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Your Future, Your Super   
Aware Super Submission

Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Best Financial Interests Duty

Treasury Laws Amendment (Measures for consultation) Bill 2020: Single Default Account

*and*

Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Addressing Underperformance in Superannuation

24 December 2020

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# Introduction

## About Aware Super

Aware Super (the new name for First State Super) has been the fund for people who value the community since 1992. We’re one of Australia’s largest funds and we’re continuing to grow.

We merged with VicSuper this year and together we manage approximately $137 billion in savings for more than one million members located across the country. As part of this, we manage more than $31 billion in retirement assets supporting over 67,000 people in retirement and a small defined benefit fund ($1.1 billion). We also completed a merger with WA Super on 4 December 2020. Our members ― teachers, nurses, public servants and emergency services officers ― work in roles that breathe life into our community and they expect us to do the same investing in ways that do well for them, and good for all.

Aware Super is committed to investing for the long-term, being a top performing fund, and providing our members with the right advice, services and support to feel confident about their retirement.

## Summary of our submission

Aware Super supports the Government’s intention to improve funds’ performance across the sector, ensuring superannuation works better for all Australians. We recognise and support the need for a low cost, high performing superannuation and retirement system.

While the *Your Future, Your Super* draft Bills aim to improve industry performance towards that goal, we have deep concerns that without the suggested amendments outlined in this paper, these draft Bills will add to red tape, overheads and confusion for super funds, members and employers.

*The overall package*

The draft legislation contains provisions which do not reflect the standards that apply to other corporations or commercial entities in Australia, specifically:

* Prohibition of certain payments and investments, and
* Onus of proof on the trustee and directors in the context of actions brought by regulators (effectively, the funds will be in the legal position of not meeting members’ best interests at all times).

The draft legislation allows for drafting of regulations; it therefore provides little detail on how each measure is to be implemented. Superannuation is very complex: the “devil will be in the detail.”

* Our preference is to see more detail in legislation and, if the regulations are to contain information relevant to implementation, that there should be a suitable period of consultation on these:
* The regulations should be issued at the same time as draft legislation to allow comprehensive review of all instruments.

*Specific concerns with each draft Bill*

We have identified specific concerns about each draft Bill and remedies which we raise in the spirit of implementing a better system for all Australians. We suggest the following amendments:

* **Addressing underperformance in superannuation** should be the starting point:
* Resolve underperformance and high fees as a first step, to ensure members are not stapled to underperforming funds,
* Ensure resolution powers are superannuation specific to protect member benefits,
* Include a periodic review of the methodology,
* Ensure APRA has discretion to allow flexibility for risk focused investment strategies designed for members’ different ages and needs, where investment strategies change, or when performance distortions arising from periods of market dislocation are reflected during the rolling 8-year review periods,
* APRA’s resolution powers should extend to flexibly assist smooth merger processes (for example, operating two MySuper products in the short term until operational issues are resolved),
* Include administration fees in performance comparisons for transparency – and to ensure the methodology doesn’t encourage gaming the outcomes.
* **Single default account** (stapling) amend to:
* Commence from 1 July 2023 to:
  + ensure full implementation of end-to-end electronic look up and delivery services between employers and ATO, and to link the comparison tool with digital worker onboarding services, estimated to require two to three years to incorporate all employers, payroll software and providers,
  + eliminate semi-automated processes for large employers (departments of health, education and police onboard thousands of new staff each new year and need bulk look-up processes),
  + lower the costs for both employers and trustees and ultimately members using a tech driven approach,
* Commence stapling after underperformance measures have been implemented:
  + avoid stapling members to underperforming products, and
  + avoid problems of the “last person standing” as laggard switchers are left in the failing fund,
* Position the member as central to the stapling process (rather than the employer) so they are engaged and actively select the right fund for them:
  + review their current fund against their new employer’s default fund, and
  + check that they have insurance that matches their occupation (eg for police and emergency services).
* **Best financial interests duty** needs amending to:
* Remove the evidentiary onus of proof on trustees, directors of RSEs and SMSFs and change to a best endeavours approach, in line with standards that apply to most corporations and institutions,
* Remove the logically inconsistent, very broad requirement for regulations to be able “to specify that certain payments, are prohibited, or prohibited unless certain conditions are met. These payments are prohibited regardless of whether the payment is considered to be in the best financial interests of beneficiaries.” (ED 117A and EM 1.24)
* Consider a concept of materiality to avoid costly bureaucratic overload.

