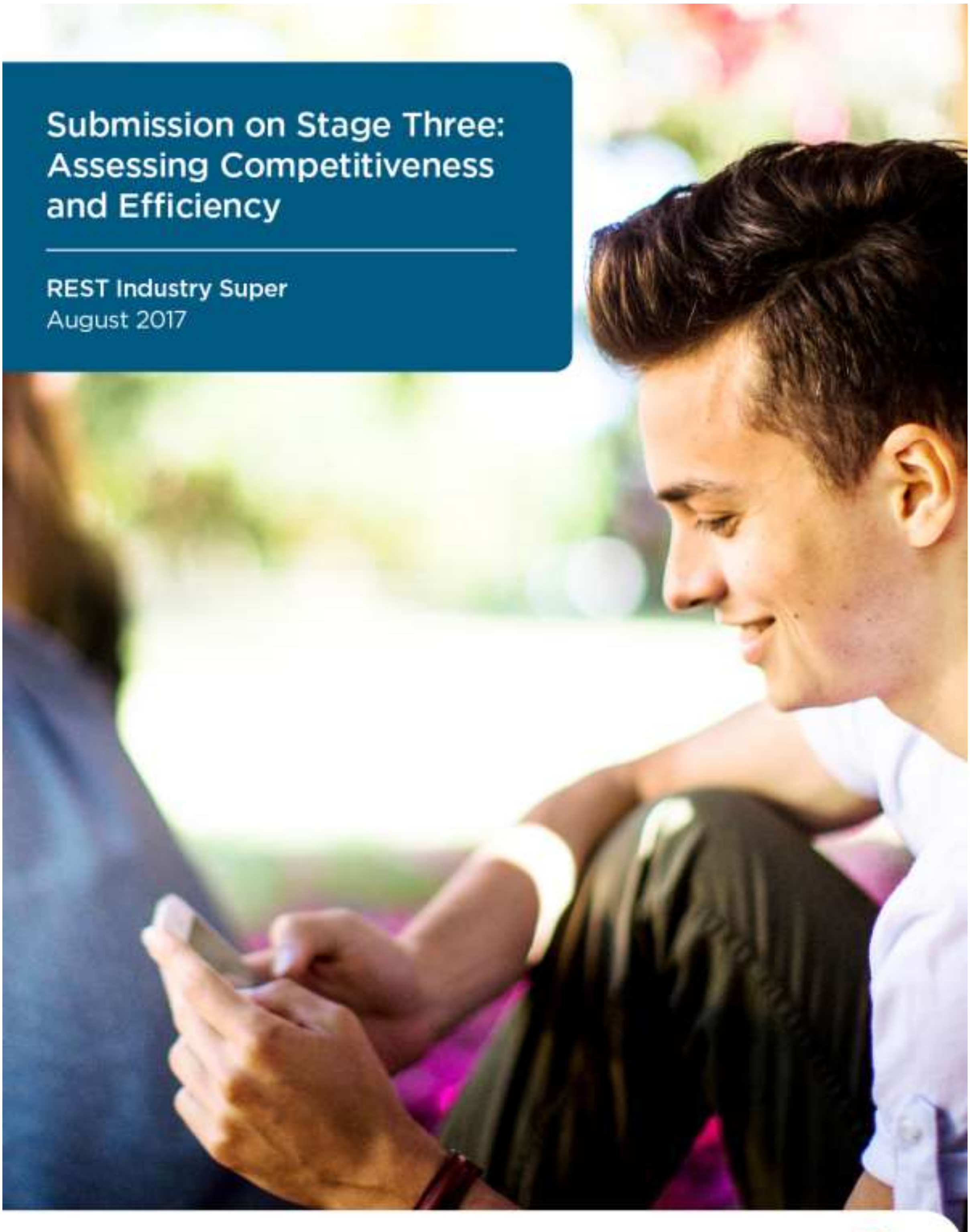
Submission on Stage Three: Assessing Competitiveness and Efficiency

REST Industry Super

August 2017



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21 August 2017

Commissioners and Assistant Commissioners
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne Vic 8003

Dear Commissioners,

Productivity Commission Inquiry into Superannuation Stage Three: Assessing Competitiveness and Efficiency

Thank you for providing REST Industry Super (REST) with the opportunity to make a submission to the Productivity Commission for its ongoing inquiry into the competitiveness and efficiency of Australia's superannuation system.

