HESTA

Productivity Commission Draft Report

HESTA welcomes the opportunity to submit a response to the Productivity Commission Draft Report distributed in May 2018.

About HESTA

HESTA is an industry superannuation fund, established in 1987 to provide retirement benefits for workers in the Health and Community Services Sector, and we operate only to benefit members. We have approximately 850,000 members and manage over $46 billion of members' assets.

The typical HESTA member is aged 43, is female and has a balance of approx. $22,347 in superannuation.

Because of our traditional industry base our members are:

1. More likely to live for five years longer than an average Australian male
2. More likely to suffer the inconsistencies and discrimination of the gender pay gap
3. More likely to take time out of the workforce on periods of unpaid leave
4. More likely to be at risk of poverty in retirement.

Our mission is to make a real difference to the financial future of every member.

We have provided some general comments about the Commission's process, and on sections of the Draft Report that we believe are most relevant to the retirement outcomes of our members.

Also, to aid the Commission, we have made comments about the role of insurance and the value it provides.

We welcome the opportunity to discuss the submission further, should you have any ueries please contact Mary Delahunty, Head of Impact

Comments on the Draft Report

HESTA welcomes reform to the superannuation system that promotes member's best interests and wider community wellbeing. To that end we have championed many reforms that would make a meaningful difference to the majority of our members, namely:

- ☐ Superannuation on paid parental leave entitlements
- ☐ Removal of the $450 threshold
- ☐ Payment for carers

We note there seems to be an ongoing focus on the well performing safety net providers and not on structural change to promote fairness that would make the most difference to the majority of our members.

We reiterate that it is an unfortunate waste of time and resources for the sector to participate in yet another round of consultation when there has been no serious assessment of the current legislated (unimplemented) process.

We believe that members could have been substantially better off if the legislated process had been enacted. We remain strongly supportive of this legislated system that has outrageously been stalled for 4 years now.

If the legislated system through the Fair Work Commission had been commenced in 2014 we could be assessing the effectiveness at this time and making any improvements that were needed. Instead we have essentially been obligated to participate in a protracted process with questionable motivations.

We welcome the report findings that the not-for-profit sector have generated greater returns over the long term - this is hardly surprising. However, the Commission then proposes to overhaul the system and replace it with a risky alternative that will do nothing to address the (seemingly entrenched) underperformance of the retail, choice and SMSF sectors.

Super is not just another financial product, nor should it become one. Superannuation is a legislated social and economic policy with the potential to:

- improve retirement outcomes for members;
- reduce pressure on the aged pension; and
- facilitate long term investment that has a positive impact.

Given these factors we concur with the ISA observation that "the performance of *all* parts of the superannuation sector should be a public policy priority."[1]

Super funds should be run to generate profits <u>for</u> members – not profit <u>from</u> members.

We would urge the Commission to consider only allowing not-for-profit funds to be given default status. Their sole purpose is to benefit members; not shareholders and members.

It remains HESTA's strong belief that in a compulsory system there are benefits from an engaged consumer base but safety net provisions are still required for those who are not engaged. Consumer

[1] *Disconnect: The PC's findings do not support its recommendations* – Industry Super Australia – July 2018.

protections and quality filters are the mark of a sophisticated retirement system, not an immature one.

We also note that:

- that superannuation is deferred wages and therefore appropriately treated as an industrial matter;[2] and
- international evidence clearly shows industrially based systems are the best performers around the world.[3]

The super system architecture was built by unions and employers to provide superannuation for all workers. Their shared purpose to establish funds which are run only to profit members (rather than shareholders) has delivered consistently better returns.

Unions and employers, and their peak bodies, have specialist knowledge of the labour force and the industries in which members are employed. This is a strength that can add significant value to tailored products and services such as insurance. (This issue is discussed in the next section)

This knowledge of workforce participation and labour mobility, understanding of employer preferences and capabilities, and employee financial literacy, underlines why unions and employers should continue to play a central role in the default system.

These bodies also create a significant competitive counter-balance to the profit-driven interests of the financial services sector, instead seeking to embed culture and values that are completely focused on the best interests of fund members.

Policy intervention is required, and welcome, in the area of member engagement. Given such obvious benefits can arise from an informed consumer base there seems to be little attention from policy makers to increase this.

Indeed, many of the proposed considerations in the Draft Report could be seen to entrench apathy, such as the concept of having one default fund for life.

Insurance

HESTA believes that automatic group insurance has been a successful policy for Australia by providing a safety net for those who would otherwise be completely uninsured. It also plays an important role alleviating pressure from the social security system and the healthcare system.

