14/10/2022

Ms Shibani Iyer
Director, Superannuation Efficiency and Performance Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

Via email to **yfys@treasury.gov.au**

Dear Ms Iyer,

Review of Your Future Your Super Measures

AustralianSuper welcomes the opportunity to provide a written submission to Treasury's Review of Your Future Your Super Measures.

AustralianSuper is Australia's leading superannuation fund and is run only to benefit members. Almost 2.9 million Australians are members of AustralianSuper and we invest over $260bn of their retirement savings on their behalf. We act in members' best financial interests by helping members achieve their best financial position in retirement.

Your Future Your Super

Over the past two years AustralianSuper has made a number of submissions to Treasury in relation to what is known as the Your Future Your Super package of reforms. As noted in our previous submissions, AustralianSuper has consistently and unambiguously supported the stated policy intent of the Your Future Your Super package, namely:

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

In each submission we have consistently advocated that unintended outcomes, contrary to the stated policy intent, be addressed. After approximately one year of operation, these matters still require attention and we invite Treasury to use this consultation to ensure the intended policy outcomes are achieved.

We refer Treasury to our previous submissions of December 2020, March 2021 and May 2021 on these matters and additional comments and responses to questions in the consultation paper as set out below.

Performance Test

The performance test subjects MySuper and (from next year) Trustee Directed Products to annual performance tests and to prevent funds underperforming over two consecutive years from receiving new members.

Given the compulsory nature of Australia's retirement system and the importance of funds acting in the best financial interests of members, we support measures that ensure only high performing funds receive Australians' superannuation contributions. As we have previously submitted, the key outcomes of these provisions must therefore be to improve net performance across the full range of superannuation funds and products, and to ensure members have the opportunity to move to better performing funds, where the performance that is measured accurately reflects the overall cost and benefit to the member.

In our submission to Treasury dated 23 December 2020, we submitted that:

> *… the performance test in its current form does not meet the stated policy aim for three reasons:*
>
> - *The scope of the provisions is too narrow, excluding many relevant funds and products;*
> - *The test for performance is too narrow, as it is focussed on 'net investment performance' only rather than 'net benefit' to members;*
> - *The chosen benchmark approach risks funds gaming the system or otherwise adopting investment approaches contrary to members' best financial interests over the long term.*

After 12 months of operation, our assessment of the performance test remains unchanged:

Scope

The performance measures currently only apply to a limited cohort of funds and products, that is MySuper and, from next year, Trustee Directed Products. Consequently, the measures do not provide Australians with a complete picture of fund and product performance, to enable them to make informed choices regarding the fund which best suits their circumstances.

APRA has previously calculated the value of funds under management in Choice products that will not be Trustee Directed Products as 33% of FUM of all APRA-regulated superannuation products.[1]

We believe that all APRA regulated superannuation products should be subject to the performance test and associated requirements, including funds being required to advise members when they fail the test.

Net benefit

The current performance test is based on 'net investment return' which ignores the impact of administration fees on member balances.

AustralianSuper has been consistent in our belief that Australia's superannuation system must place 'net benefit' to members as a highest order priority. A 'net benefit' test measures actual returns members receive into their accounts. A 'net benefit' is more reflective of the lived experience of members and a statement of whether their best financial interests are being met. High fees erode members' account balances which reduce members' retirement outcomes. APRA data shows that high fees are not correlated with high investment performance.

Treasury would be aware that the Cooper Review and Productivity Commission have also advocated for administration fees to be include in performance measures.

As such, we reiterate our view that the performance test should be updated to a 'net benefit' test, as well as applying to all relevant funds and products and improved benchmarking (as discussed below).

Performance test benchmarks

While AustralianSuper passed the performance test in 2021 and expects to do so in 2022, we remain concerned about two significant issues which persist for the performance test in its current form.

