02/04/2015

By email: fsi@treasury.gov.au

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Re: AUSTRALIANSUPER SUBMISSION IN RESPONSE TO THE FSI FINAL REPORT

AustralianSuper welcomes the opportunity to respond to the final report of the Financial Systems Inquiry.

About AustralianSuper
AustralianSuper is Australia's largest super fund and is run only to benefit members. We don't pay commissions to anyone to recommend us, nor do we pay dividends to shareholders. We have over 2.1 million members and manage over $85 billion of members' assets. Our sole focus is to provide the best possible retirement outcomes for members.

AustralianSuper supports the content of the Industry Super Australia submission. We also seek to specifically comment on matters which relate solely to superannuation and not comment on taxation matters, consistent with the parameters of this consultation. These matters are summarised below:

Key points summary

- The purpose of superannuation is to assist in providing a reasonable retirement benefit for Australians.
- Stability of superannuation and retirement policy settings is key in ensuring that this long term objective of the superannuation system is met.
- A merits-based system is the best system for selection of default funds, and the only system that can deliver improved competition and efficiency in the superannuation system.
- The retirement phase of superannuation needs to work for low account balance holders as well as high account balance holders.
- Fees are too high in the superannuation industry and we commend ASIC's efforts to require more effective fee disclosure in the industry through regulatory change.

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- We support efforts to improve the competency of financial advisers however; the real problem afflicting the advice industry is conflicts of interest, not competency. All conflicted remuneration in financial advice should be banned.
- The ability for non-recourse borrowings for property purchases in superannuation should be abolished.

Please do not hesitate to contact Louise du Pre-Alba on 03 8648 3847 if you wish to discuss this further. We are happy to provide further information on request.

Yours sincerely

Louise du Pre-Alba
Head of Policy

1) **The purpose of superannuation is to assist in providing a reasonable retirement benefit for Australians.**

Chapter 2 Recommendation 9: 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.

Superannuation exists to provide a reasonable quality of life in retirement. The old age pension alone is an anti-destitution payment only, and should not be expected to provide for all the retirement needs of Australians.

It is clear however, that there needs to be more of a bias in favour of retirement income provision, to prevent retirement monies being so readily commuted as lump sums where it is inappropriate for the member to do so. On this basis we agree that the objectives of the superannuation system need to reflect this specifically, and be enshrined in legislation accordingly.

Recommendation:
Support FSI recommendation. Use key principles in development of superannuation and retirement incomes legislation.

2) **A merits-based system is the best system for selection of default funds, and the only system that can deliver improved competition and efficiency in the superannuation system.**

Chapter 2 Recommendation 10: 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.

AustralianSuper contends that a formal competitive process already exists for this purpose. The current Fair Work Commission process for selection of default funds under Awards is a formal competitive process that should be allowed to commence. This will be able to commence when the Government appoints the requisite independent experts to the Fair Work Commission Panel.

AustralianSuper supports the Fair Work Commission process as a merits based selection process. In addition to being a MySuper product, superannuation funds must be able to meet minimum merits based criteria that the Fair Work Commission process prescribes.

We do not believe that a MySuper Authorisation alone is enough for nomination as a default fund under Awards. MySuper product licensing represents a minimum set of operating criteria – it does not, and does not purport to, go to the issue of comparative outcomes for members. Accordingly, AustralianSuper strongly asserts that MySuper compliance, in itself, is not sufficient for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in Awards.

If the Fair Work Selection process were removed, then there is a remaining concern about the inadequate regulation of current non-award related tender processes for employer selection of default superannuation funds. Tenders are not open to scrutiny, and decision-makers are not obliged to consider consumer outcomes in the decisions they make.

It is unclear how, or if any non-award related processes within the superannuation industry consider the views of affected consumers in selection of default funds presently. We strongly believe that consumer outcomes should play a prominent role in fund selection and prefer a merits-based selection process.

Recommendation: The current Fair Work Commission process for selection of default funds under Awards is a formal competitive process that should be allowed to commence.

3) **The retirement phase of superannuation needs to work for low account balance holders as well as high account balance holders.**

Chapter 2 Recommendation 10: 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.

AustralianSuper welcomes further consideration of the effectiveness of the retirement incomes framework in Australia. We welcome the FSI panel's consideration of ways to make selection of retirement products easier and to make product selection more oriented towards retirement income streams rather than lump sums.

We also support the FSI's acknowledgement of taxation reform issues evident to assist in making certain retirement income stream products more accessible to retiring consumers.

We have three primary concerns however, with the recommendation in relation to the CIPR – the comprehensive income product for retirement.

The first concern is that it does not address the primary issue with the transition from accumulation to retirement – this product still creates a point of sale. What is required is a seamless transition into retirement where consumers can draw down their accumulated balances as an income stream rather than take a lump sum. A point of sale at retirement is not necessary for a mature system and trustees should be free to develop a product that transitions members to retirement with ease, but also an opt-out.