Further, the inclusion of “financial” to the best interests concept is unlikely to add significantly to improved cost control or decision making.

# Underperformance

## Remove underperforming products first

The core focus of Trustees is, and should remain, the provision of strong member outcomes (strong risk-adjusted retirement balances, and confidence in their desired retirement income).

We support reforms to remove underperforming products and funds from the system, with the ultimate result of moving members, especially disengaged members, into high performing funds. APRA’s performance assessment should include administration fees as well as net investment returns to ensure there is no room for gaming of fees.

The draft Bill’s Explanatory Memorandum (EM) states that the measure acts upon the recommendations of the Productivity Commission. While the measures respond to the Productivity Commission’s recommendations, the Bill as drafted implements a softer approach to remedying underperformance than proposed by the Productivity Commission.

The Productivity Commission’s Recommendation 4 proposes the consequence for underperforming funds as:

“Where remediation cannot be achieved within 12 months, the fund will need to withdraw the investment option and transfer members to a better performing option (either in their own fund or a different fund), or enter into a merger arrangement with another fund (with the merger to be completed within 2 years).”

The draft Bill does not implement this consequence. Instead, it proposes funds will notify members that they have failed the performance test for the first time, and upon a second consecutive failure to no longer accept new members into the underperforming product.

This level of disclosure will not be sufficient to protect those disengaged members remaining in underperforming funds. Taken together with the stapling measure as proposed, relying solely on disclosure will result in the most disengaged and vulnerable members being left in underperforming funds, while the fund’s position and viability deteriorates.

There need to be stricter measures around underperformance to merge or move members to avoid problems of the “last person standing” as laggard switchers are left in the failing fund.

The Budget Discussion Paper outlined a high-level impact of $10.7 billion due to a) members leaving underperforming products, b) some underperforming products improving their performance and c) others merging with higher performing funds. There is no disaggregated impact of each of these drivers, so we cannot comment directly on the assumed impact of disclosure and compare it against alternative approaches with more direct support for disengaged members.

We encourage the development of a more detailed impact assessment.

We support changes that would strengthen the ability of these reforms to address the continued existence of underperforming products and funds in the superannuation system:

1. Change the consequence for underperforming products and funds to align with the original Productivity Commission recommendation quoted above to pro-actively move members out of these products, ensuring their destination remains appropriate for their circumstances and needs.
2. Ensure measures addressing underperformance in MySuper products are introduced before the stapling measures. This ensures members cannot be stapled to underperforming funds. We suggest a start date for stapling of 1 July 2023 at the earliest (this would also allow for the development of digital portals for employers and members and reduce the administrative impost on employers in particular).

* We acknowledge this extends the Government’s preferred timeline, but with PYS / PMIF in place and underperformance being addressed, the impact is mitigated. The Productivity Commission had account stapling commencing two years after performance assessments, and after remediation had occurred.

1. Commit to consulting on and finalising regulation for Choice products to ensure proposed timelines do not slip. We are concerned that in previous reforms where Choice product requirements were made in regulation, these have been deferred with no Parliamentary accountability (for example product dashboards for MySuper have been required since 2013, yet Choice product dashboards are still not available because the “necessary regulations have yet to be made”[[1]](#footnote-2)).

## Apply the resolution powers appropriately

The EM states that including resolution powers for super will “harmonise the definition of ‘prudential matters’ across the industry Acts by incorporating a specific reference to resolution under the SIS Act.”

APRA’s discretion and resolution powers should be used pro-actively to promote mergers in the face of underperformance to protect members’ interests. APRA’s resolution powers should extend to flexibility to assist smooth merger processes (for example, operating two MySuper products in the short term until operational issues are resolved), and therefore reduce the cost of mergers for Trustees.

While we support APRA creating a new Resolution Prudential Standard, we foresee unintended consequences if understandings of ‘resolution’ from banking and insurance are imported without sufficient consideration of the unique features of superannuation. Member benefits in superannuation are not relatively simple credits/debits and rates as in banking, but are benefits invested in a portfolio of assets and other benefits, such as insurance, and sometimes entitlements with similarities to defined benefits. Appropriately dealing with unsustainable funds will need to ensure resolution measures, such as mergers, are carefully managed to protect members’ interests.