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 $45 billion of funds under management as at 30 June 2017. Our mission, which underpins everything we do, is simple: to help improve the retirement outcomes of Australians by returning benefits to our members.

As a leading industry super fund, REST is committed to working with Government and the industry to help improve the retirement outcomes of Australians.

Please do not hesitate to contact me directly or via email should you require any further input from REST about this submission.

Yours sincerely

Damian Hill
Chief Executive Officer
REST Industry Super

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1. Introduction

REST Industry Super (REST) welcomes the opportunity to make a submission on the Productivity Commission's (PC) ongoing Inquiry into the competitiveness and efficiency of Australia's superannuation system.

REST is a profit to member 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, and as a result the majority of REST members are many years away from retirement.

This submission covers five main areas:

- Effectiveness and stability of the current superannuation system
- Benefits of an active investment management approach
- The need for regulators to take a long-term view on fees and performance
- Default superannuation members
- The benefit of insurance inside superannuation funds.

The submission outlines practicable and achievable suggestions for improving the competitiveness and efficiency of Australia's superannuation system.

REST reaffirms the points made in previous submissions to the PC in relation to its current inquiry and notes that this document should be read in conjunction with these.

2. Effectiveness and stability of the current superannuation system

REST strongly supports the existing arrangements underpinning Australia's superannuation system, and for the large part, believes the system is working incredibly well. Since 1992, Australia's Superannuation Guarantee (SG) system has developed into a world-class retirement savings scheme. Since that time, superannuation funds have survived large macroeconomic shocks like the Asian Financial Crisis, dotcom bubble and the Global Financial Crisis in resilient fashion.

Superannuation is a long-term investment and many REST members are between 20 and 40 years away from retirement. 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 fund options they do not want, need or use.

The exposure draft Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 has strengthened the obligation on superannuation Trustees to consider the appropriateness of their MySuper product offering and expanded the range of factors that Trustees consider.

The amendment will replace the scale test with a new outcomes tests with the supporting Explanatory Memorandum saying that 'the government recognises that member outcomes are influenced by more than just the scale of the superannuation fund. When making their annual assessment, Trustees should have regard to not only scale but also …….. include consideration of the returns, costs, fees, investment strategy and the insurance offering of the MySuper product to determine whether they are promoting the financial interests of members.'

The draft has also strengthened the powers of Australian Prudential Regulator Authority (APRA) to 'take preventative and corrective action in response to breaches of the law or where funds may not be acting in the best interests of members' as well as to 'improve the quality of MySuper products by allowing APRA to refuse or cancel an authority to offer a MySuper product'. The exposure draft also smooths the merger of funds where improved scale is the key objective of the merger. REST believes the proposed changes to s29VN (b) Adequacy of Scale test will help ensure further rationalisation of super funds.

REST acknowledges that while the new APRA oversight proposed in the exposure draft legislation will not occur at the point of selection of default funds, APRA's work in a relatively short period of time would materially inform any selection process. In this way, the purpose of the draft legislation will align with the work that the PC is already completing. Accordingly, the proposed new laws will materially enhance the existing system and potentially achieve the ultimate outcome without the need for any change to the default fund selection process. In fact, the new level of oversight proposed to be given to APRA may well address the perceived problems that the PC is aiming to address.

REST believes there is merit in allowing time for these proposed reforms and the MySuper reforms to be embedded and benefits to be assessed before any consideration of alternative models. This is particularly since the present system for awarding default superannuation, which largely directs superannuation to funds that specialise in the particular needs and requirements of their unique member demographic has meant millions of Australians have joined funds that have delivered the strongest net returns over the long-term - i.e. the current system has elements that have delivered strongly to large numbers of Australians. We note the previous work of the PC in recommending an independent panel for the Fair Work Commission (FWC) as expanding the benefits of the current system to more Australians.

In fact, the increased role of APRA in terms of possible post selection oversight methods and processes could be incorporated more overtly into the default fund selection process and in this way reflect many of the features of the 2012 work of the PC without having recourse to the four different models suggested by the PC.

In REST's view, the proposed alternative models would see counterproductive changes to Australia's superannuation system by upsetting Australian's faith in the stability of the superannuation system and enhancing the possibility of asset transfers, forced mergers and dilution of insurance benefits with a potentially negative effect on the retirement savings of working Australians.

