



December 2020

# Your Future, Your Super package

## ABOUT US

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system.

During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established 60 years ago, it is an independent voice, ensuring consumers get a fair go. Super Consumers' establishment funding is set to run out in December 2021.

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*The Superannuation Consumers' Centre is a not-for-profit company limited by guarantee. ABN 34 163 636 566 ACN 163 636 566*

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## Introduction

For too long super trustees have been left alone in the dark with our money. The bright line test and other measures proposed in the Your Future, Your Super package will shine a light on superannuation fund performance. It will introduce pro-consumer competition to the market for the first time and drive outcomes which will see Australians retiring with more savings.

Account stapling will mean no more unintentional duplicate fees and insurance, substantially boosting the retirement savings of many Australians. The YourSuper comparison tool and an objective benchmarking test will both drive competition and provide much needed guidance to consumers. The 'best financial interests duty' will strengthen the onus on funds to justify the expenditure of their members' money by removing scope for ambiguous interpretation.

As the independent advocate for superannuation consumers, Super Consumers Australia strongly welcomes the release of draft legislation enacting the reforms and the opportunity to provide feedback. Consistent with the role of our organisation, our submission focuses on identifying how the draft legislation could be further strengthened and clarified to deliver the maximum benefit for consumers, as well as issues that go beyond the legislation but are relevant to the objectives it is intended to deliver.

We recommend:

- Including administration fees in the performance benchmarking test.
- That the underperformance notice is based on the best research about effective disclosure and is consumer tested.
- Giving APRA greater power to act on underperformance.
- An iterative approach to the development and refinement of the YourSuper comparison tool, including staged consumer testing.
- Clarifying that the best financial interests duty applies equally to core and discretionary expenditure and that a single standard applies to both types of expenditure.
- Clarifying the intended purpose of the discretionary power to prohibit certain expenses.
- Establishing an independent review of insurance in superannuation.

## Summary of Recommendations

**Recommendation 1: The performance benchmarking test should be expanded to include administration fees.**

**Recommendation 2: The performance benchmarking test should be applied to all accumulation products and decumulation products by 1 July 2022.**

**Recommendation 3: The notice to beneficiaries of underperformance should:**

- a) be informed by ASIC's Good Disclosure Principles and other relevant research and guidance on consumer disclosure, including by ASIC and the Consumer Policy Research Centre.
- b) be subjected to consumer testing to ensure maximum efficacy, including by minimising user friction.
- c) make clear that the purpose of the notification is to provide the person with an opportunity to review their superannuation arrangements and transfer to a better performing fund.
- d) include a prominent and accessible reference directing people to the YourSuper comparison tool.

**Recommendation 4: APRA should take a graduated response approach to underperformance and be appropriately empowered to take action to oversee or direct a transfer of members to a better fund, as recommended by the Productivity Commission.**

**Recommendation 5: The YourSuper comparison tool should:**

- a) be developed using an iterative approach guided by an advisory group, including representatives with expertise in consumer engagement and communication.
- b) be subjected to ongoing consumer testing by the ATO to ensure it is highly accessible, comprehensible and effectively drives people to high performing, appropriate products.
- c) enable a user to determine the appropriateness of a product for their life stage and balance size.

**Recommendation 6: The best financial interests duty draft legislation should:**

- a) be amended to clarify beyond doubt that a single standard applies to ‘core’ and ‘discretionary’ expenditure, and that trustees will need to have robust quantitative and qualitative evidence to support their expenditure, regardless of whether it is core or discretionary.
- b) specify APRA as the entity which has the discretionary power, via the regulations, to prohibit certain payments, or prohibit certain payments unless certain conditions are met, regardless of whether the payment is considered to be in the best financial interests of beneficiaries.
- c) be amended to include additional examples within the Explanatory Material which illustrate the types of circumstances in which it is envisaged that the discretionary power may be required.

**Recommendation 7: The Federal Government should:**

- a) ban occupational exclusions within default insurance products.
- b) commission an independent review of insurance in superannuation to consider a comprehensive range of issues, whether it is the most equitable and efficient way to meet the insurance needs of most Australians.

## Underperformance

We strongly support an objective, annual performance test for all APRA-regulated super funds, consistent with Recommendation 4 of the Productivity Commission’s inquiry into superannuation.<sup>1</sup> An objective test is necessary to protect Australians from the poor fund performance that has thrived due to lack of transparency. A test needs to be based on a transparent methodology for calculating a product’s performance and benchmark. Below, we outline how the draft legislative provisions relating to underperformance could be further strengthened.

