AIST Submission to Treasury:

Your Future Your Super Regulations and associated measures

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Level 23, 150 Lonsdale Street
Melbourne VIC 3000

T +61 3 8677 3800
F +61 3 8677 3801

info@aist.asn.au
www.aist.asn.au

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.

Contact

Melissa Birks, General Manager Advocacy 03 8677 3800

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
SIS Act	*Superannuation Industry (Supervision) Act 1993*

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1. Executive summary

AIST supports the objectives of the Your Future Your Super package to hold super funds to account for their performance, address the creation of unintended multiple accounts, empower members and increase transparency and accountability.

The legislation before Parliament does not achieve these objectives, and in fact will result in significant member detriment as currently drafted. AIST opposes the legislation is its current form and is concerned the regulations do little to allay our concerns about the package as a whole.

AIST calls on Treasury to advise the Government of these shortcomings in relation to the regulations, and for the regulations to be put on hold until the issues in the primary legislation are addressed. This is not possible in the 37 days from the date of this submission to 1 July. Attempts to persist with this schedule will especially adversely impact the 800,000 employers that would be required to implement premature and ill-formed requirements for stapling from 1 July 2021.

The legislative flaws are the result of the Government not adequately addressing key recommendations of both the Productivity Commission (PC) and the Financial Services Royal Commission (FSRC). The package also relies too heavily on these regulations to prescribe substantive and contested measures that should be included in the primary legislation.

While the regulations make some improvements to investment indices and require that administration fees are taken into account in the determination of net returns, these changes are too little, too late, and improvements have not been made to correct other fundamental flaws.

Furthermore, the regulations exacerbate problems with legislation by further limiting the scope of performance assessment, excluding products holding the majority of assets in choice products, and confirming arrangements that will staple many super fund members to underperforming funds.

The rushed and poorly coordinated approach to the package is underlined by the regulations not being released in time to be considered by the Senate Inquiry into the Your Future Your Super Bill, reducing the efficacy of that inquiry, particularly given the depth of outcomes that are reliant on these regulations.

In addition to the legislation being overly reliant on regulations, these regulations themselves are silent on several areas in which regulatory guidance is appropriate and needed. This leaves significant areas of uncertainty that make member outcomes unclear and implementation highly problematic.

Several measures in these regulations are not related to the Bill and so are untested, having not been subject to the Senate Inquiry or submission process at all. These new measures, which are material to member outcomes, are the annual member meeting notice requirements, changes to section 68A and portfolio holdings disclosure.

2. Overview

AIST welcomes the opportunity to make a submission on the draft regulations relating to *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* (the Bill). There are three sets of regulations that are part of the Your Future Your Super package (the package):

1. Addressing Underperformance in Superannuation
2. Improving Accountability and Member Outcomes
3. Single Default Account

Regulations do not relieve fatal flaws in the bill

While we welcome the fact that the regulations include administration fees in performance assessment and have adjusted more appropriate unlisted asset benchmarks, many significant issues with the bill remain. These include:

- Substantive and contested matters are left to these sparse regulations rather than included in the legislation, reducing the role of the Parliament and making it very difficult for members of parliament, subject matter experts and the public to evaluate the full impact of the changes.
- The legislation doesn't require underperforming "choice" products to be subject to performance testing and regulations exclude non-trustee directed choice products with an estimated value of $515 billion from performance testing. These products are estimated by APRA to hold 60% of the value of all choice products, and 33% of the value of all APRA-regulated superannuation products. Given the history of delays to choice product super regulation and disclosure, we believe performance assessment for all super products should be included in the legislation. The Productivity Commission specifically rejected arguments by for-profit providers that choice products be carved out of assessment.
- Disengaged members who are currently in underperforming funds will be "stapled" to those funds. This is contrary to the Productivity Commission approach that recommended dealing with underperformance first to avoid members being stapled to dud products.
- By stapling members to their current fund without any consideration of insurance, the Bill risks workers starting in a hazardous occupation being stapled to a fund that does not have suitable insurance cover. Given the high-risk nature of these roles these individuals would be unable to obtain affordable cover outside of a superannuation fund with suitable insurance and would be uninsured.
- Closing underperforming products only to new, not existing, members will make outcomes even worse for remaining members stapled to underperforming products.
- The Bill includes a regulation-making power that will allow the minister of the day to ban any investment or expenditure by any super fund at any time. This can be done even when the investment is in the financial interests of members.