To the extent the policy measures are successful in prompting members to switch away from underperforming funds, there will be meaningful liquidity and performance implications borne by those members who remain in the fund. We are concerned this could harm the most vulnerable/disengaged members and steps should be put in place to protect them and ensure equity.

We agree that a proactive approach by APRA to mergers (avoiding the need to write to members where a sudden change of Trustee is required, for example, in potentially catastrophic circumstances), would also help to maintain confidence in the system.

## The need for periodic review of methodology

We accept that some details of the performance test are appropriate for regulation. Key aspects of the performance test should be reviewed periodically to ensure the test reflects prevailing conditions and allows for changing market structures / emerging innovation.

The next three years are likely to be a time of significant change in superannuation, especially if the broad thrust of these reforms is implemented. The superannuation system in three to five years’ time, and the funds within it, are likely to face different issues from the current challenges of higher fees, unintended multiple accounts and underperformance.

For this reason, we recommend the legislation include the requirement of a review of the performance test after three years.

This review should also include consideration of the overall structure, intent and rationale of the performance test, as well as its specifics, including:

* The number, definition and specification of asset classes (new asset classes emerge over time) and their benchmarks,
* Effective tax rates (franking credit levels and embedded effective tax rates assumptions vary over time, particularly during economic downturns with widespread dividend cuts), and
* Effectiveness of the benchmarks, including the assumed listed/passive fees.

## APRA discretion important and needs specifying

We understand the proposed performance test is to ensure Trustees are objectively adding value relative to investing in a low cost listed benchmark. We accept this simple approach is initially a reasonable basis for assessing strategy implementation. We acknowledge the inherent difficulty associated with coming up with an appropriate benchmark. On balance, we consider that simplicity is preferable to complexity, and that assessment over a long horizon is critical.

However, the use of a simple test to measure a complex problem will inevitably give rise to instances of measurement error and unintended consequences, necessitating some safeguards. For this reason, we are pleased the legislation includes the ability for APRA to use discretion in its assessment of fund performance.

While the regulations have not been released for consultation, we would like to put forward our view on certain situations where we believe it is critical that APRA applies discretion. These could include:

1. A material **change or imminent change** to a fund’s investment strategy or product offering, access to scale, and/or fees occurring during the performance window.

* *For example*: a fund merger is one instance where the investment strategy can change significantly but the product itself remains in market pending finalisation of the SFT.
* *Solution*: in this instance APRA should consider the performance of the surviving fund, the likelihood an SFT will be completed in the near to medium term, and/or broader performance trends.

1. Instances of temporary **technical underperformance driven by the rolling window**.

* Example: It is important that funds are able to respond to market conditions and take Dynamic Asset Allocation (DAA) positions relative to the Strategic Asset Allocation (SAA) to account for emerging risks / opportunities.
* When taking a large risk-off position during a period of market dislocation, the rolling window means that, as the initial period of value add rolls out of the performance window, any subsequent underperformance could cause a temporary period of technical underperformance, even if the position added value in aggregate.
* Similar scenarios could arise during market dislocations driven by short term deviations in the performance of listed vs unlisted assets.
* Solution: supplementary performance analysis taking a broader lens that captures the full period of market dislocation and/or a moderately longer or shorter performance window should make it easy to identify temporary technical breaches of the performance test, as distinct from chronic underperformance.

1. For some **member cohorts**, maximising returns is not the sole objective, and this should be acknowledged to avoid hindering innovation:

* *Example*: pre-retirees and retirees are subject to sequencing risk, and are better served by losing less in volatile markets. Where investment strategies explicitly recognise this need and incorporate risk management (typically applied to the construction of asset classes), the SAA benchmark alone will not adequately capture the risk/return trade-off embedded in the strategy.
* *Solution*: risk-adjusted performance should be considered.

Other more technical matters for regulation that we would like to highlight include:

* APRA could calculate the performance test on a monthly (assuming availability and reasonable cost of supplying data), rather than quarterly basis, ensuring the date of SAA changes is accurately captured.
* For example, reporting of an SAA change effective from 1 April should be applied from 31 March, rather than 30 June. This can make a material difference during periods of market dislocation.
* We note there would be a cost to more frequent performance tests, unless Heatmap data only were used as other data sets require extra internal and external data extracts.

