AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

SHAPING PROFIT-TO-MEMBER SUPER

AIST Submission
Your Future, Your Super Package

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AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $1.5 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Glossary

The following abbreviations and acronyms are used throughout this submission

Abbreviation	***Definition***
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
FSRC	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
PC	Productivity Commission
SIS Act	*Superannuation Industry (Supervision) Act 1993*

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1. Executive summary

AIST welcomes the opportunity to make a submission on the *Your Future, Your Super* package, which is made up of the three bills addressing:

1. Underperformance
2. Single Default Account
3. Best Financial Interests Duty

AIST supports the policy intent of the legislation to empower members, hold funds to account for their performance, and increase transparency and accountability.

This legislation follows the Budget announcement and is intended to implement the Government's response to issues identified in reviews of the superannuation system, including by the Productivity Commission (PC).

The PC Report *Superannuation: Assessing Efficiency and Competitiveness* however included important additional elements in their recommendations that should be incorporated in the Bills. The report included administration fees in performance assessment, proposed sequencing of changes so underperformance was addressed before stapling occurred, explicitly included all products in consumer-friendly dashboards and performance assessments, and proposed a regulatory approach to winding up underperforming products.

We are concerned that the Bills will not achieve their policy intent. The Bills are much softer on super fund underperformance than the PC recommended. Without further consideration, and some additional steps, the implementation of the *Your Future, Your Super* measures may result in consequences that weaken their policy intent and lead to unintended outcomes for members.

The Budget announcement stated that "as of 1 July 2022, annual performance tests will be extended to trustee-directed products (TDPs) outside of MySuper." The Bills do not explicitly cover TDPs and do not guarantee that underperforming TDPs will be addressed.

The legislation inappropriately leaves significant policy issues to be decided later by regulation. Given the enormous impact the changes will have on Australians' financial security in retirement, it is important that they are transparent and completely address the issues identified by the Financial Services Royal Commission (FSRC).

Government steps to implement the Budget changes should be clearly and completely contained in the legislation so they can be debated by Parliament and understood by the community. Such enhanced scrutiny would also serve to address the unintended member harm; overreach (in some areas); and soft implementation (in others) that are a feature of the three bills – and remove the risk of many underperforming super funds not being brought to account.

The Bills need to be refocused on addressing issues with underperforming funds, and not on areas such as the reverse onus in relation to fund expenditure. The reverse burden of proof is unreasonable, unusual and unnecessary. It was not included in the Budget announcement, has not been recommended by the FSRC or the PC, and is not required in the superannuation system.

We appreciate that policy change to achieve these objectives is challenging, due to the complex interaction between the regulation, structure and operation of the superannuation system. However, it is important that policy changes to a mandatory retirement savings system be made in the best interests of super fund members and address the areas for improvement in the system identified by the PC. We propose that you consider the following to ensure these proposals avoid adverse member outcomes:

1. **The reforms should be sequenced to avoid member detriment**

If stapling occurs before underperformance is substantially addressed, members who are currently in underperforming funds will be stapled to those funds. In line with the PC's approach, sequencing the measures to substantially address underperformance prior to introducing stapling would reduce member detriment from this.

2. **The reforms must address underperformance for existing members**

Existing members of all underperforming products should be protected by law. Closing underperforming products only to new members risks making outcomes worse for remaining members in those products.

Taking defined and legally enforceable steps to protect existing members of underperforming products is in line with the PC recommendations. It recommended that "APRA should take decisive action to oversee or direct a transfer of members to a better fund."[1]

3. **All fees should be included in performance comparisons**

Good member outcomes are best measured through clarity on returns net of all fees. The annual performance assessment and the YourSuper comparison tool should include administration fees to provide an overall net outcome measure. This will avoid confusing consumers and give them an accurate basis for comparison. This is in line with the PC's approach which included administration fees.[2]

4. **All choice super products should be subject to performance assessment and disclosure**

The annual performance assessment and YourSuper comparison tool should cover all APRA regulated superannuation products in the legislation. Without this, the members of products not included in the YourSuper comparison tool and performance assessment will be unable to compare the performance of their fund.

The PC found that choice products underperform MySuper products on average. It is important that the worst areas of underperformance in the system are addressed. Including all products in the performance assessment and YourSuper comparison tool is in line with the PC's view that all products should have simple and comparable dashboards and performance requirements.

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[1] Productivity Commission, Superannuation: Assessing Efficiency and Competitiveness, Inquiry Report No. 91, 21 December 2018 p.495.
[2] *Ibid*, p.108.

Specifically, the PC commented that benchmarking should be required of "virtually all choice investment options. This should include pre-mixed options, single-class options and options delivered through a member-directed investment 'platform.'"[3] It also noted that although dashboards have been legislated for choice products, "the process of developing these has been beset by industry resistance, missed deadlines and an attempt by the Government to exempt some products from the rules."[4]

5. Performance assessment benchmarks must reflect underlying investments

The annual performance assessment benchmarks should accurately reflect the underlying investments. Inappropriate benchmarking risks encouraging behaviour geared at tracking the benchmark allocations, which in turn would lead to poorer returns to members.

To address this, more tailored benchmarks that reflect the actual investments (including appropriate unlisted benchmarks) should be used. The benchmarks should be made up of assets that are in the asset class being assessed, have regard to the location of assets., and whether the assets are listed or unlisted. A fund's investments should not be assessed against assets that do not reflect the underlying investment. In addition, AIST suggests that a suite of metrics be considered, rather than a single point in time measure, and that the methodology used should be reviewed three years post implementation

6. Avoid unnecessary government intervention

The Bill has the potential for future governments to prohibit super funds from investing in certain assets or asset classes. Providing government with such power is an unusual approach in a free market economy.

If a trustee has made an investment now deemed illegal, it may not be able to sell the asset, with the possibility now being closed to many comparable institutional investors.

There is a risk that these proposals may be gamed by unscrupulous providers:

- Providers may open loss-leading products that are then closed as underperforming products, with existing members stapled to them – new products without a performance history can then be opened
- Providers could hide fees because administration fees are excluded from the performance assessment
- Providers may be encouraged to sell members into products early, leading to the possibility of mis-selling to vulnerable young people
- Choice products are not included in the legislation, so can continue to underperform MySuper products without repercussions

[3] *Ibid*, p.492.
[4] *Ibid*, p.34.

Table 1. Summary of AIST positions on substantial measure in each Bill

Measure	AIST Position
Underperformance	
Regulations will specify formulas for APRA to rank products according to specified metrics, including fee levels and investment returns, which will support information on the YourSuper website	The metrics used to rank products on the YourSuper website should be the same as those used to assess performance, such that the member-facing rankings (YourSuper tool) and associated information do not contradict the assessment made by APRA of performance. Rankings and performance assessment should include administration fees. The methodology and the criteria for the performance assessment should be enshrined in legislation. A minimum review period in legislation on any regulated performance assessment methodology is required, with APRA having the power to amend the methodology. An appropriate legislative framework for the YourSuper comparison tool should be included. In comparison, the requirement for the MySuper product dashboard is specified in legislation.
Trustees will be subject to civil penalties if they do not meet notification requirements in relation to underperformance	In light of the serious consequences of not meeting notification requirements, the requirements should be fully contained within the legislation. In addition, the regulator should be provided with discretion, in relation to penalties, where failure to meet notification requirements was caused by something beyond the trustee's reasonable control (e.g. natural disaster)
The legislation only prescribes that the annual performance test will apply to MySuper products. Other products (e.g. choice products) will be specified in regulations	The legislation should prescribe that all APRA-regulated superannuation products are subject to an annual performance test. The legislation should contain an inclusive and comprehensive definition of trustee-directed products that captures choice products. The PC recommendation to transfer members of underperforming funds should be fully implemented in the legislation, in order to safeguard the members' interests.

APRA's discretion in relation to the annual performance test will be limited, as the regulations will specify requirements about the exercise of APRA's discretion, investment return requirements, and allowable assumptions	APRA's discretion should be sufficiently broad to encompass unexpected market circumstances (such as those associated with a global pandemic) and a prudent response to them. Its discretion should also allow consideration of remedial action taken by a fund to address investment issues in circumstances where such action has demonstrably improved investment outcomes.
Single Default Account	
Employers will be required to contact the ATO to find out existing fund details for new employees	Stapling should progress only when automated, integrated online systems to ease the administrative burden on employers have been developed.
The term 'stapled fund' is not defined in the legislation	When the stapling legislation is progressed, it must include a definition of "stapled fund" that ensures the fund: • Is open to new members • Is subject to annual performance testing • Offers appropriate insurance for the occupation the employee is entering, including consideration of occupational industry risk
Best Financial Interests Duty	
Reversing the evidentiary burden of proof	The starting assumption of error or misbehavior is wrong, and the broad nature of the reversed burden of proof is not reflective of the risk in the sector., Without clarity around scope an application, will add unnecessary cost to members.
The draft legislation includes amendments to sections 117 and 118 that give the Government the power to unilaterally decide on investment and expenditure decisions	Governments should not have the unilateral power to unreasonably interfere in the day-to-day operation of a superannuation fund. The proposals represent extraordinary government overreach, while also lacking accountability and transparency measures.
Third party payments	The legislation should cover payments made to related third party entities. Distributions made by a super fund to a parent company in a vertically integrated business structure should not be immune from appropriate scrutiny by regulators.
Core and ancillary payments	The degree of scrutiny to fund expenditure should be consistent. Fund expenditure should not be immune from scrutiny merely because it is viewed as core expenditure.