It is unclear why the Government would be seeking such extraordinary powers, but this will lead to significant uncertainty that will impact member outcomes. No details of how this proposed power will work are included in these draft regulations

- Changing the best interests duty was expressly recommended against by the Hayne Royal Commission. The current best interests duty is already taken to mean best financial interests. The Law Council of Australia has stated that this change would impact case law and is unnecessary.
- The Bill introduces a strict liability offence for contravening recordkeeping obligations with no materiality threshold. This will take trustee attention away from activity that will improve member outcomes, and tie super funds up in unnecessary red tape that will cost members money. No details of how this proposed power will work are included in these draft regulations
- Reversal to the burden of proof so that the onus will be on trustees to prove that they discharged their duty rather than on the regulator prove they did not. The broad nature of the reversed burden of proof (given it has no materiality threshold) is not reflective of the risk in the sector. This will add unnecessary cost to members. Neither the PC nor the FSRC recommended a reversal of the evidentiary burden of proof – it is punitive and unnecessary. No details of how this proposed power will work are included in these draft regulations.

Heavy lifting: Substantive and contested measures should not be left to these regulations

As has been raised by many submitters on the Bill, the Bill inappropriately leaves significant heavy lifting to be done by these regulations. This includes substantive and contested policy issues. Given the enormous impact the Your Future Your Super changes will have on Australians' financial security in retirement, it is crucially important that Government steps to implement the 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 Bill – and remove the risk of many underperforming super funds not being brought to account.

The Senate Standing Committee for the Scrutiny of Bills report on the Bill sought the Treasurer's advice about the apparently unnecessary and inappropriate reliance on regulations and asked if the Bill could be amended to include at least the basic requirements.

AIST and many other submissions on the public consultation draft of the Bill (such as the Law Council of Australia) had previously made the same point. The Bill has not been amended as recommended by the Scrutiny of Bills Committee.

The table below outlines matters that should be included in the legislation, though it is important to note that some of these matters are not even included in these draft regulations, which is of even greater concern, as outlined in the following section

Table 2: Matters that should not be left to regulation.

Matters left to regulation that should be in the primary legislation
Underperformance
Consideration of the administration fees in the methodology of the performance test and any other requirements for assessment should be in the primary legislation rather than the regulations.
The requirement and methodology to calculate the performance and benchmarking of all choice products including Trustee-Directed Products.
Specify requirements on the exercise of APRA's discretion; the matters APRA may consider in exercising such a discretion; and allow APRA to make specified assumptions in exercising its discretion.
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.
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 that a stapled fund cannot 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, 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*

These regulations have not been subject to consideration by the Senate

These concerns were also echoed in the dissenting report issued by Labor Senators in The Senate Economics Legislation Committee April 2021 report into the primary legislation. The Labor Senators emphasised that it was vital for basic details of the legislative scope and arrangements to be included. The report stated:

> ***Lack of draft regulations***
>
> *1.5 It should be noted that this bill delegates significant power to legislative instruments. As the government has only released partial draft regulations for this bill on the day before this report is due to be finalised, it is impossible for the committee to fully assess the impacts of the bill on the superannuation system.*
>
> *1.6 It should be noted that the Chair of this committee previously recommended that regulations should be presented in a timely fashion, so the Senate is able to review legislation as a whole. The Senate should note that this did not occur.*

Given the enormous impact the legislation would have on Australians' financial security in retirement, it is vital that basic details of the legislative scope and arrangements are transparently included, and completely address the issues identified by the Financial Services Royal Commission.

These regulations are silent where guidance is needed, creating unnecessary cost, and hindering implementation

Despite the uncertainty created by the lack of detail in the Bill, there are substantive areas in which the legislation is also silent. In fact, the last three items in the table above are not referenced in these regulations at all, so that there remains an extraordinary level of uncertainty around the requirements on trustees in relation to their new obligations and penalties. This lack of guidance will cost members money.

