy development from the early days of occupational superannuation in Australia through corporate schemes, life insurers and industrial awards.

With the extension of compulsory superannuation contributions to nearly all employees in 1992, a regulatory framework was introduced in 1993 which sought to ensure superannuation funds were managed prudently and in the best interests of members. The

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1 Commonwealth of Australia 2014, *Financial Services Inquiry (*Murray*): Final Report*, Canberra, page 87.

2 Treasury analysis using ABS and APRA data as at March 2018.

3 There are 135 public offer funds. 40 industry funds hold around $543 billion and 125 retail funds hold around $590 billion. Self-managed superannuation funds hold around $700 billion. As at 30 June 2017, the top five funds by funds under management are: Australian Super ($123 billion); MLC Super Fund ($77 billion); Colonial First State First Choice Superannuation Trust ($72 billion); First State Superannuation Scheme ($66 billion); Retirement Wrap ($62 billion).
Source: Annual Superannuation Bulletin, APRA, June 2017, published 28 March 2018. Annual Fund-Level Statistics, APRA, June 2017, published 28 March 2018.

4 Australian Bureau of Statistics (ABS) 2015–16, Household Income and Wealth Australia, ABS Cat. No. 6523.0 , ABS Canberra, Table 11.2.

core elements of this framework,[5] with the addition of later enhancements, continue to form the basis for the regulation of the superannuation system today. These elements include:

- The trustee model for managing superannuation entities, including an equal representation governance structure.[6]
- A prudential framework imposing duties and responsibilities and providing monitoring and enforcement powers for the Australian Prudential Regulation Authority (APRA).
- A disclosure framework, overseen by the Australian Securities and Investments Commission (ASIC) covering information and financial advice provided to members about their superannuation.
- Default fund arrangements linked to the industrial relations system, determined via industrial awards or by employer nomination, accompanied by rules designed to allow most employees to choose the fund and investment option in which to save for their retirement (albeit with some restrictions).

Various aspects of the trustee model, the disclosure framework and default fund arrangements have been the focal point for policy development and debate since 2009. These aspects have been characterised as the ‘governance’, ‘transparency’ and ‘efficiency’ of the superannuation system. Policy has been targeted at these three levers of the regulatory framework because they have been seen as essential to achieving a superannuation system that will safeguard members’ interests and is modern, fit-for-purpose and commensurate with international best practice.

Current policy initiatives, including the Member Outcomes and Protecting Your Super legislative packages and the Retirement Income Framework in relation to income stream products, continue to seek to strengthen the superannuation system in these critical areas.

This paper is a summary of major reforms over the past 25 years, focussed primarily on regulatory reforms affecting superannuation funds.[7]

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5 *Superannuation Industry (Supervision) Act* 1993 (the SIS Act). Detail is provided in Box 1 on page 5.

6 Under the SIS Act, boards of a registrable superannuation entity (RSE) licensee that hold a non-public offer licence in respect of a standard employer-sponsored fund are required to be constituted of an equal number of member and employer representatives (equal representation requirements). An RSE licensee of a public offer fund is given a choice as to how they comply with the composition requirements: either the trustee of the fund must be an independent trustee or the fund must comply with the equal representation requirements. The former (the independent trustee model) is generally adopted by retail funds while the latter is commonly adopted by industry funds.

7 This focus is consistent with the Royal Commission’s terms of reference which covers RSEs and persons or entities that have a connection to an RSE (that is not incidental). The terms of

COMPULSORY SUPERANNUATION IN AUSTRALIA

Prior to 1986, there was no compulsory superannuation system in Australia. Employers had a choice of how, or whether, to provide superannuation for their employees. From 1986, compulsory superannuation was introduced into many industrial awards at the rate of 3 per cent of the defined award earnings base.[8] However, not all employers fulfilled their obligations under awards and not all workers in Australia were covered.

In 1992, superannuation contributions became compulsory for employees to help broaden coverage, improve retirement living standards and reduce the budgetary cost of the pension system as the population aged. This meant most employees[9] sacrificing some of their wage for their future retirement – the ‘Superannuation Guarantee’ (SG). Starting at 3 per cent, the SG rate has risen to 9.5 per cent today and is legislated to reach 12 per cent by 1 July 2025. These SG amounts and any voluntary contributions accumulate in an individual’s superannuation account and can be accessed on retirement or after they reach their preservation age.

This led to a three-pillar retirement income system consisting of: compulsory private savings through the SG; voluntary private savings both inside and outside of superannuation; and the social safety net of a means tested and publicly funded Age Pension.

Chart 1 shows incremental changes to elements of the superannuation framework in response to a number of reviews and subsequent changes over time. Superannuation assets have grown substantially since the early 1990s due to the increasing rate of compulsory superannuation contributions, voluntary contributions underpinned by concessional tax treatment and investment returns.

