

Your Future, Your Super package

Submission to the Treasury

21 December 2020

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Who we are

The Australian Lawyers Alliance (ALA) is a national association of lawyers, academics and other professionals dedicated to protecting and promoting justice, freedom and the rights of the individual.

We estimate that our 1,500 members represent up to 200,000 people each year in Australia. We promote access to justice and equality before the law for all individuals regardless of their wealth, position, gender, age, race or religious belief.

The ALA is represented in every state and territory in Australia. More information about us is available on our website.¹

The ALA office is located on the land of the Gadigal of the Eora Nation.

¹ www.lawyersalliance.com.au

Introduction

1. The ALA welcomes the opportunity to have input into the exposure draft legislation and explanatory materials for the Your Future, Your Super package (the Package).
2. We share the overarching concerns which have led to the development of these proposals – that there is a clear need to identify ways to minimise the occurrence of multiple superannuation accounts, and to maximise the retirement earnings of Australians.
3. We are not convinced, however, that the proposed initiatives optimally achieve these worthy goals. In fact, we believe that some of the provisions may lead to an exacerbation of these issues, by entrenching consumers – especially those with low financial literacy – in underperforming or demographically unsuitable funds.
4. We support initiatives that aim to provide Australian workers with the information they need to make an informed choice about their superannuation arrangements, and allow fund trustees to respond to the insurance and savings needs of their fund members. The removal of funds that fail to ‘stack up’ to community expectations is a worthy ambition.
5. The ALA supports calls for a ‘no disadvantage’ philosophy to underpin the proposed reforms. No worker should be disadvantaged as a result of these stapling reforms.
6. Another core theme in our submission is the importance of ensuring an even playing field for fund trustees to compete by allowing them the flexibility needed to tailor investment and insurance offerings to their specific industry/membership needs. This is necessary in order to avoid the over-homogenisation of superannuation products available to Australian workers and retirees.
7. In calibrating the regulatory environment, it is important to heed the lessons of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission). In particular the motif of industry funds consistently out-performing retail funds on key metrics and emerging with a relatively clean bill of health. The same cannot be said for many for-profit retail funds, whose cavalier attitudes toward profitability at the expense of members’ best interests drew sharp criticism, leading to the remediation of

hundreds of millions of dollars in ‘fees for no service’². Despite this, many of the interventions described in the Package will impact greatest on the governance of industry funds.

8. For the agreed, beneficial outcomes noted above to be achieved, it will require the setting aside of ideology, and focusing instead on promoting what works best for members bearing in mind the public policy rationale underpinning Australia’s overwhelmingly successful superannuation system.
9. Our responses to the four elements of the consultation appear below.

Responses to the four elements of the Package

Part 1: Requiring employers to make contributions into an employee’s existing fund, if new employees have one and do choose a fund to receive contributions. This reform will help ensure unnecessary fees and insurance premiums are not paid on unintended multiple superannuation accounts.

10. The ALA notes the intended aim of this section of the Package, as set out in paragraph 1.10 of the draft Explanatory Materials³:

....allowing employers to make contributions on behalf of their employees into their chosen default fund has also resulted in the creation of unintended multiple superannuation accounts. This has caused a reduction in retirement savings for affected members as unnecessary duplicate fees and insurance premiums are being paid on those accounts.

11. While agreeing that the creation of unintended multiple superannuation accounts is an ongoing issue, we believe that ‘stapling’, in its current design, will cause negative unintended consequences.
12. Our main concern is the potential impacts on workers as a result of the potential loss of insurance coverage, bought about by stapling.

² <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-193mr-asic-update-on-compensation-for-financial-advice-related-misconduct/>

³ https://treasury.gov.au/sites/default/files/2020-11/c2020-124304_single_default_em.pdf; p.4

13. We remind Treasury of the original purpose of insurance in superannuation – that is, to insure against the loss of contributions to retirement income that occurs when someone becomes unable to work.