2. The package

AIST Position
• Profit-to-member funds support the overarching aims of the package, including addressing underperformance, enhancing transparency and disclosure, and reducing unintended multiple accounts • Many important matters in the package are proposed to be settled in regulation, potentially inappropriately bypassing parliamentary scrutiny • Although intended as the Government's response to the PC inquiry, numerous measures fall short of meeting the Commission's recommendations

2.1. Profit-to-member funds support policy intent

AIST supports the Government's intention to address underperforming superannuation products, improve transparency and disclosure, and reduce the number of duplicate accounts in the superannuation system. AIST has undertaken and supported policy activity to achieve these outcomes over many years. Our existing positions on the need to address underperformance and multiple accounts were supported by the evidence presented by the PC report into superannuation.

We also support the principle that trustees have a duty to operate in the best financial interests of their members. In fact, trustees of our member funds interpret their current obligations under the SIS Act and trust law only operating in the best financial interest of their members. Not-for-profit super funds were established because of a view that superannuation funds should be run only to provide fund members with financial security in retirement, rather than being run to create profits for shareholders.

2.2. Changes should be democratically decided in legislation, not regulation

The draft laws lack substantial, important detail. It takes the overall approach of legislating broad powers to allow regulations to be made at a later date, which set out the operating parameters. Much of the relevant substance (see Table 2) is deferred to regulation. This would occur at a later date and may not involve the same level of public consultation and not have the same level of parliamentary scrutiny that primary legislation is subject to. This is not a desirable or democratic approach to making law, and is an entirely inappropriate and lackadaisical way of implementing Budget announcements.

Laws containing important or contested subject matter should be addressed in primary legislation.[5] These Bills contain profound changes to superannuation – a matter of national importance that will have a significant material impact on all Australians. While there is universal support for their policy intent, their implementation is highly contested, and substantial unintended consequences resulting in member harm

[5] Dennis Pearce and Stephen Argument, *Delegated Legislation in Australia* (LexisNexis Butterworths, 4th ed, 2012), p.5.

have been identified in their application. The changes should be subject to full and proper parliamentary scrutiny and not left to regulation.

Delegating the making of laws to regulations is only considered "both legitimate and desirable" where:

- the delegated subject matter would be overly technical or detailed;
- the subject matter is likely to be subject to frequent changes; and
- the Parliament's time could be saved.[6]

These characteristics do not apply to the matters being considered here.

Leaving important matters to regulation also raises concerns that matters will not be addressed at all and member detriment will continue unaddressed. This is of particular concern in the case of the assessment of choice product underperformance. The establishment of choice product dashboards was delegated to ASIC almost a decade ago and they remain unaddressed and postponed to this day.

Table 2: Matters that should not be left to regulation

Matters left to regulation that should be in the primary legislation
Underperformance
The methodology to calculate a MySuper product's performance and benchmark, including whether administration fees are included in the performance test, and any other requirements for assessment.
A definition of "Trustee-Directed Products" should be included, with such products subject to an annual performance assessment and underperformance measures.[7]
The methodology to calculate the performance and benchmarking of Trustee-Directed Products.
Specify requirements on the exercise of APRA's discretion; the matters APRA may take into account in exercising such a discretion; and allow APRA to make specified assumptions in exercising its discretion.
If choice products are subject to performance assessment, what the methodology for that performance assessment will be.
Protections from providers gaming the prohibition on new members by "phoenixing" underperforming products (closing underperforming products and opening a new product with no performance history).
The formulas APRA can use as a basis to rank the performance of products, according to relative fee levels, investment returns or any other criterion.

[6] *Ibid.*

[7] The Budget announcement and the Explanatory Material identify "Trustee-Directed Products" as being covered by these measures but these are not identified or defined in the legislation. Rather, subsection 60B(5)(b) states that these measures may cover:
(b) any other class of beneficial interest in a regulated superannuation fund, if that class is identified by regulations made for the purposes of this paragraph.

The criteria for when a superannuation product may re-open to new members based on when the product's performance has improved.
Single Default Account
The requirements to be placed on employers for them to find out from the ATO what fund to pay SG contributions into.
The definition of a stapled fund, including whether or not a stapled fund could be an underperforming fund.
Best Financial Interests Duty
The prohibition of any payment or investment by a trustee regardless of whether it is in the financial interests of members. *Note: The legislation introduces a civil penalty provision for a trustee failing to stop a fund making prohibited payments, but does not outline what payments are prohibited*
The trustee record keeping obligations and definition of what is intentional or reckless contravention of those obligations. *Note: The legislation introduces a strict liability offence for contravening these obligations is in the primary legislation, but the legislation does not outline the obligations or define contravention*
What evidence is required to meet the reverse burden of proof that a trustee has operated in the best financial interests of members. *Note: The legislation introduces a reverse burden of proof whereby the trustee is taken to have not acted in members' financial interests unless they provide evidence otherwise, but the legislation does not outline what evidence is required*

Uncertainty leads to member detriment

Because regulations can be made by any government at any time, leaving substantial matters to regulation leads to significant ongoing uncertainty. Given the breadth of the regulation-making power in the Bills (see **Table 2**), this uncertainty is extensive. A lack of visibility on what business practices or investments may or may not become prohibited clashes with the vital bedrock of long-term investment horizons and the stable policy settings that have underpinned the Australian superannuation system's success in generating returns for members.

The legislation creates a number of strict and onerous penalties on trustees, but leaves to regulation the detail of how these penalties will apply or be avoided. It is impossible to evaluate the validity of these penalties without understanding the trustee behaviour they are designed to promote or address. In its report, the Senate Standing Committee for the Scrutiny of Bills stated, with good reason, that the designation of a given offence as one of "strict liability should be provided by primary legislation, with regulations used only for genuine administrative detail."[8] The detail relating to the scope and application of

[8] Senate Standing Committee for the Scrutiny of Bills, 'Final Report: Application of absolute and strict liability offences in Commonwealth legislation' (June 2002), at para 7.6.

trustee penalties should be contained in the legislation and the Government should follow internal guidelines set by its parliamentary committees.

Other cases

The super sector is not alone in its concern about incomplete legislation that leaves key substantial matters of contested public policy to be decided by regulation. During the 2006 *WorkChoices* Case, the High Court was asked to rule on whether Parliament was authorised to delegate to regulations what would constitute 'prohibited content' in workplace agreements.

The Court cautioned that leaving such substantial matters to regulation was "an undesirable [drafting technique] which ought to be discouraged."[9] Among other issues, the High Court was concerned with the administrative imposition on those needing to "look outside [the new Act] in order to apply it," noting that "identifying what regulations are in force is a task which many inquirers have found difficult."[10]

These laws should be developed in a democratic and transparent way. They are important, contested, and will have a significant impact on members.

2.3. The package fails to adequately respond to Productivity Commission evidence, findings and recommendations

Although the package is intended to respond to the recommendations and findings made by the PC, crucial evidence and recommendations made by the PC are unaddressed or inadequately addressed, resulting in an approach that exempts the worst areas of underperformance in the system and risks making outcomes worse for members in underperforming funds.

Performance tests must apply to all products (PC Recommendation 4)

The PC was clear, for example, that any elevated outcomes tests must apply to *all* super products, stating that both "MySuper and choice products should have to earn the 'right to remain' in the system."[11] In terms of timing, it recommended 2022 as the point by which trustees should have "enough high-quality data on investment options" to be able to report against such enhanced performance assessments.[12] The PC made this finding in response to the significant underperformance it found among choice products. Excluding all choice products from the online comparison tool, and the legislated performance test simply does not respond to the PC's recommendation. In addition, the PC specifically found that single asset class products and platforms should not be excluded from assessment, despite the fact that retail providers had

[9] *New South Wales v Commonwealth of Australia* [2006] HCA 52, at para 399.
[10] *Ibid*.
[11] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.2.
[12] *Ibid*, p.146.

asked for this.[13] The approach in the package will allow underperformance in the choice segment to continue and lead to poor member outcomes.

