Cbus Submission
Your Future, Your Super Exposure Draft Consultation

1 Introduction

Cbus has the proud history of being one of Australia's first industry super funds. Cbus was formed in 1984, when building and construction workers won the right to superannuation. Today, we have grown into a leading industry super fund, open to all while maintaining a focus on the industries that build Australia. We work hard to make sure that the super system is delivering for our members.

Cbus, with 758,204 members, mostly male and overwhelmingly hailing from the building and construction industries, is one of the best performing funds, with investment performance of 8.98% per annum since inception in 1984. Annual returns for the Growth option over financial year 2019/20 was 0.75%, compared to -0.92% for the median return in the SuperRatings SR50 Balanced Survey. Annual returns for the Growth option over **5 years was,** 7.13%, **7 years was** 8.49% and **10 years was** 8.54% (to 30 June 2020). Funds under management total $59.1 billion as at 17 December 2020.

Cbus is a bespoke fund for the building and construction industry. Our products and services are tailored to our members' needs; the most obvious (but not only) example is our insurance cover.

The majority of our members are tradespeople – they have unique working lives and a unique pathway to retirement. They start work and form families earlier than the general population. Very few work full time for decades. They are more likely to retire early – though not by choice, and as a result have lower average retirement savings. In addition to super, our members also rely on us to provide tailored life and TPD insurance – because they work in hazardous industries, cover with other funds that is not designed for building and construction workers is unlikely to meet their needs, while individual cover is either not available or not affordable.

In 2019, the Parliament, with the support of the Government, amended legislation that banned funds from offering default cover to younger members, introducing an exemption for funds that serve members in hazardous occupations. Under the exemption, Cbus is able to offer default insurance for the majority of our members. During the debate, Cbus effectively raise awareness in the community and the Parliament about the importance of default insurance for our members and their families.

Our connection to our industry extends into the way that Cbus invests, securing outcomes for members and benefits to the economy. Our products and services, our investment approach and our insurances are specifically designed to suit our members, their employers and the environments in which they work. We invest our members' retirement savings in different types of assets for the long-term. We also invest directly in the building and construction industry through our wholly owned subsidiary, Cbus Property. This adds to the returns of our fund, creates jobs for our members and contributes to the economic activity of the industry in which our members and employers work.

Cbus Property has built a strong position in the commercial and residential property sectors throughout its 15-year history, growing from a portfolio of $0.5 billion in 2006 to $4.8 billion in 2020. Cbus Property's financial performance, that is, its annual return to members has averaged 15.3% per annum since inception. Over the past 10 years, Cbus Property has returned an average of 15.2% p.a, outperforming the MSCI/IPD index of 8.6% p.a.

Building on these achievements, Cbus Property developments have created around 100,000 direct jobs since 2006.

A key to Cbus Property's success has been long-term relationships with our tenants that deliver stable and consistent returns to the Cbus members. For example, 40% of Cbus Property's commercial office portfolio is currently backed by government tenancies. Another factor of our success is our focus on highly rated sustainable development and business practices. Progress in this area is evidenced by our market-leading ratings for our sustainability measures through assessments by Global Real Estate Sustainability Benchmark (GRESB) and National Australian Built Environment Rating System (NABERS).

Cbus is well positioned to play our part in investing to create jobs in the building and construction industry and beyond to assist Australia on the road to post pandemic economic recovery, while maximising long-term returns for members. Industry super funds' investment outperformance has added billions of dollars to members' retirement savings and deepened our national savings pool, helping protect the economy during downturns.

The Australian superannuation system is the envy of governments and business leaders worldwide, admired internationally for its key defining features - universality, compulsion and preservation – all of which have been critical to its growth, making it one of the largest pools of capital in the world. Superannuation has given ordinary working people access to the magic of compound interest – in a single word it has been transformative. In one generation, Australians who would have previously retired in poverty with sole reliance on the aged pension will now have a dignified retirement.

Cbus supports the legislated, scheduled superannuation guarantee increase to 12%, which is critical for our members, who on average earn less than the general population, and on average have less super across all age groups. Cbus also supports the preservation of super until retirement and does not support further extension or expansion of early release of super. Almost 12,500 Cbus members have entirely emptied their accounts in 2020, losing valuable insurance coverage along the way – this outcome may prove tragic for some, and will leave all worse off in retirement.

