Submission on Superannuation: Alternative Default Models Draft Report

REST Industry Super

rest.com.au 1300 300 778

REST Industry Super

28 April 2017

Commissioners and Assistant Commissioners
Productivity Commission
Locked Bag 2, Collins St East
Melbourne VIC 8003

Dear Commissioners

Submission on Superannuation: Alternative Default Models Draft Report

Thank you for providing REST Industry Super (REST) with the opportunity to make a submission on the Productivity Commission *Superannuation: Alternative Default Models Draft Report.*

REST is one of the largest superannuation funds by membership in Australia. We have almost 1.9 million members, around one in six working Australians with more than $41 billion of funds under management. Our mission, which underpins everything we do, is simple: to help improve the retirement of ordinary Australians by returning all benefits to our members. Further details about REST can be found in Appendix One.

We welcome the Productivity Commission's interest in encouraging public policy debate in this area.

Our submission addresses a number of major considerations to be resolved in relation to the adoption of any proposed alternative default model. In addition we raise specific observations and concerns about each of the four proposed alternative default models.

Thank you again for the opportunity to make a submission to this inquiry. Please do not hesitate to contact me directly should you require any further input from REST.

Yours sincerely

Damian Hill
Chief Executive Officer
REST Industry Super

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

Table of contents

1. Key points

- The current superannuation system is relatively efficient and competitive and already has a mechanism for facilitating competition via the Fair Work Commission (FWC). This is a model designed by the Productivity Commission (PC) which has not yet had the opportunity to be tested.
- REST believes that transitioning to the major systemic reforms proposed by the PC will incur significant implementation costs and risks impacting system stability and member benefits.
- The failure to address insurance is a serious omission. Flexible and affordable insurance is fundamental to the objective of superannuation and should be a core part of any default superannuation model.
- The alternative models proposed by the PC seem to encourage short-term investment approaches which are at odds with superannuation as a long-term investment time horizon.
- Any default fund model which mandates a shortlist of funds based on shorter term performance will inevitably lead to funds performing strongly over the long term failing to make the shortlist. This creates the potential for significant loss of benefits for members who find themselves displaced in non-shortlisted funds.
- Each of the proposed models do not address the issues of competing incentives and conflicts but instead rely on short term assessments.
- The current system is underpinned by trust law and legislation which impose strong obligations on the trustees of all funds acting in the best interests of members and for default funds promoting members' financial interests.
- The best elements of each of the proposed models are already found in the current default model.
- The proposed models do not adequately protect members' interests and increase potential risks in terms of lost benefits, such as insurance and reduced returns.
- Superannuation is a component of salary and wages and should continue to be addressed within the industrial relations system.
- The proposed models if developed on a stand-alone basis have quite different implications, particularly if a long-term focus is taken.
- Employers would face increased compliance costs as a result of offering multiple default superannuation funds within their workforce.
- The proposed models would introduce new agency issues that mean they would be less aligned to the interests of members than the current system.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

2. Executive summary

REST Industry Super welcomes the opportunity to make a submission on the Productivity Commission's (PC) *Superannuation: Alternative Default Models Draft Report.*

As an industry superannuation fund with a large proportion of workers from Australia's retail industry the majority of REST's 1.9 million members are young and work in part-time, casual or temporary employment. Just over half of REST members are under 29 years of age. For the majority of REST members, retirement is many years into their future. Being predominantly young, many have relatively low balances. The average superannuation balance of contributing REST members is around $22,000.

REST is committed to working with the industry and Government to drive continual enhancements which encourage better retirement outcomes for members. REST supports moves to encourage greater engagement with superannuation as an important long-term investment. REST also backs the PC's focus on providing members with the information they need to make informed choices.

REST also welcomes initiatives to reduce multiple accounts, in particular for members on lower incomes. As a foundation member of the Superannuation and Insurance Working Group, REST continues to work with the industry on initiatives designed to reduce superannuation account duplication and in particular to avoid members paying for multiple insurance policies that serve only to erode future superannuation benefits. We believe that the existing MySuper reforms supported by further strengthening of the existing regime would progressively reduce the number of accounts and providers across the industry.

The terms of reference set out by the Treasurer in the Productivity Commission Issues Paper *Superannuation: Alternative Default Models,* September 2016 include direction that the developed model(s) 'should enhance efficiency in the superannuation system in order to improve retirement incomes, including optimising long-term net returns to members, and build trust and confidence in funds regulated by the Australian Prudential Regulation Authority (APRA)'.

The principles for designing these models included ensuring 'incentive compatibility with meeting the 'best interests of members' as well as to 'drive pressure on funds to be innovative and efficient' and 'ensure the process is low-cost and easy to administer' as well as to 'avoid room for gaming the process' and 'reduce reliance on the Age Pension'.

