



# First State Super - Submission

Superannuation: Alternative Default Models

Productivity Commission Draft Report, March 2017

28 April 2017



# 1. Introduction

As one of Australia's largest superannuation and retirement income funds, First State Super is a profit-for-members fund responsible for the accumulation and pension savings of 770,000 members, managing over \$80 billion in funds (including StatePlus). We aim to provide a better future for our members, the people whose lives are dedicated to helping others - nurses, teachers, emergency services workers and public servants. First State Super is committed to its member community and to the national interest as we believe both are intrinsically linked.

First State Super has been an active participant in the Productivity Commission's (the Commission) superannuation system review and welcomes the opportunity to continue this engagement. We commend the Commission on the Draft Report on Alternative Defaults (the Draft Report) which provides an overview of four possible alternatives against which to test the current system.

Our comments in this paper arise from our belief that many of the improvements sought by the Commission can be achieved by incremental change to the existing system.

## Executive Summary

The superannuation system has grown substantially in the past 25 years and generated sound returns to members since 1992. It has helped members' balances grow towards meaningful amounts which in the next decade will make a difference to members' retirement outcomes. The compulsory system has been protected by trustees' fiduciary obligations and supported by services provided to members and, with the introduction of MySuper, fees have reduced for default members, though this is not evident for all choice members.

In any review of the superannuation system, it is important that any recommendations retain and promote a financially sound and widely trusted superannuation system that will survive over decades for coming generations. We agree that policy makers and the industry need to design system settings to deliver for members, born in this millennium, who will retire in 2065 and later.

The Commission's Terms of Reference are focused on developing alternative default models, without reference to the current state. We acknowledge the important work completed to date by the study group in identifying possible alternatives. As practitioners, we believe it will be important to reference the current state of play; while there are some weaknesses in the system, there are also major initiatives to improve the system. Funds and their providers necessarily start from the "as-is", not with a blank sheet of paper. Accordingly, we look forward to the outcome of the Commission's analysis in Stage 3, which will provide an evidentiary basis with which to examine the current state and any alternative default models.

There are specific issues relating to group insurance through superannuation for members, such as emergency services workers, who would otherwise encounter difficulties in obtaining cover through retail underwriting. We regard insurance as being part of the core offering of superannuation, not merely a regulatory add-on. We refer the Commission to the industry wide project currently focusing on resolving insurance related issues.

We address the features and risks of the four alternative models developed by the Commission and provide a high-level assessment of the impact of each model on members. Our view in general is that each model raises concerns for members' best interests, and that these concerns are often greater than the problems identified in the current defaults approach.

In considering the impact of each of the alternatives, long-term investing approaches would be affected, as funds assess changes to expected cash flows, member demographics, and liquidity needs. We consider it likely that funds, including any future default funds would be more challenged in committing to major infrastructure

investments. We also consider it likely that default members' net retirement outcomes could be negatively affected by a greater focus on the four-year time frame.

The Commission has identified the need for a selection body to administer, variously, tenders, auctions or 'best fund' selections and the quality filters. Our view is that it has not been demonstrated that another statutory administrative commission or similar body is required to undertake four yearly reviews given the existence of the Fair Work Commission (FWC) which has a legislated basis for an Expert Panel and selection criteria to decide on defaults.

We note that the Commission's approach, based on a hypothetical baseline of no defaults has been used to compare the expected benefits and behaviours of each alternative default model. However, we are concerned that the baseline does not indicate which models are viable alternatives to the current system. We are particularly concerned that it is an insufficient framework for those faced with complex future planning and transition arrangements if a change to default settings were justified. These changes are likely to be both expensive and involve significant disruption and risks to members, employers and potentially the Government which could be faced with additional Age Pension, New Start and/or disability funding.

Since 2012, substantial upgrades have occurred through the introduction of Stronger Super and this work continues. While we note there are some weaknesses in the system, many of these are being addressed by incremental change. We think this is a lower risk approach.

## Overview of our submission

This paper responds to the Commission's Draft Report on Alternative Defaults, particularly referring to the existing system and structures, discussing the following:

- Strengths of superannuation, discussing the existing default system,
- Work in progress, noting there is much underway already to improve the system,
- Insurance within superannuation, noting the importance of group insurance and providing case studies,
- Proposed alternative models, merits or otherwise and impact on members,
- Institutional framework for defaults, and
- The Commission's approach.

## 2. Strengths of superannuation

As the Commission notes, in the past 25 years, equivalent to approximately half of a 40-50 year working life, the broad-based superannuation system of superannuation guarantee and defaults has grown to billions of dollars, with much of what is now categorised as choice commencing as default contributions. It is estimated that the system has generated a median nominal return of 7.1% since 1992<sup>1</sup>. It is an outstanding achievement of savings and investments in a period which included downturns such as the Asian currency crisis, the ‘tech wreck’ of the early 2000s, the second Iraq war, the GFC, and numerous terrorist attacks.

The coverage of people with superannuation is estimated by ASFA to be 84.3% for men and 80.1% for women (all age groups) and many people are retiring with a sum of money not previously achieved.<sup>2</sup> ASFA has been tracking average superannuation balances at retirement as shown in the following table.<sup>3</sup>

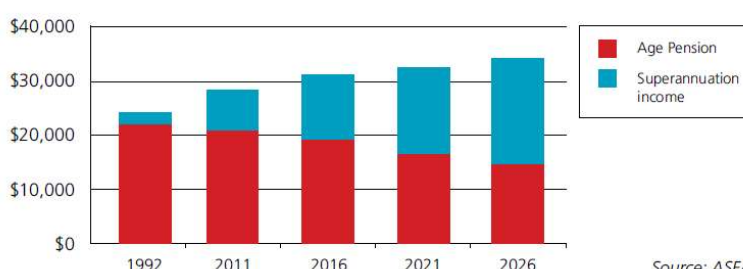
Retirees estimated average balance	Male	Female
2005-06	\$ 136,000	\$ 63,000
2011-12	\$ 197,000	\$ 105,000
2013-14	\$ 292,500	\$ 138,150

In its 2015-16 pre-Budget submission, ASFA also demonstrated relative reductions in Age Pension reliance, already visible to 2016, and forecast to continue for the next decade as shown in this graphic.

The existing default settings work well in many respects, delivering competition, strong long-term net returns, lower fees than other sectors, innovation and member services that support member financial literacy and engagement.

