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31 March 2015

Mr David Crawford
Senior Adviser
Financial System and Services Division
The Treasury
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Email: fsi@treasury.gov.au

Dear David

MERCER'S RESPONSE TO THE FSI FINAL REPORT

Contributing ideas and insights to the industries we serve is an important part of Mercer's DNA and we are pleased to respond to the final report of the Financial System Inquiry (FSI).

Mercer is a global consulting leader in talent, health, retirement and investments. We help advance the health, wealth and careers of millions of Australians and more than 100 million people globally. We also provide customised administration, technology and total benefits outsourcing solutions to a large number of employers and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have $55 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust, the Mercer Super Trust, has over 240 participating employers, 226,000 members and more than $19 billion in assets under management.

We are innovators and we have brought disruptive thinking to Australia's retirement savings landscape with world-class insights and world-first solutions.

We recently launched a game-changing retirement income product, a world-first mutual longevity pooling investment option called Mercer LifetimePlus™, which ensures superannuation can provide an income for life. In March this year Mercer LifetimePlus™ won the 2015 Canstar Innovation Excellence Award.

Our Mercer SmartPath® lifecycle investment option, introduced in 2014, has led a shift in the superannuation industry's mindset about the benefits of lifecycle investing and establishing a whole-of-life default option. Mercer SmartPath® was recognised by industry peers winning the Best Fund: Innovation award at the 2014 Chant West/Conexus Financial Super Fund Awards.

Superannuation is a core business for Mercer so we have largely restricted our comments on the Financial System Inquiry (FSI) report to those issues in the report which impact on superannuation.

Executive Summary

The FSI report considers the Australian superannuation system is not operationally efficient due to a lack of strong price-based competition. Superannuation assets are not being efficiently converted into retirement incomes due to a lack of risk pooling and over-reliance on individual account-based pensions.

We have similar concerns but also believe efficiency has been adversely impacted by continual and often rushed legislative change which has added significant costs to the administration of super funds, an overly prescriptive disclosure regime which limits the use of more appropriate technological solutions and a Fair Work Act which adversely reduces competition in the superannuation default fund market.

We support most of the FSI recommendations relating to superannuation and its aim to “Lift the value of the superannuation system and retirement outcomes”.

The following tables summarise the Mercer view on relevant FSI recommendations. We have included further comment on a number of the recommendations in the appendices to this letter.

Theme 2: Superannuation and Retirement Outcomes

Recommendation	Mercer view
Objectives of the superannuation system **Recommendation 9** *Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.*	We support this recommendation. A clear vision and future roadmap is important to benchmark future policies and proposed changes against. Refer to Appendix 1, Recommendation 9 for further details.
Improving efficiency during accumulation **Recommendation 10** *Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.*	Mercer agrees the existing system is not as efficient as it should be and a review of the system at some point is entirely appropriate. However, the superannuation industry has been subject to constant legislative change and the high cost of legislative reform. A period of stability without legislative reform (other than simplifying and removing unnecessary red tape) is essential before it will be possible to assess whether MySuper has or has not produced the intended cost savings. The constant stream of regulatory change over the years, culminating in the Stronger Super changes of recent years has absorbed significant resources and incurred significant costs. As a result, fees are higher than they would otherwise have been. The pace of change has significantly limited the opportunities to develop operational efficiencies and process improvements. There are currently two major legislative areas where amendments are necessary to enable greater competition, improved efficiency, and cost savings: 1. Greater flexibility to provide disclosure material electronically to all members (refer to Recommendation 39). 2. Superannuation provisions in the Fair Work Act which seriously restricts competition with most funds unable to openly compete for the default market. We recommend the removal of the

	default fund provisions in the Fair Work Act to open up competition which should have a further impact in reducing fees. Although a review of the system is desirable, we consider a review by 2020 may be too soon and provide insufficient time for the above changes to be adopted and the resultant reductions in costs to flow through into reduced fees. The FSI Report provided limited detail on its proposal for post 2020 new default members. As such it is difficult to properly analyse the proposal. Nevertheless we have some concerns over its application and more appropriate alternatives may be available if appropriate levels of efficiency have not been realised by the time of any review. Refer to Appendix 2, Recommendation 10 for further details.
The retirement phase of superannuation **Recommendation 11** *Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.*	We support the general concept of this recommendation. Until now there has been an undue emphasis on the accumulation phase as opposed to the retirement phase. We also support the removal of impediments to product development. Our submission sets out our thoughts on how this recommendation might be implemented. Refer to Appendix 3, Recommendation 11 for further details.
Choice of fund **Recommendation 12** *Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.*	We support this recommendation subject to a suitable transition period. For example it may be necessary to wait until current enterprise agreements expire before choice can be offered to employees covered by such agreements.
Governance of superannuation funds **Recommendation 13** *Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.*	We consider the mandating of independent directors on the board of corporate trustees is inevitable however a transition period will be necessary. We do not agree with the FSI recommendation that the SIS director penalty regime should be aligned with managed investment schemes. To do so would make superannuation trustee directors exposed to more liability than any other directors in Australia. Refer to Appendix 4, Recommendation 13 for further details.

Theme 4: Consumer Outcomes

Recommendation	Mercer view
Facilitate innovative disclosure **Recommendation 23** *Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.*	We strongly support the recommendation to remove regulatory impediments to innovative disclosure and communication with customers. To harness the potential for innovative disclosures to better inform and engage customers, it will be important to consult broadly within the Financial Services Industry on the legislative changes required. We support greater clarity for customers of risk and more uniformity in the disclosure of fees (such as the fee information of underlying investment entities). Refer to Appendix 5, Recommendation 23 for further details.
Align the interests of financial firms and consumers **Recommendation 24** *Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.*	We support this recommendation and strongly agree there is a need for the financial advice industry to raise its standards of conduct and levels of professionalism to build confidence and trust in the financial system.
Raise the competency of advisers **Recommendation 25** *Raise the competency of financial advice providers and introduce an enhanced register of advisers.*	We support the raising of competency of financial advice providers. We note an enhanced register of advisers is currently being established. Refer to Appendix 6, Recommendation 25 for further details.

Theme 5: Regulatory System

Recommendation	Mercer view
Compliance costs and policy processes **Recommendation 31** *Increase the time available for industry to implement complex regulatory change.* *Conduct post-implementation reviews of major regulatory changes more frequently.*	We support this recommendation. Refer to Appendix 7, Recommendation 31 for further details.

Other Issues

Recommendation	Mercer view
Impact investment **Recommendation 32** *Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.* *Provide guidance to superannuation trustees on the appropriateness of impact investment.* *Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.*	We believe it is important to facilitate the development of the impact investment market and encourage innovation, including social service and environmental solution delivery. Appendix 8, Recommendation 32 for further details.
Superannuation member engagement **Recommendation 37** *Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.* *Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.*	We support the recommendation to include income projections on members' periodic statements and the recommendation to facilitate access to consolidated information from the ATO. These proposals will provide members with better information to gauge how their retirement savings will support their retirement. Any new legislation and/or ASIC guidance should be designed in a way which does not discourage innovative presentation methods, enables projections to be prepared assuming benefits are taken as a pension, allows a reality check on inputs and can also take into account any potential age pension entitlement. Refer to Appendix 9, Recommendation 37 for further details.
Technology neutrality **Recommendation 39** *Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral.* *Embed consideration of the principle of technology neutrality into development processes for future regulation.* *Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.*	We strongly support this recommendation. Priority should be given to requirements relating to disclosure and transactions. Refer to Appendix 10, Recommendation 39 for further details.

