Association of Financial Advisers

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Superannuation
Productivity Commission
Locked Bag 2, Collins St East
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Dear Commissioner McRae

AFA Submission – Superannuation and Competitiveness Study

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 69 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Summary of the AFA's position

The AFA welcomes the Productivity Commission's Study of the superannuation system given that financial advisers are a main conduit via which consumers of superannuation actively access the system. Our members' interaction with the system gives us the ability to provide insight into some of the efficiency facilitators and barriers and we have some recommendations about how to increase competitiveness within the system.

Efficiency

Improving consumer financial literacy

One of the main ways that superannuation members interact with trustees of their superannuation accounts is through licensed financial advisers. This is often done through provision of personal financial product advice about the superannuation product to choose, to build their retirement savings, as well as the mix of underlying investments or model portfolio. This is not the only way that superannuation members interact with their accounts, with workplace super specialists providing financial education in the workplace.

We support consumer choice and we recognise that not everyone at every stage of their life is actively engaged with retirement goals. Nevertheless, of the channels through which consumers access their superannuation accounts and benefits, **we believe that higher efficiency and quality results where the consumer is advised by an expert financial adviser**. Further, the well-being gains delivered by better financial literacy and empowerment have a flow on effect to the public health system, the health of employees in the workplace including community benefits that result from a more confident and assured public.

The Productivity Commission Draft Report highlights that one of several barriers or impediments to optimal decision making amongst superannuation members is a **lack of financial literacy. We agree with this view**. Superannuation is a complex investment and retirement saving system with multi-level and multi-lateral inputs and influencers. As superannuation is one of the means by which government fiscal, tax and economic policy is effected – especially in regard to ever changing tax applications – the system has developed into **a difficult to navigate system of rules, exemptions and deductions**.

A recently released white paper study, '*Money, Well-being and the Role of Financial Advice – A gender based approach (May2016)'* commissioned by the AFA and conducted by the Beddoes Institute, shows that consumers who are advised by knowledgeable and experienced financial advisers have better understanding of their financial products, more confidence and peace of mind which ultimately results in better retirement outcomes. Accordingly, this shows that **there is higher financial literacy and sense of wellbeing amongst advised clients** compared to non-advised consumers – which translates into efficiency gains for those parts of the system where there are advised clients compared to non-advised.

The AFA **welcomes policies that could lower the cost for financial advisers to provide advice**.

Inconsistencies between trustee processes

Consistent with the above, we consider that **superannuation members would be better served and more efficiencies gained through clearer reporting from superannuation trustees**. Many of our members report that the differences and inconsistencies between how super trustees currently report investment performances – especially amongst presumably similar model portfolios – leads to a higher cost to serve (that is, provide advice) to their client superannuation members.

There is no current requirement amongst trustees to report information about superannuation valuations and performance in a consistent or standardised manner to other trustees. The AFA considers it to be inefficient of the system to enable super funds to inconsistently report to members the receipt of super contributions.

The AFA considers that if a homogenous or more consistent reporting system – especially between apparently similar model portfolios, for example the 'Balanced' or 'High Growth' models – were mandated, it would lead to improved efficiency within the superannuation system. This is because such a simple change would lead to more certainty amongst superannuation members and advisers but also lower costs of assessing valuations and performance.

For example, if superannuation trustees were required to implement data feeds and sharing of data, consistent reporting of returns could be better facilitated. Likewise, one way that the AFA considers this could be done is with a **review of the APRA standards on member account reporting** and another could be to ensure that certain terms were not permitted to be used if assets allocation falls out of the acceptable ranges – thereby creating consistency of expectation amongst superannuation members and their authorised agents.

Another recommendation we would make would be to **streamline certain rules and obligations** of funds on proving identity of third party authorities, such as by implementing an industry standard on how third party authorities are sought by trustees. It is not clear to our members why every fund has its own version of privacy rules when the privacy obligations upon trustees under the Australian Privacy Principles are identical.

Further, we recommend that another improvement that could be made is to **communicate to members where a pattern of contributions – such as SG contributions – is disrupted**. This would alert superannuation members to situations where arranged contributions cease or are suspended and thereby enable them to action the disruption to ensure that their retirement savings are maximised.

Assessment criteria that we recommend should be worked into the Commission's model is the question or element of **how consistent reporting and accessibility rules amongst trustees could improve efficiency**.

The absence of consumer-driven competition affects efficiency

There is evidence to suggest that there is an absence of consumer-driven competition, particularly in the default fund market. This is likely as a result of the modern award regime and Australian workplace agreements. Likewise, the bundling of insurance with superannuation creates inefficiency in the system because the quality of the insurance provided in many cases is inferior to adviser assisted policy selection – particularly because of the absence of underwriting at the time of application. This results in questionable insurance cover eroding the benefits of members over time when it would be better directed toward members' retirement balances – thereby increasing the adequacy of their retirement and likelihood of not needing to rely upon the age pension – or alternatively better quality life insurance cover.

The AFA considers that these default/prescribed systems, whilst well intentioned to plug gaps in the adequacy of the public's retirement and insurance levels, have not been implemented as efficiently or as competitively as they could have been. **The system can be improved by: opening default fund selection to greater competition; by allowing any MySuper fund to be a default fund for any employer; by educating people on choice of super and insurance; by improving the financial literacy of the end consumers and by reviewing the default life insurance arrangements within default funds.** These measures should drive greater consumer demand and choice, and consequently drive greater efficiencies in the system by encouraging existing providers to drive innovation that is better suited to members' needs.

Competitiveness

Accurate account valuations

Similar to the consistency argument amongst superannuation trustee reporting is the question of how superannuation assets are valued. Due to differences in how model portfolios are defined and the superannuation trustee investment manager investment styles, **many superannuation members' assets may not be valued properly at all times during a member's investment cycle**. There are good reasons why different managers use different asset allocation and investment styles because it facilitates competition amongst superannuation funds. We do not seek to inhibit innovation of investment styles.

