Productivity Commission
Level 12, 530 Collins Street
Melbourne VIC 3000

Submission on Superannuation: Alternative Default Models – Draft Report

Dear Commissioner

AMP appreciates the opportunity to comment on the Draft Report. As one of Australia's largest providers of superannuation products and services, as well as insurance, AMP is very well placed to provide a perspective that is both practical and sound in terms of public policy principles. This submission provides a high-level commentary on the Draft Report.

Overview

We do not provide comments on the merits or otherwise of the proposed alternative default allocation models because we don't accept that an alternative default allocation model is necessary. In fact, imposition of such a model would be poor policy that would impact the performance of the superannuation system to the detriment of the very people a new model would be intended to help.

It is AMP's strongly held view that, contrary to the premises of the Draft Report, Australia's superannuation system is not 'broken' and consequently is not in need of the radical changes proposed in the Draft Report. By world standards, Australia's superannuation system works very well. The superannuation system continues to evolve and it will not be until 2035 that the first person will have been in the compulsory system for their entire working life. We do not agree with the Commission that the system lacks competition. In our experience the majority of the system is highly competitive. An alternative model is likely to significantly reduce the number of participants or result in an oligopoly, limiting competition and resulting in negative outcomes for members.

This does not mean that the system is working perfectly. We note that the MySuper reforms proposed by the Cooper Review are still being implemented, so it makes no sense to change the system along any of the lines suggested in the Draft Report until the MySuper reforms have been fully implemented and their effectiveness has been evaluated. It is our view, that the default superannuation market should be opened to equal competition amongst all APRA approved MySuper products, with time for funds to compete for employer choice of default, before the system efficiency is then reviewed. An open market will increase competition rather than reduce it.

Aside from this important question of process, the fundamental flaw with the Draft Report is that the tender models proposed by the Commission will cause a race to the bottom in superannuation, with competition based on fees alone. If the objective is to have a superannuation system with the lowest possible fees (and this is implicit in what the Commission has proposed), then this implies that there should be a single provider of superannuation for everybody, to maximise economies of scale, who would provide a single, minimum cost investment option. This would be a recipe for either an impoverished retirement for millions of Australians or vastly increased reliance on the age pension. Presumably this is not what the Commission has in mind, especially given what the

Commission said in its recently (November 2016) issued final report on *How to Assess the Competitiveness and Efficiency of the Superannuation System*:

> "Maximising net returns (after fees and taxes) is the most important way in which the superannuation system contributes to adequate and sustainable retirement incomes."

Contrary to the premises that underlie the Draft Report, the Australian superannuation system performs well by international standards on a range of criteria, and indeed it performs better than the pension system in countries whose default systems the Commission has compared to, including Chile, a country often referred to for its tender default system.

<u>Reiteration of AMP's earlier submission</u>

We reiterate the main points of our earlier submission to this inquiry.

- Our recommended model is an open market, with employer choice of default product from APRA's list of compliant MySuper products for all members. Our model will provide equal competition where incumbent funds are pressured to compete, resulting in downward pressure on fees, increased product innovation and therefore better outcomes for members. Choice of fund must also be available to all employees.
- MySuper was designed as a simple and cost-effective replacement for default products and needs more time to deliver its benefits in an open and equal market. It was designed to meet a number of the deficiencies noted by the Productivity Commission.
- The current default system is highly competitive, with a large number of product providers. We disagree with alternative models that focus primarily on lowering fees and those that may result in an oligopoly, limiting competition and resulting in negative outcomes for members.
- The current default system and compulsory nature of superannuation have contributed to the success of the superannuation system which is recognised as one of the best systems in the world.
- Employer chosen defaults provide significant benefits to members through the provision of additional services including education and advice, to encourage positive member actions.
- The 'opt out' nature of insurance provided with default superannuation is important as it enables vulnerable members to have access to insurance that they otherwise would not have received.