Provision of financial advice and mortgage broking **Recommendation 40** *Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.*	We support this recommendation. Refer to Appendix 11, Recommendation 40 for further details.
Unclaimed monies **Recommendation 41** *Define bank accounts and life insurance policies as unclaimed monies only if they are inactive for seven years.*	The FSI has raised its concerns relating to the current lost money provisions for bank accounts and life insurance policies. We believe similar concerns should have been raised in relation to superannuation. In particular, proposals to significantly increase the threshold for superannuation accounts to be transferred to the ATO should be dropped. If they proceed, members will lose valuable life insurance and investment returns (which, even after allowing for fees, will generally exceed the low rate of interest credited by the ATO on lost monies). More detail on our views can be found in our submission to Treasury in February 2014 in relation to consultation on "Increases to the lost member account threshold". Refer to Appendix 12, Recommendation 41 for further details.

Further details on the recommendations are included in the Appendices attached.

If you would like to discuss any of the issues raised in our submission, please contact Dr David Knox on (03) 9623 5464 or at david.knox@mercer.com

Yours sincerely,

David Anderson
Managing Director & Market Leader, Pacific

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDICES

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 1

Recommendation 9: Objectives of the superannuation system

Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.

The enshrinement in legislation of objectives for superannuation is important.
The proposed primary objective *"To provide income in retirement to substitute or supplement the Age Pension"* is a sound starting point.

However superannuation has additional objectives and with this broader perspective in mind, we consider below the subsidiary objectives proposed by the FSI.

Subsidiary objective	**Why the objective is important**	**Mercer comments**
Facilitate consumption smoothing over the course of an individual's life	Superannuation is a vehicle for individuals to fund consumption in retirement largely from working life income. The system should facilitate consumption smoothing while providing choice and flexibility to meet individual needs and preferences.	To meet this objective, consideration needs to be given to adjust the current contribution caps which limit the ability of those who are out of the workforce for a period of time to "catch up" their superannuation contributions. This is particularly significant for females who may spend some years out of paid employment often because of family responsibilities. It is also significant for those working part-time while caring for young children and older parents. Such part-time workers are likely to have a very limited capacity to save for retirement during those years. Lifetime concessional tax limits to superannuation contributions, as opposed to annual limits, would create a fairer and far more equitable retirement savings system for all Australians. If an individual doesn't use the current concessional cap of $30,000 in a given year, half of what's unused should be rolled over to the next year and so forth. However, a concessional contribution in any year should not exceed three times the standard annual concessional cap, currently making $90,000 the maximum cap in any single year. Lifetime concessional contribution caps would provide all Australians with an equal opportunity to build their nest egg when they've the financial capacity to do so. This does not need to be retrospective. The reality is most Australians cannot afford additional super contributions of $30,000 for much of their working life and are therefore missing out if they leave the bulk of their

		super contributions to the latter part of their career, often when their disposable income is highest. Retirement savings are a lifetime journey and all Australians should have the opportunity and flexibility to build a more secure retirement when they can afford it. Lifetime limits would create a much fairer system; they would secure more adequate retirement incomes for more Australians; lessen the cost of the age pension to tax-payers; and allow people – particularly women – who have been in and out of the workforce to catch up in their retirement savings.
Help people manage financial risks in retirement	Risk management is important as retirees generally have limited opportunities to replenish losses. The retirement income system should help individuals manage longevity risk, investment risk and inflation risk. Products with risk pooling would help people to manage longevity risk efficiently.	This is an important aim. We note the FSI have made recommendations in Chapter 2 of their report which would assist in attaining this goal.
Be fully funded from savings	A fully funded system, as opposed to an unfunded system, is important for sustainability and stability. The system is designed to be predominantly funded by savings from working life income and investment earnings, where superannuation fund members in general have claims on all assets in the fund.	We support the concept of full funding, however, except for some public sector funds; we note this is already in place.
Be invested in the best interests of superannuation fund members	Superannuation funds are managed for the sole benefit of members, which means the investment focus should be on maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member. This results in auxiliary benefits to the economy by creating a pool of savings to fund long-term investment.	We support this proposal. Superannuation trustees should not be required to invest in particular investments or asset classes (e.g. Government bonds, infrastructure etc.) for other purposes.

Alleviate fiscal pressures on Government from the retirement income system	Government's total contribution to the retirement income system, through both the Age Pension and superannuation tax concessions, needs to be sustainable and targeted. Higher private provisioning for retirement should reduce the burden on public finances.	We agree the costs of the Age Pension and the superannuation tax concessions need to be looked at in combination. The cost of super tax concessions to Government is only part of our retirement savings story and should not be considered in isolation. Concentrating on this component only is a flawed approach to setting long-term policy that will adversely affect the development of a sound and sustainable retirement income system. For example, the potential revenue gain of removing super tax concessions is much lower than the often quoted value of the concessions. Firstly, it ignores future age pension costs which will inevitably increase if super benefits were reduced due to higher tax on contributions, earnings or benefits. Secondly, it ignores any redirection of contributions to other tax effective investments that would occur if the super rules became less favourable. Appropriate long term policy can only be determined taking into account the total cost of the retirement system.
Be simple and efficient, and provide safeguards	The system should achieve its objectives at the minimum cost to individuals and taxpayers. Complexity is less appropriate for a compulsory system, as it tends to add to costs and to favour sophisticated and well-informed investors. Given the compulsory nature of SG contributions, the system needs prudential oversight and should provide good outcomes in both the accumulation and retirement phases for disengaged fund members.	Simplicity and efficiency are important elements, but better outcomes for members should not be sacrificed for simplicity. For instance, we believe the most appropriate investment outcomes for disengaged members can be achieved through a lifecycle investment approach in which the asset mix changes dependent on the member's age. Whilst this adds some complexity, we consider the more appropriate investment outcomes outweigh the additional complexity. As noted earlier, there is much which could be simplified and made more effective in the superannuation system. This includes the current disclosure requirements and in particular the restrictions in relation to electronic disclosure.

We note a number of the proposed objectives will be difficult to measure. Nevertheless, if future Governments are required to justify future legislative changes against the enshrined objectives, this may reduce the chances of inappropriate legislative change occurring in future. Governments would need to justify why a particular change should be introduced if it did not support the objectives.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 2

Recommendation 10: Improving efficiency during accumulation

The FSI considers the superannuation system is inefficient. We agree the existing system is not as efficient as it should be and a review of the system is entirely appropriate. However a review by 2020 may be too early.

A more efficient and competitive retirement savings system will lead to better outcomes for Australians in retirement and ultimately lessened pressure on future tax payers to fund the cost trajectory of the Government age pension.

