HESTA 2017 Submission- Superannuation: Assessing Competitiveness and Efficiency, July 2017

H.E.S.T. Australia Ltd ABN 66 006 818 695 AFSL 235249, the Trustee of Health Employees Superannuation Trust Australia (HESTA) ABN 64 971 749 321

Superannuation: Assessing Competitiveness and Efficiency

Response to Productivity Commission Issues Paper, July 2017

HESTA welcomes the opportunity to submit a response to the Issues Paper on the assessment of competitiveness and efficiency of the superannuation system.

About HESTA

HESTA is an industry superannuation fund, established in 1987 to provide retirement benefits for workers in the Health and Community Services Sector, and we operate only to benefit members. We have over 820,000 members and manage over $40 billion of members' assets.

The typical HESTA member is aged 43, is female and has a balance of approx. $18,000 in superannuation.

Because of our traditional industry base our members are:

1. More likely to live for five years longer than an average Australian male
2. More likely to suffer the inconsistencies and discrimination of the gender pay gap
3. More likely to take time out of the workforce on periods of unpaid leave
4. More likely to be at risk of poverty in retirement.

Our mission is to make a real difference in the retirement outcome of every member. The settings of the system impact our members, both in the way they enter and interact with superannuation.

We reiterate our view that policy intervention and the attention of the Productivity Commission could be very helpful in uncovering the systemic factors that lead to our, mostly female, members retiring with around half the assets of men.

We have made comments on various areas of the Issues Paper that we believe are most relevant to the retirement outcomes of our members either directly or through changes to the integrity of the system.

We have focused mostly on current default arrangements in the superannuation system and restated our views on improvements to the untested Fair Work Commission system.

We welcome the opportunity to discuss the submission further, should you have any queries please contact Mary Delahunty, General Manager Business Development and Policy

Comments on the Issues Paper

We maintain our concern on the premise of the enquiry which argues a direct correlation between what is regarded as a lack of efficiency and increased competition.

The Australian system is considered incredibly successful when judging it on the most highly regarded criteria – coverage and returns. Improvements to the way in which new members are inducted should be made to safeguard them against predatory, profit motivated behaviour.

As stated in our previous submission, in response to the discussion paper, *Superannuation: Alternative Default Models, March 2017,* we do not support any of the four alternative models provided. We endorse the legislated but as yet not implemented system which properly relies on the Fair Work Commission (FWC), a quality filter and an expert panel.

The assisted employee choice model, has much of the structure of the FWC process but we do not support the need for a fund of last resort.

Any model that concentrates solely on fees, especially when fee disclosure is unnecessarily complex, would not deliver for members or the community. Therefore, we do not support the fee based auction model.

A multi-criteria tender model is correctly identified by the Commission as being very complex. It should be noted that funds commonly participate in tenders for the provision of safety net services at an employer level but there is no consistency to the processes. This does however exemplify that there is existing competition at the employer level.

We strongly oppose assisted employer choice, as a model it is missing a crucial element – the requirement to act in a member's best interest.

We maintain support for the legislated but as yet untested Fair Work Commission (FWC) process.

We also recommend that this process be strengthened by not allowing any profiteering from unengaged members and inert money.

The Issues Paper suggests that this assessment work is unprecedented in nature:

There is little precedent here (and internationally) for reviewing the competitiveness and efficiency of a superannuation or pension system in its totality. The broader efficiency and system-wide perspectives are both unique and make this a challenging task. (Pg 3 Issues Paper)

We disagree with this characterisation. There is a significant piece of work conducted every year by Mercer – The Melbourne Mercer Global Pension Index (MMGPI) (https://www.mercer.com.au/our-thinking/mercer-melbourne-global-pension-index.html)

The index is the world's most comprehensive comparison of pension systems, benchmarking on adequacy, sustainability and integrity. These are all higher order priorities than competitiveness and efficiency, in fact they are drivers of these.

The MMGPI ranks Australia's superannuation system third overall, with Denmark and the Netherland's systems as the only ones outperforming ours.

Australia's highest score is recorded for the integrity sub-index component. The commentary on this indicator is:

The third sub-index considers the integrity of the overall pension system, but with a focus on the private sector to play an increasingly important role in the provision of retirement income, it is critical that the community has confidence in the ability of private sector pension providers to deliver retirement benefits cover many years into the future.

This sub-index therefore considers the role of regulation and governance, the protection to participants from a range of risks and the level of communication provided to members. In each case, we consider the requirements to set out in the relevant legislation.

In addition, we use the Worldwide Governance Indicators published by the World Bank to provide a broader perspective of governance within each country.