In addition, the regulations are silent on:

- Stapling: Data required to be provided to the ATO by employers
- Timeframes for responses from the ATO for stapled fund data requests
- Details on how super funds are meant to manage monies that they that have received erroneously due to incorrect identification of a stapled fund by the ATO

3. Addressing Underperformance in Superannuation

Issue	AIST position
Overall	**Basic and fundamental details of the legislative scope and arrangements must be included in the primary legislation**
Underperformance	
Investment benchmarks	**AIST notes that the changed indices for unlisted infrastructure and property are an improvement on the indices proposed in the Budget announcement. If they are to be adopted, they must be subject to regular iteration and review.** **Investment benchmarks used for each asset class must be free of charge and publicly available.** **Further consideration must be given to how strategic asset allocation decisions impact on performance and how this can be factored into performance assessment.**
Scope of products to be assessed and included in the YourSuper comparison tool	**The range of products to be assessed and compared is basic and fundamental to the operation of the legislation and must be included in the primary legislation. It is inappropriate for the scope of the legislation to be determined in regulations.** **The YourSuper comparison tool should include all APRA-regulated products (other than the defined benefit interest of a product), and not be limited to MySuper products.** **The annual performance test should apply to all APRA-regulated products (other than the defined benefit interest of a product), and not be limited to MySuper products and the minority of savings in Choice products defined as Trustee-Directed Products.**

	AIST especially opposes the definition of Trustee-Directed Products (TDP) being limited to products where the trustee has control over the design of the product's investment strategy. **Products with less than five years of performance data should not be excluded from performance assessment.**
Commencement date	**Performance assessment should commence in 2021 for all APRA-regulated products and should be completed prior to the commencement of stapling.**
Assessing risk-adjusted returns	**Performance assessment should explicitly include consideration of the level of risk appropriate to the investment of the assets in a product, although this should be prescribed in the primary legislation.**
Consideration of admin fees	**AIST supports the proposed consideration of administration fees in the determination of product performance, although this should be prescribed in the primary legislation.** **The benchmark administration fee should be the median of all products, and there should not be separate administration fee benchmarks for MySuper products and TDPs.**
Time horizons for assessment	**The time horizon for performance assessment should be progressively extended to ten years, and not be a maximum of eight years as presently proposed. This should also be prescribed in the primary legislation.**
Review of performance measures	**The regulations should prescribe a comprehensive review of performance assessment after three years of operations.**

3.1. Long-time horizons crucial for optimising performance assessment

AIST has consistently sought that performance be assessed on the longest period the data will support. Accordingly, the regulations should support a rolling 10-year performance horizon, with shorter time periods used only where reliable data is only available for shorter time periods. As many of the comments in this submission, this requirement should be embedded in the primary legislation, and not relegated to the regulations.

There should be no exemption for products with shorter period of available performance data (e.g. less than five years). It is inevitable that any such exemption would be used to avoid performance scrutiny by unscrupulous market participants. For example, product manufacturers could continually release new products to the market and avoid public scrutiny of their performance. Given that performance can be compared by regulators on the basis of benchmarks constructed using the same time period/s and the same strategic asset allocation/s, it cannot be claimed that such an approach would be unfair. Conversely, it is unfair to consumers and robs them of basic consumer protections if the performance visibility of other products was not afforded to new products.

However, as new products will not have the benefit of a complete investment cycle, AIST recommend that APRA be given the discretion to review the performance of products that may have failed a performance assessment, and exclude them for the prohibition on accepting new members on a case-by-case basis. In this way, APRA will be able to assess the extent of the underperformance and consider the prevailing market circumstances.

Existing Government requirements also support the use of a ten-year time horizon. This is the requirement on the mandated MySuper Product Dashboard for both showing investment returns and setting target returns. Similarly, ASIC's MoneySmart website also uses a ten-year time horizon to show fund returns.

3.2. Performance assessment and comparison tool must include all products

The annual performance test should apply to all APRA-regulated products, and not be limited to MySuper products and those choice products defined as Trustee-Directed Products.

The range of products to be assessed and compared is basic and fundamental to the operation of the legislation and must be included in the primary legislation. It is inappropriate for the scope of the legislation to be determined in regulations.

The YourSuper comparison tool should include all APRA-regulated products (other than the defined benefit products), and not be limited to MySuper products.

AIST especially opposes the definition of Trustee-Directed Products being limited to products where the trustee has control over the design of the product's investment strategy.

Choice products containing one-third of all APRA regulated super assets should not be carved out

APRA has calculated the value of funds under management in Choice products that will not be Trustee-Directed Products as 33% of FUM of all APRA-regulated superannuation products. APRA's response of 13 April to a question on notice from a public hearing of the Senate Economics Legislation Committee shows that 60% of assets in Choice products are estimated not to be Trustee Directed Products.