<u>The Commission's premises</u>

Underlying the analysis and findings of the Draft Report is the premise that there is a big problem to be fixed. We strongly disagree with the statement about the superannuation industry and its participants, that "some claim has become complacent with a steady flow of mandated contributions from disengaged members, and as an industry has failed to improve its scale and efficiency and deliver better outcomes for members (despite the MySuper reforms)."

We also do not support the Commission's premise that if industry participants are providing a united and sound objection to the Commission's approach and proposed alternative models, that this therefore implies that they must be 'rent seeking'.

Our objection to the Commission's proposals in the Draft Report is on the basis that the existing default superannuation system is not broken, the implementation of MySuper is not yet complete and, competition is still restricted without allowing all MySuper funds to compete equally in an open market.

We also believe that the Commission's proposal for the alternative default models to only apply to new entrants is arguably "more than incremental reform". This will create two systems for both employers and superannuation fund providers, reducing simplicity and the ability for economies of scale which will therefore increase costs and decrease the overall efficiency of the system.

Selection body

As the Commission states in the Draft Report (Box 2, p16), all of its various default models would require a selecting body to choose the default funds, and this "body would be overseen by and accountable to the Australian Government". In other words, the default funds would be chosen by a bureaucratic body, according to a range of criteria.

We question how such a selection committee will be able to make better decisions than the decentralised market processes that currently exist, imperfect as they are. This will be especially true of the Commission's multi-criteria tender, with the selecting body deciding on the criteria, the weight attached to each criterion, and the score for each criterion for each entrant in the contest.

The Commission has laboured long and mostly successfully over many decades arguing against the idea of government picking winners in many industries, based on the argument that as imperfect as market processes can be, government processes are worse. On this occasion, the government would actually be picking the winners, but with much more at stake. There is currently around $2.2 trillion in superannuation accounts, an amount that is very large (larger than Australia's GDP) and growing fast. It is ironic indeed that the Productivity Commission, of all organisations, should advocate that a government committee will decide who gets to manage a large proportion of the nation's superannuation savings.

The Commission's proposed selection committee for default funds won't do better than the market. In the Draft Report the Commission has proposed a change to the system that would be highly disruptive and would risk destroying residual confidence in the system (where such confidence has already been diminished by the almost continuous change to rules and taxation). Most of all, the Commission has not demonstrated that any possible benefits from its proposed changes would outweigh the costs.

The Australian system works well

The *2016 Melbourne Mercer Global Pension Index* rates the pension system of 27 countries on the basis of more than 40 indicators. Overall, Australia ranks third, behind only Denmark and the Netherlands. Australia is at the top of the classification described as "A system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system".

The Mercer assessment also grades specific features of the pension systems. On Adequacy (comprising benefits, savings, tax support, benefit design and growth assets) Australia is ranked third best in the world. On sustainability (comprising coverage, total assets, contributions, demography and government debt), Australia is ranked third in the world and on Integrity (comprising regulation, governance, communication, protection and costs), Australia is ranked second in the world.

These results do not indicate that the Australian superannuation system is in need of radical changes, though improvements could be made (on which see below). What's more, Australia ranks ahead or well ahead of the countries with default systems that the Commission analyses in the Draft Reform: United States (ranked equal 13th overall, with a score at the international average), United

Kingdom (11th), Sweden (5th), Chile (equal 8th) and Canada (8th). (New Zealand, which appears in the Commission's analysis, is not ranked by Mercer.)

The importance of insurance on an opt-out basis

We strongly disagree with the Commission's statement in the Draft Report that superannuation account erosion "is further exacerbated where young members have inappropriate insurance policies with their superannuation funds" and the implication of the lack of importance of opt-out insurance in default super arrangements with the following statement:

"…it should also be self-evident to trustees that the Government's stated objective for the superannuation system does not envisage insurance as an essential element of the system."