2 Executive Summary

Cbus supports the objective of the Government's proposals in this package of reforms – being to reduce the incidence of multiple accounts, remove underperforming funds from the industry, and ensure members' retirement savings aren't unduly eroded by high fees. As a top performer with an enviable insurance offering, Cbus can, hand on heart, say that we deliver an excellent service to members, and will confidently remain a significant presence in the market. Our members value Cbus and its connection to their industry and tell us so often.

The draft Bills require further work, however, to ensure people are not stapled to underperforming funds, or funds whose default insurance offering won't actually cover them, are not misled about fees, and not left to languish in poor performing funds. The Bills require amendment to avoid creating a new generation of underperforming legacy products, and the proposed benchmarks must be amended to reflect the specific characteristics of the asset class, including the market structure and risk profile, so to avoid unintended consequences on asset allocation and security selection decisions. After all, what matters to the member is their access to an income in retirement - that is, net performance of their fund. Finally, the Bills introduce new restrictions on expenditure by Cbus and other profit to member funds that will not apply to retail funds that are part of a corporate group.

The Bills as drafted establish a hollow framework that do not include fundamental aspects of the package. For example, the Bill implementing the stapling proposal does not include a definition of stapled fund. The Bill introducing new requirements for fund expenditure does not define what expenditure is covered. The Bill that deals with underperformers does not include the proposed performance benchmarks. These concerns must be addressed by the Parliament and not left to be resolved by the bureaucracy. It is not acceptable to implement the key definitions and measures of the package via regulations, without full parliamentary oversight.

Legislation to implement the superannuation system changes announced in the budget should follow four guiding principles:

1. Sequencing: Prioritise removing underperforming funds from all sectors of the system *first.*
2. Focus on what really matters: Maintain a laser focus on net returns after all fees.
3. Equal treatment of all Australians: All members are equal and deserve equal protection regardless of the sector, fund, product or option where their retirement savings are invested.
4. Protect the vulnerable: Guarantee no member will be left languishing in an underperforming legacy product and ensure workers in hazardous occupations do lot lose critical, affordable insurance cover which they and their families rely on.

Recommendations

Sequencing - before the Your Future, Your Super measures are implemented

R 1. Government must provide a comprehensive formal response to the 2019 Productivity Commission review of superannuation. As recommended by the Productivity Commission, Government should implement measures to remove underperforming funds from all parts of the superannuation system before the rest of the package is implemented.

Substance of changes must be legislated

R 2. The substance of the package of reforms must be included in the Bills and subjected to full Parliamentary oversight. Important superannuation policy change must not be implemented via regulations.

Stapling

R 3. When a person joins the building and construction industry, they should be defaulted into a fund that has appropriately constructed insurance for the workforce. This will ensure that they are covered by high quality, industry specific insurance from their first day on site. The Parliament recognised this as part of the Putting Members Interests First changes to insurance. Cbus recommends a similar approach here.

Fund expenditure

R4. Measures should be sector neutral- retail funds must be required to disclose the value of members' money paid to parent entities as profits and expenditure paid by related parties relating to a super fund that is part of a corporate group, e.g. advertising costs. Retail funds must be required to ensure that these payments are in the best financial interests of members.

R5. The proposed reversed onus of proof cannot be justified and must not be implemented.

R6. The proposals should be subject to a materiality threshold.

R7. The proposed power to ban payments and investments that are in the best financial interests of members cannot be justified that should not proceed.

YourSuper comparison tool

R 8. The tool must cover every superannuation product, including single asset class and retirement products - as recommended by the Productivity Commission.

R 9. The tool must compare products by long term returns net of all fees, including administration fees.

R 10. The tool must inform members whether each product includes industry-specific insurance cover offered under the exemptions to the Putting Members' Interests First legislation.

Performance benchmarks

R 11. The benchmarks must apply to every superannuation product, from the same date, as recommended by the Productivity Commission.

R 12. Proposed benchmarks must reflect the specific characteristics of the asset class, including the market structure and risk profile, so to avoid unintended consequences on asset allocation and security selection decisions.

R 13. The consequences of failing to meet the proposed performance benchmark must be strengthened to protect existing members and avoid a new generation of members being left to languish in underperforming legacy products, as recommended by Productivity Commission.

R 14. The performance benchmarks must be implemented before the proposed stapling measure to ensure that members are not stapled to underperforming funds. Reforms to the successor fund transfer process to facilitate industry consolidation must also be made before stapling is introduced.

Commencement

R 15. The commencement date should be 1 July 2022 for performance benchmarking, followed by later commencement dates for other measures once it is clear that underperforming funds have been removed from the system.