### Administration fees should be included in the test

At present, the test focuses on investment performance and does not take into account administration fees. This approach will turn up the heat on underperforming fund managers, but do little to target inefficiently administered funds.

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<sup>1</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia’s Superannuation System*, December 2018.

The test should be expanded to include administration fees. Administration fees can have a significant impact on the retirement balances of Australians. The Productivity Commission found that an increase of just 0.5% a year in fees would reduce the retirement balance of a typical worker (starting work today) by a projected 12% or \$100 000.<sup>2</sup>

In recommending an elevated outcomes test, the Productivity Commission also indicated that all fees should be included in the assessment of a product's investment performance,<sup>3</sup> given that "the most relevant outcome for members is the returns they receive after taxes and fees."<sup>4</sup> The Productivity Commission found that while some funds may demonstrate exceptional investment returns, the evidence indicates that those which charge higher fees tend to deliver lower returns, once both investment and administration fees have been netted off.<sup>5</sup> Examining returns net of both investment and administration fees "gives the clearest picture of the net benefits members receive in relation to the fees charged."<sup>6</sup>

We are agnostic about how to include administration fees, but propose that the test should be clear and appropriately represent a member's experience of the fund across their lifetime. We have undertaken modelling to demonstrate how administration fees could be included in the test in line with these principles.

As a typical fund members' balance grows over their lifetime, we constructed a version of the proposed test that averages a MySuper product's outperformance against the benchmark net of administration fees across four representative balances (\$10,000, \$25,000, \$50,000 and \$100,000). To net administration fees from the benchmark portfolio we derived the member weighted median fee for each representative balance from the heatmap. This approach has the advantage of including administration fees and accounting for the fact that these fees impact performance differently at different balance sizes depending on a fund's fee structure.

We found that this enhanced test identified 29 underperforming MySuper products on APRA's product heatmap compared to just 22 funds identified by the proposed version of the test. This shows the proposed test misses a significant number of funds that are charging above average administration fees and ultimately eroding people's retirement balances without delivering commensurate returns.

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<sup>2</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p188.

<sup>3</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, Figure 13.2, p588.

<sup>4</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p109.

<sup>5</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p15.

<sup>6</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p185.

We would be happy to discuss our modelling with Treasury if further detail is needed.

**Recommendation 1: The performance benchmarking test should be expanded to include administration fees.**

## The test should be comprehensively applied

We understand that the test will initially apply to some 14 million accounts in MySuper products.<sup>7</sup> We appreciate that there is an intention to specify in the regulations, over time, other products to which the test will apply, beginning with trustee-directed products (TDPs) on 1 July 2022.

MySuper products and TDPs cover the majority of assets in accumulation products within the APRA-regulated fund sector, but this still leaves some products without the benefit of the new transparency measures. We recommend that all accumulation products be included by 1 July 2022 given their significant size, relative ease of inclusion and importance in driving better outcomes for superannuation members.

We also recommend expanding the test to decumulation (retirement income) products by 1 July 2022. The Retirement Income Review highlighted that these types of products will play an increasingly important role in ensuring that people have adequate income in retirement. It will be critical to ensure that these products are of a high quality and deliver the intended benefits.

Australians will trust and gain more confidence in engaging with the superannuation system if the test is applied equally across all superannuation products. This will allow people to shop with confidence in the superannuation market, in the knowledge that underperformance where it exists will be highlighted.

**Recommendation 2: The performance benchmarking test should be applied to all accumulation products and decumulation products by 1 July 2022.**

## The notice to beneficiaries should assist people to act on the information it contains

The requirement for funds to notify their beneficiaries if APRA determines that a product they issue is underperforming is a necessary but limited consumer protection. While disclosure has an important role to play in contributing to better financial markets, on its own, it is often not

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<sup>7</sup> APRA, *Annual MySuper Statistics*, June 2020, Table 5.

sufficient to produce good consumer outcomes and poor quality disclosure can result in actual consumer harm.<sup>8</sup>

We note that the regulations may specify the required form and content of the notice to beneficiaries (s60D(3)(a)). The notice must be designed using the latest research into effective disclosure including ASIC's Good Disclosure Principles as well as research by ASIC and the Consumer Policy Research Centre.<sup>9</sup> The specifications should also be subjected to consumer testing to ensure that:

- the information included in the notice of underperformance is clear and allows a lay person to understand it without difficulty; and
- people who receive a notice of underperformance from their fund understand its relevance to them and are able to act on the information provided.

The notice needs to be relevant to a fund member. It should be made clear that the purpose of the notification is to provide the person with an opportunity to review their superannuation arrangements and transfer to a better performing fund. To achieve this, the notice must include a prominent and accessible reference directing people to the YourSuper comparison tool.