In reviewing the system it is important that comparisons with overseas superannuation fees take account of the differences between the Australian system and overseas systems, many of which have limited the ability of Australian funds to reduce fees including:

- An onerous regulatory regime
- Superannuation being taxed at various stages
- Australian funds providing death and disability insurance
- Many Australian funds having a sophisticated range of member services including financial advice and web-based calculators
- Most Australian funds having a relatively aggressive asset allocation
- Most Australian funds having an allocation to alternative assets
- Most Australian funds having a high degree of active management
- Australian funds being forced by legislation to mail paper documents to many members
- Many Australian funds incur significant marketing costs within the Choice environment
- Loss of large balances to the much less heavily regulated SMSF regime
- Many Australian funds are still having to receive contributions by cheque with manual data
- Many funds have had to effectively increase fees to meet new Operational Risk Financial Requirements

Some of the above points result in funds charging additional fees to members, which are designed to improve the retirement outcome for members. We think it is critical that any review focuses on member outcomes and not just fees.

However we believe much of the current inefficiency in the system is driven by inappropriate legislation. If the industry is to become more efficient, legislative change is needed to enable the industry to provide a more efficient and cost effective product before the time of any review. For example, our analysis shows that in a much more stable (and simpler) regime utilising electronic transactions and disclosure, administration fees could fall by 25%.

In addition the industry has had to cope with a constant stream of regulatory change over the years, culminating in the Stronger Super changes of recent years. Coping with this change absorbs significant resources and results in fund costs and hence fees being much higher than they would otherwise have been. The pace of change has significantly limited the opportunities to develop operational efficiencies and process improvements. A lengthy period of policy stability is desirable to allow funds and their service providers to focus on improving efficiencies rather than complying with changing legislation.

Efficiency gains

We believe the superannuation industry has gradually improved its efficiency. However any efficiency gains have generally been offset by the costs of implementation of legislative change. The major changes to the superannuation tax system in 2007 were followed shortly afterwards by the Stronger Super changes. These tax and other changes have involved a total revamping of how superannuation operates. In this environment it is no surprise fees have not fallen significantly.

Significant cost savings would arise from greater flexibility to provide disclosure material electronically to all fund members rather than only to those who have authorised electronic distribution (refer to Detailed Comments – Recommendation 39).

Competition

The other area where legislative change is necessary now is the superannuation provisions in the Fair Work Act which seriously restricts competition with most funds unable to properly compete for the default market. We provided considerable commentary on this issue in our submission to the FSI in August 2014 and our submission to the Treasury in February 2014 in relation to the Better Regulation and Governance, Enhanced Transparency and Improved Competition in Superannuation consultation.

In view of the importance of this issue, it is worth repeating some of the points made in our earlier submissions.

Currently funds not listed in a Modern Award are unable to compete for new default members. Similarly, employers currently using a default fund listed in an Award may be unable to move to a more competitive product because it is not listed in the relevant Award.

Changes to the Fair Work system, currently on hold because of the lack of a Fair Work Expert Panel, will see further adverse outcomes as many members of competitive and efficient funds currently allowed to be used under grandfathering provisions may need to be transferred to higher cost and less effective funds when the current grandfathering rules are abolished.

The current grandfathering arrangements have generally enabled large employers who are concerned about their employees to continue using funds which are more effective for employees than those listed in the relevant Modern Award. Such employers have generally gone through a tendering process to ensure employees receive the “best” deal.

The Fair Work system is also flawed as the removal of a fund from a list in a Modern Award will effectively result in the need to transfer some members of that fund to another fund. This is likely to have severe adverse outcomes for the fund as well as its other members. Such outcomes may limit the willingness to remove funds from the relevant lists. This too will create a barrier to ongoing competition.

Removing default fund requirements from Modern Awards will avoid a number of adverse outcomes which are likely to arise if the legislation is not amended. Research by Rafe Consulting (the Rafe Report[1]) for the Financial Services Council has estimated 1.25 million new accounts may need to be established because the current employer default fund is not listed in the relevant Modern Award resulting in:

[1] Impact Of Changes To The Fair Work Act On The Australian Superannuation Sector, Employers And Their Employees (16 June 2014)

Higher fees

In some cases, fees in the new default fund will be higher than those in the previous fund. (This could be particularly significant in relation to employees of a large employer which may have been able to negotiate significant "large employer" fee discounts in their existing fund, which, can be over 0.5% of account balances.)

Multiple fees

Unless an employee "chooses" their existing fund, future contributions will be paid to the new fund. Past contributions are unaffected and remain in the previous fund unless action is taken to merge the accounts. The employee will potentially become a member of two superannuation funds (the new default fund in respect of future contributions and the previous default fund in respect of past contributions) and incur two sets of administration fees (until the accounts are merged). As most employees are not engaged with their superannuation, we expect many will not make any decisions and by default, could end up in two funds paying double fees.

Merging the accounts will generally trigger the payment of a withdrawal or exit fee in the account being closed. Unless sufficient notice is provided, some contributions may be paid to the new default fund before the employee can advise they wish to choose their existing fund.

The Rafe Report estimates the total expected cost to maintain two accounts, exit fees and the additional insurance costs at $185 million for the 1.25 million members impacted.

Insurance

Insurance arrangements in the new default fund are likely to be different from the previous default fund. Premium levels and levels of cover may be higher or lower. Whether the new arrangements are more, or less, appropriate for an individual member will depend on the individual's particular circumstances. However, unless the employee's accounts are merged, there may be two sets of insurance premiums providing, in some cases, unnecessary insurance cover and a reduction in the amount of contributions financing the employee's retirement. Further, members may not be eligible for insurance in the new fund (for example if they were not at work on the day of joining) and may eventually lose their insurance cover in their existing fund if the account balance is no longer sufficient to pay premiums.

Other

If the accounts are not merged and one becomes inactive, after five years, such accounts (up to a threshold proposed to be $6,000) may be classified as an inactive account and transferred to the ATO (incurring a withdrawal fee). Following the transfer to the ATO, the account will only earn interest at the rate of CPI, potentially significantly lower than would have been earned if it had been retained in the superannuation fund. Once transferred to the ATO, members will also lose valuable death and disability insurance.

Impact on employers

Employers will be subject to additional costs and red tape in choosing a new default fund, advising employees and processing requests from employees who wish to retain their existing fund. The Rafe Report estimates 80% of 117,000 employers currently using Master Trusts will need to choose a default fund listed in a modern award which is not their existing fund.

Further costs and red tape will arise for employers who have employees covered by more than one Modern Award where it may be necessary to have different default funds for different groups of employees and potentially change an individual employee's default fund each time the employee changes roles and becomes subject to a different Modern Award. In such cases the adverse impacts on the employee will be repeated each time.

The Rafe Report estimates around 100,000 employers will be required to redirect superannuation contributions on behalf of some or all of their employees with a potential cost to impacted employers of $30 million.

Employers with employees covered by different Modern Awards may need more than one default fund to cover all of its employees adding further to costs and red tape.

Impact on superannuation funds

Significant costs will be incurred by superannuation funds in applying to the Fair Work Commission for listing under more than 100 Modern Awards.

We also expect many existing funds that do not obtain listing in a significant number of Modern Awards (and consequently see a major fall in their contribution income as well as losing assets to other funds) will not have sufficient scale. This may result in adverse outcomes for existing members of these funds.

The Fair Work provisions may also promote the survival of homogenous vanilla products and result in less competitive products with poorer long term outcomes for consumers.

The Rafe Report conservatively estimates the cost to consumers and employers at $400 million due to the duplication of fees, insurance premiums and employer search costs.

