JULY 2018

SUPERANNUATION: ASSESSING EFFICIENCY AND COMPETITIVENESS DRAFT REPORT

CHOICE submission to the Productivity Commission

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia"s largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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CHOICE

Introduction

CHOICE would like to thank the Productivity Commission for its comprehensive draft report into the efficiency and competitiveness of superannuation. Enacting these proposals will turn superannuation from an opaque, frightening experience for consumers to something people can confidently engage with, or where they will not be materially worse off where they cannot. We have focussed our response on the areas that we see will provide the greatest benefit to consumers, particularly account allocation, and propose a few areas we encourage the Productivity Commission to examine further for the Final Report.

The Draft Report puts forward recommendations that will help people immediately and leave them with more money in retirement. It puts consumers at the heart of the superannuation system by recommending changes to support people to make high-quality decisions about their money in retirement.

Reform to direct people away from underperforming funds and remove multiple accounts has to occur to retain consumer trust in the superannuation system and to make sure more people have more of their money in retirement. From CHOICE‟s perspective these reforms are relatively simple and common-sense solutions. We do not believe they are as radical as some in the industry make them out to be.

CHOICE regularly hears from people frustrated or worse, defeated, by the current system. People talk to us about the thousands of dollars lost to duplicate accounts due to absurd system design issues. This frustration compounds as people get closer to retirement with people feeling they have been punished for decisions made unbeknownst to them decades earlier.

CHOICE strongly supports the merits based „best in show‟ proposal in the Draft Report. This allocation process will allow people to choose their own product, but it controls the choices available so that any fund chosen should be high-performing. While linking the allocation process to the industrial relations systems may have made sense decades ago, it now fails to fully support people that change jobs, industries and increasingly hold multiple jobs.

Consumers can and should be able to choose their superannuation fund, but they need support to do so. Supported consumer choice puts the right person in the driver's seat from day one: the person who‟s paying into the fund and whose quality of retirement rests on getting the right fund.

We don‟t believe the naysayers that say 17 year olds should not be trusted to make decisions about superannuation. These arguments do a great disservice to young people. A system that starts with consumer choice starts a process of engagement that should continue for life. We will never have a large group of people actively engaged with their superannuation unless we give them greater support and control over that very first decision in saving for the future.

There are three areas where we think the Productivity Commission could go further for the Final Report.

First, on trailing commissions covered in recommendation 13. We support greater disclosure; at minimum consumers deserve to know what they‟re being charged for any service. However, this really is a bare minimum. A far better outcome would be to ban trailing commissions altogether.

Secondly, the Insurance in Superannuation Voluntary Code of Practice is in need of urgent reform. CHOICE sat on the working group for this Code. Our experience was that the industry stripped the Code of its enforceability and removed many of the protections designed to end the erosion of accounts, particularly for young people. Our view is that at this point the industry is incapable of meaningful reform. We agree there should be a regulator-led taskforce to improve the Code, but stress that this should be done in consultation with consumer groups. We also see a strong need to adopt the co-regulatory proposals in the ASIC Enforcement Review and thereby enhance the role of the regulator in code development, monitoring and enforcement.

Finally, we encourage the Productivity Commission to explore options to give consumers a greater voice in debates about the superannuation system. We need a strong voice for superannuation fund members. The superannuation industry covers 15 million Australians who collectively own $2.6 trillion in assets. We need an independent and well-funded body that represents the interests of superannuation members.

Summary of recommendations

- **Recommendation 1:** That the ATO consumer test the best methods for ongoing engagement with superannuation at key times.
- **Recommendation 2:** That the Federal Government establish an inquiry into how to adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.
- **Recommendation 3:** That life cycle products no longer be allowed as part of MySuper.
    - Alternatively, that the design principles be enhanced for lifecycle products and that they be reported against as part of the proposed MySuper outcomes test.
- **Recommendation 4:** To allow consumers to tailor insurance products to their needs, bundling of insurance products should be banned.
- **Recommendation 5:** That long term funding be made available for an independent Superannuation Consumer Centre.
- **Recommendation 6:** That the Productivity Commission not endorse the automatic rollover proposal put forward by some in the industry sector.
- **Recommendation 7:** That the Federal Government introduce legislation to ban grandfathered commissions.
- **Recommendation 8:** That the Federal Government adopt the proposed co-regulatory model from the ASIC Enforcement Review to greatly enhance standards in self-regulation.

