Submission to Financial System Inquiry

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Executive summary

This submission is made by:

- Independent Fund Administrators & Advisers Pty Ltd (IFAA), a Brisbane based administrator of industry superannuation funds and managed investment schemes;
- QIEC Super
- Club Super

IFAA, QIEC Super and Club Super appreciate the opportunity to make comment on the superannuation related recommendations of the Financial System Inquiry. Each of us advocates the position of small to medium funds in the industry in being able to add value to members and provide competition to large funds.

The submission makes comment on the following superannuation related recommendations from the final report of the Inquiry:

Recommendation number	Subject
9	Objectives of the superannuation system
10	Improving efficiency during accumulation
11	The retirement phase of superannuation
12	Choice of Fund
13	Governance of superannuation funds
23	Facilitate innovative disclosure
31	Compliance costs and policy processes
37	Superannuation member engagement

Recommendation 9: Objectives of the superannuation system

Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.

This recommendation is supported.

By explicitly defining the objectives of the superannuation system, this should then frame the policy settings of the current, and all future Governments. Through the development of bi-partisan long term policy objectives for superannuation, this may discourage both sides of politics from developing short term proposals which may be influenced by the political cycle, but could in fact be contrary to the longer term objectives of the superannuation system. If the development of clear objectives results in more coherent and stable policy settings, this would be to the benefit of the industry and ultimately the members of superannuation funds.

The articulation of clear objectives would also guide debate around the appropriateness of potential reforms, such as the recent proposal to allow superannuation to be used to facilitate the purchasing of homes.

Recommendation 10: Improving efficiency during accumulation

Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

This recommendation is not supported.

It is noted that this is a longer term recommendation (post 2020), subject to a review of the current MySuper system, with a focus on competition and efficiency outcomes.

It is not clear how frequently the proposed auction / tender process would be conducted and whether only new members from that point would be covered under the proposed process for selection of a single default fund.

In addition, a competitive auction / tender process implies a focus only on fees, whereas it is considered there are other factors of equal or greater importance which also contribute to successful retirement outcomes, such as net returns and service provision. Lowest cost should not automatically be assumed to produce the best outcomes for members. For example, low cost may come with low levels of service, which is not in members' interests.

It should also be noted that the ASIC fee template included in Product Disclosure Statements includes the compulsory statement that members should consider "whether features such as superior investment performance or the provision of better member services justify higher fees and costs." Therefore, ASIC has recognised that there is a legitimate place for higher fees, if it is warranted by better service or higher returns.

IFAA client Funds aim to offer superior service through a value proposition / customer intimacy strategy. Through the provision of high levels of personalised service, including access to advice, it is contended that members make more informed decisions, contributing to better retirement outcomes.

It is recognised that keeping fees competitive is important in acting in the best interests of members. However, the focus on fees should be balanced against net returns and the services received by members. Lowest cost does not necessarily deliver on either of these objectives. If there is an exclusive focus on fees, there is a risk that net outcomes and provision of quality services will be overlooked, when in fact these factors should be of equal or greater importance.

It should also be highlighted that a competitive auction / tender process could undermine the viability of Funds who do not win the competitive tender process. This could impact the interests of the members of those Funds.

IFAA also highlighted in its previous submission that caution should be applied in making comparisons with foreign models and adopting practices employed overseas. While it is understood auctions / tenders may have been undertaken in overseas jurisdictions, inevitable differences in the respective industries, including regulation and structure, would suggest prudence should be applied in any attempts to transplant policy settings.

This proposed competitive process, along with the application of the scale requirements in the SIS legislation, imply that bigger Funds produce better outcomes for members. IFAA and its client Funds do not accept that proposition. Smaller Funds play a very valuable role in allowing greater levels of personalised member contact, resulting in outcomes more customised to the needs of the member, as well as delivering very competitive returns. In addition, policy settings which encourage consolidation of the industry, detracts from the competition that the Government wants to achieve, which is likely to reduce pressure on remaining Funds to reduce fees.

Recommendation 11: The retirement phase of superannuation

Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.

This recommendation requires further detail and consultation with industry to develop the basis of any such broader retirement income offering. It is acknowledged that a comprehensive retirement income product which addresses longevity risk would represent an enhancement to the current Account Based Pension offering of most Funds, as the risk of outliving the account balance is a major problem for many members.