3 Productivity Commission Report: Superannuation: Assessing Efficiency and Competitiveness

The Government argues that the proposed changes implement the following Productivity Commission recommendations:

- Recommendation 1: Default once: only default members without an account
- Recommendation 4: Elevated MySuper and choice outcomes tests
- Recommendation 22: Definition of the best interests duty

We do however note that there are significant differences between the proposes measures and what was recommended by the Productivity Commission. This is summarised in the table below:

Productivity Commission (PC) and proposed Budget reforms – key differences

Stapling	Underperformance test	YourSuper Comparison Tool	Transparency and accountability measures
• PC did not recommend that an employer must look up a new employees existing fund and choose to pay to this fund. PC instead proposed that the architecture around the service and the whole employment commencement process shold contain features that nudge new employees to actively engage • PC recommended that new employees should be shown a list of their existing funds and also default fund • PC acknowledged issues regarding insurance and sought to rectify this by building insurance criteria into best in show selection • PC recommended increasing balance cap fortransfer of inactive accounts to ATO and ensuring lost and unclaimed framework works in harmony with default fund selection	• PC recommended that the benchmark test apply to all MySuper and Choice investment options. • PC recommended giving APRA power to stop a fund from launching new investment options (in addition to accepting new members). • PC recommended a 12-month remediation period however if remediation not possible product would be withdrawn from the market, with members transferred to a better performing option • PC recommended the Government should also roll out the new Consumer Data Right to superannuation in parallel with implementation of the elevated outcomes tests	• PC proposed ASIC rather than ATO develop such a tool. • PC proposed for tool to be published on MoneySmart website • PC proposed that the tool should capture different levels of information to different categories of members • PC noted that such a tool should only occur once member dashboards have been developed for both default and Choice products	• PC did not recommend legislation compelling trustees to act in the best financial interests of their members • PC clear that outcome should be informed by Royal Commission - Royal Commission stated that existing rules regarding best interests and sole purpose should remain without more specific elaboration. • PC stated that advertising aimed at attracting members did not warrant a specific regulatory response

Recommendation: Government must provide a comprehensive formal response to the 2019 Productivity Commission review of superannuation. As recommended by the Productivity Commission, Government should implement measures to remove underperforming funds from all parts of the superannuation system before the rest of the package is implemented.

4 Substance of changes must be legislated

The Bills as drafted establish a hollow framework that do not include fundamental aspects of the package. For example, the Bill implementing the stapling proposal does not include a definition of stapled fund. The Bill introducing new requirements for fund expenditure does not define what expenditure is covered. The Bill that deals with underperformers does not include the proposed performance benchmarks. It is not acceptable to implement the substance of the package via regulations, without parliamentary oversight.

Recommendation: The substance of the package of reforms must be included in the Bills and subjected to full Parliamentary oversight.

5 Cbus' Tailor-made Default Insurance Offering for Workers in Hazardous Occupations

Insurance offered through group superannuation policies provides value for money compared with insurance distributed directly and through advice networks. APRA's latest Life Insurance Claims and Disputes Statistics report (released 20 October 2020) found that the claims paid ratio (being the dollar amount of claims paid out in the reporting period as a percentage of the annual premiums receivable in the same period) for the 12 months to June 2020 was Death: 42% individual advised, 40% individual non-advised, 85% group super, and TPD: 49% individual advised, 35% individual non-advised, 95% group super – noting the vast majority of these policies (including group policies offered by superannuation funds) would contain exclusions rendering many building and construction workers effectively un-insured.

Cbus has a particularly strong record of benefit provision to members, with $298 million in claims paid for the 2019/2020 financial year (and $248 million in the prior year) for close to 3,000 claims (and 2550 in the prior year). Claim acceptance rates have been excellent over the last 3 years (to 30 June 2020), with around 96% of all insurance claims accepted, and 94% of total and permanent disablement claims accepted.

In October 2019, ASIC singled out the positive aspects of the Cbus TPD policy in an otherwise scathing report into aspects of the TPD insurance market (REP 633, Holes in the Safety Net). ASIC identified generosity in our eligibility criteria and high levels of member engagement throughout the claims process as key features of Cbus insurance product.

Many Cbus members do not join the building and construction industry as their first job. For these workers, their first fund bean inappropriate fund that could detrimentally impact their access to insurance and the ability of members and their dependents to claim against insurance if tragedy strikes. Building and construction is the <u>third highest sector</u> for fatalities in the workplace, sharing a top quintile risk rating with emergency services, including policing and paramedicine and ambulance work.