In REST's view the proposed alternative models manifestly fail to meet each of these terms of reference.

In particular there are a number of major considerations to be addressed which are common to each of the proposed alternative default models.

Significant transitions impacts

REST believes that the major systemic reforms proposed by the PC will incur significant implementation costs and risks – not only in terms of increased compliance cost but also in terms of an erosion of member benefits, system stability and most importantly long-term investment performance.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

The value of insurance as part of superannuation

The failure to take into account insurance in any of the proposed alternative models is a serious omission.

REST is of the view that flexible and affordable insurance is fundamental to the objective of superannuation and should be a core part of any default superannuation model. Members would be unable to continue to build for their retirement future without the ability to protect their most important asset – their ability to earn a living. Importantly, in the absence of insurance cover provided by REST many REST members would be unable to access equivalent cover and for those who could the cost would be much greater.

Impact on members of non-shortlisted funds

Any default fund model which mandates a shortlist of funds based on shorter term performance will inevitably lead to funds performing strongly over the long term failing to make the shortlist. This creates the potential for significant loss of benefits for members who find themselves displaced in non-shortlisted funds. In particular rising operating costs, rising insurance premiums and loss of scale impacting investment decisions and ultimately long-term performance.

A core consideration must be to protect members who find themselves in non-shortlisted funds.

The impact of a short term approach

The alternative models proposed by the PC seem to encourage a short-term investment focus which is at odds with superannuation as a long-term investment. This short-term approach will impact net cash flow and affect funds investment strategy while also failing to cater for life stage cradle-to-grave investment approaches ultimately resulting in reduced benefits to members.

We believe there is merit in allowing the current important SuperStream and MySuper reforms to be embedded and matured before introducing further significant and unnecessary changes. In particular, it is preferable to assess if these changes have the potential to impact members' perception of the stability of superannuation and their willingness to engage positively to build their own retirement savings.

REST also has concerns and considerations about each proposed alternative model and these are dealt with in more detail in section 4. The key concerns include:

- Ensuring as an absolute consideration that there not be an ability for third-line forcing or inducements, particularly given the long-term nature of super (Models One and Two)
- Ensuring the selection form for the assisted employee choice (Model One) does not introduce behavioural bias and is clear and makes it easy for the employee to exercise choice.
- Resistance from employers to engage in the selection process implied in the assisted employer choice (Model Two) and the impact on members resulting from the increased cost of acquisition for non-default funds.
- Impact on system stability if the multi-criteria tender (Model Three) were adopted and finally
- The development of a fee-based auction (Model Four) encouraging a 'race to the bottom' improved retirement outcomes are impacted more by performance than fees and this is not taken into consideration in Model Four.

REST looks forward to continuing to work with the industry and government to promote measures supporting member choice, greater engagement and ongoing stability and value for members.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

3. Important considerations common to each proposed model

The PC has invited comment and input on four proposed alternative models:

- Assisted employee choice (Model 1)
- Assisted employer choice (with employee protections) (Model 2)
- Multi-criteria tender (Model 3)
- Fee-based auction (Model 4).

The PC Draft Report states that the proposed alternative default models are designed to 'address the core problem in superannuation – the sheer complexity of decision making coupled with compulsion'. It does so by increasing the availability and quality of information or nudging choice to a smaller set of high-quality products.

The terms of reference set out by the Treasurer in the Productivity Commission Issues Paper *Superannuation: Alternative Default Models,* September 2016 include direction that the developed model(s) "should enhance efficiency in the superannuation system in order to improve retirement incomes, including optimising long-term net returns to members, and build trust and confidence in funds regulated by the Australian Prudential Regulation Authority (APRA)"'

The principles for designing these models were to ensure 'incentive compatibility with meeting the best interests of members' as well as to 'drive pressure on funds to be innovative and efficient' and 'ensure the process is low-cost and easy to administer' as well as to 'avoid room for gaming the process' and 'reduce reliance on the Age Pension'.

In REST's view the proposed alternative models fail to meet each of these terms of reference.

The PC recognises that these interventions come at a cost and each model has 'different strengths and weaknesses.'[1]

While the scope of the Terms of Reference is broader than the Terms of Reference for the 2012 PC report, the 2012 report determined a number of principles that remain valid today, including a variety of possible roles for the FWC.

In the 2012 PC Report the PC stated that processes, once settled, would not be reviewed again until 2023. We note that this has not occurred with the new default models being suggested.

REST agrees that major systemic reforms incur significant implementation costs and risks – not only in terms of increased compliance cost but also in terms of an erosion of member benefits, system stability and most importantly long-term investment performance.