After noting that the Regulations were still to be released, the response stated "*APRA understands, however, that TDPs are likely to largely align with the sub-set of choice products that APRA is looking to include in its initial Choice Heatmap to be released later in 2021. On this basis, APRA estimates the performance test TDPs will capture approximately two-thirds of total member assets of APRA-regulated superannuation entities based on data as at 30 June 2020, as shown in the table below*".

APRA's comments about the composition of multi-sector Choice products assumed to be TDPs aligns with the definition of TDPs in the draft regulations.

The regulations are inconsistent with key elements of the Government's policy announcement.

Excluding the majority of savings in Choice products from performance testing, and limiting the range of products included on a YourSuper comparison tool is inconsistent with two of the key elements identified as such in the 2020 Budget announcement:

1. *Empowering members*

   The members of Choice products will not be provided with information from a reliable independent source as they will not be included for comparison on the YourSuper comparison tool. They will therefore not be able to choose a high-performing and/or low-cost superannuation product on the basis of this tool.

   The YourSuper comparison tool is intended to make it easier to choose which super fund consumers get to manage their superannuation. This support for consumers is therefore not available for Choice products if they are not part of this consideration.

   The YourSuper comparison tool is also intended to promote competition between products by making the performance of products clear. Promotion of competition between products is therefore limited for Choice products if there are excluded from this scrutiny.

   Based on the above, the exclusion of Choice products from the YourSuper comparison tool does not support the empowering of members and should be reconsidered.

2. *Holding funds to account for underperformance*

The Government has stated that it will protect consumers from poor superannuation outcomes by conducting an annual performance test for MySuper products and other products prescribed by the regulations, and require notifications to be made to members by funds offering underperforming products. The test was therefore intended to ensure funds are focused on improving investment returns and reducing fees.

The absence of these protections in relation to the majority of savings in Choice products from performance testing means that the members of these funds will not be in products that are held to account for any underperformance, and are not protected by a key policy plank of the Government's announcement.

AIST has raised these and other concerns in relation to previous consultations on the Your Future Your Super package, and notes that it is particularly important that the regulations (subject to lesser parliamentary scrutiny) are held to be consistent with the Government's primary policy announcements in relation to the package.

TDP exclusion of products where the trustee does not have control over the design of the product's investment strategy

The Government has excluded products where the trustee does not have control over a product's investment strategy from being TDPs in both its initial Budget announcement and in the draft regulations. Its basis for doing so is wrong in fact.

The draft regulations wrongly cite the Productivity Commission as providing the basis for its definition of TDPs. On page 3 of the explanatory material accompanying the draft regulations, it stated:

> *Consistent with the recommendations of the Productivity Commission review into superannuation, the intent of these changes is to subject all APRA-regulated superannuation funds to annual performance tests for their MySuper and other products specified in the regulations (recommendation 4).[*page 3*]*

That sentence is constructed to give the impression that the Productivity Commission recommended that a subset of superannuation products should be performance tested.

In reality, the commentary and recommendation 4 of the Productivity Commission made it clear that for all products should be assessed:

RECOMMENDATION 4 ***ELEVATED MYSUPER AND CHOICE OUTCOMES TESTS***

The Australian Government should legislate to require all APRA-regulated superannuation funds to undertake annual outcomes tests for their MySuper and choice offerings. These outcomes tests should include:

- *a requirement for funds to obtain independent verification, to an audit-level standard, of their outcomes test determination, at least every three years (starting with the first test)*
- *clear benchmarking requirements for all MySuper and choice investment options.*

The reasons given in the 2020 Budget announcement for a limited definition of TDPs are not in line with the Productivity Commission's recommendations.

Government rationale for a limited definition	**AIST response**
These products are most comparable to MySuper products.	Any superannuation product that contributes to the retirement outcome of an individual should be subject to performance assessment. Any product that does not do this does not meet the Sole Purpose Test.
The performance test is easily adaptable to MySuper products.	APRA's performance test has been designed and will be implemented for all superannuation products. Expanding data collection to Choice products is critical for APRA to make further progress on addressing underperforming choice products. APRA is targeting underperfoming Choice products and the performance test must be applied to them.
APRA is already collecting data on MySuper products	APRA data collection is now being extended to all APRA-regulated superannuation products and will not be limited to MySuper products. APRA has confirmed data reporting will be required for all products, investment menus and investment options.

The points made in the above table have been confirmed in numerous documents published by APRA, including the following.