14. This is not well understood in the Australian community.

15. As The Association of Superannuation Funds of Australia (ASFA) says⁴:

Rather than being an unrelated add-on to superannuation, the purpose of insurance in superannuation is, in effect, to cover the ‘future service’ period between an event, such as disablement or death, and retirement age. It helps put the member (or beneficiaries) in a financial position closer to where they would have been but for the occurrence of the insured event.

16. Clearly, the provision of insurance through superannuation funds is consistent with the ‘sole purpose test’ described in the *SIS Act*⁵, as its purpose is to ensure continuity of contributions should the worker become totally or permanently disabled.

17. Rice Warner⁶ found that:

Within group schemes, there is a large affinity to occupation; for many individuals, group insurance is their only means of viable access to insurance (especially for individuals with risky occupations). In the absence of group life insurance (for example if group life insurance were to become opt-in in nature, and take up rates dropped to an expectedly low single-digit rate), many individual’s only recourse would be to seek retail type insurance, individually rated insurance with medical, financial and lifestyle underwriting required, which would act to reduce their access to insurance or make it only available at unaffordable premium rates.

⁴ Ref: https://www.superannuation.asn.au/ArticleDocuments/359/1709_Insurance_through_superannuation.pdf.aspx?Embed=Y

⁵ Ref *SIS Act*, s.62

⁶ Rice Warner: *Underinsurance in Australia*, 2017

18. The underinsurance problem in Australia has been well documented⁷. Member disengagement data⁸ would indicate that worryingly few consumers consider their insurance arrangements at all.
19. Furthermore, insurance claims statistics compiled by APRA revealed that Total Permanent Disability (TPD) insurance claims under group policies have a considerably higher claims paid ratio than those sold through other channels including by financial advisers, as demonstrated by the following table⁹:

Table 2: Claims paid ratio^ by cover type and distribution channel

| Cover type | Individual Advised | Individual Non-Advised | Group Super | Group Ordinary |
|------------|--------------------|------------------------|-------------|----------------|
| Death | 39% | 32% | 78% | 61% |
| TPD | 45% | 28% | 71% | 25% |
| Trauma | 62% | 40% | n/a | 94% |
| DII # | 66% | 85% | 104% | 81% |
| CCI | n/a | 26% | n/a | * |
| Funeral | n/a | 23% | n/a | n/a |
| Accident | 25% | 51% | n/a | n/a |

^ The claims paid ratio is the dollar amount of claims paid out in the reporting period as a percentage of the annual premiums receivable in the same period.

DII has recurring monthly payments. For the purposes of the reported claims ratio, total payments are approximated using an assumed 24-month payout period.

20. In short, insurance in superannuation has a critical role in ameliorating the under-insurance problem by providing a safety net of affordable default group cover.

⁷ Rice Warner Underinsurance in Australia 2015 found the median level of life cover met just 61% of basic needs and 37 per cent of the income replacement level. See also <http://www.ricewarner.com/australias-relentless-underinsurance-gap/>

⁸ See for example <https://www.pwc.com.au/publications/assets/superannuation-data-risks-insurance-superannuation-jun16.pdf>, where PWC found that 71% 'were not engaged when considering life insurance [within super]', and 66% of 25 to 34-year-olds do not read their annual superannuation statement

⁹ <https://www.apra.gov.au/publications/life-insurance-claims-and-disputes-statistics>

21. It is vital, then, that any attempts to reduce the number of unintended multiple superannuation accounts does not inadvertently deny workers access to insurance, or staple the worker to a fund whose insurance coverage is incompatible with the needs of that worker.
22. The trustees of industry funds, as part of their duties in ensuring that the best interests of their fund members are paramount, have the responsibility of sourcing tailored insurance products that reflect the potential insurance needs of their members. The industry fund model has enabled trustees to understand the particular needs of their member base, and to then in turn negotiate with insurers to provide a tailored insurance product that is fit for purpose for those workers.
23. Unfortunately, not all insurance arrangements, especially those set up by retail funds, often with their own affiliated group life insurer have been of poor value. An ALA member provided the following case example:

We are aware of a logistics firm which entered into an agreement with a retail superannuation fund, whose death and TPD insurance coverage contained a specific 'hazardous occupation exclusion' for truck drivers. Around 50% of this firm's staff were truck drivers.