As we have submitted previously:

> *Superannuation investment must adopt a long term posture to deliver returns in members' best financial interests over their working lives. The regulatory system should support longer term decisions and innovation by Trustees where this can add value (with appropriate controls) to ensure Australians can maximise their retirement savings in their best financial interests.*
>
> *… While supportive of the overall benchmarking approach for assessing whether funds are underperforming, we are concerned that the proposed strategic asset allocation (SAA) benchmark approach could have several adverse consequences for members of superannuation funds including:*
>
> - *Funds may anchor their strategy to the stated benchmark, restricting the investment approach …*

[1] APRA – 13 April 2021 - Senate Economics Legislation Committee - ANSWERS TO QUESTIONS ON NOTICE - Treasury Laws Amendment (Your Future, Your Super) Bill 2021.
https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABYFYS/Additional_Documents

- *Funds may seek to game the benchmarking in an attempt to demonstrate 'outperformance' on the proposed benchmark test. For example, by setting an SAA for benchmark which is easier to outperform.*
- *The measure does not adequately capture the value-add that a fund may be generating from asset allocation decisions by Trustees.*

We continue to hold this view and submit that the performance test benchmark should be adjusted to address these concerns by:

- A more appropriate benchmark be applied than funds' own SAA. Doing so would ensure a more appropriate and objective comparison and would reduce the potential for funds to game the test against the best financial interests of members in what is a compulsory superannuation system. Further detail is set out below.
- A reasonable period for the benchmarking would be 10 years rather than the current 8 years. This is a timeframe already required to be used by funds by APRA for product dashboard and consequential disclosures designed to provide members with decision-making information about superannuation products.
- Benchmarking for administration fees (to ensure 'net benefit' is demonstrated as set out above) should be aligned to the investment performance duration, which we say should be 10 years.

Stapling

AustralianSuper has been a strong supporter of and advocate for measures to reduce multiple accounts in the superannuation system.

We also believe that new entrants to the superannuation system must be protected against being defaulted into an underperforming fund for the duration of their working lives. The advantage of once-only default (or stapling) must therefore be balanced with ensuring only the best performing superannuation funds, measured by long term net benefit, make up the pool of once-only default funds.

In line with the Productivity Commission's recommended approach, we recommend that members should only be stapled to high-performing funds, determined on a net-benefit basis.

We also believe that the stapling provisions do not achieve the stated policy intent of reducing multiple accounts, including because:

- they do not address existing multiple accounts in the system; and
- because the provisions rely on new entrants to the labour market and job change to apply, will take too long to impact the overall number of multiple accounts in the system.

As set out below there are a number of other unintended consequences with the current provisions that we recommend Treasury address through this consultation.

Best financial interests

As set out above, AustralianSuper is the custodian of the retirement savings of around 2.9 million Australians. We act in members' best financial interests by helping members achieve their best financial position in retirement. Consequently, we do not see a difference between the concept of acting in members' best interests and acting in members' best financial interests.

In previous submissions on this matter, we have been clear that AustralianSuper does not oppose a 'best financial interests' obligation on behalf of members. However, we have consistently raised concerns about the provisions as drafted. Further detail is provided in response to the consultation questions, however in summary these are:

- The provisions should recognise the nature of funds' expenditure will be determined by their overarching strategy and the test should be the outcomes delivered to members. Funds should be held accountable for their expenditure on this basis and should be prepared to evidence the rationale for their expenditure accordingly.
- To support compliance, the provisions should be redrafted to provide clarity regarding materiality and record keeping.
- The 'financial best interests' test must include dividend payments as well as all fees.
- The reverse onus should be removed for reasons discussed at question 18 below.

Consultation Questions

1. **Does the measurement of actual return using strategic asset allocation affect risk-taking behaviour by superannuation trustees?**

   Each fund's SAA is self-determined and does not represent an industry or peer benchmark. An SAA is generally considered one of the most important investment decisions that a Trustee makes and is integral to its investment approach and strategy.

   As currently drafted, the test:

   - only measures how well a fund has implemented its own chosen strategy, not whether the strategy itself is an effective strategy in generating strong returns for members over the long term;
   - is therefore largely an attribution exercise – where each fund compares itself against its own SAA;
   - does not adequately capture the value-add that a fund may generate from asset allocation decisions by Trustees;
   - rewards a poor investment strategy that is implemented well; and
   - applies an inconsistent timeline between investment performance (8 years) and administration fees (1 year).