APRA's Superannuation Data Transformation project aims to drive better industry practices and improve member outcomes by significantly enhancing the comparability and consistency of reported data. The

project will make it easier to scrutinise and reliably compare fund and product performance, especially in the choice segment of the market.[1]

…

Trustees will report this new data to APRA for the first time in September 2021, including data necessary to assess the performance of products beyond MySuper.

APRA is also currently developing its methodology for extending its Heatmaps – which provide additional information beyond the Performance Test metric – to choice products.

APRA expects to release an Insights paper outlining its approach in the coming months, ahead of release of an initial choice heatmap for a sub-set of products later in 2021.[2]

…

2021 will also see the commencement of the revised superannuation data collection, which will provide a broader and deeper data-set – particularly for choice products.

It will significantly enhance APRA's – and other stakeholders' - ability to assess key aspects of the superannuation industry such as investment performance, fund expenditure and insurance.

This expanded collection is critical for APRA to make further progress on addressing underperforming choice products, and also for implementation of the Government's Your Future, Your Super reforms.[3]

Following the publication of our choice heatmap later this year, we will also be increasing our supervisory efforts to target the choice options and products that the data tells us are not performing well enough.[4]

In its Response Paper Superannuation Data Transformation Project Phase March 2021[5], APRA advised it was changing its data collection schedule to align with its expected arrangements for the YFYS Bill, while also confirming that SDT would result in data reporting for "all products, investment menus and investment options." Each of the following quotes are from the response paper

APRA has been considering the changes contained in the YFYS Bill, and the likely changes to the accompanying regulations, to determine whether any additional changes to the new data collections may be needed to facilitate implementation of the new legislative requirements that are proposed to commence on 1 July 2021.[p.31]

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1 https://www.apra.gov.au/consultation-on-apras-superannuation-data-transformation

2https://www.apra.gov.au/letter-to-senate-economic-legislation-committee%E2%80%99s-inquiry-into-treasury-laws-amendment-your-future

3 https://www.apra.gov.au/news-and-publications/apra-deputy-chair-helen-rowell-speech-to-asfa-conference

4 https://www.apra.gov.au/news-and-publications/apra-deputy-chair-helen-rowell-speech-to-asfa-conference

5https://www.apra.gov.au/sites/default/files/2021-03/Response%20Paper%20-%20Superannuation%20Data%20Transformation%20Project%20Phase%201_0.pdf

…
APRA has sought to ensure that sufficient data is available for investment options to enable APRA to undertake the YFYS performance assessment.[p.30]
…
For the reporting periods ending from 30 June 2021 but before 30 June 2022, RSE licensees will be required to report only for those products and investment menus which have investment options that are Trustee Directed Products8 (TDP) or are MySuper products. For RSE licensees that are able to provide the full coverage of reporting earlier, they will be able to do so, however it is anticipated that this data would not be published externally.

For periods ending from 30 June 2022, RSE licensees must report data for all products, investment menus and investment options. [p.36]
…
APRA has sought to ensure that sufficient data is available for investment options to enable APRA to undertake the YFYS performance assessment.[p.36]

There is also no rationale provided for performance testing being limited to products where the trustee has control over the design of the product's investment strategy. In such circumstances, the trustee still has the legal obligation to ensure that members' financial interests are being promoted in the product they offer. This obligation cannot be delegated to the designer of the product's investment strategy.

3.3. Investment benchmarks must reflect assets and be subject to review

Performance benchmarks should accurately reflect the range of assets in which funds invest.

AIST notes that the changed indices for unlisted infrastructure and property are some improvement on the indices proposed in the Budget announcement. If they are to be adopted, they must be subject to regular iteration and review.

The identification of new benchmark for unlisted property is an improvement compared to the previously proposed listed benchmark as it allows a more credible relative performance assessment for unlisted property allocations. The index is the primary benchmark used by many domestic super funds and property managers to benchmark relative performance in an unlisted property.

The previously proposed benchmark (ASX300 A-REIT Index) exhibits higher volatility being listed and a greater exposure to funds management and development derived income.

The index is also proposed for international unlisted property, but this is not an ideal performance benchmark for offshore exposure. Further and immediate consideration should be given to developing a global unlisted property benchmark including geographic composition and index selection. Currently, there is no universally recognised unlisted property index that covers global property markets in

aggregate. The use of the index for international unlisted property should be subject to specific and immediate review.

