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27 April 2017

Mr Peter Harris AO and Ms Karen Chester
Superannuation
Productivity Commission
Locked Bag 2, Collins St East
Melbourne VIC 8003

Delivery via web page

Dear Mr Harris and Ms Chester

RESPONSE TO DRAFT REPORT:
SUPERANNUATION: ALTERNATIVE DEFAULT MODELS, MARCH 2017

We refer to the invitation to provide comments on the above Draft Report.

The Corporate Superannuation Association

Established in 1997, the Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors. The Association now represents a total of 21 funds controlling $24 billion in member funds, held in a total of some 285,000 individual accounts. Of these funds, 12 have outsourced trustee services but maintain significant employer interest through policy committees. In general, these funds are sponsored by corporate employers, with membership restricted to employees from the same holding company group, but we also include in our membership two multi-employer funds with similar employer involvement and focus. A number of our funds have defined benefit divisions.

Size, in terms of funds under management, ranges from $7.5 billion to $64 million as at 30 June 2016. Some of the smaller funds have their place in the pension fund structures of international groups, hence play an important role in the care and welfare of the worldwide workforces of these groups.

References in the following to page numbers are to pages in the Draft Report, unless otherwise indicated.

Principles

Box 2 (page 16) refers to the selection process principles. These include acting in the best interest of members, and meeting the needs of default members. We are concerned, however, that there is a potential emphasis on meeting the needs of members at a very basic level without consideration of additional benefits tailored to the needs of individuals at varying points in their lives, and to specific occupations. We understand a policy intent to break the nexus between employment and superannuation. Nevertheless, the adoption of policies for default selection that select against funds that offer benefits above the minimum (through setting selection criteria that omit all consideration of additional benefits) is not in the best interest of members.

For example, a number of corporate and industry funds require employers to contribute above the Superannuation Guarantee (SG) minimum, meaning members have more benefits in retirement and less reliance on government pension. Also, these funds offer group insurance cover that the member cannot get outside the fund or can get only at a considerable increase in premium. It is generally agreed that the Australian worker is underinsured.

We provide further comment below on the role of insurance in specific occupations and industries.

Inclusion of insurance as a default within superannuation arrangements

We acknowledge the difficulties encountered by disengaged younger employees with multiple accounts, whose need for cover is debatable. We note, however, the diverse needs of various occupations, and the increasing need for cover as employees acquire responsibilities. We note also that few employees will take the initiative in seeking cover, and that group arrangements provide significant economies. In addition, to make the provision of insurance a default arrangement avoids the risks associated with making insurance an "opt in", including adverse selection. We suggest a default requirement for life and permanent disability cover within superannuation from a specific age (25 or 30) and support the provision of cover for all ages in occupations carrying particular physical risk.

Employers can have a very strong interest in making sure that their employees have adequate insurance cover. To that end, putting employer death and TPD insurance arrangements onto the same tax footing as group insurance superannuation arrangements in a super fund would also be a good outcome.

Comments on the Alternative Models (page 12)

We support the second model, Assisted Employer Choice, as enabling the preservation of the best aspects of the current system, and avoiding a move to presentation of lowest common denominator choices, which result in poor outcomes for those intended to benefit from the arrangements.

In addition, we argue that the other options are all anti-competitive in the way that they are framed. They all seek to limit competition by having some higher power determine what is "best".

It would assist in driving competition and consolidation to stipulate a maximum fee structure that a default fund would need to comply with. A schedule of regular fee reductions over the next 10 to 15 years could drive efficiency and consolidation. This would enable any funds that are competitive on fees to contend.

In the context of competitiveness, it is helpful to consider barriers to entry. While the main issues are the existing cost of regulation and the cost of processing contribution flows, adding any new tendering/auction process will only add to the existing entry barriers.

Model 1 Assisted employee choice

In our view, this option would produce poor outcomes for employees. A "common, simple design that allows for easy comparisons" will not produce a product that "meets employee needs", as there will be no effective differentiation between products. In short, employees would be directed towards the lowest common denominator in product offerings.

Model 2 Assisted employer choice

We regard this as the preferred model. However, the use of two lists is overly discriminatory and is not necessary. Instead, the first list could have a second component to it which would include the criteria highlighted in the heavy filter. This would facilitate comparisons.

Employers would then be able to select their current fund, and justify the choice if it fell within the lighter filter.

Model 3 Multi criteria

This proposed model would significantly add to costs through the tendering by funds, but with the competition process failing in its objective of assisting and benefiting members, and resulting instead in the loss of quality products. Comparison would be compelled on the basis of filters that force funds towards providing vanilla style products. Forcing "convergence" as an objective should not be the role of the super default system.

Model 4 Fee based auction

This process would again add to costs, and the sole focus on fees cannot result in any focus on quality of outcomes for members.