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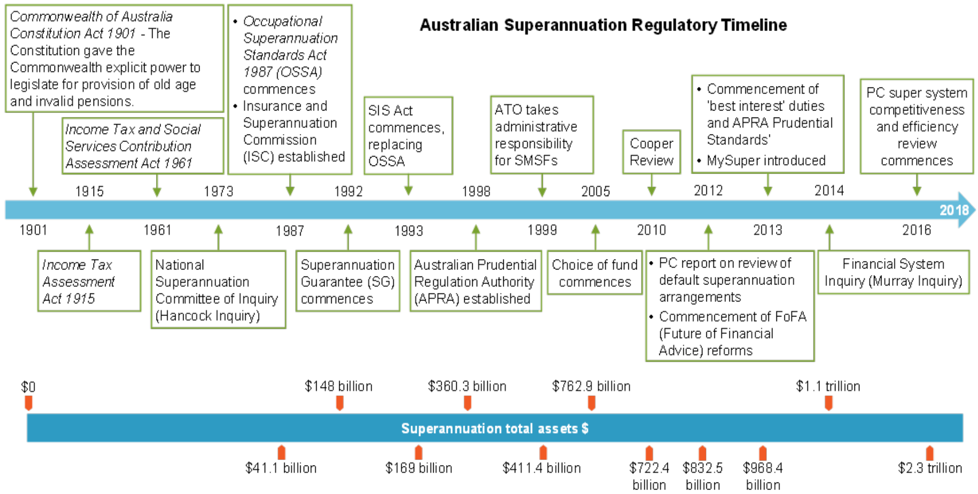
reference and consequently this paper, does not directly cover self-managed superannuation funds.

8 In 1986 the Conciliation and Arbitration Commission ruled on a wage claim by a number of unions, awarding an increase of 3 per cent of ordinary earnings to be paid into superannuation accounts (the Australian Conciliation and Arbitration Commission, *National Wage Case* June 1986).

9 Those workers not covered by SG include those earning less than $450 per month.

Chart 1: Key regulatory superannuation reforms



Source: Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness: Draft Report,* page 387. **Note:** The box at 2013 references the heightening of existing best interest duties under reforms following the 2010 Cooper Review.

The Wallis Inquiry

Five years after the introduction of the Superannuation Guarantee, the Wallis Inquiry (1997) made some fundamental recommendations which altered the way superannuation was regulated.[10] Key recommendations included the establishment of APRA as the prudential regulator and ASIC as the regulator for market conduct and disclosure.[11] In its application to superannuation, this 'twin peaks model' was designed to reflect risks arising from superannuation's compulsory and market-linked nature. The Wallis Inquiry also made recommendations about the need for superannuation trustee licencing arrangements and choice of fund and portability requirements.

Trustee licencing

The *Superannuation Industry (Supervision) Act* 1993 (SIS Act) was amended in 2004 to require all Registerable Superannuation Entities (RSEs) to be licenced, with new obligations to comply with licence conditions on an ongoing basis. These conditions required, amongst other things, that directors must meet minimum standards of fitness and propriety.

The licensing regime allowed for several classes of licence to reflect the size and complexity of business operations at the time – the classes were public offer, non-public offer and extended public offer (where the business had both public and non-public offer funds).[12]

Choice of fund and portability of superannuation

Before 2005, awards providing for superannuation contributions generally nominated an industry fund to receive the contribution. Employers could pay additional contributions in excess of the award into any complying fund selected by the employer. In practice, for administrative simplicity, employers often paid the entire contribution into the industry fund that received the award contribution.

Since 2005, most employees have been able to choose the superannuation fund to receive their superannuation contributions.[13] Where employees do not nominate a fund and the default fund is not specified in a relevant award,[14] employers select a default fund to which

10 For instance, no longer would superannuation be largely governed by a separate regulatory framework administered by the Insurance and Superannuation Commission.

11 While APRA was established as a new organisation amalgamating the prudential regulation functions of the Reserve Bank of Australia and absorbing the Insurance and Superannuation Commission, ASIC was renamed from the Australian Securities Commission to reflect an expanded mandate.

12 If a superannuation trustee wants to make public offers then they need also to be licensed under the *Corporations Act* 2001 as a product issuer.

13 *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005*

14 Awards often provide a list of funds from which employers choose a default fund.

they contribute. Superannuation trustees and their related parties are prohibited under the SIS Act from inducing employers to select their particular superannuation fund as the default. However, around one million working Australians cannot currently choose their own fund, as their ‘choice’ is deemed through an enterprise bargaining arrangement or workplace determination.

Also since 2005, superannuation fund members can require the trustee of their fund to transfer their accumulated benefit to another fund. This allowed members to consolidate multiple superannuation accounts.[15]

Whilst both portability and choice were measures designed to increase engagement, competition and efficiency in the superannuation market, subsequent analysis and reviews have shown that more needs to be done to achieve these objectives.

In particular, a major review of the superannuation system – the 2010 Review of the Governance, Efficiency, Structure and Operation of Australia’s Superannuation System (‘Super System Review’ or the Cooper Review) – identified shortcomings with the regulatory framework underpinning superannuation in a number of major areas.