Mercer believes the superannuation default fund requirements in Modern Awards should be removed. This would free up competition. Legislation already mandates the use of a MySuper product for default members (at least in respect of contributions from 1 January 2014 with existing default balances to be transferred to a MySuper no later than 1 July 2017). Hence this ensures all default members will be in a fund which has satisfied APRA's filtering requirements.

Despite this, some people have raised concerns that the repeal of the Fair Work default fund provisions will enable employees to remain in an unattractive default fund even though it is a MySuper. This is unlikely to occur in relation to large employers who often have the resources to assess the best fund for their employees' welfare. However it is possible that this adverse outcome could occur in relation to some smaller employers who originally chose a default fund where the fees charged by the default fund's MySuper are too high. If such concerns are valid, a possible solution is to limit the grandfathering arrangements for employers with, say less than 100 employees, to cases where:

- The MySuper has achieved an "appropriate" or better rating from one of the superannuation ratings houses (This approach would enable a more holistic view of a fund including its total service offering as well as its likely investment outcomes.); or
- The employer has obtained professional advice in relation to the suitability of the fund for its employees within the previous 5 years.

We consider such an approach to be far superior to the Expert Panel approach in the Fair Work Act with fund assessments being made by those who are independent as well as being experts in the field. This approach would also avoid the arbitrary limitation of the number of funds which could be used by an employer which would apply under the Fair Work provisions as currently drafted.

Proposed solution from 2020

The FSI Report provided limited detail on its proposal for post 2020 new entrants to the workplace. Much more information would be necessary before the industry is able to properly consider the recommended approach.

Nevertheless we have some concerns over its application and more appropriate alternatives may be available if appropriate levels of efficiency have not been realised by 2020. In Section 4.2.1 of our submission to the FSI Mercer outlined a number of reasons why an approach along these lines is inappropriate for Australia. In any case, it is inappropriate to consider an alternative so far ahead of time. It would be preferable to consider various options much closer to the time when more information would be available on the major causes of inefficiency at the time.

Further, introducing a new system is unlikely to provide significant increased effectiveness unless the other aspects of the system (e.g. the changes outlined above) are also implemented.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 3

Recommendation 11: The retirement phase of superannuation

For too long there has been an undue emphasis on the accumulation phase as opposed to the retirement phase.

There needs to be greater scope for a much easier transfer of a member's accumulation benefits into an appropriate pension product at retirement.

For years, the superannuation industry has grappled with how to offer members simple, affordable and flexible longevity risk protection. However tax and other legislative barriers have made it difficult for new products to be introduced. The unwillingness of many members to tie up their retirement savings in annuity products has also restricted product development.

Mercer's LifetimePlus pension product is a recent innovation which will now enable funds to offer longevity risk protection at a much cheaper cost than annuity products.

Comprehensive Income Product for Retirement (CIPR)

The FSI has recommended trustees should pre-select a CIPR for retiring members.

The FSI has indicated a CIPR is one which has minimum features determined by Government. These would include:

1. A regular and stable income stream
2. Longevity risk protection
3. Flexibility
4. Low-cost
5. A cooling-off period.

At least in the current environment, we suggest many funds would find it difficult to offer a product which satisfies all of these criteria.

Account based pensions could satisfy features 3, 4 and 5. Longevity protection could be added by including Mercer's new LifetimePlus™ product. However, the first feature would not necessarily be satisfied. Stability could be enhanced by choosing an investment mix of low volatility. However this is likely to reduce long term investment returns and hence lower retirement outcomes. In any case, the large jumps in the minimum drawdown percentages which occur at specified ages make it difficult to maintain a stable income stream.

On the other hand, life time annuities could satisfy features 1, 2 and 5 but they generally lack flexibility and have a higher cost reflecting their guarantees.

Defined benefit pensions could tick all the boxes (except for flexibility) but many funds are effectively prohibited from offering these. If they can, overly specific legislative requirements make them impractical and few employers would be prepared to "guarantee" the ongoing financing.

Deferred annuities would also assist in longevity protection but are generally inflexible and currently tax inefficient.

The following table summarises the current position:

	Regular and stable income stream	Longevity risk protection	Flexibility	Low-cost	Cooling-off period
Account based pension	×[1, 2]	×[3, 4]	✓	✓	✓
Lifetime annuity	✓	✓	×	×[5]	✓
Deferred annuity	✓	✓	×	×[5, 6]	✓
Defined benefit pensions	✓	✓	×	×[7]	✓

[1] Investment options available to increase stability (but may give lower long term returns).
[2] Mandated steps in minimum draw down factors reduce stability
[3] Members can "self-protect" to some extent by only drawing down the minimum each year
[4] Mercer's LifetimePlus product can be added as an option to provide longevity protection
[5] Reserving costs can be significant
[6] No tax relief during deferral
[7] Few employers are prepared to "guarantee" the costs of such pensions making this an unrealistic option for most Australians

If this recommendation is to be adopted, we consider significant legislative change will be necessary to enable a wider range of products to be made available. We understand the Government is currently considering some of these issues.

Nevertheless, it may be unrealistic to expect a single product could offer all of the features referred to above.

It may therefore be necessary to allow such comprehensive products to provide most but not necessarily all of the required features.

We also believe there are be other features which the trustee should specifically consider. In particular, investment strategy and investment risk. These features would need to be considered in conjunction with any consideration of the regular and stable income stream and longevity protection features. However we believe they should also be considered as key features themselves. For example, as indicated above, a very conservative investment strategy may result in a more stable income stream but may produce less than appropriate returns.

Cost

A consequence of this recommendation is cost. For some funds, incurring the high cost of developing and providing a comprehensive pension product may not be in the best interest of members. Perhaps this problem could be overcome by entering into an arrangement with another provider who does provide a suitable pension product.

Opt-in or opt-out

Although adoption of the FSI recommendation will focus the attention of trustees on their pension products, it may not necessarily result in a greater take-up of income streams in retirement as it is still based on the member opting-in to the pension.

In many funds, this will result in little change from the current arrangements where super funds already provide an income stream facility which is not utilised by all retirees.

We believe an opt-out approach where members would automatically commence receiving a pension would more be more successful in achieving greater take up of income streams.

We accept the introduction of an opt-out approach would not be straightforward. The issues to be considered include:

- How to determine when the income stream should commence – the super fund would not necessarily be aware when the member retires (although the member's age could be a suitable trigger in cases where contributions have ceased)
- How to obtain the member's bank account details (for efficiency purposes, direct credit of pension payments to a bank account is far preferable than payment of pensions by cheque). One potential method of obtaining bank account details would be to obtain them from employers who will generally have those details for salary payment purposes. Alternatively it may be possible for the details to be provided by the ATO. Privacy concerns would need to be taken into account but should not be of prime concern.
- Any default opt-out pension would need to have the facility enabling the member to opt-out of the income stream within a period of up to 6 or 12 months from the commencement of the pension. This opt-out facility could replace the current requirement for application forms.
- Legislative changes to enable the transfer of a MySuper account to a default pension would be necessary

Although the adoption of an "opt-out" approach is likely to result in greater pensioner volumes, we accept neither the industry nor the public may be ready for such an approach in the near future.

