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Deputy Chair Karen Chester
Commissioner Angela MacCrae
Productivity Commission

Dear Deputy Chair and Commissioner,

Draft Report – Superannuation: Assessing Efficiency and Competitiveness

We write to supplement our submission dated 13 July 2018 concerning the nature of employment trends and auto-consolidation.

Some of the issues raised by the Commission's Draft Report, such as the treatment of employees with multiple jobs, were dealt with in our main submission. Several issues were not. They are discussed below.

1. Inter-industrial movement of employees and funds

The Draft Report has expressed concern that a system of auto-consolidation will result in a high degree of churn across the superannuation system as employees that change employer may be defaulted into a different fund – generating additional administration and liquidity costs. Partly on this basis the Commission argues for defaulting new workforce entrants who do not make a choice once.

Table 1 presents estimates of the intra-industry movement of default member employees and their balances (sum and mean) for the 2011-2012 year.

This data indicates that out of an employed labour force of approximately 11.4 million in 2011, an estimated 0.44 million employees with default member status changed the industrial division of their employment. That is 4 per cent.

Among those who did change industry, the majority were aged 29 years or younger accounting for 14 per cent of the total superannuation balances for all default status industry-changers.

The all-age group balance sum of $9.9 billion should be understood in the context of total APRA fund assets in 2012 of $833 billion – or 1.1 per cent.

These estimates suggest that job change which involves industry change is a relatively minor feature of the labour force. Where it does occur, it does so mainly among younger employees with relatively small balances.

Under an auto-consolidation system the proportion of system assets that would move because of inter-industry employment change among default members appears likely to be very small, and unlikely to generate significant administration and liquidity costs in addition to those already caused by choice-related factors.

Concern that auto-consolidation may generate a degree of expensive and destabilising churn has to be considered in the context of the alternative envisaged by the Commission and the retail sector. The Draft Report suggested that more member engagement is desirable. Increased engagement was part of the reason why the Draft Report suggested nudging and the proposed online short-list were justified.

Presumably one measure of this increased engagement would be many more members moving more frequently between funds and products. The costs of this movement will likely take many forms: reduced investment in illiquid assets, increased marketing spend to secure more mobile members, and the higher fees/lower returns associated with many choice products.

In the Inquiry's final report we would welcome discussion of the totality of costs that a choice-driven model of connecting employees to funds is likely to entail compared to one based on auto-consolidation.

Table 1: Employees Who Changed Industry and Default Balance Movements, 2011-2012

Age Group	Employees	Balance Sum ($)	Balance Mean ($)
15-19	48,546	26,217,991	540
20-24	101,393	377,764,165	3,726
25-29	86,316	1,004,915,695	11,642
30-34	55,785	1,194,975,135	21,421
35-39	41,443	1,352,155,395	32,627
40-44	35,386	1,325,552,128	37,460
45-49	34,183	1,750,837,856	51,220
50-54	23,060	1,354,416,501	58,736
55-59	11,546	907,445,961	78,592
60-64	5,448	480,266,607	88,148
65-69	1,450	109,210,430	75,341
All	444,555	9,883,757,866	22,233

Source: ISA estimates derived from the ABS Labour Mobility Survey CURF and ABS Survey of Income and Housing CURF for 2011-12. Employee balances were matched using a matrix of 720 means (2 genders by 30 age groups by 12 categories of hours worked in main job). Notes: 'Employees' are those that changed industry division as a result of job change, reduced by 20% to estimate default member levels. 'Balance sum' is an estimate of the sum of default balances.

2. Taxing TPD benefits

At the Inquiry's public hearings Mr John Berrill (Berrill and Watson Lawyers) drew attention to how TPD benefits are currently taxed. In particular, he stated that for the purposes of determining the eligible service period that will apply for taxation purposes in the event of a successful TPD claim, the member will inherit the start date associated with any prior account rolled into the fund that is paying the claim. This will extend the eligible service period and so increase the tax payable on the TPD benefit.