Infrastructure

The super industry has never adopted a single specific benchmark for the Infrastructure asset class and there have only been limited attempts to create an unlisted Infrastructure index. Therefore, the selection and initial use of an infrastructure benchmark should be an iterative process and subject to review.

The use of the MSCI Private Infrastructure index as the benchmark for unlisted infrastructure is at least an attempt to address the specific characteristics of unlisted infrastructure assets. However, in our discussions with AIST member funds, several concerns have been raised with this index:

- the index has a severe survivorship bias;
- Treasury's understood intention to supplement the missing data due to the reporting lag with a listed index is a limited and unsatisfactory fix.

The use of the indices for unlisted infrastructure should be subject to specific and immediate review. Subscription to these indices are very expensive, and any index that is required to be used by law should be freely and publicly available. The accuracy of the indices listed in the Exposure Draft is unclear – for example, the *MSCI/IPD Mercer IPD Australian Monthly Wholesale Property Fund Index – Post-fee Total Return (All funds)* does not exist.

One option would be for the Government to acquires rights to use indices that could then be available for use by super funds.

3.4. Administration fees must be included on an even playing field

In AIST's previous engagement with Government and Treasury, it was made clear to us that the intention was to exclude administration fees into account in performance assessment of products. In contrast, AIST supported and continues to support consideration of administration fees in the determination of product performance. Inclusion of administration fees means that the investment returns "in the pocket" of fund members is more closely aligned the performance that is performance assessed.

AIST is pleased the Government has taken the concerns of AIST and many other stakeholders into account and has now proposing in the regulations that administration fees should be taken into account. However, we further submit that assessment on the basis of true net returns should be incorporated into the primary legislation: the risk of product providers gaming different fee types means that this is fundamental to the construction of the legislation.

However, AIST disagrees with the way in which the proposed regulations intend to benchmark administration fees. The benchmark administration fee should be the median of all APRA-regulated superannuation products, and there should not be separate administration fees for MySuper products

Trustee Directed Products, and other choice products. While it is acknowledged that different products offer different types and levels of service, there is no strict dichotomy between MySuper products and choice products in this regard. For example, while the provision of intrafund advice (the cost of which is incorporated in administration fees) may be more prevalent in MySuper products, intrafund advice is also a feature of some choice products.

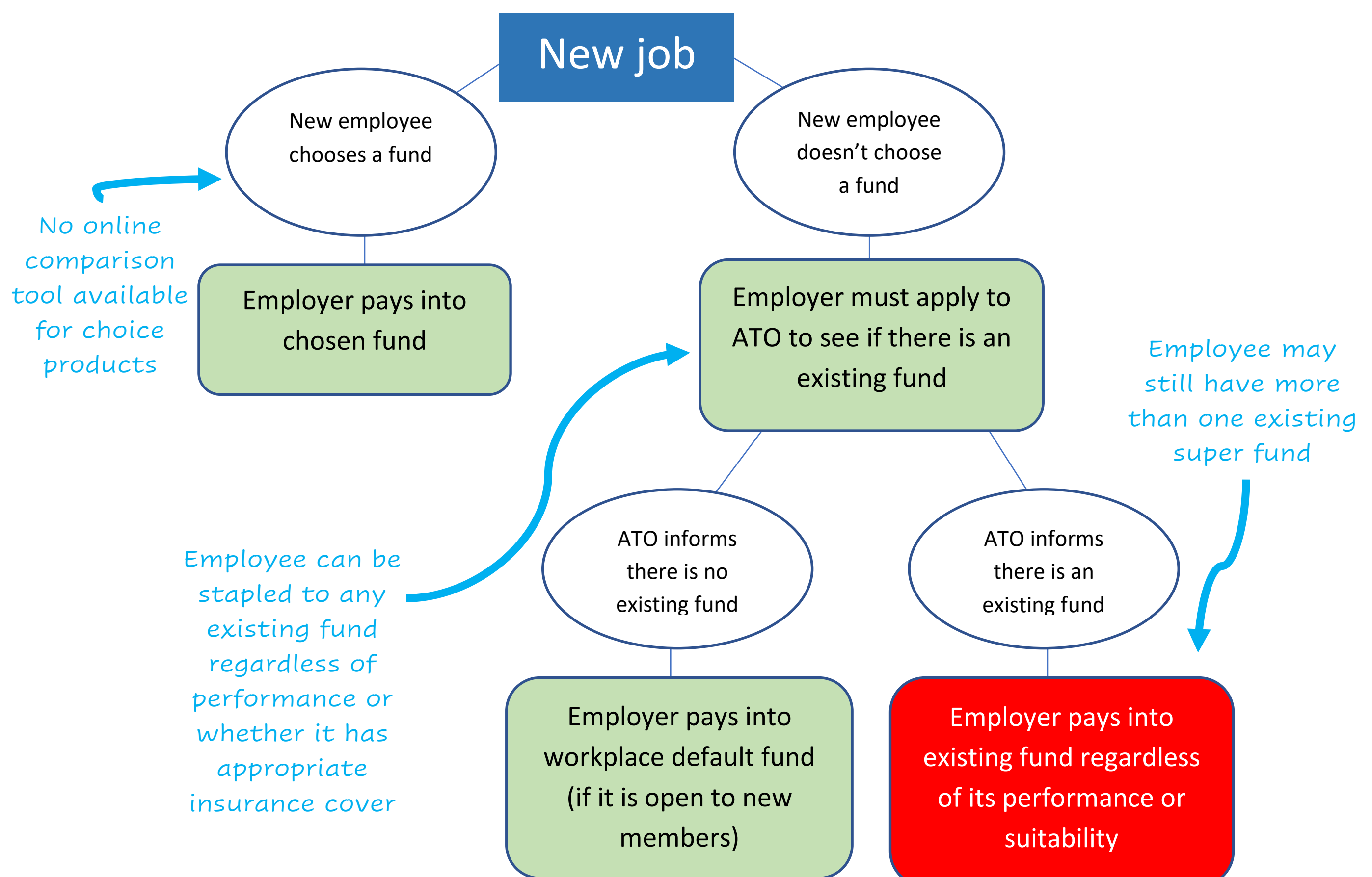
The regulations define the investment performance standard as relating to the Financial Sector (Collection of Data) determination No. 40 of 2015, or an analogous legislative instrument. AIST recommends that the regulations be revised to ensure that it is clear that all APRA superannuation reporting standards are included in the definition of investment performance standard, to ensure that administration fees reported to APRA can be taken into account for the purposes of performance assessment.