As a result of the increasing maturity of the compulsory superannuation system and individuals making voluntary contributions supported by tax concessions, average retirement incomes are projected to rise with less reliance on the Age Pension in both relative and absolute terms.

Average retirement income at Age Pension eligibility age (in today's dollars)



Source: ASFA.

### Fees in the default sector

We note the Commission's focus on fees for default products. The evidence suggests fees for default products have decreased significantly since the introduction of MySuper, although the same cannot be said for choice products. We comment on both default and choice products, as we note that a high proportion of members who leave our fund move to choice products offered by major retail funds as well as to SMSFs.

<sup>1</sup> Quoted in <http://www.smh.com.au/business/markets/the-sorry-state-of-returns-from-superannuation-funds-this-year-20160701-gpwk3e.html>

<sup>2</sup> "Despite the system not yet reaching full maturity, the cost to the Age Pension in the Federal Budget is already being substantially reduced by \$7 billion per year, with this amount growing as average retirement balances increase. In particular, an Australian's reliance on the full pension has fallen from 44 per cent in 2000 to 25 per cent in 2013, while self-funded retirees has risen from 22 per cent to 32 per cent over the same time period." from "Pre-Budget Submission", ASFA February 2016 p 3.

<sup>3</sup> ASFA, Superannuation account balances by age and gender, December 2015 using ABS Household Income and Wealth survey data

SuperRatings's analysis of fees of over 5,000 products and investment options for AIST in 2015 found significant fee reductions within MySuper products, but only small decreases in fees for choice products.<sup>4</sup> SuperRatings also found substantial differences between fees for MySuper and choice products. These differences existed even when the underlying asset allocations were almost identical. SuperRatings updated this research in 2017 and found fees are still materially lower for MySuper products.<sup>5</sup>

Hypothetically, introducing prescriptive fee caps for default products could potentially reduce fees for default members; however, experience suggests it cannot be assumed this will enliven competition or lead to fee reductions for choice products. Persistence of higher fees for choice products, even after lower fees for MySuper products, suggests regulatory review of fees and the drivers for switching behaviours are warranted in the choice sector.

### **Default members, compulsion and fiduciary duty**

In the public debate, default members are generally categorised as unaware and passive. Our experience is that this behaviour changes as members approach middle age; they often make additional contributions, whether by salary sacrifice or by non-concessional contributions, and may also make investment choices.

While we cannot categorically define this group, we are also aware of members who “choose” to accept their employers' default funds. Others retain multiple accounts to retain insurance benefits from prior employment.

Caution needs to be taken in assuming that default members are an entirely homogenous group or are disengaged for all their working lives. We are concerned that the alternative default models focus primarily on starting members, not on all member types, and that this may result in an unduly rigid system.

With a focus on members first, we support many workplaces and members with education, information and advice services to provide additional layers of help to our members throughout their working lives, in their approach to, and during retirement.

We note that as superannuation is a compulsory system there is a strong duty of care to default members, under the operation of trust law. Trustee directors have a very high level of fiduciary duty to members, and their obligations and responsibilities are stronger than those for directors of listed companies.

### **Member services**

Members display appetite for information about savings and managing money, whether in newsletters, blogs or videos, and respond well to additional information and advice services.

First State Super has always focused on providing a range of education and member services. While members may appear to be disengaged, we observe a high level of reliance on the information and support we provide. Each month, on average we experience:

- 100,000 unique website visits,
- 65,000 unique logins to member portal,
- 32,500 calls to the service centre (not including email correspondence), and
- Over 1,000 seminar attendees.

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<sup>4</sup> SuperRatings, *Fee and performance analysis*, AIST, 2015.

<sup>5</sup> SuperRatings, *Fee and performance analysis*, AIST, 2017.

We continually look for better understanding of our members' needs to refine our services. We observe that members who use our call centre and web-based services are likely to become more engaged with their superannuation. For example, approximately 20% of those who attend seminars request further advice.

Many funds provide high quality member services which have encouraged member engagement and savings behavior. Member services are valuable tools for funds to meet members' immediate needs for information, at a time which suits them, and provide a foundation to build increased member engagement and financial literacy over time. Large funds are well placed to perform this function and it is critical the default settings support this. These strengths suggest the current default system should not be dismantled and replaced unless there is a clear case that doing so will deliver greater benefits to members and the economy.

## Retirement incomes

The Draft Report observes that Australia has been slow to develop retirement income products. It is widely accepted that regulatory change is required to facilitate the development of more efficient retirement income products, and this is being addressed through a separate, parallel consultation process.<sup>6</sup>

The Draft Report contends there is limited scope initially for efficiency gains from bundling accumulation products and retirement income products within a single provider, arguing "The significant differences between the two phases is an argument for specialization by providers within each phase"<sup>7</sup>. Our experience does not support this contention, which shows that it is efficient for a single fund to provide members with both accumulation and retirement income products. First State Super has been successfully offering an account based pension since 2006; this product has grown to approximately \$7.5 billion (does not include StatePlus FUM). If it were a standalone fund it would be ranked in the Top 30 funds. Our members have taken up the account based pension both under advice and by self-selection; advice has been provided face-to-face, over the phone and through simple advice channels. Account based pensions are efficient, allow members to smooth consumption compared with lump sums, and while they do not explicitly address longevity, are a simple way to encourage members to adopt an income stream in retirement. We expect that, once existing regulatory obstacles have been removed, funds will innovate further in this area.

Most importantly, superannuation funds can assist members with education in the accumulation phase to adequately prepare for retirement, through seminars, benefit projections, calculators and the full advice spectrum. Funds build up trust with their members enabling a smoother passage to retirement. It is clearly efficient for a fund, acting under its fiduciary duty, to prepare its members for retirement in a manner familiar to the members and their interest in the fund. It is less efficient for many members to be required to learn about the product offerings of other funds for their retirement requirements, acknowledging that some members will wish to consider a wide range of potential service providers. We consider that the Commission should look at funds holistically, including both accumulation and retirement phases, rather than only considering the accumulation phase. It is the treatment of members in retirement that differentiates superannuation from other wealth creation vehicles.

## Innovation

We observe innovation in areas such as digital access for members being offered by larger funds, increases in interactive tools such as retirement income calculators and benefit projections across the superannuation

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<sup>6</sup> Department of Social Security, *Discussion Paper: Social security means testing of retirement income streams*, December 2016; Australian Government, *Development of the Framework for Comprehensive Income Products for Retirement*, December 2016.

<sup>7</sup> Draft Report, p 77.

industry. We also observe innovation in underlying investment strategies as fund investment teams search for value outside traditional listed markets.

