QSuper submission to Treasury consultation – Financial System Inquiry

Introduction

QSuper is Queensland's largest superannuation fund and, with around $90 billion in accounts, including more than $58 billion in direct funds under management, is one of the largest funds in Australia. QSuper is the default fund for Queensland's public sector employees and has around 540,000 members made up of current and former public servants and their spouses.

QSuper is an APRA regulated non-public offer fund and is authorised to offer a MySuper lifecycle investment option to its members. In addition to its Federal regulatory obligations, being an unfunded public sector superannuation scheme, QSuper is also governed by Queensland legislation.

QSuper has provided retirement benefits to Queensland's public sector employees for over 100 years. Its rich history includes many industry innovations, including its offer of financial planning services to members in 1994, which continues today. More recently, QSuper's MySuper lifecycle investment option is the first of its kind in Australia using multiple member characteristics to provide a tailored investment objective for its default members.

QSuper has a 'member for life' philosophy and is committed to continually improving its products and services for members, from their commencement in the Fund through to retirement. This philosophy has seen the Fund extend its investment options and services to members who leave the public service to work in the private sector, and to their spouses.

QSuper welcomes the opportunity to comment on the Financial System Inquiry (FSI) recommendations. The Fund has been active in providing input for the AFSA submission and generally supports that submission. Comment in this submission is confined to recommendations 9, 10, and 11 where QSuper wanted to make specific comment. For convenience and to aid understanding, comments are provided using the relevant recommendation headings provided in the report.

Recommendation 9 - Objectives for 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."

This measure is proposed to provide a framework for evaluating efficiency of the superannuation system in meeting the public policy objectives and to help provide stability as policy proposals would be assessed against meeting the proposed objectives. For these reasons QSuper strongly supports the recommendation and seeks a focus on both Government and member outcomes. Any proposal that leads to an increase in the clarity of public and parliamentary debate and as a consequence, improved public policy making is welcomed especially given the time horizons of superannuation.

The FSI report also considered and rejected the idea of the creation of a new independent publicly funded body to assess the superannuation system's performance and report on superannuation policy changes. This pathway was rejected largely due to costs for Government. Instead, a stand-alone Government report on whether the system was meeting its objectives or reporting as part of the Intergenerational Report was preferred.

It is QSuper's submission that both establishing policy objectives and mandating a specific organisation or advisory Board to report on the superannuation system's performance against objectives has merit.

This position is driven by a view that even when measured globally, superannuation in Australia has become an enormous social policy issue, as well as an enormous economic policy issue and as such, deserves regular attention as to its success.

There is a multitude of government and regulatory agencies covering the superannuation industry, all of which have interests in its performance. These include APRA, ASIC, Commonwealth Treasury, the ATO, AUSTRAC, and more indirectly, Departments of Human Services, Social Services and Health as well as the ACCC and the RBA.

Hence, QSuper believes there should be a body which can consider the inter-relationships between the social and economic policy agendas and provide adequate advice to Government.

It is acknowledged that the Government does not wish to introduce a burdensome or costly new entity and therefore we flag two options for efficient execution:

1. One could be the creation of a Board under a model similar to that of the Board of Taxation. This respected Board is tasked with advising the Government on improving the general integrity and functioning of the taxation system. The Board is supported by a Treasury secretariat and is comprised of both Government officials and experts from the non-government sector. As the Board of Taxation does, a new Superannuation Advisory Board could report to the Treasurer on an annual basis and consider more broadly the objectives for the superannuation industry and whether or not the industry and regulators were meeting them against agreed holistic measures; or

2. The Australian Institute of Superannuation Trustees (AIST) has perhaps provided another pathway on this issue suggesting that the role of the Council of Financial Regulators (CFR) be expanded to, inter alia, oversee "*the development of a nationally-accepted benchmark of what is an 'adequate' retirement (an adequacy benchmark), a sustainability benchmark and a longevity index.*" AIST, *Initial submission to the Financial System Inquiry*, 31 March 2014, p 5. The CFR is an existing body which operates as a forum for cooperation and collaboration amongst finance sector regulators.