4. Stapling

4.1. The cost of being stapled to an underperforming fund

These regulations do not address concerns related to the Bill that 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: Member harm in stapling proposal

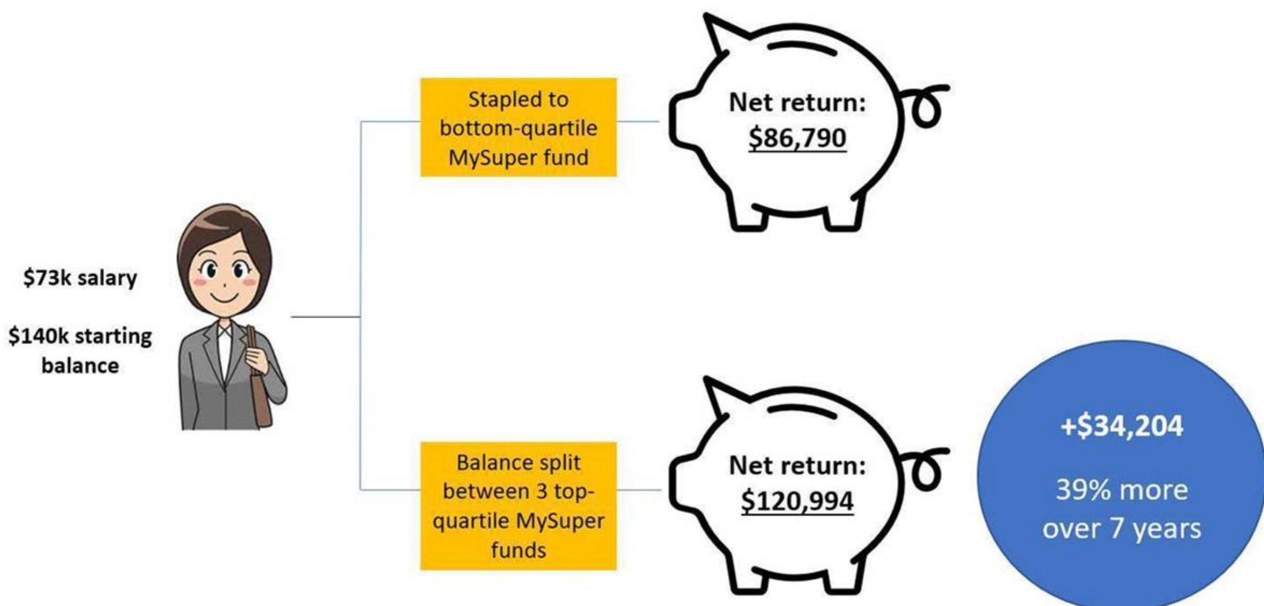


"First do no harm"

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)[6]



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.