An election to rely upon the PMIF 'Dangerous Occupation Exception', based on actuarial certification of the risk rating of occupations within the building and construction industry (top quintile of risk) and supervised by APRA, has meant that Cbus is one of a handful of funds who continue to offer all members who work in a dangerous occupation access to automatic insurance cover. Cbus has continued to provide universal opt-out cover for all manual occupation workers, including apprentices, from the first day of work, without each member having to go through full health checks with the insurer.

<u>Cbus' default insurance offering – value-adding differentiators</u>

Death cover

"Workers in the construction industry face a significantly higher risk of suicide than the general population." (*National Coronial Information System, December 2014*).

Many funds' Death cover has exclusions for suicide – being either an extended waiting period or simply no cover. Building and construction workers are at a higher risk of suicide. Cbus provides death cover for all insured members for suicide with no waiting period. Suicide is one of the most common causes of death for Cbus insurance claims. The true rate of suicide claims is likely to be significantly higher than those attributed to suicide. For X proportion of claims Cbus pays, the cause of death is unknown at the date that the claim is paid. Many of these claims are likely to involve death by suicide. Cbus has paid out more than $60 million in death and TPD claims to 373 members or their beneficiaries who have died by suicide or had self-inflicted acts over the past five years to 30 June 2020.

Case study: A male member was 22 years old at date of death from suicide and employed in a manual occupation. The member was single but was survived by a toddler who was living with their Legal Guardian. The insurance cover was 4 Units of Death & TPD cover with a sum insured of $208,000. The benefit was paid to the Legal Guardian as trustee for the child.

TPD cover

Cbus uses a fair definition for TPD 'Unlikely to ever work again'. This is broader than two other definitions that are commonly used in other policies: 'Unable or Incapable of ever working again in an occupation suited by education, training and experience or 'any occupation'.

Where a member has been unemployed for more than 24 months (better than a lesser period, which in other funds is often only 6 months) members are tested against 'Everyday Work Activities' (better than 'Activities of Daily Living' which was the area heavily criticised in ASIC report 633).

Under the Everyday Work Activities test of the TPD definition, Cbus has a 'Psychiatric Impairment' assessment for cases where the member has a specified medical condition or mental disorder.

From 1 February 2020, Cbus has increased the 'unlikely to return to work' assessment test timeframe. It applies even if members have been out of work for up to 24 months, an improvement on what was previously a 12-month rule.

Many funds do not provide TPD cover for workers in higher risk heavy blue-collar occupations. In building and construction, this includes the following jobs:

- Boilermakers
- Bricklayers
- Carpenters
- Concreters
- Dogmen
- Fitter and Turners
- Labourers
- Painters
- Plasterers
- Plumbers
- Electricians
- Riggers
- Scaffolders and Welders.

For example, some funds do not provide cover for people working above 15 metres and with heavy machinery.

Case study: A male Cbus member, 49-years-old and a sheet-metal worker fell from height in the course of work whilst installing air conditioning ducting. The member received a TPD benefit after suffering a traumatic brain injury in the accident.

Cbus is one of the only funds that provides TPD cover for all of the above occupations and workplace environments. Cbus has paid out $506 million in TPD claims to 6,653 members who have been permanently disabled and in the manual occupation category over the past five years to 30 June 2020.

Most funds exclude or modify cover for Total and Permanent Disablement. For example:

- BT Super will assess a Labourer against Activities of Daily Living – a practice ASIC concluded amounted to 'junk insurance'. This would pay out only in the most catastrophic circumstances.
- AMP, Hostplus, Colonial First State and MLC explicitly do not insure workers for TPD if they work in high risk occupations.
- Individual retail insurance policies require building and construction workers to incur significant premium loading, making these policies far less affordable – and still likely less comprehensive - than Cbus' offering.

6 Stapling members to their first fund

In the final report, the Hayne Royal Commission recommended:

> *"A person should have only one default superannuation account. To that end, machinery should be developed for 'stapling' a person to a single default account"*[1]

Whilst we support the need to reduce the creation of multiple accounts, we highlight that there are a number of ways in which this can be dealt with. For example, in 2019 Industry Super Australia engaged KPMG to model the savings to members of different stapling mechanisms. KPMG concluded that automatically rolling over member account balances to their new fund when they change jobs would increase total investment returns by $416 billion in real terms over 25 years. This policy not only deals with future multiple accounts, and increases balances but also ensures that people are in an appropriate default for their workplace which is critically important for our members.