An importance contributor to the long-term confidence of members is that they receive good value from their pension plan and that costs are kept to a reasonable level[1]*.*

This robust research not only contradicts the commission's view that the assessment is rare, it also contradicts the premise that the system is in need of more competition to promote member's interests. Clearly, on an international comparison, the system is enjoying consumer confidence, is effective and is efficient.

[1] Melbourne Mercer Global Pension Index, p.14
https://www.mercer.com/content/dam/mercer/attachments/global/Retirement/gl-2016-mmgpi-impact-ageing-populations-full-report.pdf

System specific objectives

1. **The superannuation system contributes to retirement incomes by maximizing long-term net returns on member contributions and balances over the member's lifetime, taking risk into account**

   Our system should be measured by two primary core priorities. Returns and coverage.

2. **The superannuation system meets member needs, in relation to information, products and risk management over the member's lifetime.**

   The system participants should provide high quality, consistent data to encourage informed consumer choice. We refer the Commission to industry submissions about the inadequacy of data standards regulation. We endorse the recommendation from AIST that APRA publish a league table showing returns to members over 1, 3, 5 and 10 years for all MySuper products and for each Choice investment option above an agreed threshold of assets or members.

3. **The efficiency of the superannuation system improves over time**

   The efficiency of the system can be improved over time through stability and growth.

4. **The superannuation system provides value for money insurance cover without unduly eroding member balances**

   HESTA offers insurance that is specifically designed for our members. Through this industry focus we can ensure that the design is appropriate and through the compulsion we can be confident that members who may not take up insurance outside of super experience a level of cover that is cost effective and helpful.

   Default cover settings can be explored and we note the ongoing work of the Insurance in Super Working Group in analysing the settings.

5. **Competition in the superannuation system should drive efficient outcomes for members**

   The preoccupation with competition appears to be an unworthy distraction for the Commission. Net benefit to members is the highest order priority, in a system driven by compulsion, this will not ultimately be delivered by more entrants in the market place.

   Our submission outlines the various points where we experience competitive pressures and how, through the implementation of the Fair Work Commission process this would be increased and provide better member outcomes.

Existing default arrangements

HESTA believes strongly that the FWC process is the most appropriate for the determination of default arrangements. We note that the Commission refers to this as the "current prospect" arrangements, for ease of understanding we refer to this as the "legislated but not yet implemented" arrangements. We feel this terminology better reflects the current rather ludicrous situation in which this country has missed out on years of an improved process due to a failure on the part of the current government to fill positions on an expert panel of the FWC.

We also believe the legislated but not yet implemented system has room for a slight improvement.

In our previous submission we wrote:

We agree with the finding that where third-party involvement is present there needs to be an overarching requirement that member's best interest be considered. We see this as a regulatory gap which was addressed in the Commission's review of the 2012 review, and can be strengthened by the exclusion of certain businesses from the process. HESTA believes that in a mature retirement system, businesses should not be able to profit from unengaged consumers and inert money, therefore profit seeking funds should be excluded from the safety net considerations.
It is impossible to contemplate this important overarching criteria ever being met by profit-seeking funds in a mature system. HESTA recommends that the Commission should strongly consider the appropriateness of these businesses being allowed to compete for the provision of a safety net fund at all and we believe the filter should reflect this. Member's best interest cannot truly be met by entities such as banks who seek to use inert money from unengaged consumers to build profits through their vertically integrated businesses.

Member's best interest is the most important criteria to be considered when assessing the role of safety net fund providers. Profit seeking funds have continually acted contrary to this objective.[2]

How do the existing default arrangements mitigate the paramount risk of any default system- a member defaulting to a (long-term) underperforming default product? What is the evidence of long-term underperforming default product providers exiting the default market?

We endorse the view that it is optimal a member is not defaulted into a long-term underperforming product. We also consider that it is optimal a member not be <u>sold</u> into a long-term underperforming product. We don't accept the premise that this is the paramount concern of the Australian system. Our system is well regarded internationally for having delivered well for members. Our paramount concern is the behavior of some market participants and the constant shifting regulatory environment which erodes the confidence of working Australians.

The current process and the legislated but as yet not implemented process both have mitigation arrangements in place to protect consumers (also, as noted above, these can be improved).

The quality filter applied by the expert panel through the FWC process is the reform that targets the risk of long-term underperforming products receiving inert monies. The Commission will note that the quality filter and the analysis by the expert panel are specifically designed to ensure standards for the receipt of disengaged members.

