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Commissioners
Superannuation
Productivity Commission

13 July 2018

Via: http://www.pc.gov.au/inquiries/current/superannuation/make-submission#lodge

Dear Commissioners

Productivity Commission – Superannuation: Assessing Effectiveness and Competitiveness draft report

IOOF welcomes the opportunity to respond to the Productivity Commission draft report Superannuation: Assessing Efficiency and Competitiveness. We believe that IOOF is in a unique position to respond to the draft report:

- Most superannuation business managed by IOOF is held within a single Responsible Superannuation Entity (RSE) – the IOOF Portfolio Services Super fund (IPSSF). As at June 2017, IPSSF has $26.6 billion in assets (of which 11% is in MySuper), and comprises 381,000 accounts (including 44,000 pension accounts). IOOF has had a policy of consolidation and has transferred a number of other superannuation funds into the one RSE over the past few years. This gives us a unique perspective on issues of scale and integration.
- The IOOF group provides a very broad range of financial services across the superannuation industry:
  - IOOF aligned dealer groups provide holistic personal financial advice to clients with superannuation investments in an 'open architecture' model. This means the platform within IPSSF is just one of a number of superannuation platforms within the dealer groups' Approved Product Lists.
  - IOOF manages a diverse range of superannuation entities. In addition to the IPSSF, IOOF is trustee and manager of the SMF Eligible Rollover Fund. Australian Executor Trustees (AET) is trustee to most small APRA funds (SAFs) and also administer self-managed superannuation funds (SMSFs). IOOF is also trustee of an externally managed RSE (AvWrap Retirement Service) and provides administration services to Sandhurst Trustees for the Bendigo Super Plan.
  - The IPSSF has a diverse membership including standard employer sponsored members, retained personal members (former standard employer sponsored members), personal super members (who have joined on an application form separate to an employer arrangement), account-based pensioners, complying pensioners and market-linked pensioners. This means our members can have different rights under the same superannuation fund – both in terms of trust and contractual rights. Members may also be advised or non-advised.

Our comments follow the draft recommendations and the findings that have led to these recommendations.

Yours sincerely

Paul Vine

Company Secretary

Submission to Productivity Commission: Assessing Efficiency and Competitiveness Draft Report

This submission has been prepared in response to the draft report titled Superannuation: Assessing Efficiency and Competitiveness released April 2018.

1. Defaulting only once for new members.

Draft recommendations 1 – 3 proposed that the allocation of default members should be removed from the industrial system. Using the ATO member choice form functionality, new employees should be able to choose their fund. Otherwise they would be allocated to their existing super account or if they have no super account to a fund from a list of 10 preferred funds on a sequential basis. The ATO is to develop an online system utilising functionality that is currently being developed through Single Touch Payroll. The process should be universally applied across employers and employees.

Superannuation as an industrial issue
The draft report recommends that the system of allocating default members should be removed from the industrial relations system. IOOF supports this position. In substance the payment of superannuation contributions has not been an industrial issue since 1993 when the legislation introducing Superannuation Guarantee came into being. Further there is no longer any reason why the fund into which these default contributions are made should be an industrial issue. Back in the 1980s and 1990s, industry-wide funds under industrial awards were set up so that employers did not have to contribute to a multiplicity of funds and that the funds met governance requirements. With MySuper and Superstream these reasons no longer apply. Arguments that superannuation should remain part of modern awards because of past performance of the nominated industry funds are artificial and self-serving.

Modernising the superannuation system for a changing workforce
The Commission also rightly points out that the workforce is changing. The introduction of the gig economy and a workforce more likely to move across jobs and industries, means that employees should be able take their super with them.

The Productivity Commission proposal to remove superannuation from industrial awards and restricting default members to new entrants to the workforce is an innovative approach to dealing with default arrangements and multiple accounts. We support the proposal that employees should be defaulted in super funds as a last resort and that employees should be encouraged to choose their super fund at first instance. Consequently we support an arrangement that utilises the ATO Single Touch Payroll functionality to facilitate employee choice of fund on commencement with an employer and defaults employees either to their existing account or a new account at last resort.

Our view is that one of the greatest risks to an individual properly funding their retirement is inertia. We believe that an engaged and empowered member has a better opportunity to grow their wealth and that a paternalistic approach to managing super funds is not in the members’ best interests.