Implementation

We consider the most appropriate way to implement the CIPR proposal (irrespective of it being on an opt-in or opt-out basis) would be through a principles based APRA Superannuation Prudential Standard with only very high level requirements set out in legislation. Such an approach:

- would provide greater flexibility
- could be modified more easily and promptly to reflect emerging concerns (compared to specifying requirements in legislation or regulation)
- is more amenable to enabling trustees to make decisions which are best suited to the members of a particular fund

We suggest the approach taken could be similar to that adopted in SPS 250 relating to insurance in superannuation.

Each trustee would be required:

- to have a "pension framework"
- to consider each of the specified criteria in establishing a CIPR
- to ensure that the appropriateness, effectiveness and adequacy of its pension product and framework are subject to a review at least every three years.

Note that it would not be essential for the resulting pension product to provide all of the above features. For example, if the fund's members are generally retiring with low superannuation balances, the trustee might consider the need for longevity protection may be minimal. Members will have the protection of the Age Pension which will represent the majority of their income in retirement.

Any APRA Standard should be sufficiently flexible to allow:

- A trustee to develop more than one such pension product. For example it may be appropriate to have a different CIPR depending on the member's account balance; and
- A trustee to decide a CIPR is not necessary or appropriate in the circumstances. This could include cases such as a very small fund, a fund which is likely to wind-up or a fund in which retiring members are highly likely to obtain financial advice in relation to their pension option through the fund's advice arrangements.

Having established a CIPR (or multiple CIPRs), the following would occur:

- The details of the CIPR would be included in the fund's PDS together with details of what will happen at "retirement". (It would be preferable to increase the maximum number of pages which can be included in a PDS rather than including the details in a document incorporated by reference).
- Under the opt-in approach, the member would be approached at "retirement" to gain confirmation the CIPR should commence. An application form would not be necessary although the trustee might need additional information (such as banking details, details of spouse if it is a reversionary pension, nominated beneficiary details etc.).
- Under the opt-out approach the member would be approached at "retirement" and advised their CIPR would commence in say, 1 month unless the member opts-out. A cooling off provision would provide a further period in which the member could opt-out, even after the CIPR has commenced. Again, an application form would not be required.
- Under either approach, the member could elect to commence their CIPR before Age Pension Age. An application form should not be required unless an alternative pension is chosen.

Removal of impediments

Currently the requirements relating to pensions are extremely complex and/or overly prescriptive. Greater flexibility needs to be introduced to enable better and simpler products which cover more of the features referred to above to be developed. Changes which should be considered include:

- Amending taxation legislation to provide for a similar tax treatment for deferred income stream products (both annuities and pensions) as applies to current income streams.
- Allowing pensions to be increased by rolling over additional amounts to an existing pension.
- Tweaking the minimum draw down rules for account based pensions to reduce the significant jumps in draw down that are required after achieving certain ages.
- Freeing up the overly prescriptive rules relating to defined benefit pensions.

It would also be necessary to ensure the costs of developing a pension product can be met by all members of a fund rather than just those who take out the pension product. If not, then any pension product is likely to be so expensive it will be unattractive for pensioners. In particular it must be possible for such costs to be recovered from those in the growth phase (including MySuper members) who will eventually become eligible for a pension.

Intra-fund advice

Another aspect which should not be overlooked when considering the take-up of income streams is intra-fund advice. This can provide a cheap and effective mechanism for transferring members from accumulation to draw-down stage. We comment further on the importance of intra-fund advice in APPENDIX 11 – Recommendation 40.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 4

Recommendation 13: Governance of superannuation funds
Mandating of independent directors

We consider the mandating of independent directors is inevitable since many superannuation funds are now very significant financial businesses. It is hard to argue that superannuation funds should be held to a lesser standard of governance than the standards applicable to Australian listed companies, banks, life insurers and general insurers.[2]

However, we believe that the industry should remain focused on achieving the right composition of skills and experience, since in our view the collective skill set, objective judgment and dynamics of a trustee board are just as important to effective decision-making as structural independence. That said, in our experience with funds that do have independent directors, we find that independent directors can be invaluable in supplementing the skills and experience on the trustee board and in bringing a diverse range of views to the debate. The appointment of independent directors is therefore an opportunity for funds to consider the optimal skills and attributes they wish to have on their trustee boards.

In implementing such a requirement, we suggest that the government should take account of the following considerations:

- The definition of "independent" will need to be crafted in order to enhance objectivity and minimise the possibility of conflicting interests and duties.
- A significant number of independent directors will need to be found and there may be a limited number of suitable persons with appropriate skills available to fill these roles – this suggests the need for a reasonable transition period to apply.
- In some cases, high quality directors may need to be replaced by less qualified independent directors. It may therefore be worthwhile providing some exceptions, where a director currently provides essential skills and knowledge to the trustee board that is not readily replaceable.
- Concerns regarding personal liability may further restrict the pool of potential candidates (refer to our comments below on aligning the director penalty regime with managed investment schemes).
- Consideration will need to be given to whether a person could be an independent director of more than one superannuation fund trustee company, particularly if the funds are in competition with one another.

Align the director penalty regime with managed investment schemes

We do not agree with the FSI recommendation that the SIS director penalty regime should be aligned with managed investment schemes. To do so would make superannuation trustee directors exposed to more personal liability than any other directors in Australia. This is because the director covenants would carry both direct liability to individual members for loss arising from a breach of the covenant **plus** liability for civil penalties. To impose such an onerous exposure on superannuation trustees may well detract from the feasibility of the FSI recommendation for a majority of independent directors on public offer superannuation fund boards. It is difficult to see why highly skilled professional directors would be willing to assume such levels of exposure.

[2] Subject to some exceptions

Detailed comparison

The penalty regime for managed investment schemes is constructed differently from SIS. Under Chapter 5C of the Corporations Act, a breach of a director's statutory duties is a civil penalty provision.[3] In addition, an intentional or reckless breach of a director's statutory duties is an offence carrying 2000 penalty units, 5 years' imprisonment or both.

However, under the managed investment scheme regime, directors of a responsible entity (RE) have no direct liability to individual scheme members for a breach of their statutory duties.

Rather, once the court makes a declaration that a civil penalty provision is breached, ASIC can seek both a pecuniary penalty (up to $200,000 payable to ASIC) if the breach is serious and materially prejudices the interests of the scheme or its members. In addition, the court may order compensation to be paid to the scheme on application by the responsible entity.[4]

As such, there is no direct civil liability to members of the scheme. Instead, if a court finds that an RE director has breached his or her statutory duties, the court may award compensation to the scheme (but not to individual scheme members).

By way of comparison, under SIS there is civil liability for loss (owed directly to members) for breach of a director covenant.[5] This means that a superannuation director could be sued by an individual member or by a class of members who allege that they have suffered loss as a result of a breach of covenant.[6] This threat of class actions is already a deterrent and, anecdotally, we understand that many professional directors are seeking extensive indemnities from the trustee company itself before they are prepared to assume office.

Currently breach of a SIS director covenant is not itself a civil penalty provision and therefore a pecuniary penalty cannot be sought by APRA for breach. Superannuation trustee directors can be deemed to have breached a civil penalty provision if they are involved in a contravention of a civil penalty provision by the trustee itself. Hence superannuation trustee directors do have exposure to civil penalties, but not for a breach of their personal director covenants. If the FSI recommendations are adopted in relation to the SIS director covenants, superannuation trustee directors will have direct civil liability to members for loss (and exposure to class actions as at present) but will also face the prospect of pecuniary penalties payable to the regulator and criminal sanctions for intentional or reckless breach of the covenants.