Protecting existing members

The creation of a „best in show" shortlist of up to 10 superannuation products would drive significantly better consumer outcomes. Using this approach, the Productivity Commission"s research found over 95 per cent of respondents who received a recommended shortlist of four to eight funds made a choice.[1]

CHOICE"s research also found that shortcuts to answers on superannuation, located in a central space where consumers already came, would be the most likely to drive engagement.[2] Consumers can handle and want more support and choice when it comes to superannuation.

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[1] Productivity Commission, 2018, „Draft report: Superannuation: Assessing Efficiency and Competitiveness", p.444
[2] Pollinate, 2016, „Project Superpower – informing a strategy to engage people with their superannuation", Research commissioned by CHOICE, p.32, available at: https://www.choice.com.au/money/financial-planning-and-investing/superannuation/articles/why-consumers-avoid-thinking-about-super-20161024

We have found that when people are equipped with the right information, they can move from being confused and disengaged, to informed and motivated. In our 2016 research, young people told us that they weren‟t engaged because the current system is not user-friendly.[3] People wanted a short-cut to the correct answer, not to be drowned in information by every single option. This strongly indicates that the best in show option could help all consumers but, best of all, support those who are currently worst-served by the current system.

The best in show measure will drive new workforce entrants into a far superior fund than they might otherwise end up in in the current system. Placing a best in show list on the MyGov platform is the ideal outcome.

We also need to ensure existing members are not left behind, as the Productivity Commission found:

> *"While dispersion of product-level fees has decreased over the past decade, there remains a persistent „tail‟ of relatively high-fee (mainly for-profit) choice products with total fees exceeding 1.5 per cent of assets each year. This tail comprises about 14 per cent of member accounts and 15 per cent of system assets."*[4]

For existing members the Productivity Commission has proposed that members would have access to the best in show list for switching and consolidating, and be able to join those funds as well as benefit from greater protections through enhancing MySuper standards. These measures are all well adapted to the needs of existing members.

However, to benefit from the best in show list people, particularly the 14% stuck in high fee legacy products, need to be made aware that it is available, at targeted times. We agree that the Australian Tax Office (ATO) has a role in nudging people towards engagement with their superannuation. The best way to achieve this needs to be consumer tested, but at a minimum we would expect the ATO would prompt people to compare the net long term performance of their existing fund with those on the best in show list. People could be prompted to make these checks around tax time when they are already assessing their finances.

We also see a strong need to assist people in making good decisions if contemplating leaving the default environment. This should include measures such as an obligation on a gaining

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[4] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview" draft finding 3.2

superannuation fund to actively encourage people to compare the fund against the best in show list before proceeding with a transfer.

- **Recommendation 1:** That the ATO consumer test the best methods for ongoing engagement with superannuation at key times.

Explaining differences in investment performance

INFORMATION REQUEST 2.2
Aside from administration fees, asset allocation and tax, what other factors might explain differences in investment performance against benchmark portfolios of the superannuation system, as well as segments such as for-profit and not-for-profit? What evidence is available to test the influence of such factors?

There is an inherent conflict of interest at the heart of for-profit superannuation companies who have to balance the competing interests of their shareholders and their members. This is known as the „*principal-principal conflict*‟, where:

> *"retail trustee directors may be in a situation where they have to decide whether company shareholder profits or whether pension fund member benefits should have priority in the direction of executive action"*[5]

The profit motive of for-profit funds creates a conflict between a director‟s obligations to shareholders under the *Corporations Act*, and their beneficiaries (members) under the *Superannuation Industry (Supervision) Act*. There is much talk about having measures in place to „manage‟ these conflicts. Steps can be taken, such as the appointment of independent directors and transparency around conflicts, but ultimately there are two objectives which are at odds with one another.

Theoretically organisations with a profit motive need to respond to customer needs in order to maintain this profit. Customer friendly innovations and efficiencies are often driven by this obligation to build market share and extract profit. In some markets, with highly engaged, active consumers, competition helps ensure the fruit of these innovations and efficiencies are shared

[5] Sy, W. 2008, „Pension governance in Australia: an anatomy and an interpretation‟, *Rotman International Journal of Pension Management,* vol. 1, no.1, p.36

between consumers and the business. Usually this takes the form of better quality products and lower prices. Unfortunately, superannuation is not one of these markets.