*Avoid confusion for members*

Since MySuper was introduced, funds have provided Product Dashboards reporting performance against a Target Return, which is slightly different from the Objective listed in the Product Disclosure Statement.

As noted on our website, “the return target is the average of the expected annual returns for the ten-year period, based on long-run return assumptions, net of investment fees, administration fees and taxes. The return target differs from the investment objective disclosed in the Product Disclosure Statement. The return target does not constitute a forecast or guarantee of future performance or future rate of return.”

The various benchmarks used for the Your Future, Your Super performance calculator, APRA’s heatmap and the new performance assessment are likely to cause confusion for consumers and other reviewers / commentators. We suggest consideration be given to presentation of these various sources of information and whether some are now redundant or need harmonising.

To reiterate and for completeness, the performance assessment and comparison tool should both include administration fees for full transparency, and to ensure there is no arbitrage or gaming between investment and administration fees.

# Single Default Account

## Benefits of a single account

We support the policy intent of reducing unwanted multiple accounts – and subsequent multiples of fees – in the superannuation system. A form of stapling can achieve the objective of preventing new unwanted multiple accounts being opened; however, it needs to address all products, both choice and default.

We also support the Government’s broad approach of leveraging technology solutions including the ATO’s in developing a member-centred approach to fund selection.

The measure does not address the current stock of unintended multiple accounts. The Productivity Commission estimated that there were 10 million unintended multiple accounts. At October 2020, Protecting Your Super (PYS) reforms had consolidated accounts for 1.4 million Australians, approximately 14% of the current stock of unwanted multiple accounts.

We believe more needs to be done to address existing multiple accounts.

## Manual solution an impossible challenge for employers

The draft Bill has stapling commencing on 1 July 2021, which aligns with the commencement date of a manual process for employers as outlined in the Discussion Paper. The automated process does not begin until the ATO has built the service, expected after 1 July 2022. This does not allow for all other stakeholders in the payroll chain to be brought into the process.

It is imperative that fully digital end-to-end service is in place to avoid imposing manual, possibly paper-based forms and processes onto employers.

Large employers often have large annual onboarding periods for thousands of new staff tied to educational and employment cycles:

* Public health - approximately 2-4000 new staff employed at the beginning of the calendar year in each of NSW and Victoria,
* Public education - approximately 2-3000 new staff employed at the beginning of each year in NSW,
* NSW police - approximately 1000 recruits per year.

We believe the effort and potential risk of creating what will initially be a manual system for employers is not outweighed by the benefits of stapling during this time, especially while underperformance is largely unaddressed. Our largest employers are those public sector services and agencies which are already under considerable financial and administrative stress as a consequence of the COVID-19 pandemic.

Our view is that it will be worth waiting for a fully automated solution before commencing account stapling, on the grounds that a manual paper-based look-up process will be unworkable and overly onerous for large employers.

We suggest that account stapling does not commence until 1 July 2023 at the earliest to:

* Ensure full implementation of end-to-end electronic look up and delivery services between employers and ATO, and to link the comparison tool with digital worker onboarding services,
* Allow sufficient time for payroll software to be updated, and payroll services providers to be onboarded to the ATO look-up system – and to include bulk look-up processes,
* Enable fully automated processes for large employers (departments of health, education and police onboard thousands of new staff each new year, requiring bulk look-up), and
* Lower the costs for both employers and trustees and ultimately members using a technology driven approach.

Workplace default super reduces overall costs for members and employers. For our employers who are often government or publicly funded entities, cost savings on the administering of super is a material benefit.

As a general comment, super funds provide considerable support to employers. In the three years to June 2019, Aware Super (prior to merging with VicSuper) supported our employers in administering their superannuation obligations in the following ways:

* 750 inbound calls per month to a dedicated employer relations team:
* Top four issues: clearing house 30%, contributions 20%, refunds 12%, and insurance 9%,
* 3000 emails from employers actioned per month by a dedicated employer relations team,
* 120 clearing house approvals per month for new employers,
* 6700 refunds processed per year (payroll adjustments).

This amounts to 53,140 actions supporting employer compliance every year.

