Your Future, Your Super Regulations

HESTA welcomes the opportunity to make a submission regarding the *Your Future, Your Super Regulations and associated measures*. This submission reiterates many of the issues we raised in our submission to the Senate Economics Committee inquiry into the *Your Future, Your Super* Bill that is currently before the Parliament.[1]

As previously stated HESTA endorses the overall aspirations of the *Your Future Your Super package*; however, there are still significant issues with the proposed design and implementation of the reforms which mean they do not address fundamental issues raised by the Financial Services Royal Commission or the Productivity Commission in relation to underperformance and governance.

As previously argued HESTA is concerned at the unwarranted reliance on regulations to implement matters of policy that would be more appropriate in the primary legislation. We again note that the Senate Scrutiny of Bills Committee "*assesses bills against a set of accountability standards*" and "*operates on a non partisan, apolitical and consensual basis.*"[2] It is significant that the Committee has expressed numerous concerns about the Bill, particularly the number of issues being left to regulations.[3]

We also note that a commencement date of 1 July 2021 seems simply unachievable given the *Your Future, Your Super* Bill has (at the time of writing) not even passed the House of Representatives.

In relation to the draft regulations HESTA has concerns regarding:

- The potential impacts of account stapling as currently designed and scheduled;
- The significant burden for employers to administer stapling from 1 July 2021;
- The lack of a materiality threshold in the proposed best financial interests duty;
- Regulation making powers that can arbitrarily ban certain investments or payments "*regardless of whether the payment is considered to be in the best financial interests of the beneficiaries*"[4]

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[1]https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABYFYS/Submissions - Submission 16.
[2]www.aph.gov.au/Parliamentary_Business/Committees/Senate/Scrutiny_of_Bills/Role_of_the_Committee
[3] Standing Committee for the Scrutiny of Bills – *Scrutiny Digest 4 of 2021* (pages 10-16).
[4] *Treasury Laws Amendment (Your Future, Your Super) Bill 2021 - Explanatory Memorandum* – Para 3.27 – Page 38.

Background

HESTA holds $60 billion of assets on behalf of 880,000 members in the health and community services sector, 80% of whom are women. The performance of those assets and our members' financial wellbeing can be materially impacted by even small changes to the retirement system. Our members rely on us to ensure that their retirement story is told, and their working life is considered in complex policy deliberations.

Our typical member is a 43-year-old female. She works in health or community services where she earns on average 15.9% less than her male counterpart doing the same job with the same skills.[5] She spends considerable time caring for others in an unpaid capacity which adds enormous economic benefit to the country. Because of all this, at 43, she has less than $30,000 in superannuation and will be financially penalised in retirement. The way in which HESTA can operate and invest matters to our members because they participate in a sophisticated system that doesn't yet adequately reflect their working lives.

Stapling

HESTA

- Is concerned that under the current proposal members can be stapled to under-performing funds;
- Advocates that members are not stapled to inappropriate accounts, especially in relation to the provision of insurance;
- Notes the potentially significant burden for employers to administer stapling from 1 July 2021.

The draft regulations set out the requirements for a fund to be a "stapled fund." These include being a complying superannuation fund, and that the employer will be able to make SG contributions for the employee into the stapled fund.

These regulations do not currently prevent underperforming funds from becoming 'stapled funds' and do not address the consequential impacts this could have on members of those funds. HESTA believes it is important that measures to address underperformance and stapling are sequenced in such a way that prevents this type of member detriment occurring.

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[5] https://www.wgea.gov.au/data/wgea-research/australias-gender-equality-scorecard/health-care-and-social-assistance

A commencement date of 1 July 2021 for these provisions will place additional administrative burdens on employers who will need to manually check a new employee's super account with the ATO instead of being given the opportunity to supply those details under the current choice of fund provisions.

We strongly believe that a better model for ensuring the non-proliferation of multiple accounts should be based on the automatic rollover of balances, whereby a member is "stapled" to their balance which is automatically rolled over into their new account when they join a new employer. This will require an ongoing role for the Fair Work Commission to ensure funds receiving money are appropriate for their industry.

Many of our members rely on the ancillary products we are obligated to supply – such as life and permanent incapacity insurance. Under the proposed model of "stapling" a new workforce entrant who is stapled to a product while working in a relatively low-risk industry such as retail, but who later moves into a higher-risk industry such as nursing, will retain an insurance policy that is unlikely to cover them appropriately.

Currently there is no automated method for employers to ascertain a new employee's 'stapled' fund. Considerable time and effort will be required by the employer to search for the existing fund for each new employee that commences with them. This will be a difficult task regardless of the size of the business given that small business employers may have limited administrative support and big employers can have large volumes of new starters on a regular basis. This creates the potential for harmful impacts from system compliance. There is also no way an employer can determine if the fund they identify for their employee is a high performing fund or not.

The resources required and the risk of an initial manual system for employers is far greater than any benefits likely to occur from stapling during this time, especially before underperformance is addressed. Many large HESTA employers are already under considerable financial and administrative pressure due to being on the frontline of the COVID-19 pandemic.

Time spent developing a fully automated solution and addressing underperformance before commencing account stapling would be time well spent for employers, employees, and the economy.

HESTA Recommends:

- **'Stapling' should be the automatic rollover of a member's balance upon a change of employment arrangement (unless a member chooses otherwise);**
- **Any version of stapling should not occur until after performance testing has been settled.**

Portfolio Holdings Disclosure

HESTA supports transparency and meaningful disclosure of superannuation fund investments that can benefit members. However, the proposed presentation of information by these regulations potentially mandates disclosure that will damage member returns by virtue of sensitive commercial information being made public.