Interest in product options and innovation appears to be driven more by advisers' requests than members. While a relatively small number of members choose an investment option, some make regular and apparently thoughtful and appropriate choices. We also note that some choices appear to be random (such as investing equal amounts in all 12 available investment options - which include four to five variously diversified options), which points to some of the pitfalls of choice.

### Life cycle products

We note that *Model 2: Assisted employer* model does not allow for life cycle products; it therefore appears that the Commission does not look favourably on lifecycle options in defaults.

First State Super offers a single life cycle step in its MySuper product, where members are moved from a 75% growth asset investment structure into a 55% growth asset structure at age 60. Members are contacted prior to this de-risking and given the choice to remain in the higher growth investment option. This may or may not be an optimal product design, but it is simple enough to allow comparison. As our default product it has potential for future refinement of the de-risking process.

As noted, almost a third of MySuper products now have life cycle products as their default option. Funds have taken different approaches to constructing and implementing life cycle products. The important policy matter is to facilitate transparency and comparison across different life cycle products, especially where they are extremely complex with up to 10 stages.

### Competition and performance

The largest 20 fund groups (RSEs grouped by parent company) received 76% of all employer contributions in 2014-15 and 72% in 2015-16. This includes SG contributions and salary sacrifice. The ten funds which receive the largest shares of employer contributions include four retail funds and six profit-for-members funds, demonstrating effective sectoral competition.

Analysis of APRA data presented to the Commission demonstrated that on average, default funds have consistently outperformed other funds over the short, medium and long term.<sup>8</sup> The data also demonstrate that profit-for-members funds have, as a class, on average outperformed for profit funds over the short, medium and long term.<sup>9</sup> Many factors contribute to this outperformance, including structures that do not require profits or shareholder dividends and therefore lower cost.

These strengths suggest the current default structure should not be dismantled and replaced unless there is a clear case that doing so will deliver greater benefits to members and the economy.

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<sup>8</sup> AIST, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, pp 14-18; ISA, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, Figure 1.

<sup>9</sup> AIST, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, pp 14-18; ISA, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, Figure 5.



### 3. Work in progress

We accept there is scope to further improve the efficiency of the superannuation system. This includes greater efforts to tackle the large number of small funds, multiple accounts, erosion of low balances and the level of unpaid Superannuation Guarantee contributions.

However, these issues can be resolved without dismantling and replacing existing default settings, which is likely to prove disruptive, particularly to employers, and entail costs and risks to members, Government and the economy. We note also that recent regulatory changes, such as Super Match, increased transaction reporting to the ATO, transfers of Accrued Default Amounts, and fees disclosure have either not been fully implemented or not been in place long enough to take full effect.

#### Fund consolidation

The matter of too many smaller funds is a longer-term issue, which increases costs to the system, and ultimately disadvantages members in funds in serious decline. While the number of funds has dropped by approximately 50% in the past decade, Rice Warner estimates some 90 funds have under \$2 billion in assets, which they regard as a threshold for economic viability.<sup>10</sup> The loss of default status may have the unintended consequence of more funds experiencing net outflows and becoming less economically viable. There are likely to be adverse impacts on members as funds attempt to manage liquidity.

Merging funds or closing funds is a lengthy and difficult process which requires, above all other considerations, acting in the best interests of the members. We expect that mergers will continue to occur over the coming decade, noting that merging funds are required to ensure equivalence of benefits for members. This principle will also apply if a larger healthy fund is required to ‘mop up’ an under-performing fund - it may not be in the interests of the members of the larger fund to absorb members of a significantly challenged fund.

Regardless of the mechanism chosen to encourage fund mergers, there is a risk of fund failures and stranded members if measures are either too hasty or too draconian. While it is tempting to force fund closures, there is a risk that starving small or failing funds of cash flow could lead to poor outcomes for their members.

#### Proposed framework for mergers

One area of focus for the Commission is the need for mergers and acquisitions to inject further competition into the default system.<sup>11</sup> We support this contention.

The Draft Report proposes to facilitate mergers by introducing a formal framework that specifies the process and obligations of trustees when making or considering merger proposals. Under the framework, trustees would be required to disclose all merger attempts involving their fund, as well as the reasons for all decisions.<sup>12</sup>

Care is needed in the design of the proposed disclosure framework to ensure that the industry has clarity about exactly when disclosure obligations would be triggered. Merger discussions are sensitive and difficult processes. Unless well designed, such a framework could have the unintended consequence of discouraging soft approaches and informal discussions between funds. We suggest that a merger framework should allow funds to arrive at a formal proposal, heads of agreement letter, or similar agreement, before being required to disclose the merger discussions. Without this, funds may be charged with non-disclosure on the flimsiest of discussions. While we acknowledge that there may be benefits arising from members being able to scrutinise a merger process, we are

<sup>10</sup> Rice Warner, <http://ricewarner.com/why-we-need-super-fund-mergers/> Insights Blog, 6 April 2017.

<sup>11</sup> Draft Report, p 88.

<sup>12</sup> Draft Report, Draft Recommendation 3.3, p 90.



of the view that discussions towards fund consolidation should be allowed to explore common ground, culture, appropriate mix of members, financial considerations and timing before being publicised. Our experience has been that these discussions can take six to 12 months, sometimes longer. We are happy to discuss this further with the Commission and explore alternative approaches.

Other existing levers could be used to encourage mergers and acquisitions. The tightening of quality criteria for MySuper products to qualify for defaults (such as the legislated FWC quality filters) could be an alternative way to encourage mergers. The requirements could include fees, indirect cost ratio, net returns, scale, services to members, or mandating not-for-profit status. An advantage of this approach is that it could be implemented within the existing regulatory framework, using APRA's MySuper authorisation powers with some legislative change. This would be quicker, simpler and less disruptive than redesigning the entire default system. We note there are parallels between this approach and elements of the product accreditation process proposed for the Assisted Employee Choice model, which builds on the existing MySuper authorisation framework.<sup>13</sup>

### **Consolidation of accounts and unpaid SG**

The number of superannuation accounts has declined from a high of 33 million in 2010 to approximately 28 million.<sup>14</sup> The ATO estimates that at 30 June 2016, over 14.8 million Australians had a super fund account, with some 43% of these having more than one super account.<sup>15</sup> Consolidation of accounts can be sped up with the active help of the ATO's Super Match to identify multiple and lost super accounts, so members can consolidate their accounts. We understand the ATO has the capability to combine lost accounts and to nudge members to consolidate but is limited by privacy requirements. The MyGov website shows members their accounts, but this passive service relies on members taking the initiative, even to access the MyGov site. Matching and merging accounts by the ATO should have the benefit of mitigating the impact of insurance premia on low balance accounts, at the risk of unintended lost insurance cover if accounts are merged without information or advice.