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[6] 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.

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

The regulations fail to include important member protections

The importance of sequencing was emphasised by the Productivity Commission, 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.[7] 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.[8]

It is not acceptable that both the regulations and legislation fail to ensure that employees are not stapled to funds that are underperforming, untested, and lacking in suitable insurance for their occupation.

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

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

each new employee, for some large employers this could be tens of thousands of new employees in a typical year.

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 because 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. Improving Accountability and Member Outcomes

5.1. Employer inducements

AIST is concerned that the proposed removal of SIS regulation 13.18A(1)(d) may prevent superannuation funds from providing valuable member education about their superannuation via workplace seminars. These seminars cover topics such as insurance in super, investment options, planning for retirement and particular issues facing women in relation to superannuation. The information provided in these seminars is broadly offered to members as it is also generally available to members via fund publications and websites, with the face to face seminar representing another channel by which to deliver this superannuation information. This education is of valuable to members as it improves their financial literacy and understanding of their superannuation, one of the major financial assets held by working Australians. An exemption should be included in the regulations for workplace seminars where the content relates to superannuation.

5.2. Portfolio Holdings Disclosure supported in principle

AIST supports increased transparency around superannuation fund investments through Portfolio Holdings Disclosure ("PHD"). However, we are concerned that the presentation of information as required by these regulations will prove to be confusing for members and may result in the disclosure of sensitive information that will harm member returns.

Concerns include:

- The table provided in Schedule 1 of the regulations will result in information being presented in a format that is overly complex and is likely to confuse members and therefore not meet the main objective of PHD for the following reasons:
    - AIST has heard feedback from several funds that their MySuper product alone, based on the draft regulations, would require the disclosure of 14,000 to 18,000 lines of holdings data.
    - By not allowing for the aggregating of certain investments (such as currency forwards, derivatives and fixed interest securities), and/or in the absence of a materiality threshold, members will need to sift through thousands of holdings over hundreds of pages on a website for a single investment option.
    - We believe that aggregation of certain holdings by the issuer/counterparty is more beneficial to members.

- As noted below for unlisted assets, AIST is concerned by the requirement to disclose sensitive information such as the counterparty and maturity dates of derivatives. Hence, aggregation of holdings should be allowed for.
- The 'look through' provisions are dependent on the associated entity definition which will lead to inconsistent disclosure across the industry and therefore lead to confusion to members about the underlying holdings. A simple example of this would be if the superannuation fund's ownership of a particular holding (Company X, Company Y) is held in an external investment vehicle/trust (ABC Global Share Fund), the disclosure requirements would only require the name of the investment vehicle listed (ABC Global Share Fund), not the underlying holdings.

- Based on feedback, superannuation members want clarity around where their money is invested. The proposed regulations should be designed so that the PHD regime is clear, concise, and transparent.
- AIST is concerned the proposed regulations will require superannuation funds to disclose commercially sensitive information around their investments in unlisted assets such as infrastructure and private capital holdings. The main concern the industry has in disclosing these assets is that disclosing the market value of the asset (and holding in the asset) would allow a potential buyer to work out what funds value the asset at, therefore resulting in a lower value at exit/sale, resulting in a detrimental impact to members. Furthermore, these valuations are often defined as legally confidential information with the relevant counterparties.
- As we have noted in earlier submissions around PHD, super funds should be able to apply for an exemption to disclose the value of commercially sensitive unlisted assets, where this is considered in the best interest of members.
- An exemption framework would ensure that the disclosure of an asset price would not adversely affect the capacity of the super fund to optimise the value of its investment.

5.3. Annual member meeting notice requirements are costly and unlikely to result in greater engagement

A substantial portion of the information to be provided as part of the Annual Member Meeting Notice is information that is already provided directly to members (eg periodic statements, Significant Event Notices), or made publicly available on fund websites (Annual Reports, Executive Remuneration).

While the regulations now allow this information to be provided electronically there is still an overhead cost of preparing and sending this information in the notice to members, which will ultimately be borne members.