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28 April 2011

Mr Jonathan Rollings
Principal Adviser - Superannuation
Financial System Division
Department of Treasury
Langton Crescent
Parkes ACT 2600

By email: jonathan.rollings@treasury.gov.au

Dear Jonathan:

Mercer Submission to the MySuper Consultation Working Group

Please find attached our submission to the MySuper Consultation Working Group for consideration.

Our submission details the case for allowing multiple price points for different MySuper options in a collective vehicle and sets out Mercer's belief a cohesive win:win scenario can be achieved whereby significant and well established price discounts, scale benefits and demographic attributes can be preserved at the same time as introducing the advantageous features and improved comparability proposed through MySuper.

Should you have any queries or require any further information, please do not hesitate to contact me per the above details or Bernie O'Brien on 03 9623 5152 or bernie.o'brien@mercer.com.

Yours sincerely,

David Anderson
Managing Director & Market Leader,
Australia/New Zealand

Attachment

MERCER

MERCER SUBMISSION TO THE MYSUPER CONSULTATION WORKING GROUP

MULTIPLE PRICE POINTS FOR DIFFERENT MYSUPER OPTIONS IN A COLLECTIVE VEHICLE

Executive Summary

There has been extensive industry debate about the issue of multiple price points for different MySuper options in a collective vehicle. The Financial Services Council (FSC) has presented a proposal to the consultation working group that would allow this for employers above a threshold, and this has been strongly opposed by a publication issued by the Industry Super Network (ISN), although ISN appear to accept that employers should be able to operate their own MySuper if they choose to and can do so effectively.

We believe the industry needs to agree on an arrangement which:

- Broadly preserves the existing arrangements for those who are better off than they would be if forced into a public-offer single price point MySuper;
- Acknowledges the role of the employer in providing superannuation benefits – the December 2010 Mercer Member Experience Study of super fund members, found that two out of three members rated the fact their fund was sponsored or endorsed by their employer as 'very important' or 'important';
- Creates a more transparent, lower-cost default arrangement for those who are deemed to presently be in arrangements that are too complicated or costly, and which are not well-understood by the member; and
- Creates an environment where all members can easily compare their arrangement with the various alternatives available to them whether MySuper or Choice.

We are very supportive of the FSC's proposal with the exception of the proposed 50 employee threshold. We believe this is too low and that a threshold of the order of 500 employees should be adopted or where a professional competitive tender process has been conducted.

We believe that permitting employers with more than 500 employees to choose to have their own MySuper arrangement within a collective vehicle will create a competitive market place and avoid unnecessary disruption to a number of highly competitive existing superannuation arrangements. It will allow the existing default option for existing large employer plans in multi-employer funds to be converted to MySuper products thus avoiding some difficult MySuper transition problems.

We would endorse a simple statement or test such as *"Any employer with more than 500 employees may elect to adopt as its default fund for SG contributions, a MySuper arrangement within a collective vehicle at a price point specific to its employee base and with default features selected by the Trustee and the employer based on the nature of the workforce".*

Fundamentally, what we are suggesting is that each collective vehicle would have one public MySuper price but employees of large employers would be given a discount price as negotiated which reflects their greater economies of scale, including a lower cost to serve, and an appropriate investment strategy which reflects the unique demography of the workforce.

A mechanism would need to be designed to deal with the situation when a member leaves an employer-sponsored MySuper. We believe that the Trustee should be allowed to transfer the member to its public offer MySuper option after giving the member the opportunity to select another MySuper or choice product. In effect, we are suggesting that the Trustee be allowed to:-

- Remove the employer discount from that participant (ie. once the savings resulting from being part of the employer group are no longer relevant); and
- Change the member's investment strategy to reflect the public-offer default option where relevant.

Ideally all other entitlements would be retained as is, e.g. insurance cover, intra-fund advice availability, etc. Note that insurance premiums may change if cover is continued at prior levels.