[2] HESTA 2017 Submission- Superannuation: Alternative Default Models, March 2017 http://www.pc.gov.au/__data/assets/pdf_file/0003/216876/subdr070-superannuation-alternative-default-models.pdf

The Expert Panel must not include a particular standard MySuper product on the Default Superannuation List unless satisfied it would be in the best interest of default fund employees modern awards apply to, or particular class of employees, taking into account.

- *Information contained in the application*
- *A set of performance criteria, in line with the information the applicant needs to include in their application, and*
- *Submissions made in relation to the application*[3]

Had this Government appointed members to the Expert Panel, the industry would now be reviewing the last four years and making applications to remain on the "list". This system enshrined the analysis to ensure the risk of long-term underperformance could be uncovered and mitigated.

Although there has been a number of changes in the fund landscapes, the evidence of underperforming funds exiting the default marketplace is not as apparent as it may have been had the FWC system been implemented.

How do the existing default arrangements create incentives for funds to maximize long-term net returns and allocate members to products that meet their needs? How could the existing arrangements be improved to achieve this goal?

As an industry fund we are not motivated by profit, our purpose our business model and the culture of HESTA is important drivers. Our use of scale, and our strong governance foundations all combine to add to our competitiveness. This gives us growth, provides benefits through returns and services to members and acts as our incentive.

The legislated but as yet not implemented system could be improved to ensure only funds with an incentive of member's best interests be included on a list to provide default services.

As we have previously submitted , *HESTA believes that in a mature retirement system, businesses should not be able to profit from unengaged consumers and inert money, therefore profit seeking funds should be excluded from the safety net considerations*[4]*.*

What is the evidence that existing default arrangements encourage open participation (contestability) and rivalry between funds for the default market (competition for the market)? What is the evidence that there is competitive pressure that drives innovation, cost reductions and more efficient long-term outcomes for members? How could the existing arrangements be improved to achieve this goal?

Competition currently exists and was enshrined as a part of the legislated but as yet not implemented FWC process.

At HESTA, we often compete at the industrial level and the enterprise – employer level.

---

[3] Consideration, last updated 4-April 2016 https://www.fwc.gov.au/awards-and-agreements/modern-award-reviews/superannuation-fund-reviews/overview/default

[4] HESTA 2017 Submission- Superannuation: Alternative Default Models, March 2017, p.4 http://www.pc.gov.au/__data/assets/pdf_file/0003/216876/subdr070-superannuation-alternative-default-models.pdf

In 2012/13 we sought selection into the FWC arrangement by participating in an application process. This outlined, as it was required to do, how we as a fund were meeting our member's needs and how we intended to deliver on that promise for future members.

As outlined briefly here –

Applications will need to include a range of information about the applying superannuation fund and its standard MySuper Product's performance, including but not limited to:

- *The appropriateness of the product's investment return target and risk profile*
- *Its expected ability to deliver on the product's return target*
- *Fees and costs*
- *Net returns*
- *Governance practices, and*
- *Administrative efficiency and quality of advice*[5]

This Application was to be further considered by a properly constituted expert panel. It was an open and transparent competitive procedure, until it was stopped. The Applications and submissions made by funds are all still available to be viewed on the FWC website.

On the current process it is important to note that there remains competition opportunities for both profit-to-member funds and retail funds. HESTA is currently listed in 13 Modern Awards. In all of these we are one of many funds. In a number of these we are listed with retail funds.

As an example please see the excerpt from the **Children's Services Award 2010 and the inclusion of (h) a retail fund.**

20.4 Superannuation fund

Unless, to comply with superannuation legislation, the employer is required to make the superannuation contributions provided for in clause 20.2 to another superannuation fund that is chosen by the employee,the employer must make the superannuation contributions provided for in clause 20.2 and pay the amount authorised under clauses 20.3(a) or (b) to one of the following superannuation funds or its successor:

***(a)** HESTA Super Fund;*

[20.4(b) substituted by PR530219 ppc 26Oct12]

***(b)** CareSuper;*

***(c)** AustralianSuper;*

***(d)** Tasplan;*

***(e)** Statewide Superannuation Trust;*

[20.4(f) deleted by PR546127 ppc 01Jan14]

[20.4(g) renumbered as 20.4(f) by PR546127 ppc 01Jan14]

***(f)** Queensland Independent Education and Care Superannuation Trust (QIEC Super);*

---

[5] Submitting Applications, last updated 4 April 2016, https://www.fwc.gov.au/awards-and-agreements/modern-award-reviews/superannuation-fund-reviews/overview/default

[20.4(h) renumbered as 20.4(g) by PR546127 ppc 01Jan14]

(g) *Sunsuper;*

[20.4(i) renumbered as 20.4(h) by PR546127 ppc 01Jan14]

(h) *Australian Childcare Super Fund;*[6]

At the enterprise level it is very common for employers to test the market and choose new default providers. Whilst this is a welcome process, it is inconsistent and can benefit from some further guidance which would have been provided through the FWC enhanced process.