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15 *Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 3)*

Box 1 - Core elements of the regulatory framework

Superannuation funds operate under a trustee model derived from the general law of equity. That is, a corporate trustee, or a group of individual trustees, controls the fund's assets and operates it solely for the benefit of its members and beneficiaries. The trustee has a fiduciary obligation to the members and beneficiaries, which involves taking ultimate responsibility for the entity and an obligation to manage the assets of the entity with competence, diligence, prudence and honesty.

The mandating of contributions and the provision of taxation incentives to encourage superannuation saving necessitates prudential regulation of superannuation entities. Prudential regulation does not guarantee that a superannuation entity will not fail, or that superannuation fund members will not suffer investment losses. Rather, it aims to ensure the prudent management of superannuation entities so that they can meet their financial promises to their members and beneficiaries.

Under the framework, trustees of APRA-regulated funds must, among other things, demonstrate that they meet minimum standards of fitness and propriety, possess adequate human, technical and financial resources to meet their trustee responsibilities and have in place appropriate risk management arrangements.

Other features of the prudential framework include:

- A 'sole purpose test' designed to ensure superannuation funds are maintained solely for retirement income purposes and a limited range of ancillary purposes, for example the provision of death and disability insurance;
- Requirements to report breaches of regulatory obligations and significant events affecting the trustee or the fund.
- Some enforcement powers for APRA and the Australian Taxation Office (ATO), including powers to investigate trustees and funds, issue directions and disqualify trustees.
- Compensation provisions allowing trustees of APRA-regulated funds to apply for a grant of financial assistance where the fund has suffered loss as a result of fraudulent conduct or theft (Part 23 of the SIS Act).

THE COOPER REVIEW

In May 2009, the Government commissioned Mr Jeremy Cooper to make recommendations into the governance, efficiency, structure and operation of Australia's superannuation system. The Review provided an opportunity to take stock of the superannuation system in light of how it might develop as the system matures. Whilst the Review concluded that the broad architecture of the system was appropriate, it recommended significant changes to enhance member outcomes and increase the efficiency, governance and transparency of the system.

Efficiency

In contrast to the Wallis Report, which viewed superannuation members as rational and informed investors, the Cooper Review found that many fund members were disengaged with the system. This was attributed to the complexity of superannuation and the role of employers in selecting funds on behalf of default members. The Review noted that the superannuation system should provide optimum financial outcomes for members who are disengaged. With this aspect of efficiency in mind, the Review recommended the creation of a new simple, low-cost default superannuation product, MySuper, which would replace all existing default products for members who have not chosen a superannuation fund.[16]

The Review also recommended a package of measures, SuperStream, aimed at enhancing the 'back office' activities of superannuation. These proposals sought to improve the quality of data in the system, allow the use of tax file numbers as the primary account identifier and encourage the use of technology to improve processing efficiency. At the time it was expected that these efficiencies would reduce the administration costs for funds over time with the savings increasing the retirement savings of individuals.[17]

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16 Under legislation implemented following the Cooper Review, superannuation funds are required to place members who do not make a choice about their superannuation fund (default members) in MySuper products. These products have a simple set of product features and opt-out death and total permanent disability insurance and place heightened obligations on the trustees that offer them. MySuper products are subject to legislated restrictions on when fees can be applied and the basis of their application (for example some fees can only be charged on a cost recovery basis). Trustees may also offer choice products which can provide members additional features (such as investment options). Choice products require a member to make an active choice for the product to receive their superannuation contributions. There is more discretion for trustees on fees charged for choice products.

17 The ATO estimate that, for the $1.5 billion that has been invested by APRA funds and employers from 2012 to 2018, realised efficiencies are approximately $800 million per year ($400 million each for employers and funds) and savings to members of $2.4 billion a year ATO 2017, *SuperStream Benefits Report*, available: https://www.ato.gov.au/Super/SuperStream/In-detail/SuperStream-benefits-report/).

Governance

The Cooper Review made recommendations on the governance of the superannuation system. The Review noted that improvements in governance practices are critical to improving outcomes for members. One way that the Review identified that improved governance could be achieved was for the composition of superannuation trustee boards to be modernised to include a critical mass of independent directors, in line with international best practice. In particular, the Cooper Review recommended that, at the very least, equal employer and member representation trustee boards should have a minimum one-third 'non-associated' directors although a requirement for a majority of independent directors was preferred.

In forming this recommendation, the Panel noted in its Final Report that, "it had come to the view that changes in the industry over time and certain implementation practices mean that equal representation no longer seems to achieve its original stated objective."[18]

The Cooper Review Panel made the case for its recommendation on the basis of a number of key structural changes that had taken place in the system since the equal representation governance structure was established in the SIS Act in 1993. These included the substantial shift away from single-employer defined benefit funds that were dominant in 1993, the introduction of choice of fund, the prevalence of defined contribution schemes and the trend towards funds broadening their membership by becoming 'public offer'. This materially changed and in many cases severed the once close relationship between employers and superannuation.

