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Submission – Your Future, Your Super Package

Rice Warner is pleased to provide further commentary about the ***Your Future, Your Super*** (YFYS) package released in the October Budget. This feedback is in addition to earlier commentary that we have provided in a public Insights blog released shortly after the Budget[1]. Our commentary is broken into four sections, each based on the key items of the YFYS package.

Stapling – your super follows you

The concept of having a single superannuation fund throughout a working life was one of the tenets of industry funds when they were established more than 40 years ago. For many members, this has been successful. However, other members change funds when they change employment, and this has created many unnecessary accounts.

The new Stapling rules eliminate unintended duplicate accounts by connecting all employment-related contributions to a member's existing account. The new structure will benefit superannuation funds which will have higher levels of retention as most of their members will stay with them when changing jobs. Members should also benefit from continuity of membership.

There are two areas which need further consideration.

Employer schemes

Before industry funds and master trusts, most superannuation was provided by employers as a staff benefit. Employers tailored benefits to their demographic profile, and many subsidised fees and premiums. Many employers continue these arrangements even when they outsource much of the management of the fund to a multi-employer fund.

We note that there are advantages to having all, or at least the vast majority of, employees within the same fund. For instance, clusters of fund membership aids member education as well as providing scale for fee discounts and, for larger businesses, tailored life insurance arrangements.

[1] https://www.ricewarner.com/budget-changes-for-superannuation/

Under Stapling, these employer schemes will be starved of new members and will inevitably dwindle. We anticipate that over time, most employers will have as little interest in their employees' superannuation arrangements as they do with their personal banking services for payment of wages. Employers will simply be the conduit to pay superannuation contributions.

While we concede that employers could show new employees the benefits of their fund and give them the option of joining as a Choice member, we expect that Australia's current financial advice legislation will mean that most employers will not risk a direct approach.

We consider that employers should be free to 'encourage' new members to join their fund, by **setting out the benefits of their default structure as part of the employment engagement letter.** This should not be deemed to be financial advice but would simply be providing factual information about the range of employee benefits on offer. Where a scheme is well designed, it could be attractive enough to persuade new employees to join, thereby maintaining the value of the scheme.

Many corporate funds allow members to remain in these funds after leaving service with the sponsoring employer. This allows the member to maintain the benefits and it helps the fund maintain its scale. An example of such a fund is Telstra Super. Stapling will support this structure.

New entrants to superannuation

Members entering the workforce for the first time will need to select a superannuation fund. Most of these individuals will be younger workers entering the workforce for the first time and will often have little knowledge of superannuation. Other new entrants will be migrants or Australian ex-pats returning from abroad and will often be subject to a similar lack of knowledge and expertise.

The government expects that these members will use the *YourSuper* comparison tool (see below). However, we expect that these individuals will be more likely to seek advice from family and friends. Superannuation funds will want to position themselves to these potential members but will need to be careful they do not breach the anti-hawking legislation.

Now that the standards for a MySuper product have been raised, and underperforming funds will largely be eliminated by Australian Prudential Regulation Authority (APRA) with the help of its Heat Map tools, we consider that there is little risk for a new entrant of joining any one of these funds. We believe it fair that the trustees of these products be allowed to market themselves to this group of potential members. Consequently, **we suggest that soliciting a new entrant to the superannuation system to join a MySuper product be exempt from the anti-hawking legislation**. We anticipate that this may provide an opportunity for funds who are disadvantaged under the stapling measures to compete in a newly created distribution channel.

Empowering members

We agree with the government's approach to measure the performance of superannuation funds so members can compare products appropriately. We agree it makes sense to have government control over the metrics used, though we note the subjectivity of measurement.

Recently, considering the YFYS proposal, the Conexus Institute gathered a group of Australia's leading superannuation consultants (including Rice Warner) to set out some principles for these calculations. The group came up with the following list:

1. Developing an effective performance test is a great opportunity to improve superannuation outcomes for consumers.

2. It is important to minimise any undesirable outcomes created by introducing a performance test.

3. The ramifications of failing any performance test need to be proportional to its reliability.

4. Qualitative assessment by an entity such as APRA would acknowledge changes made through time by superannuation funds to address past performance issues.

5. A well-designed collection of multiple metrics is likely to be more reliable and effective than a single metric.

6. If the intention is for a consumer outcome test, then it makes sense to include administration fees.

We consider that the *YourSuper* comparison tool as proposed will provide a simple metric of how funds have performed. However, we do not expect that it will be possible to provide an accurate and equitable comparison of funds with a single metric such as is proposed. For example, the current tool does not consider the risk profile of the investment portfolio nor the governance framework used by the fund.