On the question of contestability, we contend strongly that this already exists in the market in the form of active tendering for business through tender consultants and competition in the process of outsourcing – something that drives better member outcomes and fosters innovation that ultimately benefits fund members. We believe that competition at this wholesale level in this manner mitigates the engagement issue at the individual level.

3. Benefits of an active investment management approach

Any overemphasis on fees and costs being a key criterion for selection of super funds to increase competition may impede optimal investment and performance outcomes. Fees and costs alone do not reflect the true performance of the fund; the superior measure is long-term fund performance net of fees and costs.

For example, while an active management approach may incur more expenses, investment returns in REST's experience tend to be higher, which clearly has benefited members.

REST takes an active investment management approach whereby we seek to capture market opportunities and manage downside risk. For all investment options, this involves regularly reviewing the exposures to major sectors and markets within asset classes and appointing active investment managers to manage the underlying investments where we believe the expected benefits exceed the costs of active management.

This approach has consistently delivered excellent net returns for the over 97% of REST members in REST's Core Strategy investment option, which has outperformed similar options of super funds surveyed over the last 10 years (and longer).

Table 1: SuperRatings Fund Crediting Rate Survey – Top ten over ten years

Fund	Rolling 1 year		Rolling 3 year		Rolling 5 year			Rolling 7year		Rolling 10 year	
	% pa	Rank	% pa	Rank	% pa	Rank		% pa	Rank	% pa	Rank
REST core Strategy	11.07	19	7.38	28	10.68	15		9.06	12	6.11	1
CareSuper - Balanced	11.70	12	8.92	6	11.12	5		9.65	3	6.01	2
UniSuper Accum (1) Balanced	9.60	34	8.82	8	11.20	4		9.46	5	5.83	3
HOSTPLUS - Balanced	13.20	1	9.68	1	11.76	1		9.92	1	5.79	4
Equip MyFuture – Balanced Growth	11.92	7	8.34	13	10.83	11		9.29	10	5.72	5
Cbus – Growth (Cbus MySuper)	11.92	8	9.11	4	11.44	2		9.59	4	5.64	6
Commonwealth Bank Group Super - Balanced	9.04	38	6.34	40	8.88	39		8.21	27	5.62	7
AustralianSuper - Balanced	12.44	2	9.23	3	11.41	3		9.69	2	5.56	8
BUSSQ Premium Choice – Balanced Growth	9.76	31	8.85	7	11.03	7		9.29	9	5.54	9
Catholic Super - Balanced	11.78	10	9.09	5	10.70	14		9.30	8	5.50	10

Source:SuperRatings Fund Crediting Rate Survey SR50 Balanced (60-76) Index June 2017

An overemphasis on lower investment management costs inevitably leads to a bias toward a short-term investment philosophy requiring greater liquidity requirements and the potential adoption of a cheaper passive indexing strategy with the prospect of lower returns (and no shaping of return distributions).

It is likely that in circumstances where the risks of a loss of members and assets and/or lower future cash flows were higher, funds would potentially be more reluctant to allocate capital to investments that are less liquid and/or require a longer investment time frame. Lower allocations by funds to these sectors as a result of a shorter-term focus, a risk most pronounced with respect to infrastructure assets, could have a detrimental impact on business costs, productivity and innovation and therefore employment and growth in the Australian economy as more costly capital is required to be sourced off-shore or via less traditional avenues. We are already starting to observe this with funds with a higher proportion of aged members and would not want to see any changes to the system exacerbate this.

In the same way, where there is a risk of loss of members, superannuation funds may well be tempted to market themselves on the basis of lower costs and fees, even though those same superannuation funds know that such a focus is likely to be detrimental to the long term returns for members. The industry has already seen evidence of this with the introduction of MySuper, where some providers have moved to a high proportion of passive funds management and other low-cost forms of investment where fees/margins haven't decreased to the same extent.

REST also considers that it is appropriate for the PC to consider that if a for profit operator is maintaining a default fund at an approximately similar net return and with similar features to an industry fund, there is a strong likelihood that the operator could be either subsidising the operation at the expense of other customers or products or contracting related parties to certain services at non-competitive rates. We would suggest that as an objective point of enquiry, these practices be further investigated by the PC as these behaviours should not be supported by the PC, either directly or indirectly.