It is acknowledged that the FSI report rejected the creation of a new body but the concerns appeared to be centered on the accountability and costs of operation. Using either the Board of Taxation model or CFR option would alleviate these concerns and it is QSuper's submission that such an approach is necessary to focus regulators and the industry on meeting and measuring the very long term objectives of superannuation. QSuper would prefer the first option as it would cover social policy issues as well as the financial regulatory issues. Costs to Government would be minimal.

In relation to the objectives of superannuation, QSuper looks forward to participating in any consultative process to establish measureable objectives for the superannuation industry but submits that as a minimum starting point, legislative objectives should be directed to:

- Adequacy - ensuring that policy and legislative settings are designed to achieve an adequate retirement outcome for system participants;
- Sustainability – Policy settings should be set so that over time, retirement savings wholly or partially replace government aged pension payments together with better targeting of aged pension eligibility;
- Simplicity – in a compulsory system simplicity of solutions, together with a practical, pragmatic regulatory framework, will act to drive costs lower for providers and users; and
- Measurability – providing a consumer focus including comparability as discussed later in this submission.

Tax in superannuation is also a matter to be considered from a global sustainability perspective with respect to the provision of retirement incomes. QSuper will leave further submissions on this issue for the foreshadowed Government White Paper on taxation consultation process.

If the Government accepts the FSI recommendation it is expected that an extensive consultation process would be established to ensure an outcome that is shared, owned and supported by industry stakeholders including law makers and regulators.

Recommendation 10 - Improving efficiency during accumulation – MySuper

"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."

The FSI interim report commented favourably on a competitive tendering process for default contributions in Chile. The commentary was provided in the context of an FSI view that fees are high in the Australian superannuation industry. The interim report also offered the view that it was too early to determine whether the introduction of MySuper defaults and other Stronger Super measures would have the effect of lowering fees over time. It appears that the final recommendation is framed on this premise; to allow the industry to fully implement the Stronger Super reforms and consider the cost outcomes for members by 2020.

In any process to be developed to monitor fee levels in the superannuation sector, it should be acknowledged that superannuation funds have been required to address a myriad of legislative issues that have increased the cost to serve members. Recent reforms have led to superannuation funds investing significant amounts in order to fully address new legislative reporting and compliance arrangements.

In addition, as the superannuation sector has grown, funds have increasingly been investing in member engagement, education and advice initiatives as it has become increasingly apparent that members require support and knowledge to make sound, large financial decisions. Therefore, the cost of implementing the outcomes of legislative change and improving the service to members should be recognised when reviewing industry efficiency and especially fee levels.

QSuper's experience has been that due to scale, costs are competitive internationally. This is borne out by benchmarking surveys in which we participate.

The QSuper MySuper default option, QSuper Lifetime is unique in Australia in that it has different investment strategies for eight cohorts of members separated by using factors such as age and account balance. The investment strategies cover a spectrum from conservative to high growth yet the cost to members ranges from 0.46% to 0.68% including the administration fee (which is itself capped for high balances).

In addition, it is submitted that a focus on fees, while important, is too narrow a view when considering efficient pathways for members to achieve adequate retirement outcomes. Accordingly, this recommendation is not supported by QSuper. Specifically the reasons for not supporting this recommendation include:

- By applying to only new default fund members, the measure only addresses a fragment of the industry with low balances;
- A focus on fees ignores possible significant benefits to members accrued through targeted more personal services, guidance in decision making and communications; and
- In a continually changing legislative climate, expenditure required to ensure compliance can mask fund efforts to drive down the cost to serve.

This is not to say that further efficiencies can't be found in the industry.

If it is genuinely felt that greater price pressure needs to be applied to the industry, it is submitted that a ratings regime could provide consumers with information to objectively compare funds on the basis of fees.

A. Fee ratings

The FSI report at page 108 contains a graphic representing a sliding scale of current MySuper fees outlining that 50% of current fund fees are between 0.84% and 1.17%. It is submitted that an independent agency could be tasked with developing a 'star ratings' regime for funds in Australia. The greater the number of 'stars' would indicate lower fees charged to members. The benefits of this would be that consumers could quickly gauge that the offering had high or low fees based on the rating provided. From a public policy perspective, it is submitted that this type of regime would lead to a general lowering of fees in the industry by:

- empowering consumers to comparison shop;
- driving competition by funds trying to get more stars.