The extent of failure by employers to pay SG, and the impact of SG non-compliance is under scrutiny with the Senate Economics References Committee undertaking a review of SG non-payment. Citing research presented by ANZ suggesting that about 2% of people are not aware that their employer is required to pay SG, the Draft Report notes that employers of such employees may fall short of their SG requirements, and flags that Stage 3 of the Commission's work will examine the level of unpaid superannuation.<sup>16</sup>

The ATO has primary responsibility for SG compliance and could take a more active role monitoring and pursuing unpaid SG. Potential improvements include timely, accurate measurement and reporting of unpaid SG, better use of technology to cross-match SG contributions to wage earners to identify non-compliance, identification of employees affected and employers likely to underpay SG. This would lead to targeted compliance activity. While some funds monitor and follow up employers for unpaid SG, funds do not have complete visibility of employment and the ATO is best positioned to monitor employers and employees' SG.

### **Incremental improvements**

These enhancements could be implemented without dismantling and replacing the existing default settings. We urge the Commission to undertake a rigorous cost-benefit analysis, and consider whether there are other, less costly and risky ways to address these issues, as part of Stage 3 of the Review.

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<sup>13</sup> Draft Report, Table 5.3, p 128.

<sup>14</sup> APRA Annual Superannuation Bulletin, June 2016

<sup>15</sup> ATO, "Super accounts held by each Australian", <https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/super-accounts-data/super-accounts-data-overview/>

<sup>16</sup> Draft Report, pp 101-102.

### 3. Insurance within superannuation

The Commission has expressed its view that it is self-evident that the Government's stated objective for the superannuation system does not envisage insurance as an essential element of the system.<sup>17</sup> Insurance would not be a factor in the selection of default products under any of the alternative models the Commission has proposed.

First State Super has serious concerns with this view and the proposed exclusion of insurance from consideration in default fund selection. We think this is a provocatively narrow interpretation of the objective and that it may be an attempt to overly simplify a complex proposition.

Leaving insurance as a regulatory add-on does not adequately recognise the reduced capacity of a trustee to provide insurance when workplace defaults are removed, because it will be more difficult to sustain tailored insurance for specific groups of employees / members, especially in a model where new members are allocated sequentially to default funds.

If group insurance is undermined, the likely alternatives are that either people will purchase insurance from the retail market or have no insurance. The first is not realistic, the second is unacceptable due to increased cost to Government in welfare expenditure. We estimate the annual value of *disability* benefits paid through superannuation could be approximately \$3.2 billion in 2016 and \$3.8 billion in 2017, extrapolating from 2014 superannuation related insurance revenues for \$3 billion for insurers and allowing for 20% profit margins.<sup>18</sup> According to APRA, approximately \$5.2 billion was paid in *total* insurance benefits for 2015-16.<sup>19</sup>

#### Value of group insurance

The purpose of insurance is to provide income where a worker leaves the workforce early, due to permanent incapacity or death. This is consistent with the proposed objective of superannuation. Group insurance in superannuation has significant benefits for members, funds, insurers, Government and the community as a whole.

Group insurance is a cost-effective wholesale offering; the pooling of lives under a group policy allows insurers to more effectively price risk, which means members typically pay less for cover under a group policy than they would in the retail insurance market. Retail insurance is necessarily more expensive as each individual policy is marketed, sold and administered on an individual rather than a group basis.

Current default arrangements also play a critical role in addressing underinsurance. Approximately 70% of all life and total and permanent disability (TPD) policies written in Australia are provided through group cover.<sup>20</sup> It appears that under at least three of the alternative models, new members would be allocated to funds without insurance, without employer affiliation. In these models, groups such as emergency service members would be materially disadvantaged as they would not qualify for private insurance or it would be prohibitively expensive.

There are significant variations in risks for different occupations. This is borne out by workers' compensation statistics.<sup>21</sup> The ability to source occupation-specific group insurance delivers significant benefits to members in high risk occupations including many members of First State Super which pays approximately 250 death claims every year, and has paid \$143 million in death claim benefits in the five years to June 2016. The Police

<sup>17</sup> Draft Report, p 81.

<sup>18</sup> First State Super estimates, based on revenues quoted in "Wholesale Insurance Market 2014", Rice Warner, p 25.

<sup>19</sup> APRA, Annual Statistics

<sup>20</sup> ISA, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, p 38.

<sup>21</sup> ISA, *Submission to Productivity Commission Issues Paper: Alternative Default Models*, 28 October 2016, Table 6.

Federation of Australia noted in its submission to the Issues Paper for the Review that it is extremely difficult for police officers to find individual TPD and income protection insurance outside of the existing public sector funds, due to the dangerous nature of police work.<sup>22</sup> We note the Draft Report does not acknowledge or respond to this issue.

Payout ratios are higher under group insurance policies compared with individual combined life, disability and income protection insurance policies.<sup>23</sup>

## Case studies of benefits of members' insurance

The following case studies from the fund illustrate the real value of group insurance to members.

### Case Study A - Anthony\*, aged 41

Anthony is an emergency service worker earning \$100,000. His income supports his young family. At age 41, he left employment early due to post traumatic stress disorder and depression caused by his employment, and has not been able to work again.

Anthony is a member of First State Super and was covered by a group insurance policy in place due to the existing default settings. When he involuntarily retired, his superannuation balance was just over \$160,000. Anthony claimed on his TPD insurance and received a payout of almost \$200,000. He also received a lump sum compensation payment, regular workers' compensation payments, and payments under an income protection insurance policy (this will cease in 5 years).

On advice from First State Super, Anthony used a proportion of his lump sum compensation, superannuation, and TPD insurance payout to establish an income stream. He also reserved \$170,000 in his First State Super account, to continue to grow until he reaches preservation age.

The income stream, combined with workers' compensation payments and payments under his income protection insurance policy provides him with an income equivalent to his former salary, allowing him to continue to provide for his family, and continue to service the mortgage on the family home. After five years, Anthony will no longer receive income protection insurance payments which will reduce his income. Once he reaches preservation age, he will be able to draw on his superannuation balance to provide a tax-free income stream.