In particular, REST believes continued system wide changes to superannuation may result in:

- greater levels of disengagement
- reduced consumer confidence in using super as a primary retirement savings investment and conversely greater flows into less regulated or suboptimal vehicles and choices
- heightened risk of fund failure
- higher costs to members and lower long-term investment outcomes as a result of trustees taking a short-term and overly cautious investment approach.

Alternatively funds may seek higher short-term returns through riskier investments in order to best position their fund for shortlisting by the government.

The resulting distortion of the investment process introduces the potential for significant unintended consequences across the superannuation system.

[1] Productivity Commission, 2017, *Superannuation: Alternative Default Models, Productivity Commission Draft Report*, March 2017, page 2.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

In particular there are a number of major considerations to be addressed which are common to each of the proposed alternative default models.

Each of these concerns and considerations are dealt with in more detail in this section.

3.1 The current model is working well for the majority of participants

Given that over 97% of REST's members are in the default REST Super MySuper product, including employees covered by the Modern Awards or Enterprise Bargaining Agreements (EBAs), the existing model already incorporates the best elements of the proposed default fund allocation models.

Any further changes to the existing model as well as the existing EBA model, raise significant impacts for employers, employer representative groups, employee representatives, financial markets, the broader community and, most importantly, members.

3.2 Competitive elements are already present in current legislation

The competitive elements that the four models are seeking to generate are already present in legislation. For instance, funds must comply with the scale test/member outcomes test under section 29VN (b) of the *Superannuation Industry (Supervision) Act 1993.* This Act requires that each trustee of a regulated superannuation fund that includes a MySuper product must determine annually whether the beneficiaries of the fund are disadvantaged, in comparison to the beneficiaries of other funds who hold a MySuper product.

Super funds regularly tender for service providers in order to improve member benefits. As evidence of this, REST has changed insurers and custodians, despite the transitional costs involved.

3.3 Allowing sufficient time for the benefits of MySuper to be realised

In REST's view the current MySuper reforms and SuperStream initiatives provide a solid foundation to address many of the issues raised by the PC, particularly in relation to reducing multiple accounts and ensuring disengaged members are not paying for sophisticated multi-optioned fund offerings they do not want, need or use.

SuperMatch has already proven successful in reducing duplicate accounts. In addition, as a core member of the Superannuation and Insurance Working Group, REST continues to work with the industry on initiatives designed to reduce superannuation account duplication and in particular to avoid members paying for multiple insurance policies that serve only to erode future superannuation benefits.

The transition period for these fundamental and costly reforms is yet to expire and the Government has committed to a benefits assessment in 2020. REST believes there is merit in allowing time for these changes to be embedded and benefits to be assessed before any consideration of alternative models.

More fundamentally REST seeks clarification on the purpose and approach of MySuper in the proposed new superannuation regime.

3.4 Superannuation a component of salary/wages

Superannuation Guarantee (SG) contributions are a form of remuneration. This reflects superannuation's origin as an industrial entitlement in Awards and its position as an integral part of

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Awards for the last 30 years. To take one of these aspects from the Award is contrary to the history of Awards in dealing with employee entitlements, including superannuation. REST believes that superannuation should continue to be addressed within the industrial relations system and remain within the jurisdiction of the Fair Work Commission (FWC). For this reason the FWC's role in the selection of default funds should remain.

Similarly, when Choice of Fund legislation was introduced in 2005, there were exemptions relating to industrial awards and agreements dealing with superannuation. Where an employer made contributions subject to certain award or EBA provisions, then those contributions were deemed to be made in compliance with choice of fund requirements.[2] Accordingly, the history of policy in this area still dictates that any new arrangements for default superannuation contributions should only cover default superannuation contributions for non-award or non-EBA employees. This approach also avoids double jeopardy for employers.

3.5 Profit to members not shareholders

As an industry fund, REST is run only to benefit members, unlike funds in banks or other retail providers which have dual responsibilities to members and to assist in generating a return for shareholders.

As fees charged by retail MySuper products are becoming similar to industry MySuper products, this must mean that retail funds are operating at a lower cost (which is not supported by evidence), or are making profits elsewhere in their business.

This should not be supported by the PC. The PC itself notes that, 'a healthy dose of scepticism would suggest that there must be rents to be recovered for the benefit of members for such unanimity to be valid.[3]'

This is further reinforced by the late transfers of accrued default amounts (ADAs) by retail funds which occurred after the MySuper laws took effect on 1 July 2013. Many retail funds have delayed the transfers until the end of June 2017, disadvantaging existing members' retirement incomes by making them wait years before benefiting from the fee reductions brought about by Stronger Super.