A fee rating scale could be imposed far earlier than 2020 and would benefit all fund members, not just those suggested by the FSI tender recommendation.

Ideally though, industry efficiency ought to encompass target and performance as well as costs.

B. Investment ratings

At this point in time, all funds produce investment objectives, but consumers are provided with no digestible information on how their fund delivers against the target. Instead, funds are unceasingly compared in the media on even monthly investment returns.

In its second round submission to the FSI, QSuper put forward that fund measurement should move towards adequate retirement outcome. This could be staged

i. Funds could now be measured against their performance of consistently meeting their stated investment objectives – that is – how successful has a fund been in meeting what it is in fact publishing in its PDS.

ii. This could then be progressed over time into a 'confidence index' or 'reliability guide' that would be formulated to rate funds on the basis of improving retirement adequacy.

Whilst consumer testing would have to be done to determine the best disclosure, the ratings scale could be similar to the fee star rating suggested above. Whatever form it takes, it should be determined by an independent body.

QSuper submits that independently rated superannuation funds based on the factors above will drive the industry to be more efficient and ultimately to provide better retirement outcomes for members. From a consumer perspective superannuation fund members would have a more holistic understanding about a MySuper fund's cost and performance. Examples are set out on the following page.

Combining information for members on the objective, the success rate and the fee star rating, would enable fairer comparison than simply fees alone, especially for funds which include more expensive private asset classes.

Fund Goal

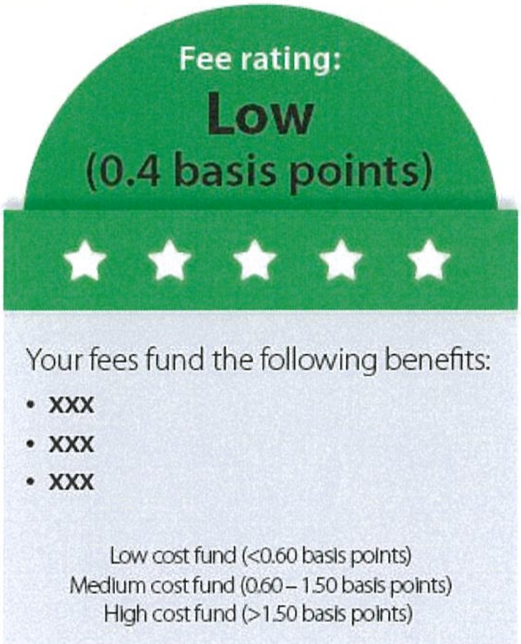
3.5% above inflation over rolling 5 year periods

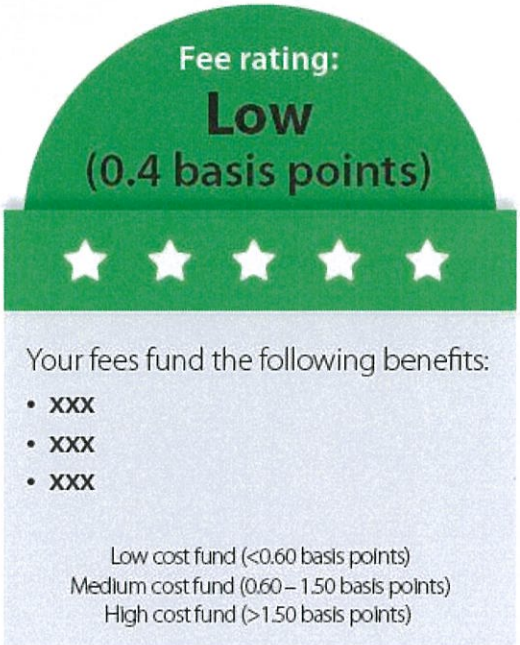
Fund's success in getting goal in last 5 years

Fund Goal

4.5% above inflation over rolling 5 year periods

Fund's success in getting goal in last 5 years





In the above example, a consumer may choose to invest in a slightly higher cost fund due to the fund's success at consistently achieving investment outcomes in accordance with the stated objective. In any event, the consumer has more reliable and independently published information and the effect would be greater competition in the industry leading to lower fees and more efficient investment strategies.

This type of concept could be taken further with the addition of appropriate regulations, including measures, to guide trustees in undertaking the annual scale review. Efficiency in the superannuation industry should be aimed at improving retirement outcomes for members. Fees, returns and risk levels are all contributors to optimal outcomes for members.