A combination of factors, such as highly complex and opaque products, a proliferation of over 40,000 investment options and a product with a value that is often not realised until retirement, constrain competition in superannuation. Under these conditions for-profit businesses are not under the same pressure to share the value they create with customers. As a result, they are poorly positioned to manage the conflicts between their obligations to shareholders and to members of a superannuation fund.

The result of this poor management of conflicts is laid bare in the Productivity Commission‟s analysis of long term fund performance. For-profit retail funds on average significantly underperformed against their benchmark, while not-for-profits outperformed their benchmark.[6] The actual return performance of the for-profit sector was just 4.9% per annum over the last 12 years, compared to 6.8% in the not-for-profit sector. For a person stuck in an underperforming fund these differences would potentially see them hundreds of thousands of dollars worse off in retirement.

CHOICE acknowledges recent research that found that while some superannuation funds had independent directors, the majority of those „independent‟ directors were affiliated with another segment of the business.

> "*on average, 78 per cent of retail fund trustee directors are affiliated, where 34 per cent of these trustee directors are either executives or employees of a related entity within the service provider group, and the remaining 44 per cent are directors of a related entity within the service provider group*."[7]

The impact of these split loyalties is clearly on display in the underperformance of some funds. It lends credence to the need for more stringent definitions of what is an independent director. It also makes it all the more important that the Productivity Commission‟s recommendations be adopted in full to apply increased competitive pressure on the for-profit sector in order to lift it out of its current state of underperformance.

[6] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview‟, p.9
[7] Liu, K. and Ooi, E. 2018, „The impact of related-party outsourcing and trustee director affiliation on investment performance of superannuation funds‟

The risk remains that any watering down of the core recommendations, say through expansion of the short-list or gaming of the system to get members to leave high performing defaults, could leave us with funds that consistently underperform. The Federal Government must vigilantly guard against this when developing legislation to enact the Productivity Commission‟s regulations.

It also lends significant weight to the Productivity Commission‟s recommendation for a broader review of life insurance within superannuation. As a for-profit component of a superannuation product, which is already poorly understood and lacking member beneficial competition, life insurance in superannuation is ripe for a thorough analysis of any conflicts driving arrangements, competition and efficiency in how it is delivered. Separate from life insurance, this analysis needs to take its starting point as looking at how to best adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.

Importantly, the Productivity Commission‟s work did find, although on a smaller scale, some not-for-profit funds underperforming against the benchmark. The outcome for someone stuck in an under-performing not-for-profit fund is the same for someone stuck in an under-performing for-profit fund: they are left with significantly less in retirement. Reform is equally required to address this problem. In these cases, it is important to look into the factors which led to underperformance, such as the lack of independent directors. Having independent voices on a board is extremely valuable to an organisation, particularly when making decisions over merger proposals, where a fund is chronically underperforming due to a lack of scale.

- **Recommendation 2:** That the Federal Government establish an inquiry into how to adequately and efficiently provide for the needs of those who are unable to work due to disability or death and their dependants.

Creating world-class competition in superannuation fees

Australian superannuation fees are high by international standards and not-for-profit fees are stagnant despite decreases in the for-profit sector, albeit from a high base. While fees alone are not the most important factor in a well-functioning superannuation system, they are far easier to control and predict than returns, so analysing how to create fee competition, without sacrificing net returns is worthwhile. As the Productivity Commission found:

> *Superannuation fees in Australia are higher than those observed in many other OECD countries. In aggregate, total fees — for administration and investment*

> *management services, and in both accumulation and retirement — have been trending down as a proportion of assets, from 1.3 per cent in 2010 to 1.1 per cent in 2016. Fees have fallen markedly for retail funds, albeit they remain higher (at least for choice products) than the (largely unchanged) fees for industry funds.*[8]

The fact that industry fund fees have stagnated, a sector typically made up of defaults, is a key indicator that there is a lack of competition in the default market. This stagnancy indicates the for-profit dominated choice sector has failed to apply pressure to the industry funds and there has been little rivalry within the industry funds on fees.

With so many default funds listed and people barred from choice in some industries, it is not surprising that fee competition is small to non-existent in the existing default system. The solutions sit in the Productivity Commission‟s recommendations to not just create competition in the market but to create competition for the default market through the best in show shortlist.