The second is that the Australian market has a very limited range of financial products with a longevity component – a limited number of annuity products only. Any annuity products that are purchased in current market conditions will perpetually provide low returns to purchasers, even when market conditions have uplift. To compel a retiree to invest in this limited range of products in adverse market conditions may lead to policy failure in retirement incomes policy, comparable to that which recently occurred in the UK market. A wider range of products needs to be developed with the assistance of relevant legislative reform.

The third concern is the requirement that this product have a longevity component. Whilst we support the concept of further enabling the development of longevity components in financial products we do not advocate that these be effectively a default product for *all* consumers. This is because the average account balance at retirement is still quite low for Australians and nowhere near the $400,000 referenced in the FSI report as a 'typical balance in a mature superannuation system.'[1]

Currently the average retirement balance for AustralianSuper's members at age 60 is $108,449, with a median account balance at $63,812.

For many retirees with low account balances the purchase of this annuity is not achievable, and for others, the mandatory purchase of such a product with a small account balance in retirement will effectively remove their opportunity to use some of their superannuation account balance to clear debts such as mortgage debt before the commencement of their retirement.

AustralianSuper is interested in reforms to the retirement incomes framework that better help Australians, especially those on low to average incomes, to transition to an orderly successful retirement. It is also important to ensure that any reforms engage pre-retirees and educate them about the benefits of retaining superannuation savings to draw down an income stream where appropriate, instead of making a lump sum withdrawal where it may not be in their interests to do so.

Users of the retirement income system in Australia would benefit from the use of income stream products instead of lump sum withdrawals by allowing the following:

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[1] FSI Final report Ch. 2-Table 6

a) **Ability to pay lump sums into income stream (pension) accounts.**

There are circumstances where a member would have a valid reason to place an additional lump sum into their income stream account, including inheritance, downsizing the family home, a transition to retirement transfer from an accumulation account, or a redundancy payment.

Currently if a member wants to add money to their existing income stream (pension) account they have two options:

(a) Open a new pension account. This requires the pensioner to roll their old pension account and any additional money into the new pension account; or

(b) Open a second pension account.

Both of these options result in an unnecessary administration burden and extra costs (which erode retirement savings) being imposed on retirees.

Recommendation: Amend pension requirements to allow for the topping up of pension accounts.

b) **Tax treatment of deferred annuities**

The existing law requires that income streams must make payments at least annually. As a deferred annuity does not meet this requirement, it does not qualify as an income stream, and therefore is not entitled to the associated concessional tax treatment that applies to earnings on superannuation assets supporting income streams.

As a consequence a deferred annuity is not an attractive option in retirement yet it meets a longevity risk need.

Further, in conjunction with point 1(a) above retirees may need the flexibility of being able to purchase a deferred annuity over a period rather than with a lump sum. This period may be before retirement, after retirement or a combination of both.

Recommendation: Amend taxation of deferred annuities, and allow deferred annuities to be purchased over a defined period rather than at one point in time.

c) **Mandated retirement products**

AustralianSuper does not support mandating the use of annuity products by retirees and is concerned about the savings disincentive this measure would be likely to generate.

The UK has recently scrapped mandatory annuities derived from defined contribution pension savings due to concerns with the low interest rates effectively forcing retirees to buy bonds at the very top of the market, when much better yields were available elsewhere. Other concerns with mandatory annuities included the high margins achieved by insurers where retirees rolled over to the default provider, the complexity of products offered, and the lack of competition or flexibility in the mandatory provision of these products.

There is definitely a place for annuities in the marketplace but the benefit of an annuity varies widely for different people. There are few consumers for whom an annuity should comprise their entire superannuation balance – it is market practice for annuities recommendations to deal with up to 30% of a member's account balance.

Recommendation
Do not mandate the use of annuity products within retirement income products – this should be offered as guidance only.

Alternatively ensure that its application does not cut in to affect low retirement account balances.

d) Default pension

AustralianSuper contends that creating a default income stream derived from members' accumulation account balances is a constructive step in engaging members and potentially reducing the prospect of lump sum withdrawals in the system. It takes away the reflex action of withdrawing a lump sum from superannuation when it is not necessary, and not in the member's best interest. A default income stream supports the philosophy that this is a retirement incomes system rather than a wealth accumulation system.

There are some issues to be considered further. This is a matter that can be appropriately dealt with at the regulatory level by the Australian Prudential Regulation Authority (APRA), acknowledging that some minor amendments to the current pension requirements would also need to be made to accommodate the following:

- Deferral of minimum drawdown for a specified period to give time for contacting members and taking payment instructions.
- Enable the member to top up the default income stream (as described above).
- Transfer to pension at a specified age, in specified circumstances, without member instruction.
- A 'no detriment' test covering fees, investment strategy and insurance is required.
- Alternatively, instead of transferring from a MySuper product to a default income stream, it is preferable that regulatory settings are changed so that the MySuper product may be the vehicle from which pension type drawdowns occur.