The form of the notice and the information it contains should be designed to minimise the effort required of people to open, comprehend and take action to respond. For example, the notice should be provided digitally to people who have elected to receive their fund communications this way and the reference to the comparison tool should be hyperlinked. Other strategies for minimising user 'friction' should be a specific focus of consumer testing.

### **Recommendation 3: The notice to beneficiaries of underperformance should:**

- a) be informed by ASIC's Good Disclosure Principles and other relevant research and guidance on consumer disclosure, including by ASIC and the Consumer Policy Research Centre.**
- b) be subjected to consumer testing to ensure maximum efficacy, including by minimising user friction.**
- c) make clear that the purpose of the notification is to provide the person with an opportunity to review their superannuation arrangements and transfer to a better performing fund.**

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<sup>8</sup> ASIC and Dutch Authority for Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, October 2019.

<sup>9</sup> ASIC, RG168: *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, September 2010; ASIC and Dutch Authority for Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, October 2019; Consumer Policy Research Centre, *Five preconditions of effective consumer engagement – a conceptual framework*, 2018.



- d) include a prominent and accessible reference directing people to the YourSuper comparison tool.

## APRA should apply a graduated response to drive fund mergers

We expect in the overwhelming majority of cases that these reforms will drive trustees to take appropriate action to protect the long-term financial interests of their members. This will likely include finding efficiencies through mergers or improved practices which lead to lower costs.

However, there is a chance that some funds may be unable to find efficiencies and that it will be too costly for another superannuation fund to take them on as a merger partner. In order to deal with the full spectrum of likely cases, we recommend the regulator take a graduated response approach and be appropriately empowered to take action to oversee or direct a transfer of members to a better fund, as recommended by the Productivity Commission.<sup>10</sup>

The draft legislation provides APRA with *“a resolution planning prudential standard making power that relates to the resolution of an RSE licensee, a registrable superannuation entity or a connected entity of an RSE licensee, in order to best protect the interests of beneficiaries.”*<sup>11</sup> This is intended to enable APRA to ensure that trustees are prepared for resolution, where required. Resolution refers to the process by which APRA manages or responds to an entity being unable to meet its obligations.

We understand that this provision may fall short of allowing APRA to direct legally enforceable actions, such as mergers or transfers, however this is not clear from the draft legislation. We recommend that APRA should be appropriately empowered to take action to oversee or direct a transfer of members to a better fund, as recommended by the Productivity Commission. The Productivity Commission observed that this may require legislative change.<sup>12</sup>

**Recommendation 4: APRA should take a graduated response approach to underperformance and be appropriately empowered to take action to oversee or direct a transfer of members to a better fund, as recommended by the Productivity Commission.**

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<sup>10</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p495.

<sup>11</sup> Underperformance Explanatory Material, at 1.49.

<sup>12</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, p495.

## The YourSuper comparison tool should be iterative and consumer tested

The YourSuper comparator tool will drive better market competition and complement the existing consumer protection regime by giving people comparable, independent information. The ability of consumers to effectively compare products and services has a direct bearing on whether they can act on this information and actually switch providers.<sup>13</sup> We recommend the ATO undertake ongoing consumer testing to ensure the comparison tool is highly accessible, easy to understand and drives people to high performing, appropriate products.

An inherent challenge for the design of the tool will be how to balance simplicity and accessibility with the capacity to generate accurate, relevant and tailored results. To get real value from the tool, consumers need a way to determine the appropriateness of a product for their life stage and balance size.

Rather than a 'set and forget' exercise, an iterative approach to developing and refining the tool will be required, complemented by consumer testing. We understand that the ATO has been funded to conduct consumer testing to inform the initial design phase. Treasury and the ATO should establish an advisory group to have input into this process. Super Consumers would welcome the opportunity to participate in such a group and would bring to the process considerable expertise in consumer engagement and communication via our partner organisation, CHOICE.

Consumer testing should also occur as the YourSuper tool is further refined following its initial implementation.

### **Recommendation 5: The YourSuper comparison tool should:**

- a) be developed using an iterative approach guided by an advisory group, including representatives with expertise in consumer engagement and communication.**
- b) be subjected to ongoing consumer testing by the ATO to ensure it is highly accessible, comprehensible and effectively drives people to high performing, appropriate products.**
- c) enable a user to determine the appropriateness of a product for their life stage and balance size.**

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<sup>13</sup> Consumer Policy Research Centre, *Five preconditions of effective consumer engagement – a conceptual framework*, 2018, p34.