Without this important change the default market will continue to flat line and we will never see what competitive superannuation funds, particularly the not-for-profit sector, are capable of delivering consistent high-quality outcomes for people‟s retirements.

The expectation and reality gap on life cycle products

INFORMATION REQUEST 4.1
Should life cycle products continue to be allowed as part of MySuper? If so, do they require re-design to better cater for the varying circumstances of members nearing retirement, and how should this be achieved? What information is needed on members to develop a product better suited to managing sequencing risk?

In terms of product design, there are obligations on trustees to weigh members‟ needs in developing investment strategy.[9] Trustees can decide whether to use a „standard balanced option‟ or a „life cycle option‟ for investment in MySuper products. Life cycle options tend to alter the level of assets held in „growth assets‟, gradually decreasing as you age. This is to control for „sequencing risk‟ or the risk that a consumer‟s investments will be subject to a significant market

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[8] Productivity Commission, 2018, „Superannuation: Assessing Efficiency and Competitiveness – Draft Report overview‟, Draft finding 3.2
[9] Australian Prudential Regulation Authority, *Prudential Standard 530 Investment Governance,* July 2013. Available at: http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-530-Investment-Governance-July-2013.pdf.

drop shortly before retirement. Many consumers experienced such a drop during the Global Financial Crisis (GFC).

By contrast, a balanced option is a fixed investment mix that does not change with age. The difference in target market for these two products primarily comes down to managing „longevity risk", or how long a consumer may live. For example, a trustee for a fund with members with lower life expectancy may reasonably decide it is in those members" best interests to develop a life cycle product which decreases risk as retirement age nears. By contrast, a fund whose members have a higher life expectancy may reasonably decide it is in members" best interests to stay in a higher risk investment option until retirement as they are likely to live and perhaps work well beyond retirement age.

In theory, depending on your expected longevity, one product may be more suitable than the other.

While the theory is clear, there are deep problems with how these life cycle options have developed in practice. Analysis conducted by Rice Warner shows that many of these products may not be living up to consumer expectations. After reviewing products available on the market the analysis showed that building more conservative (lower risk) investment portfolios at too early an age would see a reduction in member retirement benefits.[10] For example, the research found life cycle products began aggressively de-risking an investment product at age 45. People in this category tend to be 20 years or more from retirement and depending on longevity may continue to invest their funds for an additional 20 years throughout retirement. Therefore 45 is likely far too early for de-risking an investment and according to the Rice Warner modelling will not lead to the best retirement outcomes for people in life cycle products.

From a consumer"s perspective the idea that a product will be tailored to their life stage is an appealing prospect. However on the evidence someone in a life cycle product would on average be worse off at retirement. The approach also relies on superannuation funds holding high-quality data about the needs of their current members (not just trends for past or older members. It remains unclear to CHOICE if funds hold this information in order to adequately tailor a life cycle product. CHOICE recommends removing life cycle products from the MySuper system. Alternatively, the design principles to which they must adhere need to be enhanced. These design principles should force a fund to be transparent about product structure and

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[10] Rice Warner, *Lifecycle MySuper Product Fees*, 2016. Available at: http://www.aist.asn.au/media/860083/lifecycle_mysuper_product_fees.pdf

provide evidence of member longevity estimates and modelling against expected „balanced‟ investment outcomes to justify any age based de-risking.

This could be linked to the proposed MySuper outcomes test, which would enable APRA to de-authorise poorly performing products.

- **Recommendation 3:** That life cycle products no longer be allowed as part of MySuper. Alternatively, that the design principles be enhanced for lifecycle products and that they be reported against as part of the proposed MySuper outcomes test.

Bundling creates confusion

INFORMATION REQUEST 8.1
What is the case for bundling life and total and permanent disability insurance together, as is done by some superannuation funds? Are there funds that offer these separately, and if so, do many members of these funds elect to have one type of cover but not the other?

The research makes it clear that bundling adds greatly to the cost and difficulty in consumer decision making. Behavioural economics recognises that consumers have limits on the amount of information they can take in; are affected by presentation; tend to be poor at anticipating the future; and are more concerned about losses than gains.[11] Given life insurance is often complex and the benefits are in the future if at all, consumers can be particularly poor at assessing their needs in relation to an insurance policy.