For example, physical unlisted assets such as infrastructure, real property and private equity are (by definition) sensitive to disclosure of their market value. A requirement to provide an exact value for each unlisted asset will inevitably jeopardise the chances of obtaining the best possible price for those assets in the event they are offered for sale to the market.

Any potential buyer is unlikely to ever pay more for an unlisted asset than an exact value that has been disclosed compulsorily. We do not believe this push for transparency outweighs the member detriment that may occur from this approach. Essentially, the proposed disclosure regime risks harming members financial interests. These concerns have been discussed with policy makers on numerous occasions and (seemingly) disregarded for no apparent reason.

We suggest that disclosure of a value range would satisfy the Government's desire for transparency without interfering in areas of commercial sensitivity.

There are also potential issues with the sheer amount of information that may be required to be disclosed. If there is no aggregating of investments, then thousands of lines of information may need to be provided for each product. This would require considerable resources to produce; however, it is hard to reconcile the 'value' that this would provide to members given the nature of some of the information.

In addition, an obligation to disclose derivative positions held by HESTA and other funds (e.g. FX contracts used to hedge foreign currency exposure, options and swaps) creates additional risk, as these positions are generally confidential to the fund and not known in the market. Where the market becomes aware of derivative positions held by a fund, particularly where that position is illiquid, it could lead to other market participants taking active positions that create adverse outcomes for HESTA members.

HESTA Recommends:

- **Members' interests will not be served by funds disclosing the individual values for unlisted assets. An alternative approach would be to disclose a value range instead of a single dollar value.**
- **The Government retain the 5% exemption where investment items are commercially sensitive and making information public would be detrimental to the interests of fund members.**

Performance assessment

HESTA strongly support the policy intent to give greater transparency to beneficiaries and protect them from underperforming products. We endorse the recent decision by Government to include administration fees in the performance test as outlined in the draft regulations.

We would also strongly advocate that administration fees must be included in the performance test on a backwards **and** forward-looking basis. Any push to limit administrations fees to 'look forwards' only would undermine the integrity of the process and exclude important historical information.

The time-period proposed for the assessment is also not reflective of contemporary understanding of market cycles. Investment performance should be considered over a longer time-period of 10 years.

Unlisted Assets

HESTA notes the proposed new indices for unlisted infrastructure and property; however, HESTA continues to have reservations.

In our view the proposed MSCI Private Infrastructure index as the benchmark for unlisted infrastructure has several shortcomings. These include:

- the index has a strong survivorship bias;
- transparency and integrity issues given only a small pool of funds contribute to the index;
- The index requires a private subscription to access. As a matter of principle and practicality any mandated index must be freely and publicly available.

We also note the recent commentary and criticism from other market participants regarding the proposed benchmark.[6]

HESTA continues to advocate for the use of a CPI+ benchmark for unlisted infrastructure and unlisted property, similar to those that are frequently used by mature pension funds in Australia and the USA. These provide more flexibility to ensure the right asset mix to achieve their overall target objectives for their members. A CPI + 4% inflation-linked benchmark could be a reasonable and appropriate metric for consideration.

[6] *Backlash against new super performance index*, AFR 20 May 2021 – https://www.afr.com/chanticleer/backlash-against-new-super-performance-index-20210519-p57t4w

A significant incentive for HESTA to invest in the unlisted market is that they are not correlated to listed markets and will diversify a portfolio away from listed market volatility to provide earnings stability, protection from inflation and portfolio risk management.

HESTA Recommends:

- **A 10-year timeframe for assessment;**
- **Adoption of a CPI + style benchmark for unlisted assets.**

Best financial interests duty

The draft regulations are silent on the extraordinary proposed power granted by section 117A of the Bill that would allow for enactment of regulations prohibiting certain payment types. This overreach was never opined by the Royal Commission nor the Productivity Commission. The benefit of any Trust structure is to allow those who are best positioned to know the interests of members to apply that knowledge. The role of the Regulator – recently strengthened, is to enforce this.

The proposed power would allow intervention by those without knowledge and experience of the members into this structure at an abstract level. This undermines the very nature of the trust structure used widely in Australia to align the benefits of members with decision makers.

This power would potentially put funds in an untenable position and create significant unknown and unquantifiable risk. The proposal is substantial given its potential application within the operation of a fund.

Regardless of the intent, funds would need to consider the risk that;

- The Minister could prohibit investment in certain assets at any time.
- Any prohibition could be subject to legal challenges around interpretation of permitted investments or investment classes.

HESTA's investment decisions are made by investment professionals to maximise members' savings. They are obliged to act in members' best financial interests and at arms-length of government to protect them from politically motivated changes. Policy and regulatory changes are always factored into investment planning; however, the proposed power is unprecedented, unnecessary and could cause consequences that cannot be planned for.

HESTA agrees that expenditure and investments by trustees must be in the best financial interests of members and appropriate record keeping should be maintained. However, enforcing this duty with a reversed onus of proof and lack of a materiality threshold will create additional costs to the fund, which will ultimately be borne by members, with no apparent benefit.

HESTA Recommends:

- **Removal of the power to make regulations prohibiting payments or investments.**
- **A materiality threshold should apply to the record keeping obligations placed on funds.**
- **Removal of the reverse onus of proof.**