APRA research in 2015 showed that retail fund RSEs with accrued default amounts not yet transferred were $41 billion in assets, as opposed to industry funds with $5 billion in accrued default amount assets.[4] Further as at 30 September 2015, retail funds held 9.5 per cent of total assets in accrued default amounts, compared to 0.1 per cent for industry funds.[5]

This is despite APRA's guidance in relation to transition arrangements which state: 'Notwithstanding that the legislation allows for an RSE licensee to move accrued default amounts at any time up until 30 June 2017, APRA expects that the attribution to a MySuper product would be made much earlier than 1 July 2017 when it is in the best interests of members. APRA would expect the RSE licensee's transition plan to reflect this approach.[6]'

Any system, including the current FWC approach, should have as an absolute condition that there be no ability for third-line forcing, or inducements. The long-term nature of superannuation means

---

[2] Section 32 (C) (6) of the *Superannuation Guarantee (Administration) Act 1992*.

[3] Productivity Commission, 2017, *Superannuation: Alternative Default Models, Productivity Commission Draft Report,* March 2017, pages 6 and 7.

[4] Australian Prudential Regulation Authority (APRA), 2015, *Superannuation Statistics Selected Feature – Accrued Default Amounts*, September 2015 (issued 19 November 2015). APRA, Page 7

[5] Ibid, page 4.

[6] APRA Superannuation Prudential Practice Guide, *MySuper Transition*, paragraph 15.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

success is only apparent in the longer-term. As such, competition based on short term measures is largely irrelevant and can lead to inappropriate outcomes.

The most important consideration must be that the selected governors of super (including trustees, employers, government and their appointed panels) do not have conflicting incentives or motivations.

While difficult to achieve it is possible to remove the most egregious opportunities for conflicts which include:

- The possibility of employers making decisions on behalf of their employees to be tempted by inducements
- The focus on short term cost as an anathema to investing well for the long term
- The need for a more rigorous examination of the competency and alignment of Trustees in terms of acting in the best interests of the beneficiaries of the trust.

Each of the alternative models proposed by the PC fails to address issues of competing incentives and conflicts. Instead they rely on short term assessments to determine default super funds.

A necessary requirement for assessment of a short-listed fund in any arrangement (whether it be in the FWC model or any other approach) must be on the ownership model, and implicit incentives that drive the decisions and purpose of that fund.

3.6 Common reference point of unassisted active choice

REST also believes that assessing the alternative models requires a common reference point to provide a baseline for comparison. The baseline is 'unassisted active choice 'and as the PC states 'the baseline is considered the purest form of competition, albeit operating in a highly regulated market.'[7] The highly regulated superannuation industry already has checks and balances to ensure that members' best interests are served.

Superannuation is governed by the *Superannuation Industry (Supervision) Act, 1993* (SIS Act) with the system supported by other regulatory requirements, including trust law. Compliance with these requirements impact the pricing and competitiveness of any proposed model. As a result, the baseline comparisons for these models should take this into account.

Failure to take account of regulatory requirements means the pricing structure of proposed models would need to change once they were operating. Even the cheapest funds will incur extra costs e.g. the costs of compliance including MySuper compliance.

Using unassisted active choice as a baseline is also unrealistic as most funds offer advice as an important member benefit.

3.7 Insurance is an important part of superannuation

The PC's failure to take into account insurance in any of the proposed alternative models is a serious omission.

REST is of the view that flexible and affordable insurance is fundamental to the objective of superannuation and should be a core part of any default superannuation model.

REST insures over 1.4 million Australians (approximately 70% of REST members), providing $286 billion in Death sums insured, $70 billion in TPD and $2.15 billion in monthly IP benefits.

[7] Ibid.

Importantly, the majority of REST members work in part-time or casual employment for whom affordable and flexible insurance would have been otherwise unavailable because of their employment state.

Flexible and affordable insurance is fundamental to the objective of superannuation. Members would be unable to continue to build for their retirement future without the ability to protect their most important asset – their ability to earn a living.

In the absence of insurance cover provided by REST many of our members would be unable to access equivalent cover and for those who could the cost would be much greater.

Recognising that insurance is fundamental to the core objective of superannuation, the Government mandated Death and TPD cover in the SIS Act. Insurance was also included as a mandatory requirement for MySuper authorisation in recognition of its status as an important ancillary member benefit.

Research of the general Australian population conducted by AIA Australia in July 2016 revealed that almost one in two of those with insurance in superannuation believe they would not be covered if it was not provided automatically, leading to a potential underinsurance gap of almost $2.2 billion[8].

Research of the general Australian population conducted by Rice Warner in July 2015 also points to the under insurance gap facing many Australians. The research concluded that the median level of life cover meets only 61% of basic needs and that median life cover is only 37% of the income replacement level required. Alarmingly the median level of TPD cover and IP cover meet only 13% and 16% of their respective needs[9].

REST firmly believes in the value of insurance as part of superannuation and for younger Australians in particular. From 1 April 2014 to 15 November 2016, 268 Death claims were paid to financially dependent beneficiaries of members 25 years or younger. Also during this period, REST paid 478 TPD and disability claims to members under 25.