Recommendation 11 - The retirement phase of superannuation - pre-selected retirement product

"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."

The objectives for this recommendation encompass meeting the needs of retirees (including disengaged members and members who wish to delegate their retirement decisions to the Trustee), strengthening the industry focus on retirement incomes and improving retirement outcomes by pooling risk. The key features suggested by the FSI report for the pre-selected option include:

- A regular and stable income stream;
- Longevity risk management; and
- Flexibility.

QSuper strongly supports the concept of a trustee recommended comprehensive income product for retirement (CIPR).

For most employees in Australia, saving for retirement via superannuation is compulsory. The industry has become more focused in recent times on the retirement outcomes for members. QSuper's MySuper offering in the accumulation phase, QSuper Lifetime, is largely for disengaged or 'default' members and is designed to provide members with a more certain retirement outcome. QSuper Lifetime's investment strategies take into account personal member factors such as age and account balance, as well as the potential impact of age pension entitlements.

QSuper recognises that members face a number of particular risks in retirement that they did not face in the accumulation phase. These primarily consist of achieving a reasonably stable income, protecting against longevity risk while not being exposed to significant negative market movements (and the impact of sequencing risks on their savings). In order to assist members, QSuper is working to develop products which, in combination, can address these risks.

QSuper's ultimate goal is to offer a solution optimised for each member that can encompass both the saving and spending phases of superannuation. QSuper would build on its asset/liability management approach adopted for QSuper Lifetime to manage the goals and risks of the individual member. The product suite would include a 'default' strategy for members who want the Fund to continue to manage their superannuation in retirement.

Rather than a member purchasing these products "at retirement", the solution may include the funding of longevity insurance, or similar protection strategies, during the accumulation phase. In addition, the Fund is likely to offer investment strategies that have income as their key objectives to help turn retirement savings into income streams in retirement.

However, in the current environment, there are a number of barriers to QSuper achieving this goal including:

- MySuper default arrangements end at retirement requiring members to make decisions regarding appropriate retirement income strategies. The member may want to delegate to the Fund the responsibility for managing their superannuation in retirement via default arrangements which pay an income stream; and
- Current tax and regulatory arrangements combine to stifle product innovation. Choices available to retired members are essentially the same as available to accumulating members - aiming to maximize growth in capital. Retired members require targeted products that alone or in combination can provide income stability and longevity risk management. Consistency of regulatory treatment of "retirement income" products would also assist member and Fund selection. As an example, all assets used for retirement income purposes could be treated equally for tax and age pension treatment.

QSuper notes the suggested CIPR product features outlined in the FSI report. If the Government accepts the concept of funds offering a CIPR, the expectation would be that a comprehensive consultation process would take place with the industry regarding the product features and regulatory requirements.

QSuper's support for the CIPR is driven by the Fund's philosophy of providing 'whole of life' superannuation solutions for our members. QSuper has 445,000 members invested in the MySuper default option and 52,000 in its closed defined benefit scheme. A great majority of these members will not make an investment choice during the accumulation phase of their membership, preferring to leave the management of investment returns and risk to the Fund. In the current environment, these members are expected to make investment decisions for the first time upon retirement regarding how their accumulated monies should be invested to produce a retirement income for what could be decades in retirement.

The continuation of this situation for fund members is less than ideal especially in an environment where, for QSuper members, in 2014 only approximately 55% of members who entered an account based pension sought and followed professional advice. QSuper submits that a large number of retiring members would look to the Fund to continue to manage their superannuation investments and associated risks through their retirement as not all members wish to receive professional advice and/or have the capability and willingness to make their own financial decisions.

The FSI recommendation is that the CIPR would start on the member's instruction and it is acknowledged that a fund will generally not have sufficient visibility of a member's full situation to appropriately make the decision to commence income generation for a member without legislative backing. It is foreseeable however that this situation will change or that regulatory direction be specified as to circumstances where drawdown must commence – say for example reaching the age pension age and not being employed.

QSuper submits that any review of the regulatory framework for CIPR products must include consideration of specific retirement based products for 'choice' members. That is to say, supportive regulations should apply across the retirement product range and circumstances.