3.1 Regulators must take a long-term view on fees and performance

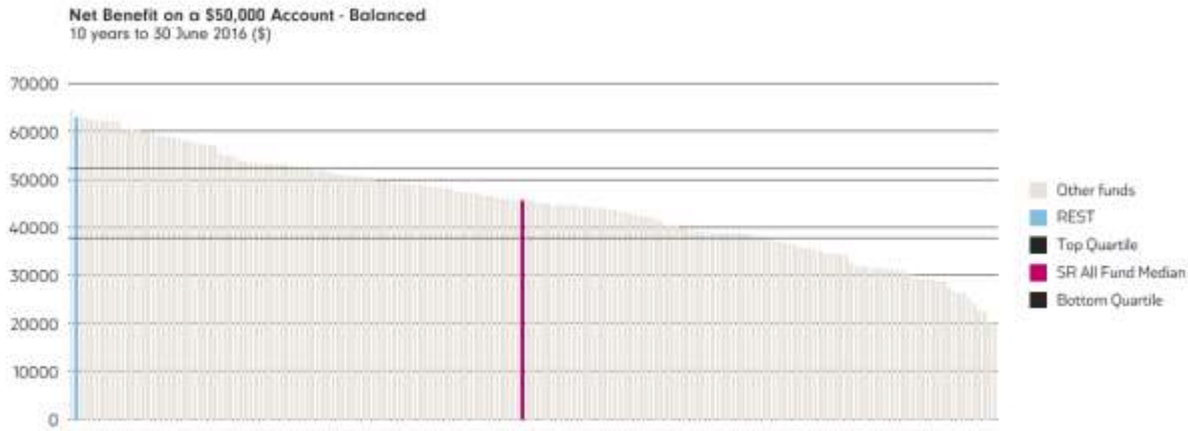
As noted above, when assessing the performance of a superannuation fund, regulators should consider net benefit as the key metric of success in maximising retirement outcomes.

Net benefit most accurately measures the actual investment experience of a member in a fund over the long term. In the decade to 30 June 2016, REST added an extra $17,992 to members with a notional $50,000 account balance in the REST Core Strategy[1], relative to the industry average. This extra return was achieved by both superior investment performance and lower fees.

[1] Assumptions: Starting account balance $50,000; starting salary $50,000, pay rises assumer to be 3.5% p.a.; inflation is assumed to be 2.5% p.a.; superannuation contributions are assumed to be in line with the mandated SG rate for each period; contribution are assumed to be made quarterly and fees are deducted annually.

Table 2: Net benefit 30 June 2016 of REST Core Strategy vs comparable Balanced style options[2]

REST **Industry average**



Over the ten years to 30 June 2016, REST's Core Strategy option Net Benefit to a member with a $50,000 starting balance of $62,884 sits above the SR All Fund Median of $45,598, and within the top quartile of all funds surveyed.

REST notes the newly proposed legislation providing enhanced member outcomes test as well as strengthened supervisory powers for APRA and believes this serves to facilitate the eventual reduction in the number of underperforming super funds. REST appreciates that management of operating costs is an ongoing challenge for the entire industry, particularly for smaller funds. As one of the largest profit to member superannuation funds in Australia, the benefits of REST's scale have been returned to members and employers in better service, better access to financial advice and affordable and flexible insurance, enhanced education and communications and greater security.

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[2] Source data: Input data provided by SuperRatings Fund Crediting Rate Survey SR50 Balanced (60-76) Index June 2017, SuperRatings (Net Benefit Modelling June 2016), and SuperRatings 2017 Benchmark Report (Cost figures as at 30 June 2016). SuperRatings Pty Limited ABN 95 100 192 283 AFSL No. 311880 (SuperRatings) is a superannuation research house with specialist areas of expertise. The information used in compiling this data comes from sources considered reliable and is not guaranteed to be accurate or complete. Past performance is not a reliable indicator of future performance. The data has been prepared for the purpose of providing "General Advice" (as defined in the *Corporations Act 2001* (Cth)) only, without taking into account the objectives, financial situation or needs of any particular person.

We will continue to work to leverage our scale for the benefit of our members and employers. We are committed to improving scale for our own fund and will support appropriate policy changes to this end.