Without employers’ involvement and funds’ administrative support, the payment of super entitlements is likely to be delayed, incorrect or in the worse cases, non-compliant.

## Workplace adds value to members

The workplace context generates higher value engagement from members than direct communication and retail marketing.

While there are good reasons why members do not engage with their super, barriers to informed engagement should be reduced as far as possible. Informed engagement leads members to make decisions that are in their own best interest and also exerts a healthy competitive pressure through demand for the goods and services that members value.[[2]](#footnote-3)

Job change is an important event in people’s lives. As super is a workplace entitlement, the process of onboarding a new employee is an appropriate and efficient context for members to engage with their super.

The ongoing relationship between super and workplace is a crucial foundation for informed member engagement.

As most employees have a superannuation account, engagement at the workplace can focus on service rather than sales. While we do not expect everyone to engage with their super, for those who do, it needs to be as effective and efficient as possible.

Our engagement at the workplace includes:

* Member education through onsite seminars, workshops and initiatives that encourage employees to engage with their super,
* Workplace specific seminars and webinars on superannuation basics, financial and personal wellbeing, transition to retirement and financial resilience,
* Inclusion of super and positive actions in employee onboarding, orientation and induction,
* Partnerships on shared issues: leadership, gender equity – including broad financial and superannuation information – and engaging an aging workforce,
* Providing single point of contact for employers to promote efficient payment of member contributions, and
* Payroll and administration support, clearing house and single-touch payroll.

## Our preference is to maintain workplace defaults

We believe the value workplace creates in the superannuation system extends far deeper than member engagement. Regarding fund selection, the Productivity Commission found:

* The selection of default funds within the industrial relations system to be largely operating in member’s interests,
* Members who are in a default fund, whether they chose the fund or by default, are 2.4 times less likely to be in an underperforming fund (though this does not prevent them from being in an unsuitable fund – for insurance needs or age appropriate investments), and
* Over the eight years to 2017, the Productivity Commission found that default products outperformed non-default, or choice products, by 0.84%.[[3]](#footnote-4)

Although not the direct issue for the proposed reforms, stapling does impact the provision of insurance in superannuation. We strongly support the provision of insurance in superannuation as a valuable and efficient way of providing insurance to the Australian population. The occupational basis for default fund selection also allows for workplace or cohort tailoring. This has important implications for insurance for emergency services workers and other high-risk occupations. Parliament has previously recognised the importance of insurance in superannuation for high-risk occupations by including the high-risk exemption in the Putting Members Interests First reforms.

We recognise the value for members arising from aligned superannuation, workplace and occupation. The ‘auto-rollover’ model of stapling would work much better for workers in high risk occupations: in this model, new employees who do make a choice of fund at job commencement would have their existing super automatically rolled into the default fund in place at their new workplace.

We are concerned that stapling is more likely to occur in ‘first job’ industries, rather than later in more professional careers. New starters without super accounts will most likely adopt the default for their first workplace occupational default. This could unfairly distort competition in the superannuation market with. Young members may start in funds that reflect their first job, but these may not be appropriate as their careers progress.

We understand the Government has not chosen this approach. With respect to the Government’s approach, we still see room for improvement as outlined in the section below.

## A simpler implementation to help workers

The stapling measure, as designed, risks reducing Australians’ engagement with super rather than increasing it. Lack of engagement risks a member being stapled to an underperforming fund they chose (or were sold) previously. Despite the intent of the policy many members will not be in high-performing funds best suited to their circumstances.

The proposed stapling approach provides little if any opportunity for the employee to engage with their super and creates a barrier to informed engagement. Instead, it places the employer at the centre of the process. Employer involvement is important to the degree they meet their own obligations (paying SG), however, most employers have no expertise in the employee’s superannuation or personal circumstances.

Implementing a more member-centric approach which positions the member at the centre of the stapling process (rather than the employer), would solve the issue of unintended multiple accounts and also drive higher member engagement and ultimately more informed members making decisions that are in their own best interest.