- To this end we elected a single investment strategy for our MySuper product, rather than a lifecycle strategy, so as to encourage members to become choice members.
- We also support and encourage members to seek professional financial advice.

Role of employers
Employers are a key player in the superannuation industry and we believe it is important that their role continues. Employers can and do take a strong interest in the financial welfare of employees. Many employers negotiate special discounted arrangements with superannuation funds. Employers will also enter into workplace arrangements with their employees that are members of a company sponsored super plan. For example IOOF has many standard employer sponsors who pay administration fees and insurance costs for their employees that are members of the designated company plan. The importance of these arrangements should not be discounted in designing a future superannuation system. Employers should be able to promote their plan to new and existing employees.

We note the Productivity Commission proposals “would not preclude employers or unions from having a role” and employer plans and funds “will remain in the system…..The difference is that members would need to actively choose the product (without obligation) rather than having it imposed on them by default.” These comments appear almost as an aside. However we believe the role of employers and employer plans warrant greater weight. Particularly employer plans with special arrangements should be provided with prominence at the point when a person starts a new job or a new employee commences work.

2. Proposed “best in show shortlist” selected by an independent expert panel.

The Productivity Commission has proposed that a short list of up to 10 “best-in-show” MySuper funds be selected by an expert panel. New employees should be “nudged” to select from this list and new entrants that don’t choose should be defaulted to funds on the list on a sequential basis.

IOOF is uncomfortable with this proposal on a number of fronts:

- Creating limited lists and “nudging” consumers towards particular products on that list is akin to providing advice. We are a strong supporter of individuals receiving quality and affordable advice and we believe this recommendation compromises the need for independent advice.
- The list is restricted to a maximum of 10 funds. Although we understand the basis behind the number – consumer behaviour – we believe that in the current climate this is impractical. It is likely to exclude many current MySuper products that relate to discrete employer groups or to particular states. A larger list of say 40 funds would be more appropriate in the medium term. This number would be able to reduce over time as super funds and MySuper products inevitably merge.
- Independent expert panel to select the best in show. Panelists should be “free from direct conflicts of interest” and “not all members would need to have a high degree of experience in super”. Although we agree that current Government bodies such as FWC and APRA are clearly inappropriate, there are inherent problems with a Government appointed panel, particularly for the partisan superannuation industry. Superannuation is not a simple industry and experts should be expert and experienced across the breadth of the industry.

As this issue is the key recommendation of the Productivity Commission draft report, further discussion on this issue is set out in Attachment A.

3. MySuper and choice

The Productivity Commission draft recommendations are that MySuper products should have their outcomes test independently verified every three years. MySuper, trustees should also adopt the Insurance Code of Conduct and must report members switching from MySuper to higher fee paying choice options.

We agree that MySuper should not be a ‘set and forget’ arrangement and should undergo regular improvement. This is the intention of the Government’s annual members’ outcome assessment. We do however question the value of reporting members switching out of MySuper. Many of these members are switching because they have received financial advice, and that advice would be in the member’s best interest.

The Productivity Commission also found that the choice segment had a bewildering proliferation of investment options – some 40,000. We believe this overstates the level of complication for members, as many of these options are provided through super wraps for advised member only and reflect an advice licensee’s approved product list.

We believe the issue of legacy products is a greater problem than canvassed by the Productivity Commission. Traditional defined benefits are not the only legacy products within the super system. Income streams with grandfathered social security benefits cannot be rationalised without regulatory change. These include life expectancy and lifetime complying pensions and market-linked income streams; defined benefit lifetime pensions in SMSFs using reserves. Trustees of retail funds are also constrained from rationalising legacy products because of contractual obligations to members. Although we support the recommendation that APRA conduct a comprehensive review of legacy products, many of the issues creating and continuing the existence of legacy products will be out of APRA's hands. A wider Government review is warranted.

4. Disclosure improvements: Product dashboards and disclosure of commission

The Productivity Commission recommended that dashboards should be simplified and funds should publish choice dashboards by 1 July 2019. The ATO should provide product dashboard on a member's existing accounts as part of a centralised online service. Super funds should also disclose commission payments on member statements.

IOOF supports disclosure that is better targeted at individual members. However ATO product dashboards would include legacy product dashboards, and this would be a significant build and cost to the fund.

Disclosure of commission
Draft recommendation 13 proposed that superannuation funds should report trailing commissions as part of their annual statements.