*Without the support of the group insurance policy (TPD of \$200,000), Anthony would have been largely reliant on Social Security.*

\* Names have been changed

<sup>22</sup> Police Federation of Australia, Submission to Issues Paper: Alternative Default Models, 28 October 2016.

<sup>23</sup> ISA, Submission to Productivity Commission Issues Paper: Alternative Default Models, 28 October 2016, Figure 7.

**Case Study B - Besa\*, aged 51**

Besa worked as an education and training professional. She is separated from her partner and has two children, one of whom is a financial dependant. Recently, she has left employment early due to injury. As a member of First State Super, Besa has default insurance cover for TPD. First State Super assisted Besa to make a claim on her TPD policy which was accepted.

The insurance benefit will help Besa meet her and her dependant child's living expenses until she reaches preservation age. Because of this, Besa will not need to access her superannuation early and all her super can be used to provide an income in retirement.

When Besa reaches preservation age she plans to start a tax-free income stream. If she had withdrawn her superannuation under compassionate grounds, Besa would have to pay tax on her benefit.

*The TPD policy has provided income, preserved superannuation savings and means she is not reliant on the public purse.*

\*Names have been changed

We are concerned that removing group cover could be very costly to Government. We encourage the Commission to undertake a rigorous cost benefit analysis on the impact of removing default insurance from superannuation on Government expenditure on welfare, before making recommendations about this in Stage 3 of its Review.

## Current developments

Group insurance is an area of focus for regulators, Government and industry. The superannuation industry has formed the Insurance in Superannuation Working Group (ISWG) to drive improvements in product design and claims handling. The ISWG has identified the following priorities:

- The impact of premiums on account balances, particularly for younger members
- Multiple default insurance policies
- Claims handling
- Member communications about insurance

The ISWG will develop standards for trustees and insurers that will set out how the industry will provide insurance that meets the needs of members and the community. The standards will be set out in a binding, enforceable code of practice which will be in place before the end of 2017.<sup>24</sup>

Retail and profit-for-member superannuation funds, insurers, consumer representatives, and retail and not-for-profit industry bodies are represented on the ISWG. First State Super is contributing to this important process.

<sup>24</sup> AIST, ASFA, FSC, IFF, ISA, Joint Media Release: Insurance in Superannuation Working Group, 2 November 2016.

## 4. Proposed alternative models

This section examines the merits, or otherwise, of the proposed alternative models. We note our concerns about the constraints on investing for the long term on page 16, especially in the context of a limited number of successful default funds.

### Model 1: Assisted employee choice model (4 to 10 funds)

This model would require employees to choose a fund themselves. Employees would be able (but not required) to choose from a shortlist comprising 4 to 10 products, selected by an independent government agency using a heavy administrative filter.

Features	Risks
This model reflects insights from behavioural finance and uses nudges to encourage members to choose from a short list of good funds.	<p>The model relies on giving people simple, standardised disclosure to inform their choice; however, disclosure has proved to be very limited in overcoming cognitive constraints and behavioural biases.</p> <p>ASIC's submission to the Issues Paper for this Review warns that relying heavily on disclosure documents and product dashboards to inform and protect consumers must be approached with caution.</p> <p>The Commission's research about how people make choices, depending on the length of a shortlist and standardised disclosure, will provide insight into how people behave, but not into whether people can choose a good quality superannuation product.</p>
The model would address problems with multiple accounts (but this can be done without the disruption, risks and costs of implementing this model).	<p>The attractiveness of funds with strong brands could be amplified by the short list, potentially intensifying rather than dampening marketing expenditure by non-default funds. The Commission notes marketing can be an inefficient form of competition.</p> <p>This model effectively excludes corporate funds (as do Models 3 and 4).</p>
	This model is vulnerable to funds and related parties offering employees short-term incentives to join the fund. This could take the form of consumer goods such as iPads, or services that are unrelated to superannuation, such as discounts on banking services or cash vouchers. The existing regulatory framework does not prohibit this.
It includes a last resort fund for people who do not choose a fund. This recognises the decision to choose a fund is different from the decision to choose between funds.	The Commission considers using the Future Fund as a temporary home for members who do not choose a fund. The Future Fund is solely an investment vehicle; it has no registry, account keeping, unit pricing, or taxation systems or procedures. Eligible Rollover Funds have the capability, but offer very low returns,

Features	Risks
	<p>as does the ATO (which can keep records, but does not have a registry for account keeping).</p> <p>There may be potential for members to see their superannuation savings guaranteed by the Government if they were held in the Future Fund.</p> <p>We note that Eligible Rollover Funds do not generally provide strong returns to members, and that these products have become largely redundant.</p>

### Impact on members' best interests

This model places a high decision-making hurdle on the youngest, least financially savvy and most vulnerable group in the workforce. We anticipate they will be targeted by many institutions to establish accounts before they even commence work. Our view is that they will be susceptible to misleading marketing, including from non-default funds, and that despite the intention to encourage only one account per member, they are still likely to end up with more than one account.

### Model 2: Assisted employer choice model (number of funds not explicit)

For small to medium sized employers, a heavy filter would define a '*preferred defaults list*' of no frill products meeting strict criteria, including higher performance benchmarks. The 'preferred list' would not be capped but could have a minimum number of funds to 'ensure meaningful competition'. For larger employers, a light filter, stronger than MySuper authorisation, would define a '*mandatory minimum standards list*' from which employers must select (including by corporate tender).

Features	Risks
<p>This model is similar to the current model, potentially less risky and less disruptive at introduction.</p> <p>Larger employers, particularly those which focus on retention of valued employees, are often happy with existing arrangements and do not wish to change defaults. There may be additional contributions or insurance benefits in agreements which are not easily replicated.</p> <p>This model will accommodate corporate funds and those employers who choose to select a suitable fund. Employers in the industrial relations system rely on a default fund/s selected by FWC.</p>	<p>Some employers may not choose a fund in the best interests of their employees, arising from principal-agent issues. The Commission concludes that this risk is 'residual'.<sup>25</sup> We consider that further analysis of this risk would be beneficial, especially in relation to inducements for employers, whether actual or 'soft dollar' benefits.</p> <p>While many employers may approach the task of default fund selection intending to choose a fund that best meets their employees' needs, not all employers are capable of this. As ASIC's submission to the Issues Paper for this Review notes, cognitive constraints and behavioural biases affect everyone, including employers.</p>

<sup>25</sup> Draft Report, p 197.