The employer, in this example, had numerous other funds he/she could have opted for which could have provided affordable insurance cover for its transport workers, such as TWU Super. Evidently, the wellbeing of his/her staff was of secondary importance to whatever other considerations were weighed up during the decision making process.

24. Workers in the above example are paying premiums for an insurance product they will never be able to benefit from which means the default insurance arrangements have failed them.
25. Obviously, it is important that the equivalent decision making processes which sit behind the proposed stapling idea do not perpetuate these types of 'fee for no service' situations.
26. Under the stapling system, the risk of insurance gaps is acute whenever when a worker changes jobs. For example, many workers start their working lives in an industry such as hospitality. While the insurance provisions contained in a fund aimed at, say, hospitality/bar staff may be entirely appropriate, they may not remain appropriate if the worker then accepts a role in the transport or construction industries.

27. In this example, the insurance offerings in the hospitality/bar-work related fund may limit or exclude high risk occupations, or apply inappropriate and harsh clauses such as Activities of Daily Living (ADL) requirements¹⁰, vastly limiting eligibility. Once again, this would constitute a ‘fee for no service’ arrangement.
28. Under the above example, it may also impact the members of the original fund (the hospitality based fund), as they may find themselves in the position of having to cover claims for higher risk occupations down the track. This would undoubtedly impact premium costs for its lower risk members.
29. The ALA further notes that many group life policies taken out by superannuation funds for their members have also provided limited cover for members:
- working for a non-participating employer (where employer has not signed up to the fund as default), or
 - who are not engaged in permanent employment – for example part time or casual employees, or
 - (as mentioned above) who are engaged in a hazardous occupation.
30. It is essential that the agreed process ensure suitability of insurances.
31. The ALA notes from the Explanatory Materials that, under the proposed arrangements, the ATO Commissioner has a central role to play in determining whether a worker has an existing stapled fund¹¹. We further note that much of the machinery as to how that happens will, under the proposal, be articulated in the regulations.
32. The ALA believes that the regulations should also have specific requirements of the Commissioner in relation to ensuring the appropriateness of insurance coverage for all members of regulated superannuation funds.

¹⁰ With at least five times the decline rate to standard TPD cover: <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-633-holes-in-the-safety-net-a-review-of-tpd-insurance-claims/>

¹¹ See paragraph 1.17, 1.18, 1.26, from 1.34 etc

33. The ALA suggests that regulations that leverage the single touch payroll system will be invaluable in giving the ATO, super funds and employers access to the live information they need to ensure workers are not disadvantaged by a change in employment.
34. The ALA believes there should be focused consultation on how this occurs. For example, we believe it would be appropriate for there to be a series of centrally agreed industry occupational classifications which could be applied to each fund member across the ATO database. This would change when there is a change in the worker's employment situation.
35. With the above data sharing arrangement in place, funds should be required, within a reasonable period (say, 30 days) of the change in role, to provide communications to the member about whether and how they are being either disadvantaged by an 'insurance gap', or not disadvantaged by remaining in the current fund. For example, it would let the worker know that they are only covered by an insurance product that uses ADL, which is not appropriate for the industry role classification applicable to their new role.
36. The ATO would need to develop a set of metrics/indicators that demonstrate disadvantage. This may include:
- The benefit amount relative to premium cost,
 - Payment type – lump sum versus by instalments,
 - Exclusion clauses, for example in relation to pre-existing conditions, or excluded occupations,
 - Definition type, for example whether the insurance product has a provision for permanent incapacity early release, or whether it uses ADL.
37. The superannuation industry should be moving toward the provision of a dashboard for fund members. In the spirit of transparency and improving financial literacy for members, it should clearly demonstrate:
- Insurance benefits,
 - How that insurance product stacks up against occupationally appropriate benchmarks (perhaps using a tiering system),

- How a member may configure their insurance arrangements¹².