Members should be transferred out of high-fee retail legacy products (PC Finding 3.5)

The proposed reforms risk making the situation worse for members currently languishing in costly retail legacy products (those no longer open to new members). At the time of its final report, the PC estimated that 4 million members, representing $275 billion in assets, remained in the "high-fee tail" of the system, around half of which comprised closed retail products.[14] They noted that any future decline in this number was "likely to hinge on the effectiveness of regulator efforts to shift members out."[15]

On this point, the PC specifically recommended APRA undertake a thorough review of the impact on members of legacy products, using the evidence to strengthen trustees' obligations to rationalise those products.[16] The draft legislation disappointingly ignores this recommendation. The failure to address member harm from retail legacy products coupled with the exemption these products enjoy from the design and distribution obligations enforced by ASIC means that these members continue to be largely unprotected.[17]

In fact, as the legislation is drafted, the package risks increasing member harm from this issue. Under the current system, if you are in a poor performing fund there is a high likelihood you will be defaulted into a better performing fund when you start a new job. By contrast, this legislation would staple people to these high-fee legacy products. Given the PC's finding that a 0.5 per cent a year increase in fees can reduce the final retirement balance of a new entrant in the workforce by around $100,000,[18] the detrimental impact of failing to act on underperforming retail legacy products is significant.

The extent to which the proposed reform package inadequately addresses the PC's findings and recommendations is summarised below.

Table 3: The package does not address the following Productivity Commission findings

Issue	Productivity Commission recommendation/finding	*Your Future, Your Super* policy response
Underperformance	• Underperformance is much more concentrated in the choice segment (p.148), as "many choice members could be doing a lot better" (Finding 2.5)	Focussing instead on the MySuper segment, the primary legislation does not require any assessment of choice performance, with a significant proportion

[13] *Ibid*, p.276.
[14] *Ibid*, p.54.
[15] *Ibid*, p.182.
[16] *Ibid*, p.74.
[17] Australian Securities and Investments Commission, *Regulatory Guide 274: Product Design and Distribution Obligations* (December 2020), p.13.
[18] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.54.

	• All products in the system must be subject to elevated outcomes assessments (Rec 4)	of choice products expected to remain exempt once regulations are made.
Legacy products	• Around half of the system's 'high-fee tail' is made up of retail legacy products (p.54) • APRA should be tasked with reviewing the impact of legacy products and, if required, strengthen trustees' obligations to move members into better performers (p.74)	The measures fail to address legacy products. There is, in fact, a risk that members may find themselves stapled to such legacy products for the remainder of their working life (see 'sequencing of stapling' below)
Sequencing of stapling	• Given the potentially dire impact of being stapled to an underperformer, poor products must be first eliminated before any stapling scheme commences (p.45)	By introducing stapling from 1 July 2021 and failing to clarify what type of product will be allowed to become a stapled fund, there is a risk that members in underperforming choice products will be subjected to ongoing poor outcomes
How products should be compared	• Products should be compared on the basis of *net returns* they achieve for members – that is, inclusive of the impact of all fees (p.108) • Retail choice products, which dominate the 'high-fee tail' in the system have proportionately higher administration fees than better performers (p.181) • This is important, as there is direct correlation between higher fees and lower net returns (pp.187-8)	The proposed annual outcomes tests will be based on *net investment returns*, excluding administration fees. This may lead to industry gaming (e.g. the hiding of fees in the administration fee category), and generally provides retail funds with an advantage in the assessment methodology with their higher administration fees
Disclosure rather than winding up underperforming products	• "While there is no shortage of information, many members find it complex, overwhelming and inconsistent with their needs … Members get excessive choice at the expense of less comparability, and even highly engaged and financially literate members struggle" (p.18) • "APRA should take decisive action to oversee or direct a transfer of members to a better fund" (p.495)	The package relies on member-facing disclosure options in attempting to reduce exposure to underperformance. Requiring members to actively switch when a fund advises them it has failed a performance test, or expecting members to access the new online comparison tool (which fails to cover choice products) keeps the onus largely on members, rather than making funds shut down, and move people out of, poor products

Trustees' best interest duty	• Government should review and clarify trustees' obligations relating to best interest duty (Rec 22)	Rather than seeking to provide clarity, the proposed new best financial interest duty creates significant confusion, with regulations (rather than legislation) to define activities/payments that will be illegal, *despite* the fact that they may meet the overarching best financial interest duty

3. Underperformance

AIST Position
• Existing members of poor performing funds should be protected by law, not disclosure • Consistently underperforming products should be wound up in accordance with a regulated timetable • The annual performance test should apply to all products in legislation, with no exceptions • The annual performance test should be based on overall outcomes – that is, returns minus all fees, including administration fees • Performance benchmarks should be risk adjusted and accurately reflect the range of assets in which funds invest • A consistent methodology based on overall outcomes – that is returns minus all fees, including administration fees – should be used across both the performance assessment and the online tool • All products should be covered by the online comparison tool • APRA should review legacy products with a view to rationalising these products as recommended by the PC • The four-yearly review of default-listed products, undertaken by the Fair Work Commission, should be revived

3.1. Soft on underperformance

The measures in this Bill fall well short of the PC's recommendations for dealing with super fund underperformance.

The Commission's 2018 report into superannuation found that most members and assets in the super system were performing well, but for some members, underperformance was delivering significant harm.

For a typical 21-year-old full-time worker, the difference between being in a bottom-quartile super product versus one in the top quartile was $660,000 at retirement.[19]

The report found products in the $731 billion default (MySuper) sector performed better than products in the larger $1.2 trillion non default (Choice) sector, on average, though there were underperforming products in both sectors.[20]

The Commission recommended super fund underperformance be dealt with as a priority, with disclosure and performance assessment for all products. Importantly, products that underperform had to be fixed and, where necessary, wound up (see Table 3).[21]

This Bill takes a much softer approach to super fund underperformance:

- It applies performance assessment and disclosure to MySuper products only. Underperforming choice products – examples of which stunned the community during the FSRC[22] – are left to be determined by regulations and it is unclear what products will be covered. This leaves a substantial proportion of underperforming products unscrutinised.
- The legislation does not explain how underperformance for MySuper products will be measured or whether all fees will be included in the measurement as they should be. However, the Explanatory Material suggests that administration fees will not be included. Given the PC's findings in relation to the impact of administration fees, these should be included in any performance assessment (see Section 3.4).
- It keeps all underperforming funds in the system by not necessarily covering all Choice products.
- By only preventing underperforming MySuper funds from taking on new members, this, only makes the situation worse for existing members of underperforming funds.
- Existing members of underperforming funds will be required to take action themselves – and will be stapled to their underperforming fund for life unless they engage and switch. In a compulsory

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[19] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), pp.10-11
[20] *Ibid*, see Chapter 2: Investment Performance, pp.107-152
[21] *Ibid*, p.591
[22] See, for instance, Misa Han, 'APRA to take action against AMP Super, board', *Australian Financial Review* (14 June 2019), https://www.afr.com/companies/financial-services/apra-to-take-action-against-amp-super-board-20190613-p51xfz; Gareth Hutchens & Amy Remeikis, 'Westpac says banks' moves into wealth management 'clearly not' a success for customers', *Guardian* (22 November 2018), https://www.theguardian.com/australia-news/2018/nov/22/westpac-says-banks-move-into-wealth-management-clearly-not-a-success-for-customers; Gareth Hutchens, 'Colonial First State admits super fees result in vastly different returns', *Guardian* (15 August 2018), https://www.theguardian.com/australia-news/2018/aug/15/colonial-first-state-admits-super-fees-result-in-vastly-different-returns; James Thomson, 'Banking royal commission smashes trust in retail super trustees', *Australian Financial Review* (17 August 2018), https://www.afr.com/wealth/superannuation/hayne-smashes-trust-in-retail-super-trustees-20180815-h13zo2

system with high levels of disengagement, low levels of financial literacy, the Government has a higher obligation to protect fund members.

- <u>If the underperforming product they are in is a choice product, no information will be available to them on the YourSuper tool to make a performance comparison.</u>
- The performance assessment measures are not contained in the legislation and will be determined by regulation. AIST urges that these measures be aligned to the underlying investments – if they are not, this may lead to adverse impacts on investment approaches.

A process for reviewing default-listed funds is already legislated, and should be revived. AIST continues to call for this framework, involving four-yearly reviews by an expert panel of the Fair Work Commission, to be reinstated, following six years of Government inaction.