Features	Risks
The Commission notes employers may use corporate tenders to choose products. <sup>26</sup>	Tenders are expensive, the quality of tender processes is not consistent, tenders can be too fee-focused, at the expense of considering long-term net benefits to members, and there are problems with conflicts of interest.
<p>Many employers will choose a good quality fund for their employees.</p> <p>The model as described does not prescribe a set number of funds, allowing for an unspecified minimum to ensure competition.</p>	<p>Employers are not fiduciaries; the current regulatory framework does not impose any accountability on employers for their choice of default fund.</p> <p>Some employers will intentionally choose a default fund to further their own interests, rather than those of their employees. There are suggestions that some organisations may be offering employers incentives to do this.</p> <p>The Draft Report notes there are existing legislative provisions designed to prevent this practice. However, ASIC, which is responsible for administering these laws, has highlighted to the Senate Economics Legislation Committee that there are significant gaps in these provisions which undermine their effectiveness.</p>

### Impact on members' best interests

In this model, the employer is responsible for selecting from panels of suitable funds, and can choose to select other funds if they have special requirements.

While there are similarities to the current approach, there is greater reliance on the goodwill and knowledge of employers to select suitable offerings for their employees. There are many employers who ensure their employees have reasonable insurance cover and select well governed high-performing funds; equally, there are indiscriminating employers who will seek out funds where they may gain an additional business advantage.

The concern for members in this model is that employers do not have a fiduciary responsibility for their employees, and their decision making may be influenced by factors other than the employees' financial best interests, including their insurance needs.

### Model 3: Multi-criteria tender model (5-10 funds)

In this model, funds that met minimum pre-qualification requirements relating to governance and transparency would submit tenders against multiple criteria, including past performance on net returns and member satisfaction, investment strategy, quality of member services, engagement and intrafund advice, fees and innovation.

The results of member satisfaction surveys and long-term net returns would be weighted higher than the other criteria.

<sup>26</sup> Draft Report, p 195.



Features	Risks
<p>This model considers multiple criteria, including minimum levels and quality of member services. This would enable funds to continue building member engagement and encourage savings behaviour.</p> <p>It considers similar criteria to the FWC's legislated criteria for fund selection.</p>	<p>Many of the proposed criteria cannot be measured objectively. The body responsible for selecting default funds will be required to make subjective judgements, which may prove incorrect.</p> <p>This model is likely to see additional costs of running and responding to the tender process. We are also likely to see the rise of tender consultants and lobbyists.</p> <p>Consequently, there is a risk of skewing the focus of funds to actions that help win tenders rather than the best interests of existing members, potentially disregarding the needs of retired members or other groups with unique needs (see earlier comments on insurance).</p>
<p>Many funds, including First State Super, track member satisfaction for internal purposes.</p> <p>Satisfaction surveys are valuable tools for internal feedback, service monitoring and service improvement.</p>	<p>The proposed criteria include member satisfaction, measured using surveys, relying on self-report, not measured outcomes. This approach presumes that funds with higher member satisfaction are providing better benefits to members.</p> <p>However, members are often not competent at assessing the value of a financial service. ASIC has previously found that 86% of the participants in their shadow shopping of retirement advice felt that they had received good quality advice, although only 3% of the advice was considered good quality under ASIC's analysis.</p> <p>In practice, experience with defining member satisfaction within superannuation, and developing techniques and metrics to measure this has proven to be very difficult.</p> <p>While the industry uses several satisfaction metrics, there is no reliable satisfaction metric that is accepted across the industry. This is acknowledged by research houses and ratings agencies.</p> <p>Current metrics and methodologies are not reliable or objective enough to make comparisons across funds.</p>

### Impact on members' best interests

In this model, there are also similarities to the current approach. The selected default funds are likely to meet quality criteria, however, there is no certainty that the insurance needs of specific member groups will be met. Our concerns about certainty for long-term investing apply to this model with its limited number of successful default funds.

Again, with the limited number of default funds envisaged, it is highly likely that members' insurance needs will not be met, especially if they are in hard-to-insure groups which face much higher priced retail underwriting.

## Model 4: Fee-based auction model (1-5 funds)

Under this model, funds that met minimum standards relating to fund integrity and capacity to handle member flows would compete for default status by winning a fee-based auction. The auction could produce a single winner or multiple winners. If multiple funds were successful, default members would be allocated to the funds on a sequential basis.

Features	Risks
The expectation is that fees would come down for the winning default providers (only) in the first few iterations.	This model could result in funds shifting to lower cost investments at the expense of returns; it is likely to result in shorter term investment focus.
	This model risks funds committing to unsustainable fee models for a minimum of four years, for all default members.
	Funds may raise other fees and neglect non-fee earning areas of performance. This includes the risk that member services such call centres, online resources and intrafund advice will be neglected. This will undermine the ability of funds to foster member engagement through the provision of these services.
	There is potential for a long run challenge to the health of the superannuation industry. This model could give rise to a small number of large, low cost, but potentially not otherwise effective funds, providing insufficient services to members.  Alternatively, as has occurred in Chile, we may see funds choosing not to compete for default status because it is not economically viable to do so.
	Potential for competitors in this model to operate under a cloak of secrecy to protect commercial interests, means that it would be hard to have confidence that the auction result was in the best interests of members.

### Impact on members' best interests

In this model, the outcome over a number of auction cycles will be a 'race to the bottom' which will reduce fees, and is likely to reduce the quality of the offering to members. The selected default funds are likely to reduce insurance cover, and may adopt a very low cost, index-based or passive investment strategy with limited allocation to growth assets, potentially resulting in shortfalls in members' long-term retirement outcomes. Our concerns about certainty for long term investing apply to this model with its limited number of successful default funds.

There may be equity and fairness issues for all members allocated to default funds which are later not successful in retaining default status, or for members who remain in current legacy products. Long-term net benefits may

be affected by either fees or returns; while this is a feature of the current environment, equity amongst members is desirable. This model is more likely to display this outcome than others.

Again, with the limited number of (rotating) default funds envisaged, it is highly likely that members' insurance needs will not be met, especially if they are in hard-to-insure groups which face much higher priced retail underwriting.

## Impact of alternative defaults on investment approaches

### Investments based on fund membership

As noted in discussing the fees auction model, investment approaches will be tailored to suit the environment for member defaults. The current settings provide some certainty for modelling the future profile of the fund, its membership - including age, gender and occupation - and matching investments to those requirements.