Recommendation: Establish a Treasury and APRA-supported working group applying the Retirement Incomes policy-making principles outlined above to development of a Prudential Standard that deals with default pension products.

4) **Fees are too high in the superannuation industry and we commend ASIC's efforts to require more effective fee disclosure in the industry.**

Scope for greater efficiencies in the superannuation system

AustralianSuper considers that investment returns, net of administration fees, and net of investment fees and costs ("net net returns") is the most accessible and comprehensible way that consumers can determine whether to invest in a particular superannuation investment. Fees are a subset of this primary consideration and lower fees should result in a better net net return for superannuation investors.

AustralianSuper agrees with the general conclusion of the Inquiry in its final report that fees are too high in superannuation in Australia and that there needs to be greater efficiency in the management and provision of benefits to superannuation fund members.

The FSI Final Report has referenced the scale problem in the industry - fees are still high despite increasing economies of scale. Whilst causes of high fees in the superannuation industry have been discussed in the interim and final report, we reiterate that there are two specific areas of concern where policy reforms would make a difference:

1) Investment Management Fees
2) The level of accrued default amounts existing in the superannuation industry.[2] Commissions can still be charged on these superannuation accounts until 2017.

AustralianSuper contends that the most needed change to affect fees and efficiency in superannuation is a real consideration of the fees charged in investment management. Investors in superannuation need a more robust and transparent system of fee and cost disclosure that applies to all relevant participants in the market, not just superannuation trustees.

Investors in superannuation suffer information asymmetry – they do not know, nor do they have access to information about the real fees and costs of the investments they make, because this information is not always available to the market.

The Australian Securities and Investments Commission (ASIC) has recently considered what is needed to improve disclosure of underlying fees and costs. We refer to ASIC's recent Report 398 *Fee and Cost Disclosure: Superannuation and Managed Investment Products*[3] where it highlights concerns about 'fee gaming' in the superannuation industry as follows:

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[2] 'Accrued default amounts' are defined in s20B of the *Superannuation Industry (Supervision) Act 1993* and are accounts held in default investment options in superannuation that are not MySuper products.

[3] Report 398 *Fee and Cost Disclosure: Superannuation and Managed Investment Products* at www.asic.gov.au.

"*Fee gaming refers to issuers taking deliberate actions (eg. structuring investments, operations or other arrangements with third parties, or adopting a particular interpretation of the requirements that may or may not be correct) with the objective of intentionally disclosing lower fees and costs that would otherwise be required.*"[4]

ASIC has recently issued a Class Order which effectively requires greater specificity in capturing and then disclosing all underlying fees and costs, with some exceptions. However, there are still some aspects that require specific legislative reform to deal with the issues.

Recommendation

- **(a) ASIC to develop a mandatory fee disclosure regime building on recent class order.**
- **(b) Mandatory fee disclosure regime to apply to managed investment schemes as well.**

This suggested reform doesn't just apply for MySuper products but is equally applicable to choice products, which should be subject to the same level of scrutiny over their net performance as they too gain taxation concessions for operating to provide retirement benefits.

To be effective, this reform should apply to managed investment schemes as well as superannuation funds.

- **(c) Bring forward the transfer of accrued default amounts existing in the superannuation industry.**[5]

Commissions can still be charged on accrued default amounts in superannuation accounts until 2017 when transfer is required to take place. Superannuation will continue to have high fees until commissions are taken out of superannuation.

5) We support efforts to improve the competency of financial advisers however, the real problem afflicting the advice industry is conflicts of interest, not competency.

Chapter 4 Recommendation 25:
Raise the competency of financial advice providers and introduce an enhanced register of advisers.

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[4] Ibid paragraph 10.
[5] 'Accrued default amounts' are defined in s20B of the *Superannuation Industry (Supervision) Act 1993* and are accounts held in default investment options in superannuation that are not MySuper products.

AustralianSuper supports raising the competency of financial advice providers by requiring individuals advising on Tier 1 products to hold a tertiary degree, and have competence in specialised areas, such as superannuation.

It is worth noting however, that it is not the competency of financial advisers per se that has afflicted the financial advice industry and corroded its reputation – it is the conflict of interest, the conflicted remuneration that has been present in *all* financial advice scandals of recent years.

In relation to the register of advisers, AustralianSuper supports the establishment of the enhanced register to facilitate consumers' access to information about financial advisers'experience and qualifications. We agree with the register being flexible to deal with future developments such as automated advice, and other regulatory issues arising.

Recommendation:

a. **Support FSI recommendation regarding competency and register of advisers**
b. **Ban all conflicted remuneration in financial advice.**

6) Direct borrowing by superannuation funds

Chapter 1 Recommendation 8: Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

AustralianSuper supports this recommendation as serving to strengthen the superannuation system and ensure liquidity of funds at retirement.

Recommendation: Support FSI recommendation.