3.2. Disclosure necessary but doesn't deal with underperformance – a regulatory response is needed

The proposal attempts to deal with underperformance through disclosure rather than regulation, risking existing members staying in underperforming funds indefinitely. Web-based information and writing to members about underperformance is important, but will not solve underperformance. Disclosure has been shown to be ineffective in disciplining product providers, and it places the responsibility on the consumer.

Consumers will be encouraged to access a new YourSuper comparison tool may prompt them to switch to or choose a better fund. A well-designed, user-friendly fund comparison tool is overdue, and something that AIST has long called for. However, the proposed comparison tool will only cover MySuper products, leaving members in choice products in the dark, despite the PC recommending otherwise.

AIST cautions policy makers to be realistic about the extent to which consumer disclosure will drive members to better funds. Last year, ASIC stunned many in the financial industry by "calling time" on disclosure. This stemmed from a research report by ASIC and the Dutch Authority for Financial Markets that found mandated disclosure and warnings had been ineffective in influencing consumer behaviour for a decade. Releasing the report, ASIC's Deputy Chair, Karen Chester declared: "disclosure was not the silver bullet once thought, nor should be it relied upon as one."[23] Even more worryingly, the report pointed to instances where disclosure had backfired and caused consumer harm.[24]

A relevant comparison is the widely recognised failure of consumer disclosure in the electricity market. While some states require providers to alert consumers that they aren't getting the best deal, many people end up doing nothing, while ostensibly independent intermediaries (e.g. price comparator websites) have

[23] Karen Chester (ASIC Deputy Chair), 'ASIC 'calls time' on disclosure reliance' (14 October 2019), https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-279mr-asic-calls-time-on-disclosure-reliance/

[24] Australian Securities and Investments Commission and the Dutch Authority for the Financial Markets, *Disclosure: Why it Shouldn't be the Default* (October 2019), pp.42-43

been criticised as conflicted by profit motives and for exercising preferential treatment of certain providers.[25]

As shown in the FSRC, arguments that members are responsible for being in underperforming super funds do not meet community expectations. The superannuation system is compulsory, and benefits are preserved until retirement, meaning that there is a higher level of responsibility for government, regulators, and funds to ensure the proper operation of the system. As Commissioner Hayne observed, "current disclosure requirements are not, on their own, sufficient to inform consumers fully."[26] Addressing underperformance is a job for the regulator, not consumer disclosure, and this should be done before any stapling begins.

Concerns about disclosure on the part of the FSRC and ASIC echoed those of the PC, which, in its 2018 report, noted:

> While there is no shortage of information, many members find it complex, overwhelming and inconsistent with their needs. Product disclosure statements seem more focussed on protecting the fund than helping the member. Members get excessive choice at the expense of less comparability, and even highly engaged and financially literate members struggle.[27]

It is hardly surprising members find disclosure so difficult to navigate when those in the industry, who are responsible for putting together such information, are often themselves lost. As a review of ASIC's Regulatory Guide 97, which sets out for super funds how to disclose fee and cost data to members, found in 2018:

> [on] numerous instances … industry participants had concerns that arose out of a misunderstanding about the requirements and some frankly admitted an inability to understand what was required of them.[28]

Consistency in disclosure to avoid consumer confusion

There is a risk of consumer confusion as different performance methodologies would apply for the annual performance test and YourSuper comparison tool. For example, administration fees will not be included in the performance assessment but will be included in the comparison tool. A fund could be classified as underperforming by one measure and not the other.

A regulatory response is needed

Giving members the primary responsibility to move from underperforming products means providers may simply leave members stapled to closed underperforming products and open new products for new members. Leaving underperforming products open to existing members may encourage unscrupulous providers to loss-leading behaviour, creating a new class of underperforming legacy products. According to

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[25] Australian Competition and Consumer Commission, *Inquiry into the National Electricity Market* (August 2019), pp.30-31.
[26] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report: Volume 1* (February 2019), pp.171-172.
[27] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.18.
[28] Darren McShane, *Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (July 2018), p.117.

the PC there are 3 million accounts in legacy products and retail legacy products account for half the products in the 'high-fee tail.'[29]

3.3. Choice product carve outs: Include the worst-performing products in legislation

AIST has long supported measures to improve super fund performance. This is particularly important for choice products, which is where the PC identified the worst occurrences of underperformance in the super system. However, the Bill only applies the performance test and associated consequences to the better-performing MySuper products, leaving members of underperforming choice products without protection unless regulations are made to extend the regime to these products. Members of all APRA-regulated super products should be protected by a legislated performance regime.

Choice products contain the majority of assets in the super system, totalling approximately $1.2 trillion for the September 2020 quarter, and dwarfing those of MySuper products ($753 billion).[30] The PC found:

- The choice segment features a much higher concentration of underperformance than the default segment, with 36% of choice investment options delivering "returns more than 25 basis points below their tailored benchmark."[31]
    - Even more worryingly, this assessment of underperformance was "likely to be a conservative assessment," as gaps in data reported by entities meant only 16% of choice assets were able to be benchmarked.[32]
- Choice products dominate the system's 'high-fee tail', in which fees are greater than 1.5% of members' balances. Around 4 million members are in these high-cost choice products, a cohort representing a sizeable portion of the system – $275 billion in total assets (17% of the system).[33]
- The "proliferation of tens of thousands of investment options" and an associated lack of transparency in the choice segment "complicates decision making and increases member fees, without boosting net returns."[34]
- In both the accumulation and retirement phases, choice products often feature high exit fees, possibly creating "a barrier to member switching" into cheaper and better-performing products.[35]

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[29] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), pp.38; 54.
[30] Australian Prudential Regulation Authority, *Quarterly superannuation performance statistics* (September 2020 [issued 24 November 2020]).
[31] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.148.
[32] *Ibid*, p.13.
[33] *Ibid*, p.54.
[34] *Ibid*, p.55.
[35] *Ibid*, p.15.

Given these findings, AIST strongly submits that choice product underperformance must be addressed in the legislation.

Single asset class and platform products should be covered

Leaving choice product underperformance out of the legislation results in a lack of clarity regarding which products beyond MySuper products may become subject to the regime via the making of regulations at a future date. The *Your Future, Your Super* policy announcement put forward a new sub-category of choice products that the performance test would apply to: so-called 'trustee directed' choice products (TDPs). In the announcement this category appeared to include only mixed asset class choice products, carving out:

- Single asset class choice products; and
- Platform choice products

However, while the Budget announcement contains an indicative definition of a TDP, there is no definition in the exposure draft or Explanatory Material.

If the Government decides to proceed with a definition along the lines of that in the Budget announcement, the possible exemption of single asset class products is problematic. Such an approach assumes that single-asset products are inherently less susceptible to detrimental outcomes caused by trustee management. As the FSRC revealed, even cash-only products can lead to poor member outcomes.[36] In specific response to a case study centring on negative returns by a single asset product, Commissioner Hayne highlighted trustees' obligations – under both Section 52(6)(a) of the SIS Act and Superannuation Prudential Standards (including SPS 530) – to, among other things, "regularly review an investment strategy for *each investment option*" and "monitor and assess regularly whether [such] investment objectives are being met."[37] In light of such findings, it is therefore disappointing that the proposed definition of TDP appears to exclude products of concern to the FSRC, which are the source of significant member detriment.

Similarly, there is no valid reason for exempting platforms from the performance regime. Although platform members select underlying investment options, it is the trustee who decides what is or is not made available to choose from. In selecting investments to make up their individual portfolios, members often receive financial advice.

As ASIC has found, such advice has frequently been compromised by conflicts of interest, with advisers often recommending products and investments offered by related parties that do not align with their best interest duty obligations under s961B of the *Corporations Act 2001*.[38] It is therefore imperative that providers of platform products be held accountable and be similarly subject to performance assessments, with the relevant penalties for underperformance to apply.

During the PC inquiry, retail providers argued against product dashboards for single-asset options, claiming they would require unwarranted "costs and [provide] very limited benefit to members."[39] These arguments

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[36] Chris Pash, 'AMP claims some super fund members chose to pay more in fees than they'd earn from investments,' *Business Insider* (16 August 2018), https://www.businessinsider.com.au/royal-commission-amp-super-fees-cash-2018-8.
[37] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report p.122.
[38] Australian Securities and Investments Commission, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest* (January 2018), https://download.asic.gov.au/media/4632718/rep-562-published-24-january-2018.pdf.
[39] NAB MLC Wealth, Submission to Productivity Commission inquiry (July 2018), p.17.

were expressly rejected by the PC, which, reiterating its preference that all products be covered, stated exceptions should "only be granted on the basis of evidence under the principle of 'if not, why not.'"[40]

Elsewhere, for-profit entities have continued to call for platform providers to be exempted from transparently disclosing the full impact of fees and costs in member-facing disclosure – instead putting the onus on members to research and add up prospective ongoing fees beyond those incurred simply for gaining access to underlying investments.[41] AIST asserts that this is contrary to members best interests and contrary to the spirit of the increased transparency the Government seeks to introduce with these reforms.