The extension of the Account Based Pension system to address longevity risk is likely to require partnership with an insurance company. This insured component will clearly come at additional cost, which may be significant, depending on the age and perhaps the health of the member. Some members may be willing to pay this additional cost to secure against longevity risk, and some may not. One size will not fit all, and it will be important for any such product to provide flexibility to allow for the different requirements of individual members. Such a product may address deficiencies in the current system if it allows members to opt-in to additional features such as longevity protection, provided they accept the additional cost involved.

Although most Funds offer pension products already, this proposal would require significant modification to the offering (i.e. longevity risk management and flexibility). It is considered that Government should liaise further with the superannuation and life insurance industry to investigate the feasibility and cost of adding a longevity component to existing income products. There would also clearly be regulatory change required to facilitate the changes to the retirement income system proposed here.

Recommendation 12: Choice of fund

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

This recommendation is supported in principle. This support is on the basis that Industrial Instruments should continue to allow for nomination of default Fund(s), with employees able to select a Fund of their choice or a nominated default Fund. Nomination of default Funds is still considered to be appropriate as the parties to the Agreement carefully select the nominated default Fund(s) based on the suitability of their benefits to the needs of the membership in the industry being covered.

Recommendation 13: Governance of superannuation funds

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

This recommendation is not supported.

It is noted that this recommendation is limited to public offer Funds. However, in considering the merits of the proposal generally, it is considered that the industry experience with equal representation on Trustee Boards has overall been a very positive one, with very few instances of poor governance and investor losses experienced. There is also a significant amount of regulation in place supporting strong governance arrangements, which have, by and large, been embraced by the industry.

Therefore, the proposal for independent Directors seems to be driven more on ideological grounds than based on actual evidence of failure in the current system. This does not appear to represent sufficient grounds for change.

In terms of the rationale for introducing independent Directors, there may be a perceived benefit in so much that independent Directors, at least in theory, bring greater diversity to discussions and decision making. However, being an independent Director is not a pre-requisite to independent thinking. There has been considerable research conducted by various parties into the merits of independent Directors. As one example, in a superannuation governance paper in 2014, Andrew Boal, managing Director of Towers Watson, outlined that there is no compelling evidence to warrant the mandating of independent Directors on Trustee Boards. Instead, the appointment of independent Directors should be considered a best practice measure for individual Boards to consider based on their own circumstances.

Mr Boal went on to reference the 2012 Productivity Commission report, which indicated the Commission's general opposition to mandating Trustee Board structures without a sufficient evidentiary basis.

Additionally, as independent Directors may be expected to be industry professionals, they will likely expect market remuneration levels. This in turn may flow through to remuneration increases for existing Directors, which will result in increased costs borne by members. As a result, this proposal may produce outcomes contrary to the Government's preference for the industry to deliver low fees. It is also not clear that independent Directors would improve the governance of public offer superannuation funds or deliver better outcomes for members.

Recommendation 23: Facilitate innovative disclosure

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

This recommendation is supported, in principle.

As per the previous IFAA submission in response to ASIC consultation paper 224, this proposal is supported, provided the introduction of more innovative disclosure material is an option rather than a requirement. It is acknowledged that production of more innovative product disclosure in multiple mediums has the potential to improve member engagement by catering for varying member communication preferences.

However, the cost of production and maintenance of multiple compliant PDS' and other disclosure documents in different formats (i.e. PDF, video, web pages etc) should not be underestimated. For this reason, it is considered important that this proposal be voluntary.

Recommendation 31: Compliance costs and policy processes

Increase the time available for industry to implement complex regulatory change. Conduct post-implementation reviews of major regulatory changes more frequently.

This recommendation is supported.

Recommendation 37: Superannuation member engagement

Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.

Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.

This recommendation is supported, in principle, provided the incorporation of external information sources in retirement income projections is an option rather than a requirement.

It is noted that many funds, including IFAA client Funds, already provide projections on member statements, in accordance with ASIC requirements.

However, development of calculators that link to external sources such as the ATO and ASIC, as well as a Fund comprehensive income product, would require considerable time and cost to develop and maintain, and should be an option for Trustees to consider rather than a requirement.

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