These issues can be compounded by the fact that life insurance in superannuation is a bundled product, let alone some products also bundling death and total and permanent disability (TPD). From a behavioural perspective, bundling, which can result in complex pricing, increases the costs of searching for the preferred choice, and ultimately impacts someone‟s ability to make an informed decision.[12] This is due to the need for consumers to obtain information and learn about the various quantities, quality and price combinations offered by a range of suppliers. Studies have shown that consumers make systematic errors when assessing the worth of bundled

[11] Office of Fair Trading, 2010, „What does Behavioural Economics mean for Competition Policy?‟, March 2010, p. 5
[12] Papandrea, F., Stoeckl, N., Daly, A., 2003, „Bundling in the Australian telecommunications industry‟, *Australian Economic Review* 36 (1), 41-54.

goods and/or services.[13] These errors may advantage producers at the expense of consumers.[14]

Ultimately people should be given the freedom to tailor a life insurance offer to their needs. Increasingly people are part of dual income households and may not have financial obligations beyond rent and other living expenses. In the event of the death of one member of this household, from a purely economic perspective, they would be much better placed to deal with the loss than someone in a household reliant on a single income. These people should be given the option of reducing their insurance spend by removing death cover and keeping TPD, which they may still find valuable.

- **Recommendation 4:** To allow consumers to tailor insurance products to their needs, bundling of insurance products should be banned.

The (lack of) case for default income protection

INFORMATION REQUEST 8.2
What is the value for money case for income protection insurance being provided on an opt-out basis in MySuper products?

As an opt-out product the case for income protection is tenuous at best. For the following groups of people it adds significant cost without necessarily delivering any additional benefit:

- People paying for more than one policy due to duplicate accounts;
- People with intermittent work;
- People in the lowest income quintile;
- People casually employed; and
- People who have taken time out of paid employment, for example to raise children.

We are not aware of any fund making any attempt to ensure groups that cannot benefit from this insurance are not inadvertently paying for cover. Superannuation funds either appear to have poor data on member needs or are unresponsive to this data. For example, an extended period of no superannuation guarantee payment would be indicative of someone not being in

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[13] Heeler, R.M., Nguyen, A., Buff, C., 2007, „Bundles = discount? Revisiting complex theories of bundle effects", *Journal of Product and Brand Management* 16 (7), 492-500.
[14] Estelami, H., 1999, „Consumer savings in complementary product bundles", *Journal of Marketing Theory and Practice*, 7(3), pp. 107-114.

paid employment and unable to claim against an income protection policy. We would expect that a fund acting in the best interest of its member would ensure it made contact to understand the situation and see if the insurance provided by default was appropriate. Better yet, given the cost and limited circumstances in which a claim can be made, checking could be done at sign up to see if an income protection product in suitable in the first place.

Many arguments for its existence seem to rely on its high successful claim rates, with ASIC research finding it had one of the lowest decline rates at 7%.[15] The justification being that, because it was being claimed and paid it was beneficial. This fails to consider the cost on retirement savings weighed against the actual insurance need of a person. At claim time an argument can be made that every type of insurance that can be claimed upon is needed. Certainly, any consumer upon discovering they may be eligible to make a claim would want to make one. However, insurance is a hedging product and its need should be weighed against its cost prior to an event which may lead to a claim.

Depending on product structure this high successful claim rate for income protection is also reflected in its cost. In some funds the default income protection premiums can be as high as $767 a year compared to $362.96 for both death and TPD.[16]

The industry funded research into life insurance in superannuation by KPMG even directed funds to consider what benefit offering both TPD and income protection offered members. Recommending funds:

> *"Consider the rationale and cost of providing both a lump sum and an income replacement on disablement. Are Death, TPD and IP cover all necessary for default group insurance cover or should funds consider offering TPD and IP interchangeably to best suit their demographic."*[17]

It is clear that some funds have already done this analysis and decided against offering income protection by default. According to APRA data 31% of funds contain income protection compared to 76% for death and 65% for TPD.[18]

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[15] ASIC, 2016, „Report 498: Life insurance claims: An industry review", p.7
[16] Based on a 36 year old with default cover in the REST superannuation fund. Available at: https://www.rest.com.au/NEW-Document-library/Guides/Member/RES0254_REST_Super-Insurance-Guide-FA_WEBSAFE.PDF
[17] KPMG, 2017, „Review of default group insurance in superannuation", available at: https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/default-group-insurance-superannuation-review.pdf
[18] Annual MySuper Statistics June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 6 – MySuper Products.