## Best financial interests duty

Evidence from the Banking Royal Commission and Productivity Commission highlighted the egregious failure of some funds to act in their members' best interests. We strongly support the new best financial interests duty, which is intended to provide a clearer articulation of what it means for a trustee to act in members' best interests. At the moment there is too much ambiguity which is leading to some funds potentially mis-spending members' money.

### It should be clarified beyond doubt that a single standard applies to 'core' and 'discretionary' expenditure

We are aware of commentary from within industry which is critical of the draft legislation for supposedly creating separate best financial interests duty tests for 'core' versus 'discretionary' expenditure by funds. The suggestion is that:

- There is a lower threshold for demonstrating compliance with core expenditure, and that this advantages retail funds because the dividends they pay to shareholders (i.e. their profits) constitute a core expense.
- There is a higher threshold for demonstrating compliance with discretionary expenditure, and that this is intended to prevent industry funds from promoting their superior performance through advertising.<sup>14</sup>

We understand that it is not the policy intent of the draft legislation to establish a 'two-tiered' system of thresholds for 'core' versus 'discretionary' expenditure but rather, to clarify *"the standard trustees must meet when they make expenditure decisions and undertake actions in relation to the operation of the fund in the best financial interests of members."*<sup>15</sup>

It appears likely that the above-mentioned criticism from within industry is enabled by certain wording in paragraphs 1.30-1.32 of the Explanatory Material. For example, in relation to 'strategic' discretionary expenditure, it is stated that *"A business case, supported by technical analysis (including cost benefit analysis, articulation of risks associated with achieving the outcome and any mitigation strategy) and quantifiable metrics to reflect expected financial outcomes would be expected to support trustee decision making."*<sup>16</sup>

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<sup>14</sup> See *Australian Financial Review*, 'Your super fund could be a dud and you won't know it' (op. ed.), 15 December 2020. <https://www.afr.com/wealth/superannuation/government-stacking-deck-for-dud-funds-20201215-p56nie>

<sup>15</sup> Best financial interests duty, Explanatory Material, at 1.6.

<sup>16</sup> At 1.31.

There is no such reference to a business case and technical analysis in the discussion of core expenditure. Rather, the relevant paragraph states that *“So long as the expenditure is essential to the prudent operation of a superannuation entity, and reporting and monitoring frameworks for such expenditure are put in place by trustees to ensure that the expenditure is necessary and competitively priced (and any ongoing expenditure continues to achieve its intended outcomes), then the expenditure decision would likely be regarded to be in the best financial interests of the beneficiaries.”*<sup>17</sup>

In order to quell the aforementioned criticism, the draft legislation should clarify beyond doubt that, as stated elsewhere in the Explanatory Material, *“Trustees will need to have robust quantitative and qualitative evidence to support their expenditures”*<sup>18</sup> - regardless of whether they are ‘core’ or ‘discretionary’.

## The purpose of the discretionary power to prohibit certain expenses should be clarified

There has also been criticism from some quarters of the provision within the draft legislation which specifies that regulations may prohibit certain payments, or prohibit certain payments unless certain conditions are met. The legislation would allow this regardless of whether the payment is considered to be in the best financial interests of beneficiaries.

The intention of the provision is to provide a mechanism for prohibiting certain payments and investments *“where they are considered to be unsuitable expenditure by trustees in any circumstance.”*<sup>19</sup> It has been interpreted by its critics to mean that the government will be able to ban, for politically expedient reasons, any expenditure they don’t like.

An important fact that this criticism does not acknowledge is that any prohibition can only be specified within regulations, which are disallowable instruments that can be contested by Parliament following well-established processes.

However, in the interests of transparency and probity, we recommend that APRA is the entity which has the discretionary power to prohibit payments through the regulations.

We accept that circumstances may arise in which a fund can provide evidence that justifies a category of expenditure as in the best financial interests of members, but the expenditure

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<sup>17</sup> At 1.30.

<sup>18</sup> At 1.28.

<sup>19</sup> At 1.61.

nonetheless causes sufficient detriment to warrant its prohibition. A flexible approach with appropriate checks-and-balances is needed to address this potential situation.

However, the draft legislation is opaque on the purpose of the discretionary power, leaving it open to the criticism described above. While prescribing the circumstances in which the provision may be used is unnecessary and would defeat its underlying intention, there is scope to better explain and contextualise this intention within the draft legislation, including by clarifying why a regulatory ‘backstop’ is desirable. It would be useful to include additional examples within the Explanatory Material to illustrate the types of circumstances in which it is envisaged that the discretionary power may be required.