Disturbing history of choice carve-outs

Failure to ensure all choice products are subject to the annual performance test would reflect a continuation of a troubling trend of exemptions and carve-outs for the non-default super segment. For example, despite being legislated under the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012*, the roll-out of consumer-facing dashboards for choice products has repeatedly been delayed. First deferred in May 2014 until July the following year, subsequent delays pushed the expansion of choice product dashboards to 1 July 2016, 30 June 2017, 1 July 2019, and, most recently, to 1 July 2023. As a result, their earliest possible introduction is (albeit still tentatively, with further delays not to be ruled out) set to occur a full decade after being legislated. Even when finally rolled out, choice product dashboards will not cover legacy products. Members of such products will face significant difficulty comparing their returns and costs to alternative products within the system.

Elsewhere in the consumer disclosure framework, platforms have escaped scrutiny by not being required to disclose to prospective members the full impact of fees and costs in product disclosure statements (PDSs). Despite numerous updates to ASIC's Regulatory Guide 97 (RG 97) – which advises super fund trustees on their PDS obligations – platforms continue to enjoy such an exemption. Although an external review of RG 97 led to the recommendation that platform providers make it clear their stated fees reflect only those associated with *gaining access* to underlying investments, the onus unacceptably remains on members to add up prospective ongoing fees in order to compare the true costs of such products to those in the non-platform segment.

APRA have a timetable – no practical reason to exclude choice products

APRA's Data Transformation Project is currently extending the breadth and depth of reporting by APRA-regulated funds. This project both extends reporting in relation to MySuper products and extends it to choice products. Data reported to APRA will strengthen their prudential management of the whole superannuation sector, and (amongst other things) provide data that will be used in APRA's forthcoming choice heatmaps comparing the performance of choice products.

As a requirement of this new and more detailed data reporting, platform providers will be required to report the investment performance of their underlying investments to APRA. Therefore, it cannot be valid

[40] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.276.
[41] Financial Services Council, Submission to ASIC Consultation Paper 308: Review of RG 97 – Disclosing fees and costs in PDSs and periodic statements (2 April 2019), p.27.

to argue that applying the annual performance test to such products is administratively impractical, and all further exemptions should be removed in the best interests of members.

Platform providers will be required to report product data on a comprehensive basis to APRA from 1 July 2022, following the implementation of the new reporting regime. It is notable that APRA has framed a key priority of its data transformation project as facilitating "performance assessments for choice products and more granular comparisons of performance" across the system.[42]

In light of the PC's findings on the scale of underperformance of choice products, any new measure designed to address poor member outcomes in the system must apply to these products in legislation. If it is the intention of the Government to include all APRA-regulated products in the performance assessment as outlined in the Explanatory Memorandum, then the details of this should be included in the legislation.

3.4. Include all fees in performance assessment for real comparison and to avoid gaming

The annual performance test does not reflect real outcomes and could be gamed, as it uses a selective net investment return (NIR) that does not include administration fees. This would be avoided if the test used overall net benefit outcomes including administration fees, in line with the approach taken by the PC. The exclusion of administration fees results in a misleading inflation of the performance of some of the worst-performers in the system.

In recent years, both the PC and APRA have endorsed and applied net return measures in their analyses. In the final report from its multi-year inquiry into the efficiency and competitiveness of the super system, for example, the PC noted that delivering "returns to members (net of all fees and taxes) is the most important way the system contributes to delivering the best possible retirement incomes." In this light, it is hard to understand why the Explanatory Material states that the NIR is "the most important factor in determining retirement balances."[43]

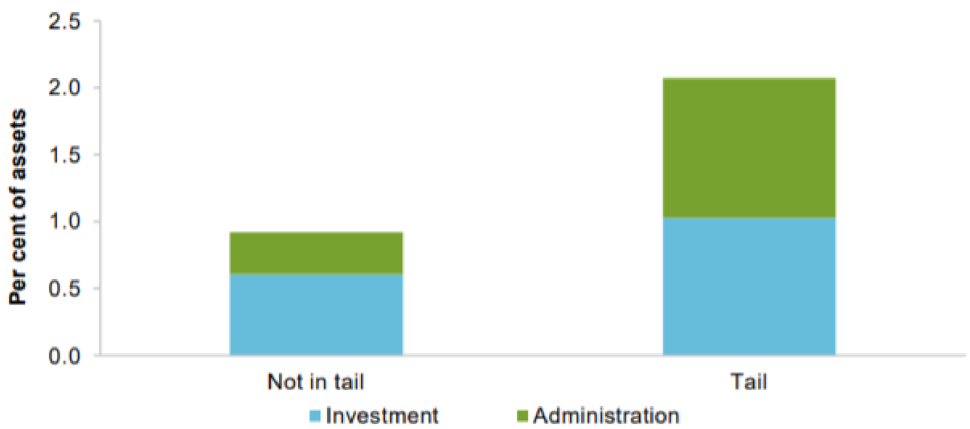
The stark impact of not accounting for administration fees is demonstrated by the PC's analysis of what they termed the 'tail' of high-fee products across the APRA-regulated system. The overwhelming majority of these costlier products were in the retail (for-profit) choice segment. As Figure 1, reproduced from the PC report, shows, such retail products have proportionately higher administration fees compared to better performers (i.e. those not in the 'tail').

Taken in conjunction with the finding of an observable correlation between higher fees and lower performance, it becomes clear that neglecting any fees seriously undermines any well-meaning attempt to compare products and subsequently tackle underperformance. In considering the significantly higher average administration fee among retail products, the PC also noted the impact of certain business

[42] APRA, *Topic Paper 2: Performance (Data Transformation Project)* (December 2019).
[43] Treasury Department, *Your Future, Your Super* (October 2020), p,23, https://budget.gov.au/2020-21/content/factsheets/download/your_future_your_super_factsheet.pdf.

practices (technically legal, owing to a lack of legislative restrictions on the characterisation of administration fees outside the MySuper segment), such as the charging of “trailing commissions as a component of … administration fees.”[44] The lack of clear and consistent definitions of fee types has been used to ‘game’ these arrangements to the detriment of consumers. ASIC has partly addressed this in Regulatory Guide 97, but it is a backward step for the Bill not to resolve the administration fee issue.

Figure 1. Administration fees especially higher for retail choice products in the ‘tail’ of high-fee products (Fees as percentage of assets, 2017)



Source	PC analysis of SuperRatings data.		
Coverage	362 products covering 78% of total assets and 76% of member accounts in APRA-regulated funds.		
Survivor Bias	Yes.	**Selection Bias**	Yes.

In criticising existing gaps in how funds have reported fees and costs data to regulators like APRA, the PC observed how this “lack of transparency harms members by making fee comparability difficult at best, and renders cost-based competition largely elusive.”[45] APRA, for their part, have used net returns as the headline performance measure in their consumer-facing ‘heatmap’ product comparison tool for MySuper products.

To a superannuation member, the outcome that matters is the dollar figure reflecting their balance – whether it’s during the accumulation phase or, more critically, at the point of retirement. Taking into account the impact of all fees and costs, it is this net outcome figure that should also be used when comparing products; be it for the purpose of facilitating decisions on whether to switch to another fund, or

[44] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.174.
[45] *Ibid*, p.16.

allowing regulators and industry observers to monitor performance within the system, a practice that should be similarly adopted by the legislation.

The factoring in of all fees when assessing the performance of super products has attracted support from both sides of politics, and from all segments of the system.[46] Liberal Senator Andrew Bragg, for instance, recently conceded that "what matters to members is net returns, so of course you [must] look at all the fees."[47]

The Government's proposal to assess products against NIR benchmarks, leaving administration fees out of the equation, falls far short. While we support performance measures aimed at tackling underperformance, only those allowing for net returns assessments will achieve this outcome.

3.5. Use performance assessment benchmarks that don't distort outcomes

While the performance assessment benchmarks are not defined in legislation and will be detailed in regulations, AIST urges that the assessment benchmarks be aligned to the underlying assets. The approach outlined in the policy documents released with the Federal Budget may encourage MySuper providers to track benchmark allocations. Index-tracking behaviour would reduce the risk of underperforming the benchmark while also limiting the likelihood of overperforming the benchmark, reducing returns over time. This may also discourage investment in higher cost-high return approaches, in favour of indexed and low cost, low return products.

Providers of underperforming funds may also be incentivised to engage in short-termism to improve short-term performance in order to reopen to new members.