In 2016, REST's cost metrics were:

Metric	REST	Industry Median
Cost Per Member	$87	$255
Cost Per Active Member	$130	$368
MER	0.42%	0.48%

4. Default superannuation member

As an industry fund, REST is run only to benefit members, unlike for profit providers which have dual responsibilities to members and to assist in generating a return for shareholders. Fees and costs are focused on providing benefits to members in the form of investment returns and product and service enhancements designed to benefit members.

Just over half of REST's 1.9 million members are young and work in part-time, casual or temporary employment. Over half of REST members are under 29 years of age and around 62% of REST members are female. For many REST members, retirement is many years in the future. Since its formation in 1988 REST has developed products, services and an active investment approach in recognition of its unique membership demographic.

REST welcomes and recognises that in the majority of cases our members have choice. From a membership of over 1.9 million members only around 300,000 do not have choice under an Enterprise Bargaining Agreement. REST is a keen advocate for moves to encourage greater engagement with superannuation as an important long-term investment. We use data and insights gained from listening to members and employers and leveraging our scale to guide significant investments in technology to enhance service offerings and to provide education and information to engage with members and employers. As a profit to member fund we do so while maintaining a rigorous approach to maximising efficiencies and effectively managing costs.

Since becoming the first Australian superannuation fund to give members online 'mobile first' access to personalised financial advice late last year, over 2,000 pieces of personalised advice have been provided to REST members. Previously, REST had launched single issue phone based advice to provide service to the around 80% of members excluded (due to low income) from the traditional financial advice industry. This service delivered over 100,000 Statements of Advice, over 25% of those to members under age 35. Our figures show that receipt and implementation of advice significantly increases engagement with members (as measured by tenure). REST believes that further investment in enhanced services will increase engagement and provide long-term value to members.

Late last year REST also became the first superannuation fund in Australia to service member enquiries 24/7 and the first to deploy secure LiveChat on our website. Over 190,000 questions have been asked of our virtual agent ‘Roger’ since launch in December 2016 and around 32,000 live chats have been answered since their introduction late last year with 22% of REST members saying it saved them a call to the call centre. In June 2017 REST enhanced Roger’s capability to seamlessly hand members over to a live chat agent to answer their enquiry if Roger was not able to help. From mid-June to mid- August over 3,000 members have been transferred between Roger and a live agent.

These initiatives are aimed at improving services for the benefit of members and employers while also lowering costs.

However, REST recognises that low engagement with superannuation is common. Nicholas Barr, Professor of Public Economics at the London School of Economics has argued that in the case of complex financial products such as superannuation, “most people can’t make an informed decision or don’t have the time to”[3]. Professor Barr’s comments discredit the position that opening-up the default super system to competition would benefit consumers because it would result in lower fees, greater innovation and investment and improved engagement with members.

Professor Barr said that competition was appropriate in the case of products and services that were readily understood, such as mobile phones and clothing, and where the costs of making the wrong decision were low. He said that the more complex the financial product, the less people understand and the less likely people are to make choices in their own best interest.

A core consideration in any alternative default superannuation fund model must be to protect members who find themselves in non-shortlisted funds.

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.

In a new system, we note an employer is likely to have multiple default funds in place across its workforce. This could result in significant variations in member insurance coverage, costs and fee levels, as well as investment risk and return strategies and outcomes within the same workforce and over numerous workplaces.

From a fund point of view there will be a loss of scale at workplaces making it more costly and potentially uneconomic, to service members. We also expect that employers will be less willing to work collaboratively with multiple funds to provide broader financial education and information to employees. Our own experience is that the best attended sessions are those sponsored by the employer and co-branded with the fund. The erosion of this alignment with employers could reduce engagement. REST believes that education, particularly via seminars, plays a vitally important role in empowering members to take action in what is recognised as a ‘low interest’ area to maximise their superannuation for a better retirement.

Transitional issues arising from changes to a default fund would simply introduce more ‘red tape’ and add administrative burden. It imposes a new requirement for employers to direct their energies not just to their business but to make sure appropriate default fund arrangements are in place for their employees.

5. Benefit of insurance inside superannuation funds

Throughout REST's history, insurance has been of critical importance to the fund. It is REST's responsibility to design insurance and investment products which aim to provide a secure retirement for members.

REST is of the view that flexible and affordable insurance should be a core part of any default superannuation model. It should not be separated.

REST is today one of the few industry super funds providing flexible long-term Income Protection (IP) cover as well as Death and Total & Permanent Disability (TPD) insurance by default, ensuring members and their dependents are protected in the event of the unexpected.