Nevertheless, superannuation members often require an accurate understanding of the value of their investment accounts at different times in their life cycle and at times of significant life events such as divorce settlements. This is important to investment strategies as well as being effective within superannuation and taxation rules. The difficulty lies in when investment managers select an investment style or particular products that have delays in redemptions or leveraged strategies where the underlying asset value is difficult to immediately determine due to investment processes that are in train at or contingent on debt repayments or derivative values.

We consider that superannuation members should have the ability to seek accurate valuations of their account balances at periodic times, such as at the end of a financial year and at important times in their investment cycle (age 65), as well as around life events. Accordingly, **we consider that revaluation of assets should be a requirement upon trustees at these times and the member's need for accurate valuation** should be given priority. Doing so will enable members to better consider their options and thereby facilitate better competition amongst super funds because the member's investment choices will be more informed and superannuation funds will be more transparent.

Group insurance claims management

Another competitiveness aspect that **concerns** our members is the **manner in which group insurance claims are handled by superannuation trustees**. Again, there are no standardised rules amongst trustees or their end insurers. Some trustees play the role of facilitator while others are less involved. Some trustees have outstanding claims outcomes for their members, such as Sunsuper who recently embedded claims managers from their preferred insurer within their offices. This model is a more efficient model for superannuation members because claims are handled in a timelier fashion with more direct interaction between the claimant and their end insurer.

Whilst we appreciate that this model may represent higher costs for superannuation members and could lead to higher premiums, which have an effect on retirement outcomes, we nevertheless consider that the differences in how claims are managed amongst group policies is inefficient. Further**, lack of transparency in how claims are handled** impacts on competition when superannuation members and their advisers try to assess the differences between superannuation funds. This inhibits competition within the system and can lead to sub-optimal satisfaction amongst superannuation members when their expectations are not met at claim time.

To resolve this without imposing undue cost to the end consumer, we consider that to improve competition amongst superannuation funds there should be better facilitation or **standardisation of claims management processes** on group insurance through super funds. Standardising rules for this non-core aspect of superannuation is one way in which superannuation funds can be more competitive in the areas that matter – retirement savings and pension streams. It will also mean that when superannuation funds make a commercial decision to change insurers of their group policies, the end consumer will be less adversely affected and have more certainty as to how their access to insurance benefits will be treated.

Application of tax on death benefits

A final aspect that we consider could be improved in the superannuation system is in relation to how superannuation trustees deal with death benefits paid to superannuation members' beneficiaries. In our members' experience, **incorrect tax is often applied by superannuation trustee officers on death benefits** and there appears to be some misunderstanding within superannuation trustee offices about what taxable portions apply to benefits. We consider this to be a result of misunderstanding than anything else which better guidance from the Australian Taxation Office (ATO) could overcome.

The superannuation system is affected on the whole because when incorrect tax is applied, if it is subsequently discovered the beneficiaries need to then go through a long process to apply to have the error rectified, which is exacerbated by the fact that they are not the member of the fund. If better guidance is provided to superannuation trustees on how binding, non-binding and lapsed death benefits should be treated, many of the inefficiencies of this part of the system could be overcome. We accordingly recommend that to improve the efficiency of the system, the ATO could provide ongoing up to date access for superannuation trustees to the relevant taxation rules on death benefits.

Default fund selection and the efficiency of default fund members' balances

The AFA agrees with the Commission that default funds are a necessary feature of the system, given the unwillingness and inability of many members to make active choices about their superannuation. We consider, however, that the method by which default funds are selected by employers is often restricted by being tied to modern awards. We encourage the Commission to examine the efficiency and competitiveness of the default system and **we propose that the factors by which default funds are selected by employers should involve the following principles developed by Workplace Super Specialists Australia (WSSA):**

1. Qualification as a default fund should require only one level of filtering (i.e. no panel selection or other award based selection is required)
2. Any MySuper fund should be able to be used by an employer as a default fund
3. Employers should choose the default fund on behalf of their employees
4. Default fund restrictions should be removed from employment awards
5. Competition should be encouraged and not restricted by regulation
6. The financial outcome for super fund members is the most important outcome
7. The entire super system should operate in the best interest of fund members, and
8. A healthy superannuation system (including insurance benefits within super) is vital to reduce reliance on social security and, particularly, the age pension.

WSSA represent corporate superannuation specialist advisory businesses, some of whom are AFA members. They have specialist expertise in default and corporate superannuation by providing financial advisory services to thousands of corporate superannuation funds across metropolitan and regional Australia. WSSA members contribute to the efficiency and competitiveness of the superannuation system by assisting employers and policy committees ensure that members are getting competitive benefits and features, at a competitive price.

WSSA members also educate superannuation members (employees) through general advice and information to help them make informed decisions about their retirement savings and life insurance choices. Their effectiveness at driving demand side factors of the system is hampered by conflicted remuneration provisions that presume that any benefits they receive for financial advice provided to retail clients of default funds is conflicted. The AFA considers this to be an unnecessary constriction of the system and it too should be reviewed by the Productivity Commission.

Conclusion

The superannuation system is the primary means by which Australians save for their retirement. Although the system has many good attributes, the complexities of the system and evolution of the system have led to much inefficiency which translates to retirement outcomes not being maximised. We consider that through our recommendations the system could be improved for the end consumer and which ultimately will benefit the public through reduced reliance on the public welfare and health systems.

If you require clarification of anything in this submission, please contact us on 02 9267 4003.

Yours sincerely,

Brad Fox
Chief Executive Officer
Association of Financial Advisers Ltd