Successful investment in infrastructure, unlisted and alternative assets in the past 25 years has relied to some degree on expected member cohorts, likely retirement ages, and expected fund flows of existing and new members (net rollovers, contributions etc). This feeds into the selection of investment philosophy and assets: a level of certainty of timeframe and liquidity contributes to determining the most suitable types of assets. Also, as a fund's demographics change over time, the asset mix and investment strategies will adjust to suit requirements. For example, investment approaches for retirees are likely to be more weighted to income producing assets.

### Long term investing and performance

In a very low cost environment, with a four-year time horizon (until the next review or auction), there is a strong probability that competing funds will opt for low cost, largely passive or index investing. If reduced fund inflows were to be predicted, funds could require greater liquidity accompanied by de-risking in portfolio construction. We could see a reduction in infrastructure or nation building assets; these are large and lumpy assets, not available as low cost index options, and, while all assets and investments are subject to periodic review for performance and suitability, without a longer time frame, infrastructure investments may be less attractive. In this environment, we may see reduced long-term performance for default members, and, potentially, reduced contribution by the superannuation sector to investment in nation building assets.

### Future investment performance

Net returns to members are a key measure of performance of both funds and the system. Having said that, long-term performance can be hampered by excessive focus on short-term returns, for which there is potential in any of the proposed default models. By definition, performance league tables have top 10, median and bottom 10 performers and funds' returns can vary according to investment bias and cycle.

Long-term investment requires deep analysis and commitment to investment themes; while performance of assets requires constant review, funds should be able to demonstrate that their investment approach *is likely* to achieve consistently reliable returns at an acceptable level of risk for members. All asset classes have long-run cycles which are difficult to predict. There are no guarantees with investing, and a fixed focus on net returns may exacerbate short-term thinking.

## 5. Institutional framework for defaults

### Selection body

Our view is that it has not been demonstrated that another statutory administrative tribunal or commission is required to undertake four yearly reviews, given the existence of the Fair Work Commission, which already has a legislated basis for an Expert Panel and selection criteria, to decide on defaults in modern awards. Without appointees, the Expert Panel has not been able to demonstrate how well it could work under the Fair Work Act and meet the needs of both employers and employees.

The Commission's work in Stage 3 must be able to demonstrate that the current system of default funds is not in the best interests of employees before it recommends significant changes.

The Commission's proposed institutional arrangements for default fund selection include a temporary body with the skills and expertise to select default funds applying appropriate criteria, that is independent of Government, to avoid problems with actual or perceived political interference. The existing institutional settings for selecting default funds meet these requirements.

The Commission's alternative models all propose dismantling the current settings and establishing a new body to be overseen by and accountable to the Federal Government. It notes that this would place some of the responsibility for the outcomes on the Government. In our view, this responsibility is appropriate given the compulsory nature of the superannuation system, and because the Federal Government is responsible for designing the default settings.

Our view is that if a new body is required, it should be a **permanent** body with the structure and standing of a tribunal or commission is required, and it should have the following characteristics:

- Established by statute with specific powers and duties, and legislated criteria for judging alternative default funds,
- Members appointed by the Government, who are required to act independently and in the best interests of employees,
- Headed by a President appointed for an ongoing period (up to either age 65 as for the FWC, or to age 70 as for Federal Court judges), and
- Take evidence and hold public hearings, publishing reasons for its decisions to ensure transparency.

The Commission proposes the members of the body should be accountable to the Minister. This may politicise the process, or increase the perception of politicisation, which would reduce confidence in the body and the outcome of the process. The Commission proposes the selection body should be established specifically for the selection process, and then cease operations once the process is complete - it would have no ongoing role. This undermines the accountability of the body and would add to concerns about the politicisation of appointments to the selection body.

These concerns can only be addressed by establishing a permanent independent body, preferably a tribunal or commission, and appointing members to it on a long-term basis. We submit that there is scope for an impartial, expert superannuation body to perform additional functions which complement the selection of default funds, such as:

- Assessing the compatibility of proposed future superannuation policy changes against the Government's stated objective for the superannuation system,

- Making recommendations for improvements to the superannuation system,
- Accommodating the Superannuation Complaints Tribunal as a companion organisation, for the purposes of expertise, secretariat and funding,
- Producing regular reports on the efficiency, performance and sustainability of the entire system, in conjunction with APRA and ATO, and
- If any of the alternative models proceed, provide the ongoing monitoring and enforcement functions contemplated by the Commission.

Such a body could potentially take over the ATO's role in following up non-payment or underpayment of SGC contributions and require the payment of the same (with interest) into the superannuation accounts of employees, similar to the powers of the Fair Work Ombudsman in relation to the underpayment of wages, and prosecute employers. This could be on its own motion, on receiving reconciliations from the ATO, on the basis of complaints by employees, or at the request of super funds.

## Expanded roles of ATO

Under the current system, the ATO performs multiple roles including:

- Collecting contributions tax, income and capital gains tax from funds,
- Collecting small and lost superannuation accounts,
- Recovering unpaid SG and consolidating accounts on behalf of members,
- Providing services to employers and funds in the form of SuperStream, SuperMatch, SuperTick, Small Business Superannuation Clearing House, and other related services which are now core to superannuation system processes, and
- Regulating self-managed superannuation funds.

This is a significant remit and it is not clear whether the ATO has the capacity or will be granted the resources to deliver on all these responsibilities. We have noted the ATO's poor record of pursuing and recovering unpaid SG earlier in the paper. In December 2016 and February 2017, the ATO experienced system outages due to failures in storage hardware that impacted all ATO systems, including superannuation enabling services. The first outage lasted for 11 days. The outages caused delays in the time superannuation funds take to process payments that rely on ATO services, such as account consolidation requests, rollovers and departing Australia payments. A PwC review and an internal ATO inquiry are examining the causes, impacts and consequences of the outages. What is clear is that increasing reliance on the ATO has increased interconnectivity in the superannuation system, and a consequent increase in systemic risks.

The Draft Report contemplates expanding the remit of the ATO further still, to deliver a centralised clearing house service to enable employers to identify which employees do not already have an existing account, and facilitate account consolidation. The Commission intends to explore this further in Stage 3 of the Review.

It is not clear how the proposed ATO clearing house differs from the existing Superannuation Transaction Network established by the industry with the ATO as part of the Stronger Super reforms. Oversight of the Network was recently transferred from the ATO to a not-for-profit, industry sponsored Gateway Network Governance Body. We look forward to further clarification of this proposed clearing house in Stage 3 of the Review; our preliminary understanding is the central clearing house is merely an expanded version of the Small Business Superannuation Clearing House, which has limited capacity and capability, and which will fundamentally remain as a switching mechanism, not as an administration hub.