As an advice-led business IOOF believes all consumers should be able to easily understand the fees advisers are receiving and the source of those fees, such that the consumer can decide if they are receiving valuable advice. If advisers are not providing this information to clients, superannuation fund trustees should.

Prior to 2013 we supported the industry-held position that super funds need not disclose commissions on member statements, as members received this information from their advisers. However since recent hearings of the Royal Commission into Misconduct in Financial Services it has come to our notice that a number of members were not aware of the commissions that they were paying – even though their adviser's details were regularly disclosed on annual statements.

In light of this, we agree with the proposal that superannuation funds should report trailing commissions as part of their annual statements.

Whilst trailing commissions are typically deducted from administration fees, some payments from a superannuation fund to a licensee are not based on an individual client's investment – such as volume-based shelf fees. These payments can be incredibly difficult to reasonably proportion on a member basis and are not explicitly related to the fees the client pays their superannuation trustee. As such we would suggest it is inappropriate for these fees to be captured in trailing commission disclosure.

5. Fees and insurance

The draft recommendations for: cleaning up lost super accounts; restricting exit fees, ceasing insurance on inactive accounts; introducing opt-in insurance for members under age 25;and balance erosion issues have largely been accepted by the Government and legislation introducing these changes is currently tabled before the Parliament. IOOF has some concerns with the practical outworking of the insurance reforms – particularly where employers have industrial agreements that will be affected. We have responded to the exposure draft legislation released by Treasury for comment.

We also support the recommendation that adopting the Insurance Code of Conduct should be part of MySuper. The Code has been drafted with default super in mind. We do however believe that the Code should be revisited to provide trustees with some flexibility in relation to retail (individual) insurance arrangements.

6. Regulatory and governance recommendations

The Productivity Commission draft finding 10.2 found that there was significant overlap between APRA and ASIC and questioned whether responsibilities between the regulators should be made clearer.

If member outcomes are to be the priority, the role of the ATO as a regulator of the individual's superannuation should be more closely considered. The ATO is the regulator of SMSFs but it also regulates payments and contributions for all superannuation funds. In the future, the ATO will be the source of truth from the consumer's perspective for contributions, income streams, choice of fund, First Home Super Saver Scheme determinations and release amounts, compassionate ground payments, successor fund transfers etc. Government initiatives in the future (like the First Home Super Saver Scheme) will largely be determined by the functionality of the ATO systems. Additionally the ATO will be receiving granular data from superannuation funds and employers on individual taxpayers, which could be used to better understand superannuation fund membership and target future regulation.

7. Merger recommendations – CGT relief and APRA

Draft recommendations 6 and 7 provide that capital gains tax rollover relief for mergers should be permanent and that APRA should be notified of planned fund mergers and also reasons why a merger did not succeed.

We agree that merger activity should be reported to APRA once a memorandum of understanding has been entered into between two trustees, as well as a subsequent report if the merger does not proceed. Arming APRA with more information about potential barriers for consolidating funds, particularly in relation to smaller funds, can help develop future prudential guidance and encourage efficiency within the superannuation system.

We agree with the proposal to make the capital gains tax relief for mergers permanent. This relief is critical for assisting superannuation funds to merge as otherwise the application of capital gains, or the inability to use carried forward losses on their own could result in a successor fund transfer being unable to be completed. Providing this relief is core to ensuring trustees can transition member accounts without having to be concerned about creating significant capital gains tax liabilities, particularly in a wrap-style superannuation product where such control over tax outcomes is one of the core features of the offering.

Additionally, relief should be extended to partial transfers between superannuation funds, particularly in the case of corporate superannuation plans. At present corporate plans tend to be 'trapped' with a single provider as these are structured as sub-plans within a greater trustee arrangement and do not qualify for relief under the current rules. Allowing these sub-plans to access relief would increase efficiency to the corporate superannuation system – which is likely one of the least efficient areas of superannuation in this regard.

We ask that additional consideration be given to extending relief to small superannuation funds, such as self-managed superannuation funds, which are winding up in full and transferring their benefits to a public offer superannuation fund (retail or not-for-profit). This would help improve outcomes for members who historically wished to operate their own self-managed fund but have found the costs or onus of such an endeavour is no longer effective for their circumstances. The triggering of significant capital gains or inability to benefit from carried forward losses are significant considerations for small fund members and can result in the sunken cost fallacy resulting in further deterioration of their superannuation assets.