## Recommendations:

### **Recommendation 6: The best financial interests duty draft legislation should:**

- a) be amended to clarify beyond doubt that a single standard applies to ‘core’ and ‘discretionary’ expenditure, and that trustees will need to have robust quantitative and qualitative evidence to support their expenditure, regardless of whether it is core or discretionary.**
- b) specify APRA as the entity which has the discretionary power, via the regulations, to prohibit certain payments, or prohibit certain payments unless certain conditions are met, regardless of whether the payment is considered to be in the best financial interests of beneficiaries.**
- c) be amended to include additional examples within the Explanatory Material which illustrate the types of circumstances in which it is envisaged that the discretionary power may be required.**

## Single default account

Account stapling will end the inefficiency and retirement income erosion created by millions of unintended multiple accounts. It will also make super much easier for people to manage.

Some within industry have objected that account stapling may result in people being left without adequate insurance coverage. We don’t accept this objection as an argument for account stapling not proceeding. However, it does highlight problems with insurance in super that require further consideration.

## Occupational exclusions should be banned in default insurance products

Those concerned that account stapling will leave some people without adequate insurance cite the example of a person whose first job is in hospitality and who is stapled to the industry fund for that sector. Later, the person is employed in construction but remains stapled to the original fund, with a default insurance policy that is no longer suitable because their occupational risk category has changed.

This scenario could indeed occur because of the wide variation in the terms and conditions of policies, and the low level of consumer engagement with insurance in super. All funds have a fundamental duty to act in the best interests of members when designing and negotiating their insurance offering, and they are accountable for the outcomes their members receive. Yet a recent review by ASIC found large variations in the costs and benefits of cover across the market, confirming that while Australians collectively pay more than \$9 billion a year<sup>20</sup> from their super for insurance, value for money can be extremely hit and miss.

For example, ASIC found that some products offered over 20 times as much default death and TPD cover than others to the same type of member and that, depending on the MySuper product, a 30-year-old woman's total premium could vary by 25 times (from \$29 to \$732 a year) and a 50-year-old man's by 37 times (from \$40 to \$1,480 a year).<sup>21</sup> Poor disclosure practices by insurers, such as the use of generic labels (such as 'standard' or 'general') for the most expensive category of insurance product, make it difficult for even the most engaged consumer to make informed decisions about their insurance arrangements.<sup>22</sup>

ASIC's review confirmed that many people are eroding their retirement savings to pay for 'junk insurance' in super that they have little or no chance of successfully claiming due to restrictive terms and conditions.

For example, research we released in July this year confirmed that almost all insurers apply a different definition of total and permanent disability to claims by people who are unemployed, work less than a specified number of hours per week or work in certain occupations. In one policy we found occupations such as actors, musicians and long distance truck drivers. As a

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<sup>20</sup> Productivity Commission, *Inquiry into the Efficiency and Competitiveness of Australia's Superannuation System*, December 2018, Technical supplement 9, p3.

<sup>21</sup> ASIC, REP 675: *Default insurance in superannuation: Member value for money*, December 2020, p6.

<sup>22</sup> ASIC, 'Trustees to improve occupational classification practices in insurance in superannuation', Media release, 3 December 2020.

result, some people who are unemployed or working limited hours pay full price for cover they are five times less likely to successfully claim upon.<sup>23</sup> Insurers and super funds have made it nearly impossible for people to compare products and figure out which ones are good quality and appropriate for them.

### Funds with ‘hazardous’ occupation terms

<b>Fund</b>	<b>Insurer</b>
Aon Master Trust	AIA Australia
Asgard	Westpac
IOOF	TAL

Insurance in super is a lottery, but the solution is not to prevent account stapling. In light of the concerns that have been raised about the potential for account stapling to result in the unintended consequence of some workers losing their insurance coverage, the Federal Government should ban the use of occupational exclusions in default insurance products within superannuation.

### A review of insurance in superannuation is needed

There should be an independent review of insurance in super, as recommended by the Productivity Commission, to consider a comprehensive range of issues. A review should include consideration of whether insurance in superannuation is the most equitable and efficient way to meet the insurance needs of most Australians. In the meantime, Super Consumers will continue to identify funds that have junk insurance policies and call on them to deliver better outcomes for their members.

### Recommendations:

#### **Recommendation 7: The Federal Government should:**

- a) ban occupational exclusions within default insurance products.**
- b) commission an independent review of insurance in superannuation to consider a comprehensive range of issues, whether it is the most equitable and efficient way to meet the insurance needs of most Australians.**

<sup>23</sup> Super Consumers Australia, ‘Restrictive definitions in default TPD insurance policies’, July 2020. <https://superblog.netlify.app/2020/07/08/tpd/>