Must reflect underlying investments

In considering the appropriate methodology, it is important to consider that trustees have typically held the CPI+ benchmark over the appropriate time horizon as the most important objective for superannuation products. This is because providing a real return on enforced savings ensures that this fundamental objective is met. Certain unlisted assets, such as direct property and regulated infrastructure, have a contracted flow of income that keeps pace with inflation. These assets are typically valued infrequently, and have the potential to underperform listed equities over an 8-year period, even though they provide diversification and inflation protection to members.

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[46] For evidence of support from both not-for-profit and for-profit funds, industry observers, and the Federal Opposition, see, for instance, Clive van Horen (CEO Banking and Wealth, Suncorp Group), 'House of Representatives Standing Committee on Economics inquiry into Australia's four major banks and other financial institutions: superannuation sector' (6 November 2020), p.43; Ian Silk (CE, AustralianSuper), *Ibid*, p.10; David Bryant (CEO, Mercer Australia), *Ibid*, p.49; Kirby Rappell (Executive director, SuperRatings), cited in John Collett, 'New super comparison plan 'significantly flawed'', *Sydney Morning Herald* (20 October 2020), https://www.smh.com.au/money/super-and-retirement/new-super-comparison-plan-significantly-flawed-20201016-p565qg.html; Paul Karp, 'Labor signals fight over 'massive design fault' of super changes in Coalition budget,' *Guardian* (12 October 2020), https://www.theguardian.com/australia-news/2020/oct/12/labor-signals-fight-over-massive-design-fault-of-super-changes-in-coalition-budget.

[47] Andrew Bragg, 'Interview with Tom Connell on *SkyNews AM Agenda*' (15 October 2020), https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F7604299%22;src1=sm1.

We are concerned that the proposed test has limits in relation to taking into account the different risk characteristics of the range of investments within superannuation. These risk characteristics reflect the underlying investment objectives and the management of the associated risks to match members' needs across their lifetime, and need to be considered when assessing performance.

Risk of well-performing funds failing the test

Frontier Advisors undertook modelling which identified a 65% probability that a well-constructed portfolio (with exposure to unlisted assets) will outperform the listed Strategic Asset Allocation (SAA) over rolling eight-year periods. The analysis showed there is a significant chance (36%) that the well-constructed portfolio underperforms the listed SAA benchmark by more than 0.5% pa in any single year. Over rolling eight years this likelihood is reduced to 16%. There is a 11% probability that the well-constructed portfolio will underperform by more than -0.5% pa in two consecutive rolling 8 years.

4. Stapling

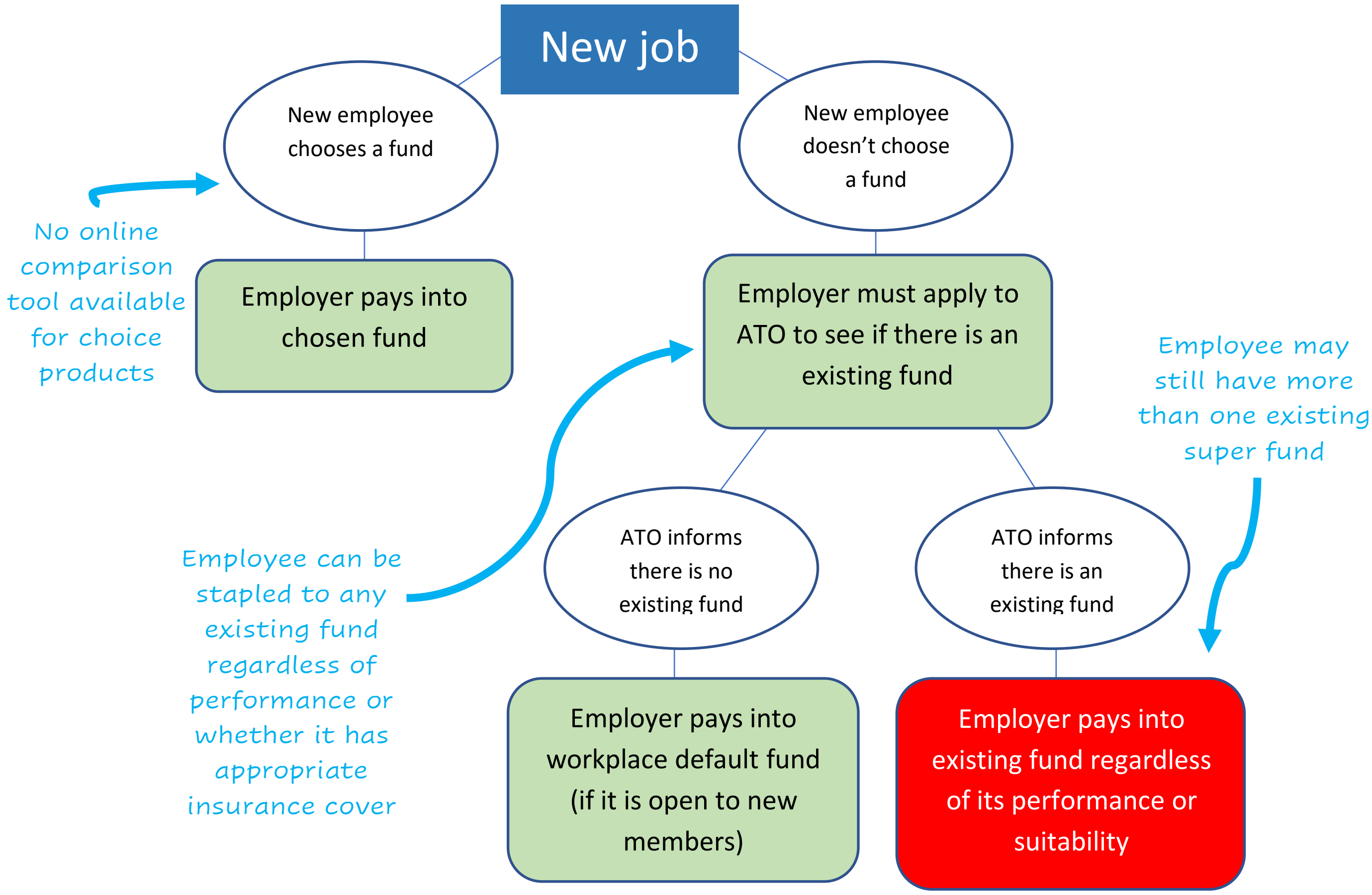
AIST Position

• Changes should be sequenced so that underperformance is substantially addressed before stapling occurs, in line with the approach recommended by the PC
• When the stapling legislation is progressed, it must include a definition of "stapled fund" that ensures the fund:
  ○ Is open to new members
  ○ Is subject to annual performance testing
  ○ Offers appropriate insurance for the occupation the employee is entering, including consideration of occupational and industry risk
• Stapling should progress only when online systems to ease the administrative burden on employers have been developed
• The process of consolidating new and existing multiple accounts in the current framework should be further developed by making more efficient use of the ATO online commencement processes and fully implementing the PYS and PMIF measures.
  ○ The success of these measures is evident. In October 2020, 74.5% of Australians held a single superannuation account, an increase from 67.5% in June last year

4.1. The cost of being stapled to an underperforming fund

If stapling occurs without member protections and before underperformance is substantially addressed, members who are currently in underperforming funds will be stapled to those funds, potentially for the remainder of their working life (Figure 2). Including member protections to avoid this, and sequencing the measures to address the worst examples of underperformance prior to introducing stapling, is vital to avoid this type of member detriment.