Fundamentally however, the Cooper Review noted that since the introduction of compulsory superannuation in Australia, significant industry consolidation had occurred and funds had grown much larger and more complex. As such, the Review found it was appropriate for the governance foundations underpinning the system to be updated to reflect best practice.

In addition, the Review more broadly recommended enhanced trustee obligations for all trustees as well as additional obligations on directors of a trustee that offers a MySuper product.[19] These obligations require a high standard of care in 'promoting the best financial interests' of beneficiaries who hold MySuper products and were introduced in recognition of the fact that such beneficiaries are generally 'default members' who do not make active decisions about their superannuation.

APRA was also given the power to issue prudential standards for the superannuation industry. This allowed APRA to align the prudential requirements for the industry more

18 Commonwealth of Australia 2010, *Super System Review Final Report: Part Two*, Canberra, page 53.

19 Division 6 of Part 2C of the SIS Act.

closely with those in place for its other regulated industries. APRA issued prudential standards relating to, amongst other things, risk management and governance, fitness and propriety requirements for persons holding positions of responsibility, outsourcing, business continuity, audit and conflicts of interest.

Transparency

The Cooper Review found that transparency and comparability are critical to the efficiency and operation of a market-based savings system, even where participation is compulsory. It found that members should be provided with a minimum amount of information when considering options. The Cooper Review recommended that this be provided through the development of a plain English product dashboard that would provide members with a standardised format through which to compare core information (risk and return targets, fees and costs) across superannuation products.

The Review also found that the Australian superannuation system lacked systemic transparency—that is, broader disclosure to academics and analysts, including portfolio holdings disclosure. There was too little high quality information available to experts who would be able to use it for the ultimate benefit of members as a whole. The Review stated that Australia lagged behind international best practice on portfolio disclosure and transparency, driving the view that there should be new standards for web-based systemic disclosure in a range of areas.[20]

Whilst legislation aimed at improving the transparency, governance and efficiency of the superannuation system is currently before Parliament and will be discussed later in this paper, it is worth noting that these areas were singled out again as needing improvement by the next major review of the superannuation system – the 2014 Financial System Inquiry.

THE FINANCIAL SYSTEM INQUIRY

The Financial System Inquiry (the Murray Inquiry) (FSI) was established in late 2013 to examine how the financial system could best be positioned to meet Australia's evolving needs and support economic growth.

The FSI found that Australia's superannuation system was large by international standards and had grown rapidly since the Wallis Inquiry in 1997, predominantly due to Government

20 The CFA Institute report compared portfolio holdings disclosure between different jurisdictions including Australia, China, Hong Kong, India, Japan and Singapore and identified Australia as the only jurisdiction that does not currently require some level of portfolio holdings disclosure. CFA Institute 2013, *Periodic Reporting for Retail Investment Funds in Asia Pacific: An Investor's Perspective.*

policy settings. It concluded that while the superannuation system had considerable strengths, it was not operationally efficient in certain areas and needed improved governance to strengthen the system further.

Efficiency

To improve efficiency during accumulation, the FSI recommended introducing a formal competitive process to allocate new default fund members to MySuper products unless an additional review by 2020 concluded that the Stronger Super[21] reforms were effective. Following this recommendation, the Government commissioned the Productivity Commission to undertake a review of the efficiency and competitiveness of the superannuation system, which will be discussed later in this paper.

The FSI reiterated the Cooper Review finding that the absence of strong consumer-driven competition in the default superannuation market had resulted in higher fees than expected given the increase in the scale of the system. However, it noted that while the Stronger Super reforms were implemented to address these issues it maintained concerns over the extent to which they would improve members' long-term net returns.

The FSI also found the retirement phase of superannuation was inefficient. It attributed this to the complex decisions retirees faced at retirement without the same level of guidance that exists in the accumulation phase, behavioural biases and the limited range of retirement income stream products on the market. It recommended that superannuation trustees pre-select a comprehensive income product in retirement (CIPR) for members to receive their benefits.

A pre-selected CIPR aims to provide an easier and more streamlined transition into retirement, including helping retirees navigate complexity and providing a balance between competing objectives in retirement: income, flexibility and risk management. A CIPR comprises of a portfolio of underlying products that provide the security of income for life.

The FSI found that CIPRs and greater use of risk pooling could significantly increase many individuals' retirement income, noting that incomes from CIPRs could be 15 to 30 per cent higher than drawing down the minimum amount from an account-based pension.[22]

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21 Stronger Super was the Government's response to reforms arising from the Cooper Review.

22 Commonwealth of Australia 2014, *Financial System Inquiry: Final Report*, Canberra, page 123.

Governance

The FSI recommended a number of measures that sought to strengthen governance of the superannuation system after finding practices that were inconsistent with good governance principles and the practices of other entities that manage funds on behalf of others, such as managed investment schemes (MIS).