38. The ALA reiterates the need for a ‘no disadvantage’ measures to underpin the proposed reforms. Where a worker’s superannuation arrangements are no longer fit for purpose to a worker’s current working arrangements, they should proactively be given the information needed to make a better decision about their current arrangements.

Part 2: Requiring APRA to conduct an annual performance test for MySuper products, and other products specified in regulations. Trustees will be required to give notice to members when a product fails the test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in the regulations are satisfied. This reform will ensure underperforming superannuation products are held to account.

39. The ALA notes the context for this part of the Package, as described in paragraph 1.3 of the Explanatory Materials:

Superannuation is a unique system. It currently manages around \$3 trillion of retirement savings of Australians and its compulsory nature means that the Government has a heightened responsibility in holding funds to account and protecting member outcomes. Several reviews, including the Productivity Commission’s inquiry into superannuation, have found that persistently underperforming funds are a flaw of the system. These amendments build on the existing law to strengthen the protections against underperformance in the industry.

40. We would add that the ‘persistently underperforming funds’ are, almost without exception, for-profit retail funds.

41. The ALA agrees with the need for APRA to conduct an annual performance test for superannuation products, but believes it should apply more widely than just MySuper

¹² This is in line with the findings of ASIC Report 673: <https://download.asic.gov.au/media/5860841/rep673-published-20-november-2020.pdf>. Ref p.9, How members’ experiences may be improved

products. Failure to make the regime applicable to all regulated superannuation funds would leave millions of Australians in unscrutinised funds¹³.

42. The ALA believes that the information currently collected to populate ASIC's Heatmap¹⁴ for My-Super products could easily be expanded to capture data that would identify persistently underperforming funds across the superannuation spectrum.

43. The main headings used in the current Heatmap are appropriate:

- Investment Performance
- Fees and Costs
- Sustainability of Member Outcomes

44. It is important that, in adapting this model to be fit for purpose, the metrics include:

- Annual returns, nett of fees (net return benchmark)
- Management Expense Ratio (MER)
- Fee disclosure practices to avoid hidden fees such as performance fees paid to investment managers and multiple investment fees being bundled¹⁵
- Managing conflicts of interest including through robust procurement/tender practices by trustees

Part 3: Providing certainty and transparency about the basis by which superannuation products will be ranked and published on a website maintained by the ATO.

45. The ALA applauds Treasury's commitment to transparency in this process.

¹³ See <https://thenewdaily.com.au/finance/superannuation/2020/12/11/performance-check-leaves-members-short/>

¹⁴ <https://www.apra.gov.au/mysuper-product-heatmap>

¹⁵ <https://thenewdaily.com.au/finance/superannuation/2019/01/09/super-fund-fee-disclosure-asic/>

46. The ALA submits that, for a ranking process to be useful:
- It must be thorough,
 - It must be robust, and
 - It must be equally administered across the industry.
47. Current mechanisms for ranking and rating superannuation funds are incomplete. They lack consistency and rigour in ensuring that they are ‘comparing apples with apples’. For example, not all fees and charges are measured and reported equally.
48. As noted elsewhere in this submission, it is important that retail and industry funds are ranked and published side by side, so an industry-wide comparison can be made by consumers. Any performance testing must be done equally, regardless of the ownership structure of the fund.
49. We also support reporting measures that demonstrate a willingness to take an appropriate level of risk according to their member base in order to encourage innovation and avoid homogenisation through index hugging.
50. The ALA is aware of general concerns that much of the proposal mapped out in the Package relies heavily on detail that will be included in regulations. Transparency and clarity around what information the ATO is using to make its determinations around the relative performance of funds is essential, and the criteria which the ATO uses needs to be made public.
51. The ALA looks forward to any proposed criteria to be used by the ATO being released for public consultation.