<u>Members who join the building and construction industry must not be stapled to funds with inappropriate insurance</u>

Industry specific insurance is critical for building and construction workers. Cbus is a longstanding supporter of the existing industrial default system which sees building and construction workers defaulted into the fund that offers default cover designed for their industry.

We support a member's right to choose their fund, though it is well established that members in general are not engaged with superannuation, and we know based on engagement with our members that building and construction workers are busy people – they're experts on the tools, not on super. Many do not have the time or expertise to wade through 40,000 product options. As the Productivity Commission found, members face a bewildering number of products to choose from. *"An efficient super system would offer members a range of products and services <u>suited to their needs</u> and make sure they can readily access good quality (salient and simple) information to make decisions. It would also direct those who do not make a choice to good defaults."*[2]

Nor are many members, including many Cbus members, equipped to differentiate valuable industry-appropriate insurance from junk, which ASIC found exist in Report 675 Default insurance in superannuation: Member value for money.

[1] Pg. 253, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf
[2] Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report Overview 2018, https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment-overview.pdf

Stapling a worker who is commencing a role in a hazardous occupation to a fund with inappropriate default cover for their needs would be a perverse, and no doubt unintended, consequence of this suite of reforms. Cbus will, therefore, seek to work with Government to address this issue.

The elimination of multiple accounts is the stated focus of stapling reform – a worthy goal. Multiple accounts erode balances, and risk charging workers in hazardous occupations, including builders, police, paramedics and ambulance workers, premiums for insurance they can't claim on. Defaulting workers and consolidating old accounts into a high performing fund with industry-appropriate default insurance from day one on the job is the outcome which is in the best interests of members who work in hazardous occupations.

Cbus also encourages the government to consider lifting the threshold balance trigger embedded in the Protecting Your Super package to sweep more members' funds into an appropriate active account.

Recommendation: When a person joins the building and construction industry, they should be defaulted into a fund that has appropriately constructed insurance for the workforce. This will ensure that they are covered by high quality, industry specific insurance from their first day on site. The Parliament recognised this as part of the Putting Members Interests First legislation. Cbus recommends a similar approach here.

The interaction of hawking and stapling

We strongly support the implementation of the Royal Commission recommendation to ban the hawking of superannuation introduced in the Financial System Reform (Hayne Royal Commission Response) Act 2020. The unsolicited sale of superannuation under a 'general advice' mode does not allow members to make an informed decision on the implications of changing superannuation products and does not require advice to be in the bests interests of the member, leaving members at risk of being switched to a fund that will leave them significantly worse off through inadequate insurance and/or underperformance. Cbus members are at significant risk of being switched into an underperforming product and losing insurance that is tailored to their unique needs. Cbus members regularly report attempted hawking activity. This appears to have been increasing since 2019.

We are however concerned that the ban on hawking is not due to commence until 5 October 2021. The ban must come into effect prior to the introduction of any stapling mechanism – otherwise there will be an increased risk that members will be mis-sold into underperforming products of which they will be then stapled to, potentially for the rest of their working lives. This issue would be exacerbated if the fund/s they are sold into are not included in the underperformance benchmarking test and the YourSuper comparison tool.

We also note that the proposed Hawking ban provides an exemption for personal financial advice. Cbus members regularly report experiencing repeated cold calls from organisations purporting to provide personal financial advice including being subjected to misleading statements to encourage members to replace their superannuation fund with a more expensive and underperforming fund.

This type of behaviour was also evidenced during the Royal Commission. For example, the Royal Commission revealed that advisers were encouraged to stop accrued default amounts being transferred to a cheaper MySuper product by obtaining an investment direction.

The Royal Commission recommendations addressing misconduct within the financial advice industry are yet to be fully implemented. On 9 December 2020, the Government announced that the

Financial Adviser Standards and Ethics Authority, established in April 2017 to set the education, training and ethical standards of licensed financial advisers in Australia, will be disbanded.

Other concerns in relation to the proposed hawking legislation are:

- It provides powers to introduce exemptions via regulations.
- Problems with consent – As found in ASIC Report 622[3], telemarketers use strategically complex and unfair sales tactics. This includes using ambiguous language to obtain consent.