*Modify the process*

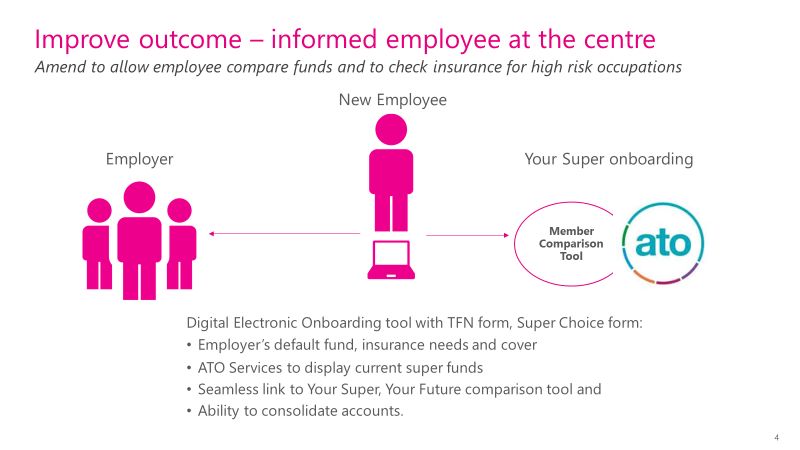
We suggest a modification to the proposed process where members would be presented an opportunity to engage, consolidate and select a fund for their super at job commencement.

Members could check their fund’s performance and fees, including choice products. They could check they had suitable risk and asset allocation for their life stage and circumstances, and that their choice aligned with ESG or other values.

The solution would draw on the ATO’s MyGov portal, Your Super tools and Single Touch Payroll data, and should build on existing technology and processes to make account stapling as efficient as possible, especially for employers. Large employers would prefer the ATO to offer a fully digital service connecting new staff, the employer and the ATO, allowing for bulk search for stapled accounts and upload of new staff.

We propose a process that:

* Implements a seamless digital interface for people starting a new job to complete the onboarding steps (personal details, TFN, Choice of fund etc), using single touch payroll together with ATO data to provide a new employee with three options and prompt them to select one of:
* the member’s current fund/s (including choice products),
* default fund of the new employer (more likely to be suited to their current occupation for insurance, and personal financial situation), or
* exercise the option to choose another fund with a link to the comparison tool.
* Prompts the member to consolidate accounts with Your Super guidance,
* If they do not choose, the employer pays to a fund according to the ATO’s activity rules; first timers are put into the new employer’s default fund,
* Implements a bulk digital search and upload function for employers, ahead of introducing account stapling.

The following diagram outlines our suggested changes.

# Best Financial Interests Duty

## Adding “financial” does not add clarity

Aware Super supports ensuring all participants in the super industry adopt commercial disciplines such as strategic planning and financial control. We note that the Government and APRA already have increased focus with the Annual Member Outcomes Assessment and Business Performance Review. Further, superannuation trustees must already meet the “members’ best interests” requirements of the *SIS Act* at s52(2)(c) and the Sole Purpose Test.

In our view the proposed amendment, inserting the term “financial”, is unnecessary and lacks sufficient justification. There is potential for increased confusion with the increasing number of tests that trustees are required to complete to demonstrate appropriate financial control.

*The focus on expenditure is inconsistent with evidence*

The draft Bill’s EM focuses on trustee expenditure by outlining the significance of inserting “financial” into the best interest duty: “Trustees will need to have robust quantitative and qualitative evidence to support their expenditures.”

The EM cites the Productivity Commission review as the basis for reform. The Productivity Commission looked closely at trustee adherence to the best interest duty and highlighted 10 areas where, at times, “trustees and regulators adopt a broad and at times inappropriate interpretation of members’ best interests”. These examples covered the areas of board composition and capability (3 examples), conflicts due to related parties and vertical integration (2), disclosure (1), investment strategy (2), mergers (1) and providing benefits to employers (1). None of these examples directly relate to operational and strategic expenditure decisions (although they may influence poor decisions due to underlying issues).

In its conclusion, the Productivity Commission ultimately deferred to the Royal Commission and recommended:

“The Australian Government should pursue a clearer articulation of what it means for a trustee to act in members’ best interests under the Superannuation Industry (Supervision) Act 1993 (Cth). … In clarifying the definition, the Government should decide whether to pursue legislative change, greater regulatory guidance, and/or proactive testing of the law by regulators. It should be informed by the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.”

The Royal Commission found that:

“the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.”