As a compromise position, if the Government does want to impose pecuniary penalties for breach of the SIS director covenants, then we believe that it should align **all** aspects of the SIS liability regime with the managed investment scheme regime by, at the same time, removing the direct liability to members that superannuation directors currently have. In other words, fund members would no longer be able to sue a director personally for a breach of covenant, but rather any compensation would be awarded by the court on application by the trustee and such compensation would be payable to the fund, not to individual members.

[3] These duties also apply to other 'officers' of the RE.
[4] As with SIS, there are powers for the court to give judicial relief to persons who have acted honestly and ought fairly to be excused having regard to all the circumstances.
[5] SIS Act, s.55(3)
[6] Subject to leave of the court: see SIS Act, ss 55(4A) – (4D)

Strengthening the conflict of interest requirements

The FSI has recommended strengthening conflict of interest requirements by specifying that each board member must acknowledge when a director adds an interest to the register. The FSI believed this would focus the attention of the board on director interests and ensure a rigorous oversight process.

In our experience, this would be good practice and many boards already comply (through reviewing and approving the conflicts registers required under APRA Prudential Standard SPS 521).

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 5

Recommendation 23: Facilitate innovative disclosure

The industry is being left behind

Restrictive legislation has resulted in the superannuation industry being left behind in the technological era. Legislative change is needed quickly to give superannuation providers more flexibility to harness technology to better engage and inform customers.

We support the work being done by ASIC in areas such as Consultation Paper 224 – Facilitating Electronic Financial Services Disclosures and the ASIC Pilot. However, before settling on the legislative change needed, it is important for the Government to consult more widely in the Financial Services Industry to:

- understand the views of organisations that are not part of the ASIC pilot; and
- consider the benefits of other technologies and innovations relating to disclosure that do not currently form part of that pilot.

Evolving technology will generate ongoing innovation of effective and engaging customer disclosures. To ensure the benefits of future innovation are realised, the Government should ensure that legislative changes to remove impediments to innovative customer disclosure and communication are technology neutral and are principles based.

However, opportunities for innovative customer disclosure that informs and engages the customer will extend beyond that work or the current ASIC pilot. We therefore request a broader engagement with the Financial Services Industry on the legislative changes required to harness the potential for innovative disclosures to better inform and engage customers.

Fees and charges

The FSI has recommended that industry should develop standards for disclosing risk and fees, and, if significant progress is not made within a short time frame, the Government should consider a regulatory approach.

We support greater clarity for customers of risk and more uniformity in the disclosure of fees (such as the fee information of underlying investment entities). We also support the proposal that the industry develop standards for that disclosure rather than more regulation.

We note the disclosure of fees and charges is already strictly regulated in the superannuation industry. Hence there is little opportunity, without the involvement of ASIC, to improve disclosure of fees and charges.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 6

Recommendation 25: Raise the Competency of Advisers

Raising of standards

For the advice industry, the spotlight is now firmly on education and professional standards. Mercer supports the view that the entry requirements for providers of financial advice are too low across the industry. The recent Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry has supported the view to increase the professional, ethical and education standards.

Higher education and professional standards are integral to gain the trust of consumers and increase the usage of quality advice.

We note the training obligations of RG146 are focused on financial products, rather than competencies on providing advice that acts in the clients best interests.

The PJC enquiry has recommended a minimum degree qualification for all new financial advisers; an independent body to be controlled and funded by the professional bodies to set the education standards, a professional year and minimum requirements for ongoing CPD points.

Given the recommendations above provide a holistic education and professional framework to lift advice standards we do not support the PJC's proposed examination for all advisers. For instance, advisers who hold the CFP designation or have studied at a Masters level and have committed to ongoing professional development should not have to sit an annual exam. It is unlikely to add any value to the consumer and increases the compliance costs and regulatory burden leading to an increase in the cost of advice. This is in conflict with the overall aim to make advice more affordable. We note the FSI did not recommend an annual exam at this stage.

Mercer Financial Advice has already implemented a minimum degree qualification for all new and existing advisers. We require our strategic advisers (new and existing) to have a CFP designation or Masters or be working towards these designations. We have a minimum of 40 hours ongoing CPD. Our standards are much higher than those proposed by the PJC.

Register of financial advisers

As this register is launching on 31 March 2015, we have not commented on this point.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 7

Recommendation 31: Compliance costs and policy processes

Our comments below relate to superannuation. We expect other parts of the financial services sector would encounter similar difficulties although the pace of change in superannuation law seems to be significantly greater than in other sectors.

Any new legislation results in implementation costs for the superannuation industry. In many cases these costs have been significantly higher than they should have been due to:

- Too short a period to implement the system and process changes required. This has often led to
  - the need for costly short term manual processing until a permanent solution can be implemented,
  - the need for last minute relief provided by the regulator when it becomes apparent the industry is not coping, and sometimes the relief itself requires manual workarounds because it comes too late for systems to be developed

- Insufficient time for consultation and insufficient notice taken of industry concerns. Due to the pace of change, there are often multiple consultations relating to different aspects of super at the same time, particularly when Treasury as well as APRA, ASIC and the ATO may instigate consultation processes.

  - Multiple consultations at the same time and short consultation periods restrict the industry's ability to properly engage in the various consultation processes
  - In many cases we understand Treasury and/or the relevant regulator are also under pressure from Government to move quickly. This often results in serious issues raised in the consultation process being either ignored or their importance underestimated by Treasury/the regulator or alternatively an inadequate fix being applied

- Unclear, inconsistent and inappropriate legislation. We expect most of the problems could have been solved pre-implementation, if greater notice had been taken of concerns raised during the consultation process, and/or more time had been available to implement appropriate fixes. Some examples include:

  - The application of Division 293 tax to defined benefit arrangements in which there are significant flaws in the legislation. We incurred significant external legal costs as well as extensive internal costs trying to understand how the new law should be applied. Subsequently, the ATO released its view on some, but not all, of the contentious issues. (Although we consider the ATO tried to take a practical approach, their advice conflicts with the legal advice we received in some aspects.) The costs to funds and eventually members continue to grow as these issues remain unresolved.
  - The application of excess contributions to defined benefit members. Although the relevant legislation and regulations were in put in place in 2007, a number of serious issues remain unclear. The industry has been trying unsuccessfully to seek appropriate legislative fixes for nearly 8 years however a solution of these problems appears to have low priority in Canberra. In the meantime we expect different funds will be adopting different interpretations of some aspects of the legislation.

- o The introduction of legislation enabling cross-Tasman transfers of superannuation. Initially, in order to initiate a transfer of an Australian benefit to a KiwiSaver fund in New Zealand, it was necessary for the member, after having left Australia, to sign an Australian statutory declaration creating much inconvenience for members due to the difficulty of obtaining an authorised witness in New Zealand. Further, very few Australian funds have been prepared to spend the very high costs which would need to be incurred to accept transfers from KiwiSaver (due to the onerous regulatory requirements).