AMP believes that default insurance in superannuation should continue to be provided on an 'opt out' basis because it provides life insurance cover to those Australians who may not otherwise have access to insurance and has an important role in protecting Australians' retirement incomes. Determining the appropriateness of cover is the responsibility of the Trustee (in line with their Insurance Management Framework obligations under S52 of the SIS Act) where they must determine the appropriate types and levels of cover for their membership.

Suggested amendments

There are reforms that can and should be made to improve Australia's world class superannuation system – just not the ones suggested by the Commission.

We believe that the Government needs to do 4 things to improve the competitiveness and efficiency of the superannuation system:

1. Open the default superannuation market to all APRA approved MySuper funds
   - This will increase competition by putting pressure on incumbent funds to compete equally for selection in future as the default, continuing to put downward pressure on fees and increase product and service innovation for the benefit of members.
   - Employers should continue to choose the default to provide significant benefits to members including investments and insurance aligned to the workforce and additional services including education and advice.

2. Allow choice of fund for all employees
   - AMP unequivocally supports the concept of member choice, and the development of information systems to assist that choice.
   - While the Government confirmed in its response to the Financial System Inquiry in 2015, its agreement "to extend the choice of fund arrangements to more employees by removing the deemed choice for certain enterprise agreements and workplace determinations", draft legislation that was issued in March 2016 lapsed with the election and has not been reintroduced. We agree with the Commission's statement in the Draft Report that it is "…essential to extend genuine member choice to all employees".

3. Finalise CGT relief for fund consolidations before 1 July 2017
   - Existing CGT relief under Division 310 of the Income Tax Assessment Act ("the Act") for inter-fund transfers (also known as successor fund transfers) will expire on 1 July 2017. The Government should legislate for this relief to continue so that fund consolidations can take place with a purpose to achieve economies of scale for the benefit of members. APRA has indicated that they are supportive of further fund consolidations and recently issued a new

Draft Prudential Practice Guide SPG227 Successor Fund Transfers and Wind-ups to assist Trustees in this regard. The absence of this relief going forward will be a significant barrier to inter-fund consolidations. We also note and are supportive of formal submissions to the Government on this issue from the FSC and ASFA.
- In addition, while CGT relief under Division 311 of the Act has been provided specifically for inter-fund Accrued Default Amount (ADA) transfers, the Government has agreed to issue draft legislation to extend this relief for intra-fund ADA transfers prior to 1 July 2017. AMP supports this relief and is working with Treasury in the consultation process on the draft legislation.
- Appropriate CGT relief as outlined above will enable further consolidation of super funds in line with the Government and APRA's intentions.

4. Increase confidence in the system
   - Allow time for MySuper to work after implementation is complete on 1 July 2017. As stated in a previous submission to the Commission, we believe it is too soon to assess the competitiveness and efficiency of the superannuation system. Ideally, the Commission's work should be delayed by (at least) five years. If not, the conclusions of the inquiry will need to be clearly marked as preliminary, incomplete, and certainly without any necessary implications for further changes in policy.
   - Continuous changes and tinkering creates uncertainty and reduces confidence in the system, particularly after such significant changes as the Stronger Super reforms and the changes to the taxation of super as part of the 2016/17 Federal Budget.
   - Reduce regulation and make the system simpler – it cannot be denied that the system is unnecessarily complex and can be difficult to navigate. This is predominantly due to government legislation and regulation. AMP supports the idea that the system should be made simpler and easier to use. This does not have to be achieved by reducing competition.

<u>Conclusion</u>

It is our belief that after implementing the above, and giving the system time to benefit from these changes, it will then be appropriate for the Commission to review the competitiveness and efficiency of the system. At that time the Australian superannuation system will be world leading and there will be no need to introduce such significant, costly, untested and fundamental changes to the default nature of the system as proposed by the Commission's Draft Report.

We would be pleased to discuss the contents of this submission with the Commission

Yours sincerely,

Alastair Kinloch