As a member of the Superannuation and Insurance Working Group REST continues to work with the industry to introduce further enhancements to insurance as part of superannuation including work to reduce multiple superannuation accounts to avoid members paying for multiple insurance policies.

3.8 The importance of a long-term investment approach

The alternative models proposed by the PC seem to encourage a short-term investment focus which is at odds with superannuation as a long-term investment.

In particular the proposed four year tenure of superannuation funds for the member choice model will impact net cash flow and affect funds investment strategy while also failing to cater for life stage cradle-to-grave investment approaches.

REST's membership of predominantly young, part-time and casual employees is an important consideration in setting our investment objectives. For example, the age profile of our members and in particular their time to retirement will affect cash flow and is a factor in determining our investment horizon and risk tolerance.

Declining cash flow may alter allocations to unlisted assets such as direct property and infrastructure which have long holding periods. Importantly, these asset classes have directly contributed to REST's strong long-term returns and overall outperformance when compared against retail funds who typically have less investment in infrastructure and direct property.

[8] Insurance consumer Research, AIA Australia July 2016

[9] *Underinsurance in Australia 2015*, Rice Warner July 2015

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

In fact, REST Super Core Strategy has been ranked number one for long-term investment performance over rolling 10 year periods by independent ratings house SuperRatings more times than other funds put together.

It is rare for funds to perform in the top quartile of investment performance for six years. This means a fund may or may not be in the top performing quartile at a particular time but may overall outperform peers in the medium to long term.

A focus on fees and costs as a key criterion for selection of super funds is another factor which impedes optimal investment and performance. For instance, an active management approach may incur more expenses but the net investment returns should be expected to be higher.

The PC report in its report claims the benefits of scale have not been passed on to members in the form of lower costs. It is important to note that member satisfaction and good customer experience comes at a cost which is ultimately funded from fees. Ultimately members benefit from a superior product both in terms of better communications channels as well as access to affordable financial advice and important additional benefits. Just as in other industries, members want and expect quality service as well as a quality product.

3.9 Impact on members displaced in non-shortlisted funds

Any default fund model which mandates a shortlist of funds will inevitably lead to funds performing strongly over the long term failing to make the shortlist.

A core consideration must be to protect members who find themselves in non-shortlisted funds. It may be expected that the level of roll overs or switching will be exacerbated among members of non-shortlisted funds leading to the potential for significant displacement and system wide costs which may in turn impact system stability and ultimately member benefits.

The resulting reduction in scale for non-shortlisted funds may also have potentially serious flow-on effects to the broader economy. In particular potentially increasing costs of providing superannuation services leading to increased fees. If membership was to decrease, operating expenses would rise. Members remaining in the fund would ultimately bear these additional costs.

Any erosion of the insurance pool would also lead to rising premiums and reduced ancillary benefits which could potentially affect a fund's future competitiveness. Members leaving the fund may experience reduced or even become ineligible for insurance benefits under another fund. If an allocated default fund was to lose its default status, the members might be required to change funds which would result in a loss of an existing insurance benefit. If this cover was not offered through superannuation, these members would not be able to get cover elsewhere or at least at an affordable price. This places a heavier burden on the government.

The resulting loss of cash flow for funds who fail to make the short list will also significantly reduce their ability to fund and support continued innovation to the detriment of members. Funds will be faced with a decision to either invest or innovate leading to the potential for short-term spurts of innovation when funding revenue is stable, followed by periods of reticence.

REST believes there must be a provision for members to be informed if their fund is not included on a shortlist. While this places an increased cost on members we believe this is a significant event requiring member disclosure.

REST is also seeking further clarification on how the government will deal with the likelihood that there may be 20 or 30 funds who are off the list but who are performing better than the shortlist of funds.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

3.10 Disincentive for employers to support financially and mentally healthy workplaces

The models proposed by the PC place the responsibility to engage with complex financial products overwhelmingly on individuals. Individuals who may be poorly armed to deal with important decisions commonly rely on friends, family or their employer for support and advice. The role that the workplace plays in these situations should not be underestimated. There is strong evidence that people who feel more financially secure have better mental health and in turn contribute to a mentally healthy and more productive workplace.

In our experience best practice employers who deal with a small number of super funds are more willing and incentivised to support greater financial education for their employees. This is due to the smaller number of investment, insurance, education or advice offerings to communicate to employees.

The models proposed by the PC would significantly increase complexity for employers and reduce the incentive for them to work with super funds to educate their employees about their insurance and superannuation leading ultimately to reduced engagement.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

4. Model specific comments and insights

REST has concerns in relation to each specific proposed alternative model and these are dealt with in more detail in this section.

4.1 Model One: assisted employee choice

REST is asking for further clarification from the PC as to how this system will be implemented.