In purely income replacement terms, other social security payments may more than cover the needs of people on low incomes. For this demographic income protection is a poorly targeted product. Again superannuation funds do not appear to be adequately considering the needs of some segments of their membership. Instead funds have focussed on developing products for the „average member" which may be totally inappropriate for some cohorts. As mentioned, we see a strong need for a broader piece of work to develop a more efficient and effective way to provide for people who are impacted by disability.

Superannuation Consumer Centre

The superannuation industry covers 15 million Australians who collectively own $2.6 trillion in assets, which for many will be relied upon to cover cost of living expenses for the last 20 or so years of their lives. Yet there is currently no single funded consumer voice to ensure their interests are advocated in major policy debates. To date CHOICE has funded, through its subscription model, a part-time role to ensure there is a voice in these crucial discussions.

Regulators can perform elements of consumer protection, but without a strong voice advocating solely for the interest of members, the space can be crowded out by the views of industry. This is particularly true for consultations into complex issues initiated by regulators. To give a sense of the size of the current imbalance in policy staffing, a recent parliamentary inquiry uncovered that the major industry lobby groups spent a combined $25.8 million, employing 100 staff, with more than 20 dedicated to superannuation policy and research.[19] The funding for this came directly from the retirement savings of consumers, yet not a cent was dedicated to a truly independent consumer advocate.

Australia needs a consumer group that can focus on the highly technical area of superannuation and represent their interest. The concept of a Super Consumer Centre, or SCC, was first raised by CHOICE as a contribution to the Cooper review. Work has been done since this time to develop a strong business case for an organisation that would directly assist consumers, advocate for reform and educate people about the system.

The SCC would be a valuable steward in ensuring long-term, that the superannuation system is efficient, competitive, and truly works for the interests of members. Ideally, the organisation would work alongside of a regulator that focuses on and champions member interests. It would

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[19] Senate Economics Legislation Committee, 10th October 2017. https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/SuperannuationNo1/Public_Hearings this does not include the Australian Banking Association or smaller lobby groups

be useful in ensuring that the member focused work of the Productivity Commission is followed through and enacted beyond this inquiry.

Specifically, an SCC would be well placed to deliver original research into consumer needs and experience with the superannuation system, advocacy for consumers and a series of consumer education and empowerment initiatives. This combination of direct assistance and policy, research and advocacy projects to would directly help consumers to better understand their superannuation and make the case for improving the system in their interests.

Given the vast size of the superannuation sector, it is essential that we have a SCC to promote the long-term interests of members. This is common practice in other consumer sectors. Unless there is a strong organisation dedicated to representing consumers in debates about superannuation, we‟ll continue to see industry groups dominate discussion and conflate their interests with the interests of their members.

Funding for similar consumer advocates is commonplace across other key services. For example the Australian Communications Consumer Action Network, in communications, Energy Consumers Australia, in the energy sector and the Consumers Health Forum, in the health sector. Typically these are funded through a small levy on industry. Their work includes direct education to consumers, policy expertise, research and advocacy in important policy debates.

- **Recommendation 5:** That long term funding be made available for an independent Superannuation Consumer Centre.

Automatic rollovers

At the hearings, an automatic rollover approach was discussed by some industry members, whereby members would see their balance move to a new superannuation fund each time they changed jobs or industries. This was posed as an alternative to the Productivity Commission‟s recommendation that people have a single fund which was linked to them rather than their place of employment. CHOICE is concerned that this industry proposal represents yet another antiquated approach to superannuation which will add cost, drive down engagement and ultimately deliver few additional benefits to consumers when compared to the Productivity Commission‟s model.

The cost alone of the industry model makes it grossly inadequate as a modern way to manage superannuation. Due to normal movement in the workforce, people would be chopping and changing funds at a frequency which would have disastrous impacts on their retirement savings.

According to ABS labour mobility data there were 2.2 million people who have been with their current employer for less than 12 months.[20] Assuming these trends continue, across the life of an average 18 year old entering the workforce today and retiring from all work at 75, they would have changed employers every six years and had almost 10 different employers in their lifetime.