Attachment A

Draft recommendation two – ‘best in show’ shortlist for new members

We broadly agree with the concept of a ‘best in show’ list of funds that is available to new members from which to select their first superannuation fund. Whilst we understand the more funds which are included in the shortlist could reduce the effectiveness of individuals exercising choice, allowing only roughly 10% of active MySuper products1 on such a list would appear to be highly restrictive and could lead to significant concentration of providers in this list.

As such our view is the best in show list should be expanded to 40 MySuper products, at least at commencement. This still accounts for less than half of MySuper products and should reduce the risk of concentration of product providers, noting that multiple MySuper products may be administered by the same provider and have very similar features and returns. Should less than 80 MySuper products be eligible to qualify for the best in show list, we would then propose reducing the number of funds on the list to no more than half the total eligible products.

Expanding the list enhances the chances of a MySuper product qualifying as ‘best in show’ and should encourage healthy competition for a ‘seat at the table’ without lowering the bar to such an extent that funds would be included in the list by default, without having to show merit for inclusion.

Over time as MySuper products consolidate the number of funds present in the best in show list would need to be reviewed to ensure an appropriate balance is struck between reducing member confusion when it comes to choice, and giving funds a genuine opportunity to be considered best in show. Including too many funds could reduce member outcomes for new members who select, or are defaulted into, less efficient MySuper products however including too few could result in concentrations of product providers and a lack of genuine competition.

When new members go to complete their choice of fund form, it is important that for employers who offer a corporate superannuation plan which has novel features, such as reduced fees, additional contributions to cover insurance premiums or access to discounted financial advice, are not relegated below the best in show products. These bespoke employer funds should be incorporated in the selection process by being shown separate from MySuper products which are not in the best in show list or appear in the list at their ‘retail’ rate and at least in line with the best in show list. Many employers continue to use superannuation as an incentive to both attract and retain staff and, although not explicitly part of the Commission’s review, it would be fair to say these additional employer benefits would produce better member outcomes and are important for members to consider as part of their superannuation choice process.

We agree with the proposal that the list should be shown in a randomised order, and this should be made incredibly clear to the member at the time that funds are not shown in a particular order. We would further suggest the best in show list is monitored to see if members are disproportionately selecting the first fund on the list. This would suggest although a choice is being exercised, there is little detailed consideration in that choice.

If a member does not make a choice, allocating the member to one of the best in show funds on a sequential basis is appropriate. We would suggest that members are advised (if possible) of the fund they would be ‘defaulted’ into if no choice is made, however this may not be possible given multiple members may be making this choice at the same time.

Although a best in show list should help reduce the complexity when it comes to members with little knowledge making a choice in relation to their first superannuation fund, simply having fund names would not be sufficient as a new entrant into the superannuation system is unlikely to have any product awareness. As such members should be provided with some high-level information in relation to the best in show options, summarising the high level features of the fund. For simplicity, quantitative measures such as historical returns or fees could be shown as a quartile ranking using simple graphics. This information would not necessarily be as detailed as MySuper product dashboards, however incorporating this information into the best in show list would help members understand the potential trade-offs between different products and make informed decisions.

[1] Based on the 2017 Annual MySuper Statistics from APRA, March 2018

In relation to helping existing members review their superannuation product when making a new choice when changing employers, we agree the best in show list should appear in addition to their existing funds. If the member had previously selected a best in show product, showing how that product has changed over time would also help these members understand if their current product is performing as expected. Also allowing existing members who have selected from the best in show list to track whether their product is still performing through MyGov can help members keep track of their superannuation and potentially encourage member engagement.

Care should be had when using the best in show list to 'nudge' members to move from their existing fund to a more 'current' best in show option. These members may have existing insurances or have accrued significant tax liabilities on their underlying investments. Any suggestion to these members to consider changing their options needs to be appropriately framed – perhaps even encouraging members to seek guidance from their existing funds as to the consequences of transferring their benefit to another fund.

Draft recommendation three – independent expert panel for 'best in show' selection

Before considering the operation of the panel, the draft paper suggests MySuper products would be required to apply for consideration in the 'best in show' list. However we propose that MySuper products are included in the analysis by default, with the ability for trustees to 'opt out' of consideration if appropriate. This approach would ensure that sub-optimal funds cannot avoid being reviewed, effectively 'hiding' poorly rated funds. Allowing funds to opt out should be considered for MySuper products which are not available to the wider public, such as State public sector schemes or larger corporate funds with their own MySuper offering.