While the draft BFID Bill appears to respond to the Productivity Commission, it ignores the Royal Commission’s finding that existing standards should be applied. We support the Royal Commission’s approach.

*Investment decisions differ from operating business*

The draft BFID Bill makes no distinction between the types of expenditure incurred in the core investment activities of a fund, and the operations of managing members’ accounts and providing services. Both activities are essential but are different in nature. There is a scale and qualitative difference: the amounts spent by the trustee office will seldom equate to the amounts spent in acquiring assets on behalf of members.

*Managing risk broadly*

Global financial commentators are increasingly viewing broader financial impacts of corporate activity. In future, costs of damage to communities, environments and stakeholders could negatively impact asset owners. This reinforces our view that “best financial interests” is a broad term, loaded with assumptions, that cannot be reduced to a simple ratio or measure.

If this legislation passes, the “best financial interests duty” should be interpreted with an eye to risk, consequences for members, and long-term outcomes.

## Managing investment risk is not black and white

With respect to investing on behalf of members, applying the best interests duty is no simple matter and that adding the word “financial” will not enhance value for members.

Applying a risk adjusted approach to managing assets for different member cohorts means they will potentially have different but appropriate outcomes. We offer members a lifecycle investment approach in MySuper on the grounds that younger members need to grow their assets as much as possible, while members approaching retirement benefit from a less volatile investment experience. The returns will necessarily be different – but still in members’ best financial interests, even though older cohorts may have lower returns. It can be argued that not offering a lifecycle approach is deleterious to older members’ best interests.

*Investment decisions look forward decades and are reviewed frequently*

Decision making for investments is run by the investment division, its executives and committees, and the Board Investment Committee with strict delegations. These decisions are accompanied by quantitative analysis of the target acquisition and judgement as to its future prospects or its continuation as an asset.

Given funds’ long timeframes in seeking high net returns at an acceptable risk level for members, we typically consider both short-term performance (indicative of progress) and long-term expectations. Certain investments have low cash flow characteristics in the short- term but can delivery stellar longer-term performance. Others deliver more predictable cash flows and returns, but with less promise of growth. The application of judgement as well as analytics is critical to decisions, some of which may not appear to deliver in the short term.

*Decision making process*

We assess long term economic, sovereign, governance, environmental and commercial risks. The pursuit of the highest possible return is measured against the risks and we may choose not to invest where the long-term risks imply either a collapse of the asset, failure of its markets, or conditions which make its longevity improbable. These assessments apply to expectations as to whether management of an investment can deliver or whether there will be consequential damage to the asset, its environment and community.

At Aware Super, we have built a number of models which allow us to test the impact of proposed investments, expenditures and changes to our environment. These powerful decision support tools are part of the solution and are one of the benefits of scale and of having a long history in the sector. In future, costs of damage to communities, environments and stakeholders could negatively impact asset owners.

This reinforces our view that even if the duty applies to “financial interests” the inability to reduce this to a simple ratio or measure will mean it will remain a matter of interpretation with no further clarity than that already provided.

## Appropriate regulatory overview of expenditures

The short-term focus on trustees’ expenditure, suggested in the commentary on the best interests amendment, is unlikely to promote additional value in fund decision making because the benefits from particular expenditure often emerge over long timeframes and are more complex to measure than the Government may anticipate. Regulators will need the flexibility to apply expertise, industry knowledge and judgement in determining whether expenditure is appropriate.

*Example: System and change programs*

Implementing major programs in financial institutions can take several financial years, and we are cautious about seeing implementation of a short-term focus on expenditure. Such programs can run for two to three years or longer, for example:

* Major systems or platform upgrades touch all the interrelated, networked systems across a super fund, from the point where contributions enter the system, through registries, general ledgers, advice systems, workflow and office systems etc,
* Much is expected of digital services, information and possibly advice in future – again these systems are resource and capital intensive,
* Superannuation and retirement are very complicated, needing the right approach over an extended timeframe.

*Example: Marketing and member communications*

The changing market structure (increasing mergers and proposed account stapling) means that funds are likely to need to increase marketing activity and promotion to repeatedly reinforce their positions. No Australian superannuation fund is in a monopolistic position where it can prosper without marketing or building a strong brand.