Finally, we would note that unless some form of multiple pricing is implemented, large employers will have an incentive to spin out of collective arrangements and set up their own stand alone replicas of what they have for their employees, using the scale of their current provider. This would increase costs for no benefit and is contrary to the Government's desire see consolidation in the industry.

Background - How a Multi-Employer Corporate Fund Works

The following is a simplistic example of the variety of sub-plan fee arrangements which may exist in a multi-employer corporate fund.

Sponsor	Plan	Members	Fees
Large Employer A	Sub-Plan 1	15,000	0.50%
Large Employer B	Sub-Plan 2	10,000	0.60%
Medium Employer C	Sub-Plan 3	3,000	0.70%
Medium Employer D	Sub-Plan 4	1,000	0.80%
Small Employer E	Sub-Plan 5	200	1.20%
Small Employer F	Sub-Plan 6	100	1.30%
	Public Offer Sub-Plan		1.35%

Large employers can negotiate lower fees than small employers, and typically do so by appointing an independent professional tender manager to negotiate on their behalf. The tender managers charge on a fee for service basis. Multi-employer corporate funds have allowed stand-alone corporate plans to reduce costs to members by 0.20% to 0.40% by joining such multi-employer funds.

Each employer sub-plan has differential fees due to:-

- Employer branding
- Its own benefit design (DB and/or DC) including insurance levels
- Tailored unique investments for some large employers
- Tailored insurance arrangements including a separate insurer for some large employers
- Sub-plan specific communications materials and websites

The different fee levels reflect the different costs of operating each employer sub-plan which may include:-

- Sub-plan specific communications materials (print, web, call centre)
- Liaison with employer and policy committee
- Plan set up costs on joining the multi-employer fund
- Configuring the sub-plan benefit design on the administration system

- Sub-plan specific insurance arrangements
- Other plan-specific procedure variations.

Essentially each employer plan is like a separate superannuation fund with its own fixed costs of operating the plan except for:-

- A common legal structure
- A common investment structure for most sub-plans
- Some common administration and insurance processes.

It is the need to spread these fixed, employer sub-plan-specific costs across the members of each sub-plan that lead to the differential fee structure.

Another relevant factor is the cost of transferring data from employers and members to the fund, which is simpler for large employers than for small employers. This will remain a significant difference between employers so long as SuperStream is not to be made mandatory.

Impact of Imposing a Single MySuper Approach in These Funds

Assume the multi-employer fund above sets the single MySuper fee at say something like 0.90%, based on commercial and competitive considerations. This would create an incentive for large employers to spin out of the multi-employer fund, since the large employer could set up a new arrangement solely for their employees with a fee that is slightly higher than at present but well below the single public-offer MySuper price.

For employers who did spin out of the multi-employer fund, default members will pay slightly higher fees than at present. For those who do not spin out, default members will pay significantly higher fees of 0.9%.

Previous successive governments have encouraged corporate fund consolidation as it has resulted in better outcomes for members, and we believe that a reversal of the consolidation trend is an outcome Treasury and Government would want to avoid.

Transfers to Personal Sub-plan on Ceasing Employment

One important aspect of the current operation of multi-employer corporate funds is that, in many cases, members of the corporate section who cease employment with the sponsoring employer are automatically transferred to the personal section of the fund with higher fees. The higher fees in part reflect the fact that it is more costly to deal with individuals than with members of corporate plans.

We accept that the current practice of charging higher fees to former employees to subsidise lower fees for current employees in a corporate arrangement in a collective vehicle ("flipping") is likely to be banned in the post MySuper era. However, we believe that the lower cost arrangements that employers can negotiate should be allowed to continue, and that when a member leaves employment with an employer a Trustee should be allowed to remove the corporate discount and transfer that member to the fund's public-offer MySuper section unless the member makes some other nomination.