In relation to establishing an independent panel of industry experts, we propose that a set of objective criteria, established by the Government in consultation with the industry, would be more beneficial to the superannuation industry than relying on a panel of industry representatives.

Creating a panel of superannuation professionals without any significant bias – particularly in relation to the 'not-for-profit v retail superannuation' divide could prove difficult, and whilst conflicts of interest could be declared this underlying bias would be hard to address. Additionally, only allowing 1/3 of any panel to remain across best in show assessments may help reduce the impact of these biases but could introduce unnecessary variability into the selection process as the panel bias should shift drastically between panels. Relying upon a clear set of objective criteria would reduce the impacts of these problems as well as providing transparency into the selection process.

Criteria for selection of "best in show"

Even if a panel is used, rather than just a simpler assessment process, the criteria under which the best in show products are reviewed will be critical for both the success of the list itself, as well as for industry to understand the metrics under which the list is compiled. Undoubtedly this is a difficult task as there are many considerations which need to be had. The following topics are likely candidates for contention amongst the industry:

Measurement of returns

The funds management industry has long understood that trying to predict future investment performance based on historical returns comes with a range of challenges. Whilst historical returns can provide some insight into the past, there is little to suggest that extreme outperformance from the mean is able to be sustained by the same provider over the longer term. As such comparing return relative to the best in show cohort and identifying funds which have returns around an expected figure would appear to be more appropriate than considering raw rates of return.

When viewing return, consideration should also be had to applying a risk-adjusted return measure to view the return in context. If two funds are generating the same return whilst putting their member's capital at significantly different levels of risk, the lower risk product could be argued to be providing a more efficient outcome for their members.

Additionally, return could be considered relative to the fund's stated long-term return objective. Funds which are consistently generating below-target returns would likely be less appropriate for their members, all other aspects considered. Conversely, funds achieving significant outperformance relative to their benchmark may suggest they are not investing 'true to label' which could give rise to concerns of funds purposely investing in a more aggressive manner relative to investor expectations.

Another factor that would need to be considered is the impact heavily weighting towards recent investment performance may have on 'return chasing' behaviour. It has been suggested in previous analyses that investors who continually 'follow' investment return may in fact generate a sub-optimal outcome compared to staying invested in the same strategy. Whilst this impact is lesser over the longer term and the best in show list is only expected to be reviewed every four years, it will be important to see if this behaviour appears after such an approach is implemented.

Accounting for differing asset allocations
Similar to the approach undertaken by the Commission in comparing returns across different investment methodologies, consideration should be given to ensuring each fund's returns are additionally considered relative to the underlying asset allocation of that option. We have not undertaken a detailed analysis of the specific approach used by the Commission however the concept is certainly valid given the disparate investment options for MySuper options – both in terms of the split between growth and defensive assets, as well as the specific underlying asset classes used.

Consideration of fees
Fees are certainly an important consideration in measuring the efficiency of MySuper products, however care would need to be given to distinguishing between fixed and percentage fees. On lower balances fixed fees will have a disproportionately large impact relative to percentage-based fees however as member's balances increases fixed fees provide a better outcome. Given the primary purpose of the best-in-show list is to assist first-time members with selecting a superannuation product perhaps a preference to percentage based fees (or using a lower balance to 'rank' funds relative to each other) would appear appropriate.

Considering non-financial aspects of superannuation
Efficiency of a superannuation provider should not be restricted to investment considerations but should also extend to non-financial aspects of how a superannuation fund operates, including the efficiency of administration of superannuation benefits, historical insurance claims information and the ability for the fund to provide additional services such as intra-fund advice. These factors may not influence retirement outcomes to the same extend as poor returns or excessive fees, however they can go a long way to driving member engagement and satisfaction with superannuation overall.

Measuring innovation
A metric identified by the Commission for consideration is a superannuation product's history of being innovative. Whilst understanding the history of how a specific product has changed over time and how it has adjusted to shifting consumer needs is a positive, measuring this could prove a difficult challenge. Indirect metrics, such as those discussed in the non-financial metrics section, could form an important part of such a measurement.