In turn this would lead to nine different rollovers. The number of rollovers would impact a fund‟s investment strategy, requiring them to hold larger amounts of liquid assets to facilitate the timely movement of savings between funds. Liquid assets, such as cash, tend to have far lower returns than alternatives. This heavier loading into liquid assets would ultimately drive down the retirement incomes of people.

Selling in and out of asset classes also carries cost. Some funds recoup these costs directly through a buy/sell spread, and others share the cost across the entire membership. Either way it is a real cost which is incurred due to member movement in and out of investment options. The industry model would greatly increase the rate at which these costs would be incurred. As an example, one major default fund charges a buy/sell spread of up to 0.47%, if a male with an average balance at age 55 were to change jobs under the industry plan they would be charged up to $1,114.[21] Depending on the fund and balance, that person could be forced to pay a similar amount for each job move. This desire to keep superannuation within the industrial relations system at all costs is clearly detrimental to consumers and leads to poorly thought through policy proposals.

This proposal would also play havoc with people‟s insurance coverage. Constant switching has the potential to impact people‟s coverage and could lead to lapses or gaps in cover. In some instances people consciously increase, decrease, add and remove different types of cover based on their needs. There is no system to carry forward this tailoring as people are bounced around the superannuation system under the industry‟s proposal. Insurance also differs dramatically from fund to fund, for example, some offer income protection, some don‟t, some offer TPD cover which is much easier to claim against compared to other policies. This could lead to a person being left without cover they thought they had, or paying for more cover than they intended.

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[20] ABS, 2017, „Participation, Job Search and Mobility, Australia, February 2017‟, available at: http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6226.0Main%20Features4February%202017?opendocument&tabname=Summary&prodno=6226.0&issue=February%202017&num=&view=

[21] Based on a 55 year old male having an average balance of $237,022 moving from REST to a new fund.

Sectors of the industry have tied themselves in knots attempting to show that low engagement in the current system has actually led to better consumer outcomes. The fact is assisting consumers to positively engage with superannuation would help them avoid some of the worst traps in the system and allow the market to operate where it can. The relatively high fees, chronic underperformers, inappropriate insurance and high levels of duplicate accounts are all emblematic of a system which shuns any attempt to encourage positive member engagement.

CHOICE has consistently maintained that we should be driving for supported engagement so that people are empowered to take control of their superannuation at key moments in their lives and are helped to make good decisions. As a simple illustration, we want people to feel ownership of their fund when they first enter the workforce, by selecting from a list of high performing funds. The system as proposed by the Productivity Commission would see these decisions lead to a culling of the chronic underperformers from the system. A system of automatic rollover, where many would never exercise any choice, would drive down engagement and allow the underperformers to fester, unchecked and unquestioned.

In the face of the damage already done to retirement savings by duplicate accounts this recommendation from industry is disappointing.

- **Recommendation 6:** That the Productivity Commission not endorse the automatic rollover proposal put forward by some in the industry sector.

Ending grandfathered trail commissions

As part of recommendation 13 the Productivity Commission has proposed greater disclosure around ongoing trail commissions. The intent is to inform consumers of the cost and that they are no longer legal for new members. At minimum, consumers deserve to know what they"re being charged for any service. However, the better outcome would be to phase out trailing commissions all together.

The Future of Financial Advice (FoFA) reforms were predicated on a clear understanding that commission-based payments led to conflicted advice, i.e., advisers giving advice not in the best interests of their clients. Exemptions were fought for by industry to ease the shock of moving to a business model with fewer conflicts. One of these exemptions allowed advisers to continue to earn commissions on agreements entered into prior to the FoFA reforms coming into effect. The original intent of grandfathering was to “facilitate a smooth transition to the new regime for

industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable."[22] Counter to this intent, it is clear from the evidence from the Royal Commission hearings on financial advice which found members of industry have sought to prolong the existence of conflicted remuneration by taking steps to evergreen conflicted remuneration rather than remove it entirely.