   <u>Recommendation</u>

   For these reasons we recommend:
   - The performance test be adjusted to reflect relative performance against a universal industry benchmark (tailored to the respective product type). This has the dual benefit of ensuring a more objective test is applied to all industry participants, as well as providing consistency and clarity to members seeking to use the information to make decisions about their retirement savings.
   - We do not recommend additional benchmarks or more granular benchmarks be applied.

2. **Does the current set of indices used to calculate benchmark returns unintentionally distort investment decisions or reduce choice for members? If so, is there a way to adjust the benchmark indices while maintaining a clear and objective performance test?**

   As set out above, the current test only assesses how well a fund has implemented its chosen strategy, not whether that strategy is effective in delivering strong investment performance for members over the long term.

3. **Does the calculation of actual RAFE [relevant administration fees and expenses] and benchmark RAFE discourage non-performance related product features that members may value (such as customer service or platform products)? If so, can this be addressed without diminishing the test's focus on performance?**

   We are not aware of any compelling rationale for the performance test to apply a 1-year timeframe for administration fees, as superannuation is a long term investment, the investment performance period is 8 years and net benefit is what is most important to outcomes in members' best financial interests.

   <u>Recommendation</u>

   As set out above, the overall structure of the performance test should be adjusted to:
   - Apply to all APRA regulated superannuation products;
   - Apply a universal industry benchmark (tailored to the respective product type);
   - Be a 'net benefit' test, by including both investment performance and administration fees; and
   - Extend the duration of the test to 10 years; and
   - Apply that period to both investment performance and administration fees.

4. **What are the longer-term impacts of the performance test on market dynamics and composition? How will these factors impact on long-term member outcomes?**

   AustralianSuper has advocated that Government and/or regulatory authorities should adopt a more interventionist approach to underperforming funds in the interests of members of those funds. Where a properly constructed test (see our response to question 3) is applied consistently across the industry, we believe it will go some way to improving outcomes for Australian superannuation fund members.

If the test is properly constructed, and operates in accordance with the policy intent, it should result in underperforming funds being closed to new members, with those funds then being required to demonstrate sufficient performance to pass the test before being re-open to new members. This will result in some funds actively considering what opportunities and options exist to improve their performance and otherwise meet their regulatory obligations. For example, we note that as a result of the first test in 2021, some funds were required to write to fund members about their performance, as required by the test.

7. Are the measures in place to resolve underperformance sufficient given the potential for members to be stapled to these products? How can the system best support members in underperforming products?

As set out above, we do not believe the test is properly constructed to ensure underperformance is properly identified and communicated to members and that Government and/or regulatory authorities should adopt a more interventionist approach to underperforming funds in the interests of members of those funds. We hold these views because of the compulsory nature of Australia's retirement system and the importance of funds acting in the best financial interests of members.

We note that the current rules for stapling to not provide appropriate protection for Australian workers as they allow that worker to have their superannuation contributions automatically stapled to:

- a product that is not a <u>high performing</u> product (determined on a net benefit basis), noting that passing the performance test is not, of itself, an indication a product is high performing;
- a product that is not subject to the performance test at all; and/or
- a product that has failed the performance test, if the stapling occurs prior to the product failing the test a second time.

<u>Recommendation</u>

As previously submitted, we recommend that, in line with the Productivity Commission's recommended approach, new entrants to the superannuation system should only be stapled to high-performing funds, determined on a net-benefit basis.

9. What would be the impact of extending the current performance test to other Choice products (such as single sector or retirement products)? How could any issues be addressed?

We believe that all APRA regulated superannuation products should be subject to performance benchmarking and annual performance assessment, not just MySuper and Trustee Directed Products. This includes Choice products and retirement products.