Like the Cooper Review, the FSI recognised the need for more modern trustee governance arrangements. However, the FSI went further than the Cooper Review by proposing to mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair. It noted that including independent directors on boards is consistent with international best practice, aids decision making and holds other directors accountable specifically in respect to any conflicts of interest.

Further, it recommended aligning the director penalty regime with that of MIS to incentivise directors to act in accordance with their best interest duty and strengthen the conflict of interest requirements. The FSI concluded that this was particularly important in the superannuation system as members are required by law to participate but lack the power to remove directors who breach their duties or, as is the case in MIS, vote to replace the responsible entity managing their fund.

Transparency

Finally, based on research indicating that providing members with a retirement income projection improves their engagement with saving for retirement, the FSI recommended publishing retirement income projection on member statements from defined contribution superannuation schemes.

The FSI identified a range of issues that have led to the 2017 reforms that seek to support positive outcomes for members – see Members Outcomes section below.

Box 2: 2016–17 Superannuation Tax Reform Package

Superannuation contributions and earnings are more concessionally taxed than other forms of saving. The common public policy arguments for this are the compulsory nature of the Superannuation Guarantee and to incentivise saving by compensating for deferring consumption until individuals reach preservation age.

The tax treatment and contribution caps for superannuation have changed over time. Pre-tax contributions, whether compulsory or voluntary, are generally taxed at the rate of 15 per cent. Income generated in the fund is generally taxed at 15 per cent during the accumulation phase and tax exempt in the retirement phase where assets are supporting a retirement income stream. Benefits withdrawn in retirement are then generally exempt from tax. The broad settings were largely put in place in the 2006–07 Budget 'Simplified Super' package which also abolished the reasonable benefits limit.

In some cases the concessional environment for superannuation has facilitated tax minimisation and unlimited intergenerational wealth transfer.

In response, in 2016, the Government introduced a package of measures designed to improve the sustainability, flexibility and integrity of superannuation tax.

Sustainability

Sustainability measures included introducing a $1.6 million transfer balance cap which limits the total amount that can be transferred into the tax-free earnings retirement phase, requiring those with incomes greater than $250,000 to pay 30 per cent tax on concessional contributions and lowering the annual non-concessional contributions cap to $100,000 for those with balances below $1.6 million. Tax concessions provided for savings in superannuation are valued at over $30 billion and growing.[23]

Flexibility

Flexibility measures included allowing the rollover of unused concessional caps benefiting those with broken work patterns, extending eligibility for deductible personal contributions, encouraging partners to make contributions to their low income spouses by extending the eligibility for individuals to claim a tax offset for these contributions and extending the earnings tax exemption to more innovative retirement income stream products.

Integrity

Finally, by reducing the extent to which the superannuation system is used for tax minimisation and estate planning purposes, the changes sought to improve the integrity of superannuation.

23 Based on the 2017 Tax Expenditures Statement

MEMBER OUTCOMES

In September 2017, the Government introduced the Member Outcomes Package into Parliament.

The Member Outcomes Package progresses findings from the FSI and the Cooper review, which highlighted that several aspects of the regulatory framework do not meet contemporary best practice, or the standards applied elsewhere in the financial system. These reviews, as well as analysis by APRA showed that the superannuation framework was not holding funds to the high standards of governance and accountability required, ultimately to the detriment of members.

To increase governance standards, the Member Outcomes reforms require a minimum one-third independent directors on fund boards and for the Chair of the board of directors to be one of those independent directors.

The Member Outcomes reforms also seek to strengthen the powers of the regulator, APRA, to allow it to respond specifically to underperformance and misconduct by individual entities by amending APRA's directions powers to enable it to intervene early where it has governance or conduct concerns, similar to powers APRA already has for other regulated industries. The reforms also aim to hold superannuation directors accountable for their conduct in the same way as directors of MIS, by subjecting them to criminal or civil penalties in relation to their duty to act in the best interests of members. It is intended that these increased powers will enable APRA to step in based on poor member outcomes, rather than having to hold a fundamental concern about the solvency and safety of superannuation assets. The proposed strengthening of the directions power would give APRA the power to intervene earlier and more appropriately than they currently can.

To reduce the potential for fraud against superannuation fund members, the Member Outcomes Package will also give APRA more power to prevent or control ownership changes of a corporate trustee. This seeks to close a regulatory loophole that allows persons or entities to purchase and operate existing superannuation funds without regulatory checks of their suitability, which is likely to have played a significant role in the Trio Capital collapse in 2009, through which approximately $176 million of members' superannuation benefits were lost.