A well-known brand helps funds to attract and retain members, which in turn starts a virtuous circle. Scale is needed to deliver continuous service improvements (eg, digital services which are expected by today’s members), to underpin cost efficiencies, and deliver fee reductions.

Building business cases for advertising brand and abstract concepts can be challenging, and linking these directly to member acquisition and retention is not straight forward:

* While we expect quantifiable increases in FUM and member numbers from advertising and marketing, we may not always be able to point to a 1:1 relationship between expenditure and outcome, or between creativity, excitement and engagement.
* Our business cases for advertising currently have targets for awareness, consideration, retention and growth metrics; and have estimated the percentage increase in FUM we expect over four years from advertising (above planned growth).

The single time period in Example 1.3 of the EM oversimplifies the situation, especially if success is measured over years. The expected changes in superannuation market dynamics and the long timeframe over which member behaviour is measured make it unlikely that adding “financial” to the best interests provides greater clarity to funds’ marketing and engagement decisions. Further, if funds are prohibited from material marketing and communication expenditure, competition and member engagement are likely to suffer. This is where discerning regulatory guidance or overview will be constructive.

## Provisions exceed corporate standards

We note that the draft legislation contains provisions which do not reflect the standards that apply to other corporations or commercial entities in Australia, specifically:

* The EM notes there is no materiality threshold (nor is there in the current legislation),
* Prohibition of certain payments and investments, and
* Onus of evidentiary proof on the trustee and directors in the context of actions brought by regulators (effectively, the funds will be in the legal position of not meeting members’ best interests at all times).

*Consideration of materiality*

The heightened focus on expenditure controls in this draft Bill, suggests it would be appropriate to acknowledge considerations of materiality in decision making. This is a standard concept in the operation of all businesses and contributes to setting priorities.

The current drafting of the BFID Bill could lead to excessive reporting overheads, confusion, potential paralysis or simply ‘tick a box’ approaches to quantifying member benefit. The cost of monitoring expenses is already considerable.

We suggest including a concept of materiality in the legislation.

*Prohibition of certain payments - logical inconsistencies will become unworkable*

We observe with interest a statement in the draft Bill and EM that allows regulations “to specify that certain payments, are prohibited, or prohibited unless certain conditions are met. These payments are prohibited regardless of whether the payment is considered to be in the best financial interests of beneficiaries.” (ED 117A and EM 1.24) As the regulations have not yet been released, this places funds in an impossible situation – effectively making it very difficult to plan.

In practice, there are likely to be two outcomes:

* The respective Minister of the day may choose to prohibit investment assets arbitrarily, which could range from government sponsored infrastructure assets, to water rights, to certain food manufacturers (eg, sugar or alcohol based) or certain energy sources, without regard to the entire portfolio, and
* The contradiction inherent in the instruction is likely to lead to legal challenges and confusion as to interpretation of permitted investments or investment classes.

The measure is extreme in its breadth and depth of application into the operation of a fund, and is not in keeping with a philosophy of free enterprise.

We are also concerned that payments to industry bodies, think tanks, market and employer organisations through which we engage with the business community as both investor and steward of employee savings could be impacted, and consequently weaken our ability to serve members best interests.

We suggest these clauses are removed entirely from the draft legislation.

*Onus of proof is excessive*

The draft Bill requires that the onus of evidentiary proof for best interest rests with Trustees and Directors of RSEs and SMSFs. It is a very blunt instrument which effectively implies that all super funds must establish that they are not guilty of mismanaging members’ money, whether as investments or in the cost of operating the fund.

A best endeavours approach is appropriate and more in line with standards that apply to most corporations and institutions. We recognise that even with best intentions, errors of judgement and honest mistakes occur, and on these grounds argue that inspection is relevant, but that a starting assumption of error or misbehaviour is not.

We suggest these clauses are removed entirely from the draft legislation.

1. ASIC, ‘MySuper product dashboard requirements for superannuation trustees’, accessed 10 December 2020: <https://asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-relief-and-legislative-instruments/product-dashboard/mysuper-product-dashboard-requirements-for-superannuation-trustees/> [↑](#footnote-ref-2)
2. Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness*, December 2018: p 246. [↑](#footnote-ref-3)
3. If relying on the default fund system, only 14% of members end up in an underperforming product. If relying on the MySuper regime, 24% end up in an underperforming product. [↑](#footnote-ref-4)