Figure 2: Possible member harm in stapling proposal

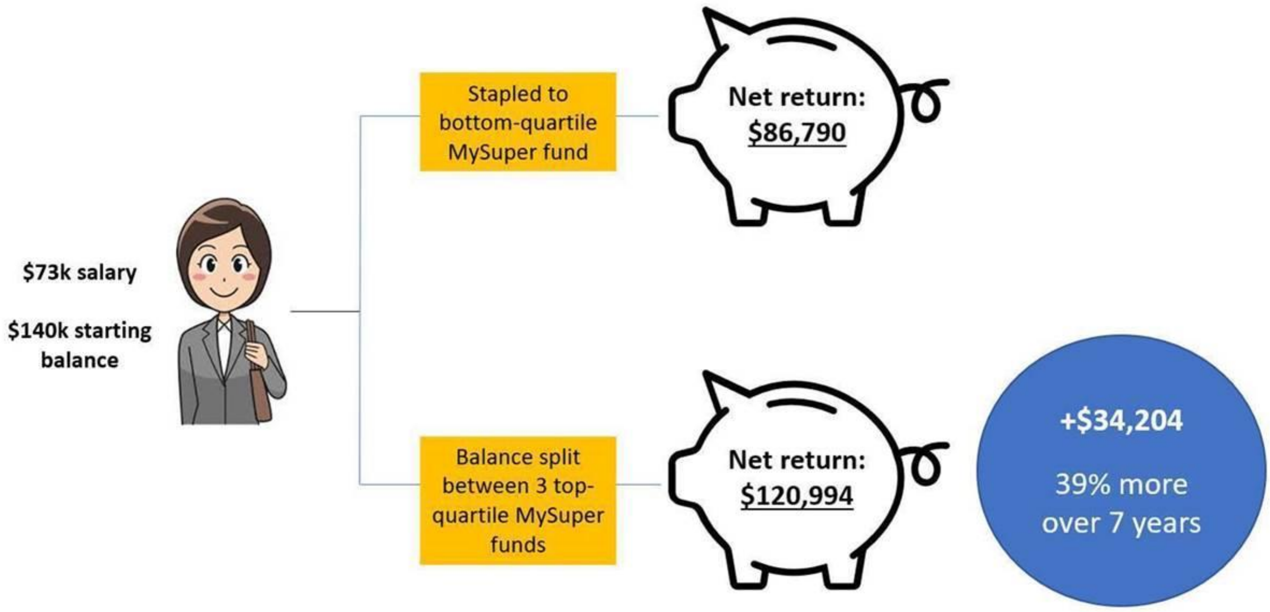


"First do no harm"

Recent analysis undertaken by SuperRatings for AIST highlights the increased danger to members of failing to substantially tackle underperformance prior to introducing a stapling mechanism. Using a hypothetical member with a salary of $73,000 and a balance of $140,000, the research showed the significant potential for member detriment in stapling before underperformance is addressed.

It found that notwithstanding the ideal outcome is for a member to be in a single high-performing fund, a member was better off being in several large high-performing default funds than stapled to one poorer performing fund.

Figure 3. Being stapled to an underperforming fund could be worse than having multiple accounts (net return outcomes over 7-year period)[48]



While this analysis is not intended to downplay the importance of reducing unintended multiple accounts, it shows that the measures need to be implemented carefully, with utmost focus on a robust response to underperformance. There is greater potential member harm from underperformance (and indeed even more so from being stapled to an underperforming fund) than there is from multiple accounts.

Low-cost group insurance cover another cost of stapling

Measures addressing the multiple account issue should ensure members remain not only in high-performing funds, but in funds able to provide them with appropriate product features and services, and

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[48] Analysis based on median level of net return performance amongst the *bottom quartile* of existing MySuper products and the three largest products in the *top quartile* (by FUM) (to 30 June 2020). As the PC's analysis demonstrated, there is a high likelihood of even worse outcomes among choice products, which deliver lower returns, on average, than MySuper products.

particularly with appropriate insurance coverage for their occupation. Funds are only able to offer insurance cover for high-risk industries as a core offering of the whole membership.

Adding member protections

The importance of sequencing was emphasised by the PC, which warned that only once underperformance was reduced (by the imposition of elevated outcomes tests, analogous with the Government's annual performance assessment) should its recommendation of a 'default once' framework be introduced.[49] It is of central importance that this approach be followed.

Contextualising the reduction of underperformance as a prerequisite for stapling would also align with the approach taken by the FSRC. By grouping the recommendation for a single default account with that calling for a banning of treating of employers, Commissioner Hayne acknowledged the importance of limiting the exposure of disengaged members to default products which may not necessarily have been subject to the most rigorous selection processes.[50]

In addition, employers should not be able to pay into an underperforming stapled fund for new employees. Under the existing proposal, when an employer looks up a new employee's existing fund there is no performance requirement applied to the information provided to the ATO. This is the point at which an important member protection could be inserted in legislation through a robust, legislated definition of 'stapled fund'. Elements that should feature in any legislated definition of a stapled fund include:

a) it is open to new members;
b) it is subject to annual performance testing; and
c) it can provide appropriate insurance coverage for the member's current employment circumstances**,** including consideration of occupational and industry risk.

[49] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.45.
[50] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, pp.250-253.

4.2. Impact on employers

The measure will place a new administrative obligation on employers to identify and pay into an employee's 'stapled' super fund for employees who do not choose a fund and who started their employment on or after 1 July 2021. Employers cannot rely on the employee to advise them whether there is a stapled fund; they must apply to the ATO.

If an employee does not choose a super fund:

- Employers can't satisfy the choice of fund requirements by paying into the workplace default fund if the employee has a stapled fund
- The default fund will still apply if the employee doesn't have a stapled fund, but the employer still needs confirmation from the ATO that there is no stapled fund

There are concerns that this will be an onerous task, particularly for large-volume employers. For at least the first 12 months it appears there will be no automated solution, integrated with payroll software, to determine a new employee's current fund. The employer would need to look up the existing fund for each member.

New administrative requirements for employers include:

- Employers must request the ATO to provide information on whether each new employee has a stapled fund
- Employers will not be permitted to independently determine whether an existing fund is a stapled fund – they must apply to the ATO
- Employers must have a notification from the ATO that an employee doesn't have a stapled fund before they can meet the choice of fund requirements by paying into the default fund
- If the employer's default fund has been closed to new members due to the performance test, the employer will need to choose a new default fund for employees without a stapled fund
- There may be circumstances where the ATO changes an earlier notification about an employee's stapled fund
- The legislation does not state how long the employer will need to wait for the ATO to determine whether there is a stapled fund.

Corporate plans – default fund

AIST is of the view that the proposed measures should continue to allow employers to highlight the benefits of the organisation's default super fund to new employees. In certain instances, particularly where a corporate plan is in place as a default fund, employees are given discounted fees. This may be as a result of an employer paying the administration fees or insurance premiums for members. While the performance test will eventually provide an important filter to assist members, employers should not be considered to be providing financial advice in providing more information to members. AIST encourages Treasury to actively consider how corporate plans/ large employer plans fit into the current legislative framework.

5. Best Financial Interests Duty

AIST Position
• The inclusion of the word 'financial' in the best interest duty is in line with profit to member fund approach and the current interpretation of trustee duties • The broad nature of the reverse burden is not reflective of the risk in the sector, and without clarity around scope an application will add unnecessary cost to members • Funds should be able to engage third party providers on a standard commercial basis • The covenant should apply to distributions made to parent companies • More clarity is required as to how a trustee will meet this obligation • AIST has no objection in principle to record keeping standards, but they should be defined in the legislation • The liability provisions should allow exemptions for circumstances beyond the control of the trustee • AIST does not support the changes to 117A and 117B of the SIS Act

5.1. The duty itself

The inclusion of the word 'financial' in the best interest duty is in line with profit-to-member funds' approach, and the current interpretation of trustee duties.

The profit-to-member superannuation industry has always been guided only by the interests of members, across all fund activities. Since inception, profit-to-member super funds have operated a business model that is consistently member-focused. These funds have always ensured that the activities undertaken (including investment decisions) are in the best financial interest of members.

The duty to act in the best interests of members[51] has long been interpreted by trustees as a duty to act in the members' best financial interest.[52] Given this, the clarification of the duty through the inclusion of the term 'financial' will not require alternate interpretation of current approaches.

The PC, in recommendation 22, identified that the Australian Government should pursue a clear articulation of what it means for a trustee to act in members' best interests. The exposure draft does little to clarify the best interest duty; it merely acknowledges the long-established position that trustees consider the financial interest of members in the exercise of their duties.

AIST notes that the PC's recommendation was qualified by the findings of the FSRC which examined the best interest duty in some detail. The FSRC did not make any recommendation to change the best interest covenant. Rather, the FSRC recognised that the duty of "acting in members' best interest is not hard to understand".[53] Protestations that the covenant is incomprehensible, or content unknowable were rejected by the Commissioner. The FSRC referenced several common law cases that have clarified the covenant.

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[51] Superannuation (Industry) Supervision Act 1993 (Cth) s 52(2)(c).
[52] *Cowan v Scargill* [1985] Ch 270, 295.; *Commonwealth Bank Officers Superannuation Corporation Pty Ltd v Beck* (2016) 334 ALR 692.
[53] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, p.227.

Specifically, a trustee “must do the best they can for the benefit of their beneficiaries, and not merely avoid harming them.”[54]

5.2. Reverse onus (burden of proof)

While trustees rightly undertake rigorous business cases in line with the current interpretation of the need for expenditure to be in the financial interests of members, AIST has concerns about the scope and application of the reversal of the evidential burden of proof.

A reversal of the evidential burden of proof is usually confined to offences that are serious, and where there are difficulties of proof.[55] While a breach of the duty would certainly be serious in the context of the superannuation sector, it is unlikely that a breach would be difficult to prove.