The Member Outcomes reforms also set new requirements for trustees to assess the quality of their MySuper product and whether it is providing outcomes that are in the best financial interests of members. The Package includes a measure that will replace the existing scale test with a broader outcomes test, which requires trustees to make and publish, an annual written assessment of their product against a broad range of features and metrics, including against other MySuper products. APRA will also be given an enhanced capacity to cancel an authority to offer a MySuper product, including where it has reason to believe the trustee will not comply with its enhanced MySuper obligations, including relating to the new outcomes assessment. The Productivity Commission suggests that these measures ''should better enable APRA to eliminate such products and promote fund consolidation.''[24]

The Package also includes reforms that strive to empower members, including through greater transparency, by increasing fund accountability. The Package will introduce compulsory annual member meetings and will require funds to report and publish annually more transparent information on how their fund is being managed, including information on the underlying assets of each of their investment options, how funds charge fees and the way members' money is being spent.

In 2013, the *Financial Sector (Collection of Data) Act 2001* was amended to allow APRA to collect information on fund investments on a look-through basis (that is, to capture the ultimate investment of fund assets including where these are invested through an associate). However, APRA is unable to require funds to report the same detailed information about other expenses including, for example, detailed information about financial arrangements with related parties, sponsorships, marketing and other expenditure. The Member Outcomes package will extend this look-through power to information about fund expenses. This additional information will enable APRA to have much greater visibility of the nature of fund expenditures and whether they are in line with covenants under the SIS Act, including the obligation for funds to act in their members' best interests.

APRA is also consulting on enhancements to its prudential framework, through its own package of prudential standards and practice guides, related to business planning, fund expenditure and assessing the delivery of outcomes to members, which will apply to all APRA-regulated products, not just MySuper products.

Legislation to give effect to the Member Outcomes reforms (comprising three Bills) was introduced into the Parliament on 14 September 2017.[25] The Bills were referred to the Senate Economics Legislation Committee for inquiry, with the Committee publishing a report on 23 October 2017 recommending that the Senate pass the Bills. The Bills are currently before the Senate.

24 Productivity Commission 2018, Superannuation: Assessing Efficiency and Competitiveness: Draft Report, page 389.

25 Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Member Outcomes Bill) and Treasury Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 (Increased Independence Bill)

Protecting Your Super Package

In June 2018 the Government introduced legislation into Parliament to implement the Protecting Your Super Package. The Package, announced in the 2018–19 Budget, includes reforms seeking to guard against the erosion of low superannuation balances through excessive fees and inappropriate insurance arrangements and proactively reunite inactive, low balance accounts with active accounts.

In 2015–16, superannuation account balances below $6,000 comprised over 40 per cent of all balances in the system.[26] Members with low account balances face disproportionately high fees and insurance premiums, which can mute the growth of these accounts. As shown by the FSI and the Productivity Commission's recent draft report, holding multiple accounts can materially erode retirement balances.

Fee protections

Administration fees have a regressive impact on low balances. MySuper charging rules require charging fees on the same basis to all members, which may result in low balance accounts paying disproportionately high fees. The removal of Member Protection Standards[27] as part of the MySuper reforms removed fee protections for very low balance accounts (less than $1000) and, combined with the MySuper fee rules, resulted in significant fee erosion for smaller accounts, particularly where they are receiving small or no contributions. Treasury analysis of 2017 APRA data indicates that the median annual administration and investment MySuper fees on accounts with balances of $1,000 are 9 per cent of their balance.[28]

The Protecting Your Super reforms impose a fee cap to limit erosion on balances less than $6,000. The fee cap will prevent trustees from charging administration and investment fees and costs exceeding 3 per cent of the balance each year. The Package is set to save members $570 million in fees in the first year.[29]

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26 Treasury analysis using 2015–16 data sourced from the ATO.

27 The Member Protection Standards required that administration fees not exceed investment earnings on accounts with balances below $1,000 or held in Eligible Rollover Funds. The Standards were repealed from 1 July 2013 in response to the findings of the Cooper Review, which found that the Standards effectively required cross-subsidisation of protected members by unprotected members (Explanatory Statement, Superannuation Industry (Supervision) Amendment Regulation 2013 (No. 2); Commonwealth of Australia 2010, *Super System Review Final Report: Part One: Overview and Recommendations*, Canberra, page 18).

28 Treasury analysis.

29 Treasury analysis.

The reforms also include a ban on exit fees for all accounts, designed to benefit the many Australians who want to rollover their superannuation accounts to a different fund, or access their superannuation. Exit fees cost members $52 million in 2016–17.[30]

Treasury receives a significant amount of ministerial correspondence from, or on behalf of, young people and people who have worked in casual jobs for a short period of time and accrued a small amount of superannuation through the Superannuation Guarantee. Those balances have been significantly eroded (or in some cases completely eroded) by fees in the fund and/or exit fees.

Insurance for superannuation members

A significant number of members hold duplicate or inappropriate insurance policies, including policies they cannot claim against. This is a result of the current MySuper settings which mandate the provision of death and total and permanent disability insurance on an opt-out basis and allow for income protection insurance to be provided on an opt-out or opt-in basis.