Due to our size and the fact we operate one of the largest insurance pools in the southern hemisphere, REST's scale allows us to negotiate and provide cover to members at wholesale rates. Members are also able to access this insurance without paying any commissions to brokers, third party sales channels or intermediary agents. This significantly reduces the cost of insurance, as commissions paid through retail channels are commonly upwards of 80% of the first year's premium.

REST currently insures over 1.4 million members (approximately 70% of our total membership), providing $286 billion in Death coverage, $70 billion in TPD cover and $2.15 billion in monthly IP benefits.

Our insurance design and policy definitions are developed to maximise the number of REST members receiving insurance cover that is appropriate to their life stage. Benefits are relatively low for young members with default cover increasing with age when financial commitments are usually higher and there is a greater dependency on income (and a greater capacity to afford). REST has attempted to minimise cross subsidies between different age groups and this should be a focus for the system.

Recognising that everyone's insurance needs are different members can opt out of insurance at any time including by phone, by mail or online through our member access portal. REST's insurance design is flexible and empowers members to alter their cover as they wish to suit their own needs. REST also works to ensure members have one superannuation account with us and that they are eligible to hold one insurance policy with us.

Importantly, most REST members work in part-time or casual employment. We have no doubt that without the affordable and flexible insurance cover provided through their fund membership, access to such insurance would not be available to many of our members and for those where it was available the cost would be much greater.

REST firmly believes in the value of insurance as part of superannuation for younger Australians. From 1 April 2014 to 15 November 2016, REST paid out 268 Death claims to financially-dependent beneficiaries of members who were 25 years or younger. During the same period, REST paid 478 disability claims to members aged 25 or younger.

REST's insurance offering is continuing to evolve and is a core focus of the fund. As the needs of our members change our insurance offering will continue to evolve, ensuring members have access to the most appropriate insurance solutions and industry leading insurance claims experience.

REST also regularly reviews its insurance service providers leveraging our scale to ensure we get the best value for members and that members receive the best claims service at what is a crucial time in their lives. As part of this commitment REST has completed several initiatives to reduce the time and effort required by members to submit a claim including halving the number of claim questions.

Recognising that insurance is a fundamental part of superannuation and to address the issue of population underinsurance generally, the Government has mandated Death and TPD cover in the *Superannuation Industry (Supervision) Act 1993*. Insurance was also included as a mandatory requirement for MySuper authorisation in recognition of its status as an important ancillary member benefit.

REST's IP insurance today is market leading. It provides cover to at least age 60 with a two- year benefit period to age 65 irrespective of whether a member is employed on a casual, contract or part time basis. Members are eligible to receive an IP benefit if they are disabled continuously for more than the Waiting Period of 60 days. When REST first introduced default IP cover we consulted with the Welfare Rights Centre to assess whether part-time and casual workers would genuinely benefit from this insurance cover.

The focus on IP also provides for the opportunity to support members while they are unable to work with additional health services that are designed to help them return to wellbeing and to meaningful work as soon as possible so that they may be able to continue to save for their retirement. We are increasingly engaging with both members and employers on rehabilitation opportunities.

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.

Similar research conducted by Rice Warner in July 2015 would appear to confirm the under-insurance gap. It concluded that the median level of life cover in place in Australia meets only 61% of basic needs, and that median life cover is only 37% of the income-replacement level required. Further, the median level of TPD cover and IP cover meets only 13% and 16% of the respective needs of the working population.

As a member of the Insurance and Superannuation Working Group, REST continues to work with the industry to introduce enhancements to insurance as part of superannuation. This includes reducing the incidence of multiple superannuation accounts with multiple insurance policies attached; ensuring that default cover is designed appropriately; that communications to members are as clear as they can be; and that the industry moves towards a more Plain English approach to communications, with standardised definitions where it is appropriate. As an industry, we all benefit when consumers are aware of the insurance they hold inside superannuation and can engage with it to ensure that it is set to a level that meets their personal circumstances.

REST regularly reviews our insurance offering to ensure it's not only competitive but meets our members evolving needs. This review incorporates not only the underlying insurance pricing, but also the benefits design to ensure it's sustainable, equitable and in line with the REST's core insurance principles.

6. Additional background: 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 $45 billion of funds under management as at 30 June 2017. 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. 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.

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
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.