<u>Choice products</u>

We are aware of arguments that the variety of Choice products means it would be unworkable to apply the performance test to those products and these arguments should be rejected. The Investment Objectives (including the benchmarks that the product is designed to meet) for each Choice product is currently included in disclosure documents. This includes single sector products.

Choice products represent the retirement savings of Australians. It is unclear why the former government would make an active decision to exclude those Australians from transparency and accountability other Australians have in relation to their retirement savings. This is an even greater imperative once it is recognised that some Choice products represent the worst examples of underperformance in Australia's compulsory superannuation system.

<u>Retirement products</u>

We are also concerned by arguments that retirement products should remain exempt from the performance test. Strong performance in retirement products is particularly important given a member in retirement does not have an extended period of time to build savings like a member earlier in their working life.

Recent statistics from the Australian Bureau of Statistics[2] indicate that the average Australian male will be in retirement for 20 years, the average Australian female for 23 years. Similarly, ASIC recognises that retirement can last for decades (see Regulatory Guide 276) by mandating a drawdown period of 25 years (essentially from age 67 to 92) for retirement projections where this is included in a member's benefit statement.

Recommendation

- The performance test should apply to all APRA regulated superannuation products.
- This includes Choice products and retirement products.
- The benchmarks should be consistent between MySuper and Trustee Directed products and Choice products.
- A benchmark for retirement products should be applied, align with the Retirement Income Covenant and not impede future innovation.

14. To what extent are employers putting into practice processes to seek stapled fund details from the ATO? How has the implementation of stapling changed onboarding, software and payroll processes for new employees?

We are concerned that, as an unintended consequence of stapling, these solutions could lead to employees and particularly younger Australians being locked into poor performing superannuation products. We are aware of an increase in the use of onboarding and payroll products which integrate the selection of a superannuation fund for new employees and partner with superannuation funds to do so. These products may also be provided free of charge to employers.

While there are a number of factors driving the uptake of these products, the obligation on employers to request each new employee's stapled fund from the ATO represents an administrative burden that incentivises work arounds.

Recommendation

Consideration should be given to whether this model is consistent with current regulatory frameworks, including stapling, members' best financial interests and the spirit of rules regarding inducements to employers.

15. Are there any barriers in the current framework to achieve the intent of the stapling reform?

AustralianSuper has long advocated for strong measures to reduce multiple accounts in the system so members can avoid paying multiple fees. We believe there are multiple barriers in the stapling framework to achieving this and other important policy outcomes:

- We support measures to reduce multiple accounts in the system. However, given the compulsory nature of Australia's superannuation system, the advantage of stapling in potentially reducing multiple accounts, must be balanced with ensuring only the best performing superannuation funds, measured by long term net benefit, make up the pool of funds into which new members can be stapled.
- Where workers are stapled to a poor performing fund it will leave them with substandard financial outcomes over the duration of their working lives. This is a consequential adverse outcome for working Australians, who are required to be part of our compulsory superannuation system, and one which government should actively work to address.
- The provisions apply to new entrants to the labour market and Australians changing jobs. Therefore, stapling is not an immediately impactful measure to meet the policy intent of reducing multiple accounts. Treasury should consider alternative measures to reduce multiple accounts in the system in a timelier and, given the risk of being stapled to a non high performing fund, more appropriate response.
- The stapling provisions do not act to reduce multiple accounts already in the system, including for workers already in jobs or who move employers and choose a new or existing fund and keep their old account. These workers will continue to pay the multiple fees and charges these measures are designed to address.

[2] https://www.abs.gov.au/statistics/people/population/life-tables/latest-release

- Our experience is that there has been an increase in employees making a choice of fund, which removes the need for employers to request information from the ATO. Determining a new employee's stapled fund through requesting a stapled super fund from the ATO requires time and effort for each new employee joining a business. This task clearly has an administrative cost, whether for small business employers with limited administrative support, or large volume employers. As a result, there is the potential for negative impacts on system compliance. In addition, there is no way for an employer to discern if the fund they are identifying on behalf of their employee is a high performing fund or an underperforming fund, or indeed an underperforming fund that may be closed to new members.