The evidence which came to light during the hearings showed financial advice licensees have systemically prioritised maintaining grandfathered commissions over acting in the best interest of their customers. Including:

- Evidence that a subsidiary of ANZ, RI Advice, purchased advisers without undertaking appropriate due diligence, before the 1 July 2013 FOFA deadline, to ensure that they received ongoing grandfathered commissions.[23] This included offering $150,000 to one financial planner, despite the fact he had failed his initial competency exam, continued to provide consistently poor advice, and received his first complaint just three months after joining ANZ.[24]

- Evidence that AMP management made a concerted effort to structure their business to allow „orphan" clients to continue to be charged grandfathered commission, even though their clients changed advisers.[25]

- Evidence that even five years after the passing of FoFA, 60-70% of fees that AMP pays to its advisers are commissions, rather than fees-for-service.[26]

- Evidence that Commonwealth Financial Planning Limited (CFPL) has made no efforts to „dial down" grandfathered commissions to zero, and that the CFPL views grandfathered commission as simply providing "some relief" to their bottom line.[27]

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[22] Treasury, 2018, „Key reforms in the regulation of financial advice", p.8
[23] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 20th April 2018, p.1527
[24] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 20th April 2018, p.1492
[25] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 17th April 2018, p.1138
[26] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 17th April 2018, p.1153
[27] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 19th April 2018, p.1345

These examples are not isolated incidents. They exist on an industry-wide level. Financial service licensees have systematically endeavoured to profit from existing pre-FoFA customers. This behaviour falls well below community standards and expectations. It has been unequivocally shown that commissions distort the quality of financial advice offered to consumers, and grandfathered commissions are no exception. The current exemption has helped to foster the attitude that advisers are justified in continuing to reap these commissions. Industry members have sought to exploit this exemption and it is past time to close it down.

Should grandfathered commissions cease?

Industry has been given ample time to adjust to a new business model with fewer conflicts, yet large elements of it have failed to make the move and seem intent on squeezing every last cent from this tainted advice. Consumers stuck in these arrangements will continue to be slugged with large commission-inflated fees for products that are likely not in their best interests. Attitude change will not come from within, with players like AMP denying it should be up on criminal charges for misleading the regulator over the independence of the report it commissioned into the fee for no service breaches of the law.[28] Change will only come from a legislated ban on grandfathered commissions.

Ending grandfathered commissions will also serve as a catalyst for advisers to offer new advice to consumers who may currently be acting on conflicted advice. Turning off these conflicted revenue streams will force advisers to work for future income by offering advice to these clients which meets the best interest test.

- **Recommendation 7:** That the Federal Government introduce legislation to ban grandfathered commissions.

Insurance in superannuation code taskforce

CHOICE is also concerned that the Insurance in Superannuation Voluntary Code of Practice still falls well short of community expectations, not just in its lack of enforceability, but in the fact that it is filled with carve outs and loopholes. CHOICE sat on the working group for this Code and gave extensive feedback on its many failings. We endorse the Productivity Commission"s recommendation that an insurance code taskforce be immediately established. However, our view is that the industry is incapable of meaningful reform and that the regulators, in

[28] SMH, 2018, „AMP 'strenuously denies' it should face criminal charges", 4/5/2018, available at: https://www.smh.com.au/business/banking-and-finance/amp-denies-it-doctored-independent-report-20180504-p4zdcz.html

consultation with consumer groups, advise the industry on what further steps need to be taken for the code to meet ASIC"s definition of an enforceable code of conduct under Regulatory Guide 183. We agree that action should occur immediately to lift standards and make requirements

We also see the current self-regulatory process as deeply flawed and in need of overhaul. The lack of regulator involvement in code development, oversight and ultimately enforcement has allowed the superannuation and financial services sector in general get away with developing meek codes that do little to lift standards. The evidence of this can be seen in the numerous examples of self-regulatory failure in the Banking Royal Commission as well as industry failure in relation to the Insurance in Superannuation Voluntary Code of Practice.

We repeatedly see the need for legislative reform to fix industry inaction, the most recent of which is the *Protecting Your Superannuation Package Bill 2018*, which was introduced to correct the failing in relation to the Code. Without solutions such as the co-regulatory model, proposed in the ASIC Enforcement Review industry will continue to let self-interest get in the way of meaningful consumer protection. This would see a far greater role for the regulator in development, monitoring and compliance and ultimately deliver far more responsive codes which actually lift consumer standards.

- **Recommendation 8:** That the Federal Government adopt the proposed co-regulatory model from the ASIC Enforcement Review to greatly enhance standards in self-regulation.