Trustees currently undertake detailed business cases to ensure expenditure is in line with trustee duties to members, however, there are concerns that a legislated civil penalty, paired with lack of guidance around what is required to satisfy a reverse burden of proof, will result in costly and overly complicated record-keeping. This is heightened by the absence of a materiality threshold.

Without clear guidance around an appropriate materiality threshold, it is unclear whether or not trustees would need to conduct full analysis on every item of expenditure incurred within a fund. This would significantly impact the proper functioning of the superannuation fund, particularly if such analysis is required on nominal expenditure items such as stationary orders or travel expenditure.

Neither the PC nor the FSRC recommended a reversal of the evidentiary burden of proof in the SIS Act.

5.3. Third party providers

AIST has no in principle concerns with the best financial interest duty extending to payments made to third party entities. It is sound practice for funds to scrutinise expenditure decisions to ensure that payments meet all legal and regulatory obligations. There is, however, a need for greater clarity around what would be needed for a trustee to discharge this duty in practice.

It is unclear what would be required for a trustee to be satisfied that a payment to a third party is for the intended purpose. The Explanatory Material suggests that the degree of ‘look through’ is much deeper than simply being satisfied that the service rendered or purchased good provides market value commensurate with payment. It would appear that a trustee would need to be satisfied that the payment covers only the cost of the goods or service rendered. This raises questions such as whether the payment would be able to

[54] *Cowan v Scargill* [1985] Ch 270, 295.
[55] Australian Law Reform Commission, Justifications for reversing legal burden (July, 2015), https://www.alrc.gov.au/publication/traditional-rights-and-freedoms-encroachments-by-commonwealth-laws-alrc-interim-report-127/11-burden-of-proof/justifications-for-reversing-legal-burden/.

include third-party profit markups, and whether the trustee is responsible for what the third party chooses to do with their profit.

It would be impossible and unmanageable for a trustee director to have that degree of look through into the commercial operations of a third-party business.

In addition, the exposure draft should make clear that all distributions made to a related third party be captured under the best financial interest covenant, including profit distributions made to parent companies. Extending the coverage to profit distributions will ensure that superannuation funds operating under a vertically integrated business model are not able to circumvent the law.

It seems inconsistent with the intention of the legislation that a fund making payment to a third party must comply with the covenant, if a payment to a parent company is subject to no such scrutiny. It follows that should the covenant not extend to a parent entity, that entity can effectively make payments that are not in the financial interests of members as long as that expenditure is not seen as being on behalf of the fund.

5.4. Record keeping obligations

AIST has no objection to the inclusion of standards relating to record keeping provisions. However, the standards are not provided in the legislation. As this is a civil penalty provision, standards should be included in the legislation and not in regulations. Moreover, as a breach of this section will be a strict liability offence it is imperative that the responsibilities and standards of record keeping are made clear in the legislation alongside the penalties.

Record keeping obligations should include certain exemptions for matters that are beyond the control of trustee directors. For example, this may include an exemption in circumstances where records are destroyed by way of a catastrophic event.

5.5. Government overreach

AIST is strongly opposed to the changes the draft legislation makes to sections 117A and 117B of the SIS Act. The Explanatory Memorandum does not detail why Government would desire the extraordinary power to prohibit any payment or investment by a super fund at any time even if such a payment is in the best financial interests of members.

There is no reasonable basis to institute a law or regulation which gives government the power to unilaterally intervene in the operations and investments of superannuation funds that are discharging their duty to operate in the best financial interests of members. It is well-established that as a matter of principle governments should remain at arm's length from investment decisions.[56] The FSRC and PC made no finding that supports this power.

The overarching best financial interest duty will catch any activity that is not considered to be in members' financial interests. The penalties and obligations associated with that duty provide extensive capacity for regulators to police this duty. Therefore, from the point of view of ensuring funds don't undertake activity that is not in members' financial interests, the power is unnecessary.

The power also presents a number of significant risks to member outcomes, distorting investment approaches and creating an environment where trustees are unable to make secure long-term business and investment decisions as they are unable to anticipate what payments or investments may be banned.

Investments

These changes would open the potential for government intervention in private markets by providing governments (of any persuasion) the power to prohibit super funds from investing in certain assets. For example, a future government that does not approve of coal investments could introduce regulations to ban super funds from investing in coal assets. Likewise, another government that does not approve of super funds investing in renewable energy could prohibit such investment. Providing government with such power is an unusual approach in a free market economy.

Even if the new law is not made retrospective, the scenario may arise where a trustee which has previously made an investment now deemed illegal finds itself at a considerable commercial disadvantage because of a newfound lack of opportunities to sell the asset, with the possibility now being closed to many comparable institutional investors.

Other payments

A lack of visibility on what business practices may or may not be banned in future clashes with the vital aspects of longevity and stability that have underpinned the Australian superannuation system's success in generating returns for members. There is no regulatory or legislative framework that has been proposed which outlines the manner in which such decisions are to occur. It seems incongruous with the best financial interests covenant that a government can decide what is in the best financial interest of a particular fund's members, while a trustee director is required to prove that every expenditure decision meets the same standard.

5.6. Payments

AIST is concerned with the position outlined in the Explanatory Material that certain types of expenditure will attract differing levels of scrutiny. The Explanatory Material states that expenditure that is considered to be 'necessary' would likely be regarded as being in the best financial interest of beneficiaries, whereas

[56] World Bank: A Framework for Public Pension Fund Management, pg. 12 Musalem & Palacios (2003).

expenditure that is discretionary or non-essential would require closer scrutiny. This position appears to be inconsistent with the intention of the best financial interest duty.

AIST submits that the application of differing standards on certain types of expenditure ignores key findings observed in the PC's final report. In particular, the PC observed how some funds within the industry "may not be achieving value for money in their outsourcing arrangements."[57] The PC specifically identified how funds that outsource administration to related parties pay more.[58]

If the best financial interest duty is going to be applied, it must be consistent across all areas of expenditure. It would be unacceptable for a fund to pass on inflated core service costs to members and for such expenses to escape proper scrutiny.

5.7. Implementation issues

While not specifically referenced in the EM or exposure draft, the policy document accompanying the Budget announcements detailed additional information to be provided to members as part of Annual Member Meeting (AMM) notifications.[59] There are implementation issues that must be addressed should government proceed with this requirement. These include constraints around the timeframes to produce required materials, and the associated costs incurred in producing and distributing the materials.

Timeframes to produce materials

The document outlines that funds are required to provide notice for the AMM no later than six months after the end of the financial year and at least 21 days before the AMM. While funds have the email contact details for a large proportion of their members, there remains a proportion of members for whom no current or correct email address is held (e.g 30% of members). For those members that need to receive a mailed notice, at least 10 days needs to be factored in the timeframes for delivery. A lack of current email address can be caused by a number of reasons including employers providing incorrect details, or providing a generic email address (e.g. info@abc.net.au).

The list of required documents is lengthy and in order to manage costs funds are likely to have to decide between delaying their annual member statement mail-out (generally occurring in August/September) to allow the annual report to be finalized, or incurring the cost of two whole-of-membership communications. Final and audited accounts are generally signed off by the end of September but then need to be added to the printed document which can take a number of weeks.

Funds endeavour to get their member statements out as soon as possible after the end of financial year, and any delay will reduce member experience, lead to increased calls to the fund, and affect the currency of the information in the statement.

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[57] Productivity Commission, *Final Report – Superannuation: Assessing Efficiency and Competitiveness* (21 December 2018), p.26.
[58] *Ibid.*
[59] Treasury Department, *Your Future, Your Super* (October 2020), https://budget.gov.au/2020-21/content/factsheets/download/your_future_your_super_factsheet.pdf.

There are also concerns that the period for which the AMM can occur becomes extremely limited. That is, if all the requirements are to be fulfilled funds will likely be limited to having their AMMs in December.

Cost producing and distributing required materials

An additional concern is that the cost of producing and distributing the required materials to members, along with the AMM notice, is likely to be significant. Larger funds tend to have annual reports that are just under 100 pages, which does not include member outcome statements, significant event notices, or full financial accounts. As a result of the proposed changes, a member who has either chosen to receive communications by mail, or for whom the fund has no current email address, may be presented with well over 150 pages of materials.

A profit-to-member fund estimated in a submission to the Senate Economics Legislation Committee that the cost of organising and hosting an electronic annual member meeting for nearly 2 million members may be up to $5.9 million.[60] The cost is likely to be significant for almost all super funds.

AIST strongly supports measures that increase transparency. Therefore, we encourage Treasury to work with industry to ensure that members are provided with all relevant information in a manner that is both practicable and cost-effective.

[60] Maged Girgis and Phillip Turner (2020), Annual Members' Meetings: One small step for member empowerment. Superannuation Law Bulletin 31 No. 9&10.