Similar comments apply to new requirements issued by the regulator. For example, APRA, in its “Update on regulatory cost savings” issued in February 2015 claims to have saved the superannuation industry over $4 million dollars as follows:

- Extension of due dates for quarterly super collections from 28 to 35 days – cost savings for relevant entities achieved through giving the industry additional time to adapt, RSEs time to deal with transitional issues related to implementation. Estimated cost saving $460,000.
  This highlights the importance of implementation time frames where significant savings can be achieved with only a small extension to the implementation time frame. It would have been preferable for a more realistic implementation period to have been allowed in the first place

- Superannuation Reporting FAQs – the 123 FAQs addressing common issues during implementation of the reporting requirement has provided additional guidance during the transition. Estimated cost saving $300,000.
  Whilst the release of the FAQs were clearly beneficial, we note that if the original instructions had been clear, the industry would have saved far more than $300,000 because it would not have struggled with interpreting the requirements over the months before the FAQs were released.

- Deferral and re-consultation on select investment option reporting - revised reporting requirements were released in January 2015. These requirements have a significant reduction in the coverage and scale of reporting requirements for select investment options, and will provide material cost savings for the industry. Estimated cost saving $3.5m.
  This highlights the importance of a continuing consultation process.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 8
Recommendation 32: Impact Investment

Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.

We believe it is important to facilitate the development of the impact investment market and encourage innovation, including social service and environmental solution delivery. The first step must be to define and reach a consensus on what the term "impact investment" actually means to key stakeholders who participate in markets and communities. This is a critical step given that, as one commentator has observed, "the impact investment scene in Australia is nascent"[7] and therefore open to a wide variety of interpretations.

Secondly, we believe it is important to identify key stakeholders and create an Impact Investment 'Platform' or centralized 'hub', under the auspices of an industry leadership body[8], that includes community sector representation. This body should represent stakeholders such as:

- **Communities** where impact investment is required to deploy services that deliver "intentional …positive social or environmental impact as well as a financial return."[9]
- **Charitable Trusts,** including Private Ancillary Funds (PAFs), which have, or wish to make allocations to impact investments. These could include corporate foundations, public foundations, foundations attached to institutions (e.g. universities, hospitals), community foundations as well as private charitable trusts including private ancillary funds.
- **'Not-for-Profit' (NFP) Capital:** While many NFPs initiate impact projects, a significant number also invest their own funds, either alone or with other investors. The projects may be located within the NFP organisation or established as an independent organisation.
- **Individual investors and their advisers:** Private wealth advisers helping clients make impact investment allocations – e.g. Ethinvest, Ethical Investment Services, Ethical Adviser Co-op, JBWere etc. Retail individuals investing in SEDIF funds, impact investment allocations from single-family offices, multi-family offices or directly from family wealth.
- **Fund managers and super funds with stated social and environmental goals:** Specialist impact or social enterprise fund managers – e.g. IIG, SEFA, SVA, Foresters, Unitus. These funds are both investors and invested in.
- **Mainstream fund managers:** Super funds and managed funds, especially those with mission alignment – whether that be faith-based or because of the industry that the fund represents such as education or health.
- **Asset Consultants:** Asset consultants that develop and implement the investment strategy of aforementioned NFP corpuses, philanthropic capital and super funds.
- **Financial Institutions:** Retail banks, community banks, credit unions, investment banks, insurers[10].

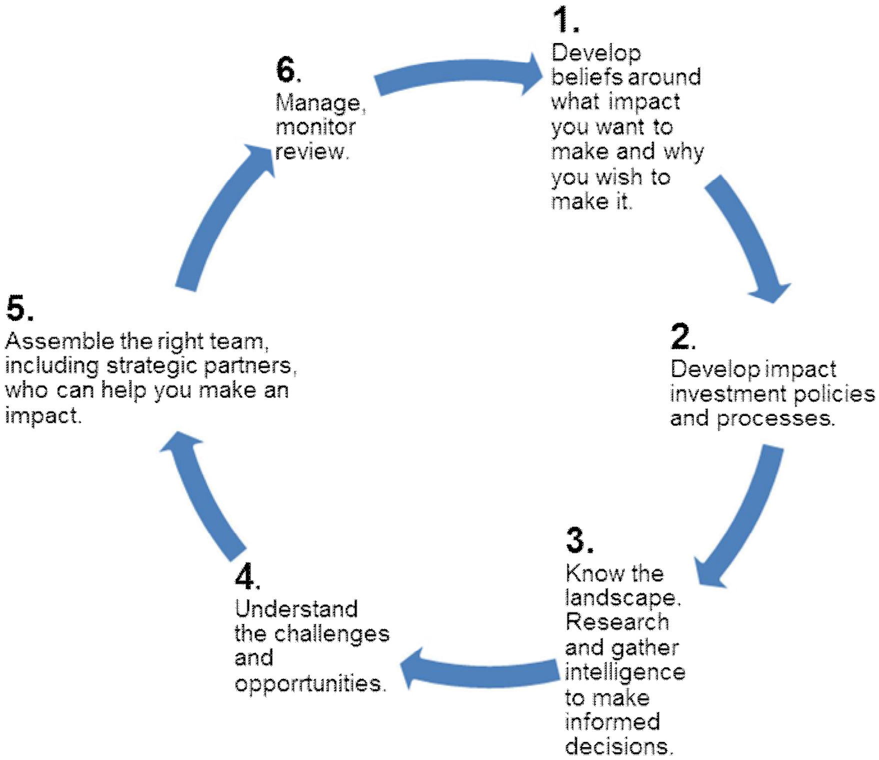
Finally, the development of impact investment should be supported via data collection, establishment of data registries and case studies showcasing good practice both locally and globally. This could be supported by leveraging the data/studies of local organisations (e.g. SEDIF funds' annual reporting structure

[7] Eyers, J. 'Private capital 'impact investment' a meaningful social solution: Murray report', *AFR*, 22/7/2014
[8] See Impact Investing Australia http://impactinvestingaustralia.com/
[9] http://impactinvestingaustralia.com/ accessed 27/2/2015
[10] Acknowledgement: Louise O Halloran and notes from Working Groups of Impact Investing Australia accessed 27/2/2015

for government acquittal process; RIAA – total assets from community finance providers; and JP Morgan Australia's global survey).[11]

Provide guidance to superannuation trustees on the appropriateness of impact investment.

Impact investment should be an integral aspect of a super fund's Environmental, Social and Governance (ESG) policy. As such, trustees should be guided by their ESG framework. At Mercer, we believe the ideal framework involves the following six steps:



Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.

Mercer supports law reform, but information on how best to achieve it is currently insufficient.

[11] See: "Spotlight on the Market: Impact Investor Survey" JP Morgan/GIIN, "The Good Analyst, "GIIRS Ratings", B-Analytics, "Benchmark Report" RIAA.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 9

Recommendation 37: Projecting retirement incomes

As indicated in our submission to the FSI in August 2014, we believe there are valuable benefits to be gained from projecting retirement incomes on superannuation statements. These include:

- Improved member engagement with their superannuation fund
- The means to represent retirement savings as an income to which members can relate
- The ability to use a standard comparator (eg. ASFA standard, replacement rate) to assist with understanding adequacy
- The leveraging of a fund's investment in retirement tools and advice services
- Driving positive action on retirement savings

A more educated and engaged superannuation membership will be more likely to take steps to meet their own retirement needs, by evaluating contribution levels, consolidating accounts, reviewing their investment strategy, assessing the value for money offered by their fund and seeking financial advice.