Under the current model, rigorous selection of employee default funds is performed through the award/Enterprise Bargaining Agreement process, with consideration given to fee structures, insurance, returns and additional services to members. This level of diligence is unlikely to be exercised by young members who are not adequately aware or qualified to make this decision with an appropriate long-term view.

In these circumstances, employees may be unduly influenced by other factors, such as:

- Design of the selection form, ensuring it is clear and easy for the employee to exercise choice.
- Order of appearance – time-poor individuals may be more likely to select the first fund to appear on the list.
- Selection bias favouring large, well-known brands that may not be relevant to their personal situation and industry.
- Ensuring adequate information is available to employees –including recent returns, fees and ownership model.

Creating an environment of informed and assisted choice is essential. REST is concerned that employees would lack an industry wide view of high performing funds outside the government's shortlist. In the absence of advice an individual's ability to choose a fund best suited to their needs will be compromised.

In addition, needs of employers should be taken into account with employers likely to pay default contributions into multiple funds resulting in a more onerous administrative burden for companies of all sizes.

It is also worth considering whether a 'last-resort' fund is appropriate for the allocation of employees who do not opt to make a choice. The choice of an eligible rollover funds (ERFs) or the Future Fund would not be beneficial for members, particularly in relation to investment returns. For instance, the Future Fund was established in 2006 to accumulate financial assets to offset the Australian Government's unfunded superannuation liability from 2020. It is an intergenerational sovereign wealth fund and not a superannuation fund. To operate as a 'last resort fund', the Future Fund would need to establish a governance framework to enable it to operate as a superannuation fund. In addition, it would need to set up administrative and registry capabilities enabling it to receive and allocate member contributions and other transactions. Accordingly it is not suitable as a fund of 'last resort'. Similarly, ERFs would also require governance and operational changes. ERFs are currently designed as a temporary repository for member benefits and must facilitate consolidation of members' active super accounts. Further the investment returns from ERFs are low and would have a detrimental effect on the balances of default members' balances who do not choose a fund.

Engaging with a super fund who will assist them in making appropriate investment decisions is essential for younger members. REST is concerned that a significant proportion of employees will default to the 'last-resort' fund, losing insurance cover as well as the ability to receive access to financial advice and assistance provided by many superannuation funds.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

REST recommends the PC consider building a series of short lists of carefully selected products, with reference to specific industry's (i.e. nursing, teaching, construction, retail, administrative, manufacturing), ensuring employees are provided with a product design that is suitable to their industries' unique needs.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

4.2 Model Two: assisted employer choice

A model of assisted employer choice puts the employer in a quasi-trustee position.

REST's research indicates 82 per cent of employers believe it is their employee's responsibility to choose the best superannuation fund for them, and more than half of SME managers spent less than five minutes selecting their employee's superannuation fund[10].

Providing greater responsibility to employers who are resistant to engage in the selection process gives rise to an increased risk of employer inducements. This model also encourages 'product-bundling' which further increases the risk that employees are allocated into a fund that does not meet their needs.

Any system, including the current FWC approach should have as an absolute condition that there not be ability for third-line forcing or inducements. Given the long term nature of super the pre-conditions for them are very fertile in this model.

For employers, the transitional issues arising from changes of a default fund would introduce more 'red tape' and a requirement to direct their energies not just to their business but to spend considerable effort to ensure appropriate default fund arrangements are in place for their employees.

This has flow on implications including:

- Less engagement, support and education of employees. An employer may have multiple default employees who experience quite different outcomes (because of different default funds) despite being otherwise quite similar.
- The employer is less likely to support education from each and every super provider.
- From a super fund point of view, there will be an increased cost to service.
- Slower insurance claims processing from employers having to deal with multiple benefit designs, providers and different claims processes.

REST believes that employers would wish the selected funds to be tailored to reflect the demographics of their industry.

Ultimately, a new system could result in employers having multiple default funds for its workforce. This could result in potentially significant variations in member insurance cover, costs and fees, as well as investment risk and return strategies.

The additional regulatory burden of a change to the light filter (beyond the current MySuper authorisation process) will increase compliance costs, which ultimately are passed on to members and reduce returns. The heavy filter will need to be carefully managed to create long-term performance incentives to meet the definition of 'best performing products' that are aligned with the long-term purpose of superannuation.

The proposed light and heavy filters are a hybrid of MySuper authorisation and FWC criteria and duplicate existing and successful regulatory frameworks.

Consideration could be given to providing different default lists for different sectors/industries, to ensure that employers in these situations choose the most relevant product for their employees.

REST recommends the PC consider providing different filters for different industries that incorporate relevant insurance cover into the criteria and produce a preferred default list for different industries.