Arguably, these matters are more important than past investment performance, which is not available to any new member, and may not be repeated. In fact, it would be confusing to have a Government-mandated comparison tool that only considers past investment performance when ASIC – in common with many regulators internationally - requires funds to state that past performance is no guide to future performance.

Setting *YourSuper* in a ranking order will mean that most people using the comparator will pick the top-ranked fund. They will do this without any knowledge about the structure of the fund, nor its relevance to their own circumstances, nor the impact of administration fees on outcomes for the amounts which they will be investing. We note that the list will be updated quarterly, but this will have little impact from one quarter to the next as the measurement period chosen is eight years. New funds or those which have radically changed their investment structures will not appear in this list, even though they could be appropriate for many members.

We suggest a few enhancements be made:

- The list be grouped in blocks of five funds to negate the presentation of a fund appearing at the top by a very small margin.
- The period of measurement be changed to show results over both 7 years and 10 years. These are the periods commonly used by the global investment community for long-term measurement. It does not make sense to pick a new period without any evidence to justify it. We note the Productivity Commission (whose advice the government relied upon to select its measure) did not present any rational case for selecting an eight-year period.
- Development and inclusion of appropriate measure(s) of risk.
- Inclusion of the investment target for members (e.g., CPI+ 4% over rolling ten-year periods) for reference alongside the historical absolute performance of the fund.
- The size of assets held in MySuper should be shown as many members would consider a large fund to be safer.

New superannuation funds will not have an eight year track record. They could be listed with their track record since inception. However, it will be eight-years before they appear on the main table. This is a disadvantage as they will not attract many, if any, new members through this process.

Some new entrants will suggest a proxy performance for comparison purposes. However, this is highly subjective and might not lead to a fair comparison.

Similarly, those funds which have radically changed their investment processes and fees will be burdened by their history. Arguably, the legacy years should be removed, or a framework for communicating significant changes in the product should be developed. Once again, a proxy could be considered, but this is highly subjective.

To improve YourSuper to be a sensible comparator for consumers, we suggest a formal review be held which will lead to a meaningful comparison of superannuation funds. It should also properly assess measurement of new funds and funds which have changed their investment structure and/or reduced fees.

Holding funds to account for underperformance

We understand and support the goal of eliminating underperforming funds. However, we believe this should be based on APRA's *Heat Map* work which considers many factors including investment performance. We note some problems with the prescriptive measure of forcing funds to notify members of underperformance and then a year later of requiring them to cease accepting new members.

Some of the problems we foresee:

- The currently proposed benchmark would not measure the impact on member outcomes of asset allocation, which is usually the most important source of investment returns. It would also fail to measure methods of reducing risk other than asset allocation, for example hedging against tail risk within asset sleeves.
- Funds will know now whether they are going to fail the test in a year or two. Many will be unable to turn around their performance in this period without taking excessive risks. These funds could run campaigns to convert members into Choice products that are very similar in structure to the MySuper product. This will mitigate the effectiveness of the legislation.
- Under the proposed benchmark, there would inevitably be funds failing the test which, due to differences in asset allocation and administration fees, actually delivered higher net returns to members than some funds that passed the test. This would be contested and would be detrimental to consumer confidence in the system and its regulatory framework.
- Funds could establish and promote platforms for SMSFs and begin to encourage members to move into products with no performance measures. This may lead to a paradigm in which larger funds are subject to differing legislative requirements and will increase system complexity.
- Funds with poor past investment performance which enhance their investment philosophy, governance and asset allocation could still fail the test due to the weight of their past poor performance. We would question whether it is desirable to eliminate these funds if their likely future performance is expected to be reasonable? We believe APRA should be able to review such cases and monitor them appropriately. At the extreme, they have the power to withhold a MySuper licence if the changes are not satisfactory.
- New entrants to the system will not have an eight year track record, so any measurement of their investment prowess will be subjective, and arguably unfair.
- The currently proposed benchmark for infrastructure has less than 3% in Australian infrastructure and may discourage the further increase in Australian infrastructure which would otherwise naturally come from Australian superannuation funds.

Increasing transparency and accountability

We support superannuation trustees being compelled to act in the best financial interests of their members. We view this as being an appropriate requirement and an improvement on the current (strong) requirements placed upon trustees.

However, under the proposed measures there is the potential for inequity. For instance, commercial funds with a parent with a strong capital position could be promoted without using member funds. Conversely, an industry fund has no capital and can only use member funds for promotion (which might now be illegal in some cases). We have argued in the past that all funds should hold capital to support some activities (for example, inorganic growth) and recommend that this be considered as part of these changes.

Yours sincerely

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