In response to Mr Berrill's comments the Deputy Commissioner stated:

"We're trying to get rid of unintended multiple accounts by having members, new job entrants default once and then going forward people auto-consolidate as they go. The other option on the table by some industry participants in the media…is instead of the member having one account that follows them through their life, the member takes their balance with them and rolls over with every next job. So that's going to trigger the problem that you're talking about."

In our main submission we have explained why, in the context of the specific model being proposed in the Draft Report, we do not support members being defaulted into one fund for life. The risk that disengaged and low-information members will be sold, nudged or defaulted into poor quality funds by their bank, their employer or through inappropriate advice is too great. To fulfil the collective social policy purpose of compulsory superannuation, it is appropriate for government to intervene strongly to ensure members are protected from such risks. We have previously explained how this can be achieved in the context of a strengthened industrial safety net.

If rolling prior accounts into current accounts creates a problem for TPD purposes, it is not a problem unique to an industrially-based system of auto-consolidation. It will arise in any circumstance where a prior account is rolled into a new one, perhaps as a result of pending legislation for inactive accounts, or perhaps in response to individual choice prompted by a "best in show" shortlist or marketing from a bank. The date for taxation purposes in respect of TPD benefits appears to be a relatively minor issue that could be dealt with via narrow relief: for account consolidation driven by automatic processes (such as legislation to address inactive accounts or a new auto-consolidation policy), the start date will be the most favourable to the taxpayer of any of the relevant consolidated accounts.

3. Member engagement

In a context where participation in the superannuation system is compulsory, but all participants suffer from behavioural biases and cognitive limitations, and the large majority of those compelled to participate have levels of literacy and numeracy below those needed to make optimal choices, and all participants may have (rational) preferences to spend their time on other things, the main priority for public policy should be to ensure employees are connected to good quality funds.

As the evidence presented in the Draft Report makes clear, when members do engage by joining a non-APRA fund, a retail fund or a choice option, many find themselves in underperforming products.

Given the low level of public understanding of superannuation, and the resulting poor outcomes for many of those who have made their own choices, the Draft Report's emphasis on engagement as a means of connecting employees to funds is misplaced.

Disengagement is rooted in low financial literacy and cognitive limitations, further compounded by the complexity of the superannuation system, routine regulatory change and the 'confusion marketing' strategies of many retail funds and SMSF providers. As such, disengagement is rational. Poor decision making cannot be solved by simply nudging people into making choices and offering them more dashboards. Any quantitative increase in engagement by such means will be superficial, reflecting the design of the system rather than any real increase in the capacity of employees to make better choices.

The strengthened industrial safety net outlined in our main submission recognises the reality of behavioural biases, cognitive limitations, and low financial literacy. It does not prioritise 'engagement' as a connection mechanism for the simple reason that there is no reason to expect that such a mechanism will work in the interests of most members.

We discuss problems of member engagement, and why a strengthened industrial safety net is an appropriate public policy response, in our main submission.

4. Interaction with Single Touch Payroll

ISA does not support the iteration of the Single Touch Payroll system currently in the process of being implemented by the ATO. The implementation of an online choice of fund system should await government decisions about what the default system will look like after 2020, and be designed to support that system.

The design currently being implemented by the ATO suffers a number of important weaknesses. In particular, it does not identify which of the displayed products in which the member has a balance holds a MySuper authorisation. Instead, the system encourages employees to make a choice while failing to provide essential information to help guide that choice.

In the strengthened industrial safety net proposed in our main submission, an online ATO choice function would play a role.

When an employee joins an employer, that employee will be defaulted into a fund that has been subject to the quality filter applied by the Fair Work Commission (FWC). If the employee wishes to choose to join another fund, they will be able to do so by accessing the ATO system.

The online system would offer choice from those funds that have been approved by the FWC. Given the negative consequences for the public interest of poor fund performance, it may not be appropriate for a public facility to facilitate employees joining an underperforming non-FWC approved fund. Funds who have not been approved by the FWC could of course market their products to employees, subject to the 'better off test' or 'earned profits requirement' outlined in our main submission.

We look forward to the Commission's views on these issues in your Final Report. If you wish to discuss any of the issues before the Report is published, please do not hesitate to contact me

Yours sincerely,

Zachary May
Director of Policy