Summary of the Adverse Impacts on Members of a Single MySuper Arrangement

If the use of multiple pricing points in a multi-employer corporate fund is not permitted, we believe the following will ensue:

- **Market competition between MySuper products will be substantially reduced**

  A single MySuper product per fund is likely to result in broadly the same fees and asset allocation for all default members. A major driver of competition (and hence value) in the corporate superannuation industry for most of the 1 million Australian workers in multi-employer corporate funds will be lost.

  Although virtually every Australian worker has a choice, the majority of Australian workers do not exercise a choice about where they want their super to be. Those workers are in default products.

  Those default products are chosen by the employer with advice from a third party tender manager. Large employers generally take great care in choosing the default fund and negotiate hard with product providers to ensure value for employees which our market study results demonstrate is valued by employees.

- **Immediate fee increases for many existing members and many new defaulted employees**

  The removal of differential pricing will force a ‘one size fits all’ product with higher fees for around 750,000 Australians presently in large master trusts.

  This is because the majority of members in large master trusts are with large employers where there are significant efficiencies and generally much lower costs. Given that the SuperStream reforms will not be mandatory, the large number of smaller employers with fewer employees will have a much higher cost of operation per member than the small number of large employer plans.

  Therefore, to set a single price for everyone, the employees of more efficient employers will pay more and subsidize the employees of smaller employers.

  The likely consequence of this will be large employers spinning out of multi-employer plans to avoid this happening, or possibly employers actively discouraging MySuper options and promoting choice arrangements at a fraction of the MySuper price.

A Proposed Alternative Approach

A proposed alternative approach which we believe fits with the underlying objectives of MySuper, including low cost and comparability between MySuper products, is to permit (but not require) multi-employer funds to offer a number of different MySuper sections within the fund, with different product features (with potentially different fees, investments and insurance) being permitted for, say, each employer with 500 or more employees. This should be an option but not a requirement for these employers.

The employer plan in the multi-employer fund will generally contain many grandfathered benefit design features which ensure that members were not disadvantaged on transferring from a former standalone employer fund. Allowing these employers to operate their own MySuper arrangements will allow many of these grandfathered provisions to be maintained while the employer plan converts to the MySuper regime by converting the existing plan’s default arrangement to a MySuper product.

We note that employers of this size generally do not use financial planners operating on a commission basis.

In addition, each multi-employer Fund should be allowed to offer a general public offer MySuper section of the fund for:

1. All the members at transition whose employer is not establishing a MySuper section of the Fund, unless those members are “choice” members;
2. Members leaving employment with an Employer with their own MySuper sub-plan;
3. New entrants to employee participants of the corporate section where the number of employees of the sponsoring employer is less than 500 and no choice is exercised.

On ceasing employment a member of any Employer MySuper section in the fund should be able to be transferred to the general public offer MySuper section, with the fees and other terms and conditions for this MySuper section being fully disclosed both on joining the large employer MySuper section and on transfer to the general MySuper section.

It is likely that this kind of arrangement would make the transition relatively simple as the existing Employer sub-plans could be rebranded as the Employer Choice section at the time the Employer MySuper sections are launched. Similarly, the new employer MySuper investment option for large employers would be established by simply renaming the existing default investment option.

We understand the Government has a preference for having a manageable number of MySuper products on the market. One reason for this is so that “league tables” of fees and performance information do not become unmanageably large. In this context, we propose that each large employer MySuper product in a multi-employer corporate fund be allowed to be closed to members of the public, and open only to employees of the relevant employer and possibly their family members.

Given this, there is less need for information about the employer MySuper products to be publicly available in league tables, because the public cannot join them. We would endorse an arrangement where the league tables excluded corporate MySuper options but accept that Government may want to require that the same information be available at an “APRA MySuper” website or some other similar data portal.

In this situation what is required is simply to make sure that employees of the relevant employer are given the appropriate information about their own large employer MySuper product in such a way that they can easily compare it with every other MySuper product in the market that they are able to join.