[10] *Bridge the Gap* research was conducted among 1,700 Australian workers and employers using a customised online quantitative survey between 27 May and 6 June 2016

REST Super | REST Select | REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

4.3 Model Three: tender

A tender model has the potential to significantly disadvantage existing members of superannuation funds and could have the net effect of reducing competition, by forcing members into a small set of funds selected by the tender process.

Further clarity is required on how superannuation funds can position themselves to be on the shortlist in the future, as the criteria provided are so broad as to be ineffective. It is REST's view that almost all funds in Australia are currently competing on the basis of broad criteria similar to this, so sees no advantage in advancing this model.

If these criteria are to be utilised, insurance, should be included.

Investment strategy, member services and fee levels are all dependent on the member profile of the fund, and repositioning funds to compete to set tender criteria could disadvantage members.

The Australian population does not have homogenous needs, and a selection of ten superannuation funds, allocated sequentially, will not provide the most utility to default fund members.

Sequential allocation will also produce unintended side-effects in terms of lumpy, irregular default fund flows. Members in one industry may also be allocated into a fund servicing another. The appropriateness of investment options, member communications and education or advice may be poor and tailored to employees of a different industry.

The potentially negative impact on the overall stability and the likelihood of rising insurance costs must also be considered.

Performance monitoring and enforcement will also need to be carefully designed, as a long-term investment strategy will produce irregular periods of short-term poor investment performance. The potential to create a short-term incentive for managers also needs to be carefully managed.

Tendering for default superannuation contributions has the potential to significantly disadvantage existing superannuation fund members and reduce the utility of superannuation for members.

REST Super | REST Select | REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

4.4 Model Four: auction

As the PC noted in its 2012 report, as trustees become reluctant to increase their expenses, including investment management expenses, this could lead to a 'race to the bottom'.

A focus on cost alone will not introduce competition and efficiency, but create additional costs to members in terms of reduced stability and investment returns. These costs would far outweigh the benefits.

The development of a fee-based model would encourage this 'race to the bottom' forcing managers towards passive investing, higher allocations in cash, reduced growth asset allocations and reduced returns.

These low fee investment options are particularly unsuitable for younger members who comprise a substantial portion of the default market.

A fee-based auction impacts the sustainability of funds as the push to cut costs may result in poor management practices and increased organisational risk for members as funds will increasingly use sub-optimal providers, refrain from investing in new technologies, and reduce their corporate governance and risk management practices to minimise costs.

To ensure the stability and strength of the superannuation system value for money must be considered as an important measure.

The most comparable model to this internationally, the Chilean model, resulted in 'a race to the bottom among funds to reduce fees at the expense of returns and member services.'[11]

A competitive tender model should not be based purely on fees, but should also include metrics on total value to members, investment returns and suitability of product design for members in specific industries. Consideration should also be given to providing a method for competition to be sector-specific, not agnostic, to ensure members have access to appropriately designed superannuation products

[11] The Association of Superannuation Funds of Australia (ASFA), *The Chilean pension tender model*, February, 2017, page 5.

Appendix One: About REST Industry Super

REST is significant

REST Industry Super is one of Australia's largest industry superannuation funds by membership. REST has around 1.9 million members across Australia, around one in six working Australians, with over $41 billion of funds under management as at 1 November 2016. Around 143,000 REST members are aged 20 years and under.

REST is a not-for-profit industry fund

As an industry fund, REST is run only to benefit members. REST does not pay commissions to financial advisors or dividends to shareholders.

REST is established

REST has been looking after members' superannuation and insurance since 1988.

REST has a retail heritage

Our origin is in the retail industry; REST has represented the interests of workers in the retail industry since its establishment in 1988. REST has been open to all Australians since 1998.

REST has delivered strong long-term investment performance

REST has delivered strong net returns over the long term. REST Core Strategy has been No 1 for long term performance more times than all other super funds put together, surveyed monthly with similar options over rolling 10 year period. [12]

REST is a key insurance provider in Australia

REST provides almost 1.4 million working Australians (around 70% of REST members) with insurance as an important part of their superannuation. REST is one of the few industry super funds providing flexible long-term Income Protection (IP) cover as well as Death and Total and Permanent Disablement (TPD) insurance by default.

REST operates one of the largest insurance pools in the Southern Hemisphere

REST's scale allows us to negotiate and provide insurance cover at the best possible value to members.

Total insurance cover provided to REST members comprises $286 billion in Death sums insured, $70 billion for TPD and $2.15 billion in IP benefits to November 2016.

REST is an innovator

REST is committed to continuing to develop member focused products and services to make it easier for members to maximise their superannuation. REST was the first Australian superannuation fund to give members online 'mobile first' access to personalised financial advice; service member enquiries online 24/7 and offer an inbuilt consolidation tool as part of personalised, interactive member statements.