While insurance in superannuation can be of value to individuals, the insurance premiums deducted by the fund trustees from member accounts are also a key driver of balance erosion and can reduce low income earners' retirement balances (particularly with a high prevalence of multiple accounts). Of people with insurance in superannuation, over 20 per cent – or around 2.5 million – have two or more accounts with insurance cover.[31]

Under the Protecting Your Super Package, insurance within superannuation will now be offered on an opt-in basis for accounts with balances less than $6,000, new members under age 25 and accounts which have not received a contribution or rollover for 13 months or longer. These members will still have the opportunity to opt-in to insurance cover if they decide it is appropriate for their circumstances.

According to the latest data, these changes will allow an estimated 5 million people, who paid a combined $3 billion in insurance premiums, with the opportunity to choose if they want cover, rather than paying for it automatically.[32]

Inactive low-balance accounts and consolidation into active accounts

While there is a current regime for transferring lost superannuation savings to the ATO to protect them from erosion, the existing regime requires long periods of inactivity before

30 The Australian Prudential Regulatory Authority 2017, *Annual Super Bulletin,* Table 6.
31 Treasury analysis using 2015–16 data sourced from the ATO.
32 Treasury analysis using 2015–16 data sourced from the ATO.

amounts are transferred and savings can be eroded entirely by fees in the interim. In addition, numerous exceptions permit trustees to avoid transferring balances below $6,000 to the ATO, allowing these balances to continue to be subject to ongoing erosion.

Under the Protecting Your Super Package, accounts which do not have insurance cover, have balances below $6,000 and which have not received a contribution or rollover for 13 months will be transferred to the ATO to protect them from further erosion. For the first time, the ATO will be empowered proactively to reunite these accounts, alongside lost superannuation it already holds, with a member's active account where possible, boosting their balances at retirement. Together, these changes are expected to send $6 billion of superannuation back to 3 million Australians in 2019–20.[33] The changes will supplement existing account consolidation processes, which will remain available to members. Reducing the number of low balance accounts in the system will generate system-wide efficiencies by reducing administration costs for funds.

At its heart, the measures contained in the Protecting Your Super Package seek to ensure people have the opportunity to maximise retirement savings. How these savings are most efficiently drawn down in retirement is currently being considered via consultation on the Retirement Income Framework.

33 Treasury analysis based on 2015–16 data sourced from the ATO.

RETIREMENT INCOME FRAMEWORK

In 2014, the FSI concluded that the retirement phase of Australia's superannuation system was under-developed and could be more efficient to meet better the income and risk management needs of many individuals in retirement. There is currently limited availability and take-up of products that help people manage risks in retirement, particularly the risk of outliving their savings.

While there has been a significant focus on reforms to the accumulation phase of superannuation over the past 20 years, as the population ages and life expectancy increases greater demands will be placed on the superannuation system to deliver more efficient income over an individual's retirement.

The Government aims to address this through the development of a Retirement Income Framework, announced in the 2018–19 Budget.

The proposed Retirement Income Framework strives to improve the extent to which the superannuation system provides income in retirement through increased availability and take-up of products that more efficiently manage longevity risk while also enabling trustees to provide individuals with a smoother transition into retirement.

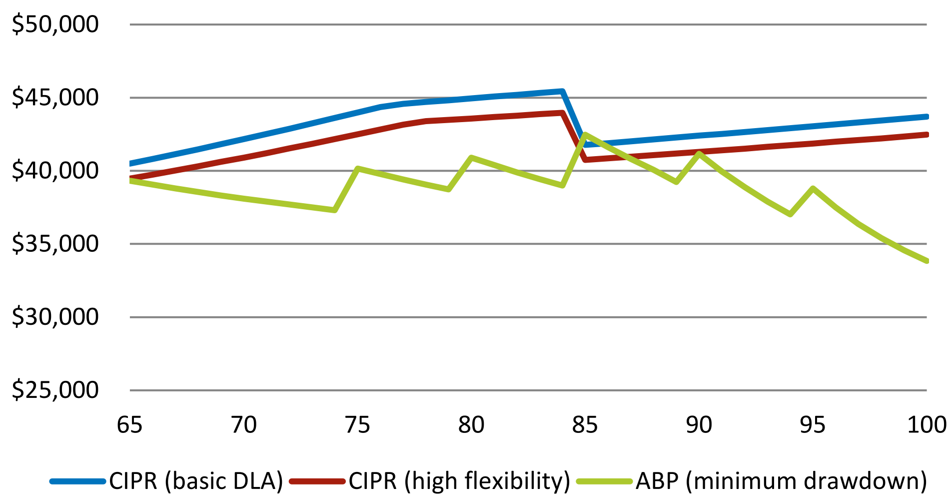
The first step of the framework will be the establishment of a new retirement income covenant, which will require superannuation trustees to develop a retirement income strategy to assist members to achieve their retirement income objectives. Existing covenants in the SIS Act include obligations to formulate, review regularly and give effect to investment, risk management and insurance strategies; but do not include an obligation to formulate a retirement income strategy. Trustees will also be required to guide members to choose a retirement income product that is right for them.