Frequency of selection process for preferred funds under the various models

The Draft's suggested frequency of 4 years for the selection process for preferred funds appears a reasonable compromise. We are nevertheless concerned about situations such as where a fund wins selection one year, then performs badly the next, or experiences unexpected costs that result in significant fee increases. Although the Draft refers to "monitoring" and "threat of losing default provider status", these "threats", we believe, will provide an impetus to shift to conservatism at all levels.

All of these models ignore the retirement phase and discourage product development - who would go to the trouble of developing a product (accumulation or retirement) without knowing if they would win a tender or auction?

Comments on Key Recommendations (page 19)

3.1 Allocate a person a default fund only once, on initial entry to the workforce.

The recommendations 3.1 to 3.3 start from the initial premise that one of the four recommended alternatives to adopting defaults is undertaken (per the summary starting on page 12). Therefore, when we look at the proposal to allocate a default fund only once, the situation is going to be radically different depending on whether the framework is Model 1 (assisted employee choice), Model 2 (assisted employer choice) or Model 3 or 4 (arrangements where there is a competitively appointed pool or restricted number of funds available for default member entry).

We agree that proliferation of accounts is detrimental to the member, given that the premise is that members are not engaged. However, allocating members to a default product only once could lead to members being disadvantaged as their needs change. For example, assume that Model 2, Assisted Employer Choice (or some modification of it) is adopted. A person may be perfectly well served in the fund provided as a default when the person works as a casual teenage worker in the hospitality industry, with superannuation support provided at minimum levels in a fund providing basic levels of benefits (no matter how competitively). Later, the person enters full time employment in the mining or maritime industries or in heavy industry. In these latter occupations they may be much better served in a fund serving their occupational needs in the way of insurance risk and of retirement options, but unless they default on changing employment into an occupationally appropriate fund, inertia may leave them in the very basic fund they entered in the context of their school weekend occupation.

In funds serving specialist industries and separate larger employer-sponsored funds, the following comments also apply.

Under the framework being proposed almost all of future employees are likely to have had superannuation contributions made by a previous employer to a default fund before they become employed in their current job. To the extent that these future employees have already entered the system through employment with a previous employer the default system becomes somewhat irrelevant, and the employer would need new employees to elect to change to the employer's fund.

In the past the employer would not have been that concerned about having employees elect to participate in an employer fund as the employer is typically willing to contribute at a higher level to ensure an adequate retirement income. This becomes more problematic with the reduced emphasis on distinction by additional benefits (given that the proposed comparison focuses on standard benefits).

3.2 Provide a centralised online Government service for reference when a person changes jobs

In principle, we support this proposal. These arrangements would seem practical when founded on adaptation of existing forms and ATO services including SuperStream.

We agree account proliferation is a problem, but a member should not be left without an overt choice on changing jobs. One approach would be to adapt the current Choice of fund form, to ask the new employee for their current super details and providing that Superannuation Guarantee goes to the existing fund as the first option rather than as the alternative option.

3.3 The Australian Government should introduce a formal framework that specifies the process and obligations of trustees when making or considering merger proposals. As part of the framework, trustees would be required to disclose all merger attempts involving their fund, as well as the reasons for any decisions.

We accept that although there are existing legislation and APRA standards relating to these, there is pressure on trustees in this area and legislative or regulatory adaptations may be needed.

Responses to Information requests

3.1

Non-public offer funds and limited public offer funds may not compete unless all funds are required to be fully public offer. We do not know how many members one may get from the "first-timer pool", but we suggest that product development would be low (as this cost would be reflected in the fees) and product features very basic (not necessarily in member's best interest).

3.2

Funds now provide media releases when merger talks have reached a critical point. To do so earlier would break confidentiality and could harm the reputation of both or either of the funds. The system currently allows for mergers, and there is no need to "promote mergers" other than APRA assessing the PAIRS for a fund.

3.3

On the first-timer approach, see comments under response to Recommendation 3.1 above.

5.1

Specific information should include insurance offerings and, if the trust deed provides for it, employer contributions above SG minimum; however, the drive seems to be that factors for competitive appraisal would not include such features. Exclusion would be to the distinct disadvantage of members.

Short-term benefits unrelated to super should be discouraged.

8.1

Regarding the dual list approach for assisted employer choice, we favour the use of a single list incorporating the dual filter levels ("preferred" and "light filter"), as outlined under the comments on alternative models above. In our view, this assists employers to weigh the advantages of adopting a fund from a recommended list against the additional employee benefits that may be present in a fund in the wider list.

We have discussed above, in relation to the separate models and in relation to insurance, the importance of providing benefits that the employer considers valuable in the context of their employees' work environment and risks. We consider that tailored insurance offerings and enhanced benefits based on support in excess of the minimum required are some of the benefits available in corporate employer-sponsored funds.

Conclusion

We are happy to provide further information as required. Our particular experience lies with employers' continuing involvement in the management of their corporate funds, the particular governance strength in these arrangements, and in defined benefits.

Yours sincerely

p p Mark N Cerchė
Chairman
Corporate Superannuation Association