REST is committed to making it easier for Australians to seek affordable financial advice

REST recently became the first Australian super fund to provide its 1.9 million members with 'mobile first' access to personalised financial advice via REST Advice so members can seek financial advice on their own terms in a way and at a time that best suits them.

REST is passionate about improving the retirement outcomes of our members

[12] SuperRatings survey as at February, 2017.

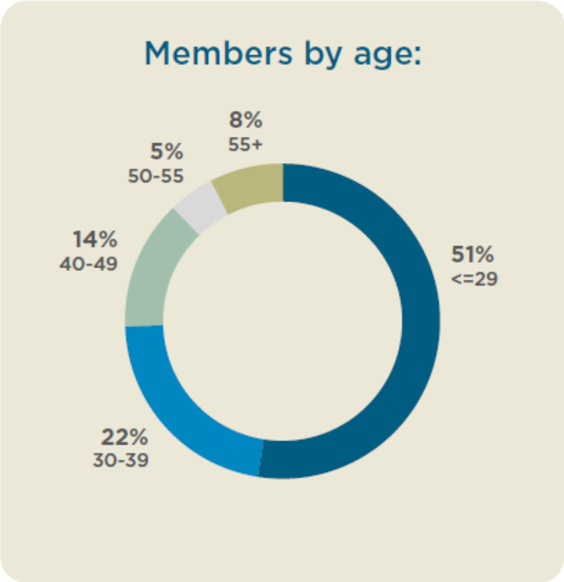
REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au

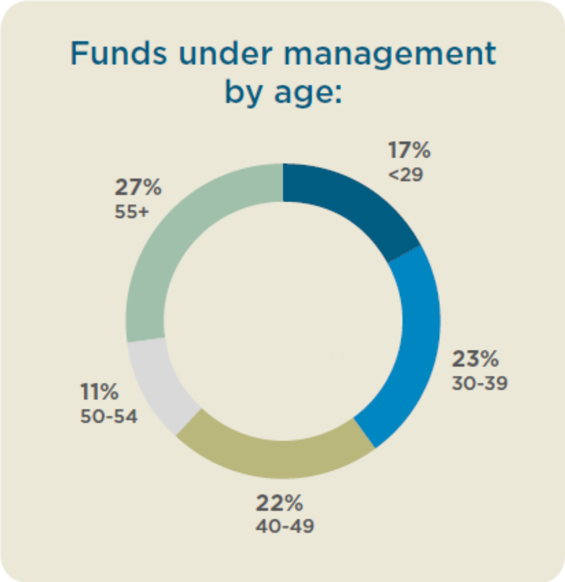
Registered office: Level 7, 50 Carrington Street Sydney NSW 2000. The Trustee company of Retail Employees Superannuation Trust ABN 62 653 671 394 is Retail Employees Superannuation Pty Limited, ABN 39 001 987 739, AFSL 240003

Our mission, which underpins everything we do, is simple: to help improve the retirement outcomes of our members. We do this by investing our profits back into member benefits through lower fees, increased investment choices, access to affordable and flexible insurance and advice.

REST Super | REST Select | REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

Appendix Two: A profile of REST members

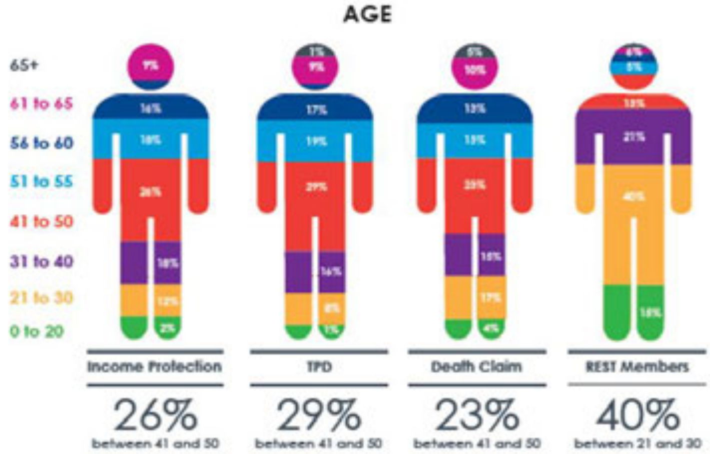




REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 **www.rest.com.au**

APPENDIX Three: A summary of REST insurance claims experience

Claims snapshot for REST Super as at October 2016



REST believes in the importance of insurance cover for younger members

- **40%** of REST members are between 21 and 30.
- **21%** of member who made a death claim are under age 30.
- **14%** of members who made an IP claim are under age 30.
- **9%** of members who made a TDP claim are under age 30.

REST Super I REST Select I REST Corporate
Phone: 02 9086 6330 Fax: 02 9299 4618 www.rest.com.au