Expanding the role of the ATO in this way would involve numerous risks, including:

- Concentrating more functions in the hands of the regulator,
- The ATO's capabilities and resources not growing in step with its additional responsibilities,
- The resulting risk that funding for the ATO's core services could be adversely impacted by the pressure to deliver additional functions, and
- Potential for industry levies for additional functions to be set inappropriately in the absence of a competitor or alternate provider.

We think there is already significant potential for conflicts of regulation and service provision in the ATO's remit. If the ATO runs a centralised administrative hub or clearing house, and it potentially becomes part of a solution if members do not choose a fund, it could also become a competitor in the superannuation system. This is clearly not a desirable outcome.

## 6. Commission's approach

This section examines the Commission's approach and issues raised by the Commission as worth discussion which go to the core of the reform process and consider the methodology and the speed of change.

### Baseline

We understand that the Commission has used a hypothetical baseline of no defaults and unassisted employee choice to help compare the proposed alternative default models. However, it is important to recognise that:

- The baseline provides no indication of whether the proposed models are viable alternatives to the current system, and
- It is an insufficient framework for the industry and regulators, those faced with complex future planning and transition arrangements, in the event a change to the current default settings were found to be justified.

The Commission states that the “assessment of the baseline helps identify possible market failures and indicates the problems to be addressed through government intervention in alternative default models”<sup>27</sup>. This means the nature of the baseline does to some degree become ‘baked into’ the alternative models and understandings of their viability. Because the alternatives logically emerge out of the baseline, at least conceptually, when assessment of the current system is undertaken and problems in the current system are identified (already started to some degree in the Draft Report) the alternative models may not adequately or effectively address these problems or point to appropriate policy interventions.

### First timer pool

First State Super notes the Commission's decision to confine the proposed new default model to a first timer pool. This is intended to tackle multiple accounts with minimal disruption.

We are concerned that such a move undermines the workplace nature of superannuation, which has underpinned the superannuation system until now. This deserves more serious consideration by the Commission in the development of the Final Report.

Contributing employers to our fund have expressed to us that having a single default fund has many benefits including efficiencies in addressing issues and providing support, providing workplace education and advice, other intangible benefits related to cohesive workplaces and tailored insurance. On insurance, we are concerned the risk that such an approach poses for employees moving into an occupation and workplace where the benefits of group insurance present a case for having an effective nudge such as default fund with tailored insurance. More broadly, while larger employers may still be able to negotiate valuable insurance cover for their employees, small employers or individuals may not have the resources to access and benefit from group insurance within superannuation. This concern is greatest in relation to high risk employment groups, such as emergency services, for which insurance is difficult to obtain.

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<sup>27</sup> Draft Report, p 96.



## Importance of default settings

While acknowledging the historical importance of default settings, the Draft Report makes the case that as the system matures, there is less need for defaults. The Commission contends the system has matured over the last quarter century as more employees and employers become familiar with the concept of superannuation, people change jobs more frequently, more members grow older and approach retirement, and funds build expertise in interacting with members and attracting new members.<sup>28</sup>

However, the fact that the system has existed for 25 years is not a proxy for maturity. Maturity implies a reasonable level of member engagement, a significant proportion of members who have had the benefit of the system and full superannuation contributions for their entire working lives. None of these conditions yet exists.

According to the Commission, about two thirds of members rely on current default settings.<sup>29</sup> Switching rates have been persistently low since choice of fund was introduced in 2005. Most recent estimates are that only 7% of members switched super funds in the past year, the lowest switching rate since June 2010.<sup>30</sup>

This system-level data is consistent with our experience, with our fund level data suggesting that the cumulative rate of choice is 13% of super members. We note again that some members report through surveys or discussions that they are ‘actively default’ (i.e. have chosen to stay in the default, or are happy to be in the default), although we are unable to provide specific statistics on this.

Nudges can improve savings behaviour, but cannot overcome the fundamental problem that defaults seek to address; that many members, especially young employees entering the workforce, are challenged by making long-term, complex financial decisions such as choosing a super fund. System maturity will not overcome this problem and our view is that default settings will be required for the foreseeable future.

## Transition processes

Dismantling the existing default system, and implementing a new system would involve significant disruption, costs and risks, which should not be underestimated. We therefore suggest that the Commission should recommend a prudent, lower risk and staged approach, and assesses feasibility of any proposed changes, should it find that changes to the current defaults systems are warranted.

The Commission’s work in Stage 3 should clearly identify evidence for the need for change, that the best interests of members are served in any proposed changes, and that if a transition process is required, the Commission should identify risks and downside for members and the entire system. It should not be assumed there will be only upside in this process.

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<sup>28</sup> Draft Report, p 42.

<sup>29</sup> Draft Report, p 49.

<sup>30</sup> Investment Trends 2016 Member Sentiment & Communications Report, based on a survey of 20,654 super fund members

## 7. Conclusion

We thank the Commission for the opportunity to comment on the four alternative default models and acknowledge the thoughtful analysis that has gone into developing these scenarios.

As outlined in this paper, we approach the subject of proposed changes to the current default system in superannuation as practitioners who are very aware of how challenging and costly change can be in a complex environment, whether the change is driven by regulation or Federal Budget changes, system wide changes such as MySuper and SuperStream, or by fund mergers (which alone are time and energy consuming). The four alternative default models all represent major changes for the Australian superannuation system, at least on the scale of MySuper and SuperStream. If implemented, there are likely to be unintended consequences and downstream ramifications for members, particularly if some funds are pushed into a decline more rapidly than indicated by their current trajectory, or if default funds take a more conservative approach to investing, driven by competition based primarily on lowering fees.

In the Stage 3 assessment of system efficiency and competition, we encourage the Commission to consider the transition framework which may be necessary to minimize the risks and potential disruption of any proposed changes.

Our view is that many of the identified systemic shortcomings can be, and are being, addressed by incremental change, the major initiatives and review processes which are already in place. We think this is a lower risk to the system.

In addition, we maintain that group insurance (for death and disability offerings) must be included in MySuper products eligible for default status. The absence of group insurance in default superannuation risks many employees lacking insurance cover, raising consequent risks to the Government, which could be faced with additional Age Pension, New Start and/or disability funding.

We believe there are significant benefits in the current superannuation system, including the default setting processes, and that assessment of Stage 3 should preface any decisions as to future default structures.