Part 4: Requiring superannuation trustees to act in the best financial interests of their members. This reform ensures trustees are focused on members’ financial interests when they undertake the many actions in operating a superannuation entity. These actions include incurring day-to-day essential operational expenditure and investing members’ money, to less frequent strategic decisions and discretionary expenditures.

52. The ALA notes the intention of this part of the Package, as noted on the inquiry website¹⁶:

This reform ensures trustees are focused on members’ financial interests when they undertake the many actions in operating a superannuation entity. These actions include incurring day-to-day essential operational expenditure and investing members’ money, to less frequent strategic decisions and discretionary expenditures.

53. The ALA notes the shift in language/focus here, from “Best Interest” to “Best Financial Interest”. One is an essential subset of the other. In order for a fund to operate in the best interests of its members, it must operate in the best financial interests of its members.

54. The ALA is concerned that narrowing the focus in this way may lead to elements that currently make up the member’s best interest being lost, as they are not specifically of a financial nature. For example:

- HESTA, a fund with 80% female membership, actively and purposefully campaigns for issues which further the causes of gender equality¹⁷. This is underpinned by research supporting benefits to governance, culture and performance. Hence it is in the best interests of its members, but may not have an immediate or measurable direct link to their financial interests.
- In an effort to ensure the long-term environmental sustainability of the planet, many trustees have divested from fossil fuel investments and have developed green energy investment strategies¹⁸. Recent litigation in this area has also helped drive change as younger members in particular seek assurances from their superannuation funds that

¹⁶ <https://treasury.gov.au/consultation/c2020-124304>

¹⁷ See for example <https://www.hesta.com.au/campaigns/gender-equality.html>

¹⁸ <https://www.marketforces.org.au/super-funds-october-2020-update/>

everything possible is being done to avoid future investments being underwater¹⁹. It would be regressive to censure trustees implementing green investment strategies who cannot readily demonstrate an immediate or measurable direct link to members' financial interests.

- Many funds invest in efforts to increase the financial literacy of its members, and the broader population. This is very much in keeping with the findings of the Royal Commission. While clearly in the best interests of fund members, potential fund members and the broader community, it may not be seen as having a direct financial benefit to the members.

55. As noted in relation to other aspects of the Package, the ALA believes it is essential that the 'financial best interest' initiatives are applied equally across the superannuation industry. For example, if there are concerns about whether the distribution of surpluses in industry funds are in the financial best interests of members, then there needs to be equal concern about whether the distribution of profits to shareholders in retail funds attracts the same level of concern. Especially when those costs are taken directly from member's accounts.

56. Similarly with advertising, if trustees of industry superannuation funds are required to demonstrate how their advertising strategy is in their members' financial interest, the same must apply to retail funds.

57. The ALA perceives this section of the Package as an unprecedented government intervention in a free market. We urge Treasury to act with caution in its assessment of the impacts of such an intervention.

58. The ALA believes that Australia needs to protect the sensible position where trustees have the latitude to make governance decisions without worrying that all decisions need to be viewed through a financial lens. The appropriate test should be whether a decision of a trustee negatively impacts on the overall best interest of the members.

59. As noted earlier, we need to remain aware that there are circumstances where trustees will make decisions which are not directly quantifiable in a financial sense, but are still in the members' best interest.

¹⁹ <https://www.abc.net.au/news/2020-11-02/rest-super-commits-to-net-zero-emissions/12840204>

60. In an increasingly competitive market, the true test of the values proposition offered by any superannuation fund lies in its capacity to retain members.

Conclusion

61. The Australian Lawyers Alliance (ALA) welcomes the opportunity to have input into the exposure draft legislation and explanatory materials for the Your Future Your Super package (the Package).

62. We would be pleased to meet with Treasury officials to discuss any of the contents of this submission.

A handwritten signature in black ink, appearing to read 'J. Mennen', with a large, stylized flourish at the end.

Josh Mennen

Australian Lawyers Alliance