As we have previously reminded the Commission, some of the greatest threats to the safety and confidence of the system exist in this lack of transparency. This is unaided by the inadequate fee disclosure standards.

We are aware of inducements being offered by participants who are profit motivated. As we noted in our previous submission:

Despite the practice of offering inducements being illegal, the sector is aware of the existence of it. In 2010 the ATO released survey results suggesting that around 13% of employers admitted to receiving a direct or indirect benefit from a superannuation provider.4
In 2014, ISA commissioned more research into the practice of offering inducements for small – medium sized enterprises. Alarmingly the practice is still common. Of the 550 businesses surveyed, a third admit to having switched funds promoted by their bank. Over a quarter of employers report having been recommended a default by their bank. Employers reported that some of the most common bundled offers made by the banks are "those which provide a direct benefit to the business rather than the employees (like discounts on banking and insurance products)". ISA concluded that the inducement practice is very effective.

This concept of 'third line forcing' is very hard to police. HESTA believes that the existence of a quality filter is imperative to at least provide some barrier to the practice[7]*.*

It is because of this lack of consistency and transparency at the enterprise level that we recommend profit seeking funds be removed from consideration.

Although the practice of offering inducements is illegal, employers are allowed to benefit from bundled arrangements. This convenience for the employer has no regard to member's best interests, it may not even be considered. We happily work with employers on the selection of default products and we can see that this process would better reflect member's interests if fiduciary duty was extended to employers, as suggested by AIST.

For an example of the operation of tenders at the enterprise level we recommend the Commission speak with the Northern Territory Government. Every four years, the Northern Territory Government conducts a tender process for the provision of default superannuation services to new employees who do not make a choice.

---

[6] **Children's Services Award 2010 and the inclusion of (h) a retail fund,** http://awardviewer.fwo.gov.au/award/show/MA000120#P600_45689

[7] HESTA 2017 Submission- Superannuation: Alternative Default Models, March 2017, p.6, Industry Super Australia. *Bank cross-selling to employers: A threat to Australia's super safety net, February 2015 p.3*

How could the process for constituting the body for selecting default products be designed to deliver accountability (and thus not be judicial in nature) while mitigating the risks of politicization and bias?

We welcome the renewed effort to remove politicization from any constituted body but we are alarmed at the Commission's view that the judicial process does not deliver that mitigation. The Fair Work Commission has the necessary judicial and legislative controls and regulations to deliver the outcome that's best for the country. Time and again the FWC has proven to be accountable and processes exist if persons or bodies feel aggrieved by decisions of the FWC.

It is surprising to hear that the Commission does not share this view but we welcome the focus on a need to de-politicize the constituted body.

The members of the expert panel of the FWC were to be appointed by the Minister of the day but under advisement of senior departmental staff and in consultation with the relevant shadow Minister.

Conclusion

HESTA welcomes the opportunity to comment on the Productivity Commission's Inquiry into Assessing the Competitiveness and Efficiency of superannuation.

We are proud of our superannuation system, but we realise that as it matures it can always be improved.

We maintain that policy intervention and the attention of advisory bodies such as the Productivity Commission would be welcome to focus on the systemic issues that have led to the majority of our members retiring with substandard assets due to broken work patterns, longevity issues and the gender pay gap.

We trust it is helpful for the Commission to understand the current competitive landscape described in the submission regarding the provision of default superannuation. This information doesn't touch on the new entrants into the choice world any of which could apply for a MySuper license and begin the process of competing in the default market.

HESTA again would like to highlight that we have participated with purpose in all reform consultations through our peak bodies or directly. In 2012 and beyond, we and many sector participants worked with the Productivity Commission to make improvements to the way new entrants were allocated with safety net funds, if they failed to make a choice. The current situation where the legislated process has not been enacted is a failure of government. Moreover, the lack of analysis of this process, developed at considerable expense to the taxpayer, is an egregious waste of resources.

Further improvements can be made to the safety net superannuation space. Members' best interest is the paramount criteria to be met, we believe this cannot possibly be met by funds who seek to profit from unengaged members and inert money. We recommend that improvements to the allocation system consider excluding profit seeking funds.

We reiterate our strong support for the current legislated but as yet not implemented system for the allocation of default members. We recommend that this process be allowed to commence and if any improvements are to be considered they should protect members from predatory profit-seeking motivations.

We welcome the opportunity to discuss this further.