CIPRs will form a core part of how trustees implement the retirement income strategy they have developed for their members. The recently released Retirement Income Covenant Position Paper proposes the introduction of regulations that will require superannuation trustees to offer members a CIPR upon retirement, though with no obligation on the member to take-up the offer.

A CIPR, as previously discussed, is a hybrid retirement income product designed to balance competing objectives in retirement: maximising income, providing flexibility to access capital and ensuring income is provided for life.

The below chart shows some potential retirement income outcomes for an individual who retires at age 65 with a $400,000 superannuation balance and owns their own home. Total income includes income from both the Age Pension and the retirement income product. The products have not been customised but demonstrate potential expected outcomes from a 'Flagship CIPR'[34] offered by a trustee. It demonstrates the increased retirement income that could be achieved from a CIPR relative to the current typical drawdown in an account-based pension (ABP).

Chart 2: Income from $400,000 superannuation balance, homeowner



- **CIPR (basic deferred lifetime annuity (DLA))**: 20 per cent of the individual's balance at retirement is allocated to a deferred lifetime annuity, 80 per cent is placed in an ABP with an efficient drawdown profile.
- **CIPR (high flexibility)**: $50,000 (12 per cent) of individual's balance is placed in a cash account to provide higher access to capital, 18 per cent of the balance is allocated to a deferred life annuity and 70 per cent placed in an ABP with an efficient drawdown profile.
- **ABP (minimum drawdown)**: 100 per cent of the individual's balance is placed in an ABP and drawn down at minimum rates.

As part of the Retirement Income Framework, the Government has also announced it will progress the development of simplified, standardised metrics in product disclosure to help consumers make decisions about the most appropriate retirement income product for them.

34 A CIPR that is designed to be appropriate for the majority or a large cohort of members of a fund.

Productivity Commission – Superannuation: Assessing Efficiency and Competitiveness

As mentioned earlier, in response to the FSI, the Government tasked the Productivity Commission with undertaking a comprehensive three stage review of the competitiveness and efficiency of the superannuation system. Stage 1 involved the development of criteria to assess the efficiency and competitiveness of the superannuation system (completed and a final report published in 2016); stage 2 involves the development of alternative models for a formal competitive process for allocating default fund members to products (a final report for this stage will be included in the final stage 3 report); and stage 3 involves an overall assessment of the efficiency and competiveness of the superannuation system.

The review is still in progress, however the draft report for stage 3 was released in May 2018. In the draft report, the Commission found that, while some funds consistently achieve high net returns, a significant number of products underperform markedly across all segments of the industry, even after adjusting for differences in investment strategy. Most (but not all) underperforming products are in the retail segment.

The Commission also found that fees and unnecessary insurance are a significant drain on net returns, especially for individuals with unintended multiple accounts (10 million accounts, representing one third of all accounts). In some instances, the report found that duplicate or unsuitable insurance policies can erode a member's retirement savings by $50,000.[35]

The Commission also raised concerns about members' lack of access to quality, comparable information about products that best meet their needs.

The Commission attributed these outcomes to a lack of informed member engagement, the existing arrangements for allocating members to default products, poor fund governance, inadequate competition and shortcomings in the broader regulatory framework.

The Commission recommended a new model for allocating new members to default products. Under this model, new workforce entrants would be defaulted into a superannuation fund only once. They would be encouraged to choose their own product by being provided with a 'best in show' shortlist. Employees who do not make a choice would be defaulted into one of the products on the shortlist.

The Commission also recommended the removal of barriers to the appointment of independent directors on superannuation trustee boards and a clearer delineation of

35 Productivity Commission 2018, Superannuation: Assessing Efficiency and Competitiveness: Draft Report, page 2.

APRA's and ASIC's respective roles'.[36] It described the presence of at least one-third of independent directors as 'best practice'.[37]

Overall the draft report contains 22 draft recommendations and over 40 draft findings for improvements to the system. Several of the report's recommendations are consistent with current Government policy initiatives, including the Members Outcomes Package[38] and the Protecting Your Super Package.[39]

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36 Productivity Commission 2018, Superannuation: Assessing Efficiency and Competitiveness: Draft Report, pages 55, 60, 64.

37 Productivity Commission 2018, Superannuation: Assessing Efficiency and Competitiveness: Draft Report, page 39.

38 A strengthened MySuper authorisation process (Recommendation 4); additional board requirements and the removal of restrictions on independent directors (Recommendation 5); a ''critical mass'' (at least one third) of independent directors (Finding 9.2).

39 "Cleaning up lost accounts", including providing the ATO the ability to auto-consolidate accounts and changing the lost account threshold (Recommendation 8); limit exit fees (Recommendation 12); insurance inside superannuation should become opt-in for members under 25 (Recommendation 15); insurance should cease on 'zombie' accounts that have not received a contribution in 13 months (Recommendation 15).