We believe the best way to promote these outcomes is to implement regular projections with the following features:

- An illustration of retirement income in today's dollars should be mandatory on accumulation-phase periodic statements (DB members optional). Members should be able to translate a super balance into a retirement lifestyle that keeps pace with inflation. (If not mandatory, we expect many funds will not provide such a projection.)
- This might be as simple as a ready reckoner to show the level of income that $100K, $200K etc might generate in retirement, or as complex as a personalised projection showing the impact of retiring two years later, contributing an extra $500 per month etc. An age pension estimate should be included based on prescribed assumptions. Subject to minimum principles based on content and disclosure guidelines, the format of the illustration should be at the discretion of the trustee.
- Projections of superannuation benefits and income streams should comply with the principles of Actuarial Practice Guideline 499.02 prepared by the Actuaries Institute (or equivalent), and be signed off by an appropriately qualified professional. Illustrations that comply with the Practice Guideline should not be deemed personal financial advice. We note the requirements of ASIC Class Order 14/870 can lead to misleading/inappropriate results in some circumstances (for example a requirement to base the projection on contributions and fees in the previous year). Greater flexibility is required to modify the projection where the previous year's details are inappropriate.
- Assumptions about fees, investment returns etc. should be consistent with the provider fund's PDS.
- The illustration should provide a link to an online calculator where the same result can be generated (within a reasonable timeframe after issuing the statement), so that members can model the impact of different inputs (such as contribution levels, retirement age) from a known starting point.
- Funds should be permitted to offer retirement income illustrations outside the periodic statement cycle, provided they comply with the guidance.
- Funds should have at least two years' lead time to prepare systems for including the retirement income illustration.

As indicated above, greater flexibility to adopt more reasonable assumptions than those mandated by ASIC CO 14/870 is required.

Whilst we support the idea of gaining access to consolidated data via the ATO, some obstacles exist with privacy, consent, scope of data, assumptions for other accounts, contemporaneity of records. It should initially proceed on a non-mandatory basis.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 10

Recommendation 39: Technology neutrality

We strongly support Recommendation 39 in the FSI Report. Allowing electronic service delivery to be the default means of providing disclosure to customers would result in significant savings for superannuation providers and better outcomes for customers.

The cost efficiencies just from electronic delivery are significant. For example, on average, each regulated document costs more than $2 to produce and post to a customer. However the same document costs less than 5 cents if given electronically to the same customer. For a large superannuation fund, this results in a potential saving to members of millions of dollars each year.

Key points relating to this issue are:

- Customers who receive information and transact electronically should receive the benefits of doing so and not subsidise the cost of those customers that choose paper. Therefore, product providers should be able to charge a reasonable fee to reflect the additional cost of paper based interactions. This is already operating in the banking sector.
- To maximize efficiencies and minimise cost, a provider of a choice product should be able to nominate that choice product as “electronic only”.
- For MySuper products, appropriate opt-out arrangements may be necessary to ensure those customers (such as senior Australians) who may not have the internet can access the relevant material (subject to the reasonable fee referred to above).

We consider that regulatory requirements relating to disclosure and transactions are among the regulations that should be prioritised for amendments to provide technology neutrality. Our submission to the FSI in August 2014 provides more detail.

Broadly, the disclosure regulation should be amended to:

- remove any paper bias;
- remove need for customer consent;
- ensure all regulated communications can be given by any electronic means; and
- ensure consistency across each type of regulated communications.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 11

Recommendation 40: Provision of financial advice

Renaming general advice

We support the proposal to replace the term general advice with product sales information as it more closely aligns with the nature of information being given and removes ambiguity. The use of the word "advice" in general conversations can be misleading to consumers who don't differentiate between general and personal advice.

We would prefer the term "financial advice" to be enshrined in law, much like other professional titles and clearly linked to the provision of personal advice. In order to use the term, a person should meet minimum competency and education standards and be a member of a professional body.

Disclosing ownership structures

Requiring advisers to disclose ownership structures is also likely to lead to greater transparency.

Intrafund advice

At Mercer, we believe it is critical that superannuation members continue to access intrafund advice so that the availability of financial advice doesn't reduce to a situation where it is only available to the wealthy or those who wanted complex and comprehensive financial advice.

Thousands of Australians currently access simple superannuation advice through their superannuation fund, which is called 'intrafund' advice. We've been providing the equivalent of intrafund advice through our Financial Advice Helpline Service since 2003.

Our research indicates members who access simple super advice (or intrafund advice) are more inclined to change their investment options appropriately, improve their insurance arrangements, seek further information through the website, ensure their nominated beneficiary details are correct, and take action to maximize the benefits offered by their super fund.

Intrafund advice is facilitated by the ability to collect the costs to cover this advice from the superannuation management fee, as long as the advice is confined to the member's superannuation account only. Under the proposed changes to the Future of Financial Advice (FOFA) legislation, the definition of intrafund advice is protected and will become a note in the Corporations Act to mirror the definition in the Superannuation Industry Supervision (SIS) Act.

The intrafund fee is bundled into the superannuation fee and paid by the member, or the trustee, and not by the product provider (administrator, insurer or investment manager). It is not a commission, or a trail commission, designed to sell the superannuation fund. The member is already in the superannuation fund. If they wish to rollover their benefit or consolidate their superannuation funds then intrafund advice cannot be provided. Consolidation and switching are specifically excluded.

If the superannuation administrator were to specify each service with its respective fee, the cost of doing so would far outweigh any benefit.

Members contact superfunds for help, very rarely advice. The fact that they end up being provided advice is because they inevitably ask “tell me what should I do?” and this takes the adviser into personal circumstances and recommendation territory.

Intrafund advice can be provided very efficiently and very quickly. Members benefit from having a personal recommendation supported by the Statement of Advice, which they can review and then act as appropriate. General advice falls far short of the type of service members ask for in relation to their super account.

The objectives of FOFA have always been and will continue to be to improve the trust and confidence of Australian investors in the financial advice industry. Easy access to affordable advice in super was at the heart of the Stronger Super reforms because superannuation has become such a critical asset for most Australians. Combining the two reform packages to deliver low cost advice to superannuation members has been a major breakthrough in sound public policy. Success has been proven with the hundreds of thousands of members that receive intrafund advice and have taken action to improve their superannuation benefits and hence, their retirement outcomes.

MERCER'S RESPONSE TO THE FSI FINAL REPORT - APPENDIX 12

Recommendation 41: Unclaimed monies

The FSI has raised its concerns about unclaimed monies in the banking and life insurance industries. We have similar concerns in relation to superannuation.

In recent years:

- The inactivity period for unidentifiable members reduced from 5 years to 12 months
- The account balance threshold for treating inactive accounts and uncontactable members as unclaimed increased from $200 to $2,000.
- Government policy includes a further increase in the account balance threshold to $4,000 from 31 December 2015 and to $6,000 from 31 December 2016.

In particular the increase in the account balance threshold will result in the closure of more accounts which will result in members losing valuable insurance cover and potentially significantly higher investment returns than the CPI rate credited by the ATO. These higher returns would in most cases outweigh the fees payable by the members.

We recommend the Government abandon its proposed increase in the thresholds and consider reverting to a 5 year period for unidentifiable members.