In addition, in terms of the operation of stapling, as set out above, the current provisions are deficient such that they permit a worker to have their superannuation contributions automatically stapled to:

- a product that is not a high performing product (determined on a net benefit basis), noting that passing the performance test is not, of itself, an indication a product is high performing;
- a product that is not subject to the performance test at all; and
- a product that has failed the performance test, if the stapling occurs prior to the product failing the test a second time.

Recommendation

The stapling provisions should be amended so that a fund can only be a stapled fund for an employee if the product is:

- a product that is subject to the performance test and has not failed the performance test;
- a product that is a high performing product (determined on a net benefit basis).

We also recommend that Treasury consider alternative measures to reduce multiple accounts in the system in a timelier way.

16. What is the actual, or likely, impact of stapling on insurance coverage?

AustralianSuper is aware of concerns raised that stapling a superannuation account to individuals who change occupations may result in them having inadequate or inappropriate insurance coverage.

AustralianSuper members represent a vast range of industries and occupations. AustralianSuper's default insurance is therefore designed to provide coverage that is appropriate to members across all industries and for a member remaining with AustralianSuper during various life stages while working in various jobs. This insurance is an age-based scale reflecting life stages and includes death cover, total & permanent disablement (TPD) cover and income protection cover. With the exception of employment with the armed forces[3], our default coverage has no occupational exclusions.

In our submission to Treasury's *Review of occupational exclusions in default insurance offered through MySuper products*, AustralianSuper strongly supported the removal of occupational exclusions in default insurance.

17. To what extent has the BFID required trustees to change their processes and procedures? Has this caused any unintended consequences or impacted member outcomes in any way?

AustralianSuper has always acted in members' best interests with due consideration to our expenditure through our regulatory obligations and purpose to help members achieve their best financial position in retirement. As set out above, given our purpose, we do not see a difference between our obligation to act in members' best interests and our obligation to act in members' best financial interests.

While our internal financial, risk and other practices aligned to our values and obligations, AustralianSuper has taken steps to ensure compliance with the new procedural requirements contained in the Your Future Your Super legislation and internal training on these matters.

[3] Armed forces are the sole exception due to the existence of significant death and disability benefits under the Military Superannuation and Benefits Scheme and the *Military Rehabilitation and Compensation Act 2004* and because the purpose of insurance in MySuper generally is not for military compensation.

18. Are there certain types of expenditure or activity that trustees are particularly concerned about being able to prove compliance with the BFID in respect of? Why is it difficult to demonstrate compliance? Should there be a materiality threshold?

In our December 2020 submission to Treasury we identified that the legislation provides no guidance in relation to the level of expenditure covered by the provisions, the test provides no difference between records that should be generated for minor expenditure or significant investment of member funds. The Explanatory Memorandum explicitly states that there is no materiality threshold.

<u>Recommendation</u>
At the introduction of these provisions we encouraged Treasury to set out more clearly where they consider expenditure is material enough to require additional documentation and we reiterate that recommendation.

19. Is the reverse onus of proof the most appropriate way to achieve the objective of improving member outcomes?

A reverse evidentiary onus of proof is highly unusual for provisions of this nature. It is not reflected in the general ‘members best interests’ test applying prior to the commencement of these provisions. The use of a reverse onus is an approach used in a small number of areas (for example terrorism offences).

The rationale for why a reverse onus is required to protect members’ interests has never been satisfactorily outlined, nor has a rationale for why government considers current system regulators ill equipped to enforce regulatory obligations using the previous, standard evidentiary model.

<u>Recommendation</u>
The provisions should align with other civil penalty regimes, other regulated entities and the risk profile of the superannuation industry.

Thank you for the opportunity to comment as part of this consultation. We would be pleased to provide additional information or to discuss this submission in further detail. If that would be of assistance, please do not hesitate to contact me or Nick Coates, Senior Manager External Affairs (**ncoates@australiansuper.com**).

Regards

Sarah

Sarah Adams
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