HESTA members are some of the most vulnerable and marginalised workers of Australia. When these members are forced to cease work due to injury they often tell us they were unaware of the insurance they had within superannuation until this critical time. Their lack of awareness does not diminish the importance of this protection for them and their families. This lack of awareness is a failure of policy settings which should be aimed at increasing the level of education around our compulsory superannuation system, and not constantly aimed at attacking the protections that exist even if people don't engage.

In Australia, one of the biggest assets a person has is their ability to generate an income. In a social sense we are all insuring this asset for one another through the social security system. Any changes

[2] The claim that superannuation was not an industrial matter was dismissed by the High Court - 160CLR 341 (15 May 1986)

[3] *Living In An Empirical World, The Best Retirement Income Systems in the World Rely on Industrial Defaults* – Industry Super Australia Submission re: Alternative Default Models Issues Paper

that diminish the insurance cover within super will need to be met by the rest of the taxpayers through the social security system.

HESTA believes that account balances are not inappropriately diminished simply by the inclusion of automatic insurance. If the insurance product is well designed, affordable and members derive benefit then it is an important part of the system. To demonise insurance premiums as merely "erosion" is a misrepresentation of the facts. Insurance premiums are paid to provide a product which can be valuable even if a member doesn't realise they have purchased it.

HESTA primarily has members from the Health and Community Services Sector. Our members typically draw a wage and are usually in a traditional employment arrangement under a collective agreement or award. They are predominantly light blue/blue collar workers. Often required to lift and perform medium duty manual tasks as a part of their role.

Our ability to identify the best insurance design for this group of workers is one of our strengths as a fund. With our traditional member base in mind we designed an insurance structure that would provide for members if they could no longer perform their vocational role.

We provide low-cost default insurance consisting of Income Protection (IP) to age 67 and Death cover to age 75. This is different to the majority of superannuation funds who mainly provide Total Permanent Disability (TPD) and Death cover as their default or automatic arrangement. We have chosen our unique structure for three main reasons;

1. The provision of an income through insurance in place of income lost is the most sensible and manageable structure for our members.

   Typically our members are in traditional employment arrangements, we believe that an insurance arrangement that mirrors this is most appropriate – as opposed to a lump sum arrangement which the member would then have to invest and draw an income from.

2. Well-designed IP can help members do better than TPD over time.

   TPD is typically paid in a lump sum to a member who is then required to invest or save that money in a manner that provides for them for the continuation of a typical working life. This is a difficult task for the most experienced of investors. A well designed IP structure releases funds to members in instalments over a period of time.

   Under the HESTA structure, this period of time matches a typical working life – that is, up until the age of 67 when a member can then access social security benefits. These instalment amounts are indexed, so the investment challenge to maintain the buying power of the money does not rest with the member – it stays with the insurance provider. A member receiving IP payments who then dies is entitled to their death benefit. A member who has received a lump sum TPD who later dies is entitled to the death benefit LESS the TPD amount. TPD and Death covers are related and off-set one another. This is not the case with IP and Death.

3. IP encourages rehabilitation.

   The HESTA IP structure encourages a continuing relationship with the member and naturally incentivises return to work through occupational rehabilitation.

   The best chance our members have of a dignified retirement is long and meaningful participation in the workforce. Our members are skilled and motivated. The most appropriate insurance structure for them is one which encourages and provides mechanisms to aid this participation.

This design is useable regardless of work classification, it is important for our members that they can make claims even if they are employed on a casual basis. Many superfunds have similarly tailored their approach to insurance design to ensure it is equally as appropriate for their member base.

While there are improvements that can be made in the provision of insurance within superannuation, it is important that policy makers agree that safety nets in super are worthwhile.

Conclusion

HESTA welcomes the opportunity to comment on the Draft Report.

We are proud of our superannuation system, but as it matures it can always be improved.

We maintain that policy intervention and the attention of agencies such as the Productivity Commission should focus on the systemic issues that have led to the majority of our members retiring with substandard assets due to broken work patterns, longevity issues and the gender pay gap.

The current situation where the legislated process has not been enacted is a failure of government. Moreover, the lack of analysis of this process, developed at considerable expense to the taxpayer, is an egregious waste of resources. We reiterate our strong support for the current legislated but as yet not implemented system for the allocation of default members.

We believe that further improvements can be made to the safety net superannuation space. Members' best interest is the paramount criteria to be met, we believe this cannot possibly be met by funds who seek to profit from unengaged members and inert money. We recommend that improvements to the allocation system consider excluding profit seeking funds.

We also encourage the Commission (and others) to recognize the value that insurance within super can provide, not just the cost of providing it.

We welcome the opportunity to discuss this further.