Impact on employers

The stapling proposal will require employers to contact the Australian Taxation Office every time they hire a new worker to get information about the worker's existing superannuation. The Government acknowledges that initially this will need to be done manually. Some Cbus employers have expressed concerns about this proposal. In particular, small employers are concerned about being required to get superannuation information from the ATO every time they hire a new worker, particularly in the absence of a system to facilitate this. Some employers have also expressed concerns about workers being left without industry-specific insurance.

The Government's aspiration is that eventually technology will enable integration of superannuation and payroll systems. However, there is no plan to deliver an integrated technology solution for employers, many obstacles to this, including employee privacy issues.

YourSuper tool should inform members about the importance of insurance

The proposed Your Super tool will not provide any information about the insurance cover provided as part of each superannuation product.

Industry specific insurance is critical to Cbus members, and other workers in hazardous occupations, such as emergency services workers. Most insurance products are not appropriate for building and construction industry workers, or workers in other hazardous occupations. The quality of insurance more broadly varies considerably. For these reasons, the consumer tool must inform users whether each product includes insurance that is suitable for building and construction industry workers and others in hazardous occupations.

This is particularly important given that APRA has not produced insurance heatmaps.

Recommendation The tool must inform members whether each product includes industry specific insurance cover offered under the exemptions to the Putting Members' Interests First legislation.

7 Expenditure

The Royal Commission examined expenditure by Cbus and many other funds in depth. Cbus received a clean bill of health. Commissioner Hayne found usually when a trustee did not act in the best interest of beneficiaries was because a conflict arose between the beneficiaries' interests and the interests of the trustee of a retail fund, or another person or entity in a for profit corporate group,

[3] https://download.asic.gov.au/media/5201456/rep622-published-11-july-2019-1.pdf

observing that 'the interests of the fund's parent company and the interests of members are not only different but are often opposed'[4].

Fund expenditure is subject to prudential requirements which commenced on 1 January 2020 for an RSE licensee to regularly assess the outcomes provided to members and identify opportunities for improving these outcomes, supported by sound strategic and business planning. These requirements build on the sole purpose test and the duty to act in the best interests of members.

The proposal to clarify that fund expenditure must be in the best financial interests of members, which will be imposed in addition to the existing regulatory requirements, will be applied inconsistently and in a way that undermines competition.

We note that the Royal Commission did **not** recommend changes to the best interests covenant, instead it suggested that better enforcement via strategic conduct litigation was needed to address immediate member harm and deter future conduct when retail trustees have failed to manage conflicts effectively[5].

> *'I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.'*[6]

Investing responsibly is important for our members' long-term returns. As a responsible investor, we consider the long-term material ESG risks and opportunities in investment decisions. That is, the ESG risks and opportunities most likely to have a significant impact on the value of an investment. Companies that take ESG factors into account are likely to have sustainable business models and an ability to generate long-term returns for our members.

The Government's objective that more members exercise choice of fund increases the need for Cbus to protect and build its brand. Achieving and maintaining scale is in members' best financial interests. Once the market consolidates and even with stapling there will be innovation and eventually some funds may be underperform. Advertising will be critical as a tool to inform and market and attract members from incumbent poorer products to better, more fit for purpose products.

Sector neutrality

The new requirements must be balanced, and treat all funds equally, given the impact on the membership – as the Explanatory Memorandum says, *"… so that Australians have confidence that the effort of trustees is solely focussed on improving their retirement incomes and not some subsidiary or ancillary purpose."* In particular, retail funds must be required to demonstrate how the diverting of member funds to related party entities by retail funds is in the best financial interests of members. However the exposure draft Bill does not define expenditure, while the draft Explanatory Memorandum accompanying the draft Bill refers to expenditure made towards investments in systems, risk management, governance and the engagement of sufficient resources to operate the trustee's business operations but does not refer to payments made by retail funds to parent entities.

[4] Royal Commission, pg. 231
[5] Royal Commission, pg. 234
[6] Royal Commission, pg. 235

In addition, the new standard must apply to expenditure incurred by a parent company or other related party on behalf of a retail fund.

At a recent hearing of the House of Representatives Standing Committee on Economics, Melinda Howes, General Manager of Superannuation at BT (part of Westpac Group) explained the convoluted process through which retail funds can avoid accountability for advertising spend, while spending as much or more than their industry peers:

Dr Mulino: We've talked a bit today around the impact of fees on returns and the fact that the more a fund spends on advertising, for example, the more that that will impact negatively on the returns that members receive in their accounts. Again, if I am using the wrong terminology please correct me and let me know what the right terminology is. But to the extent that any payments or dividends that go to a parent entity increase, that, again, would have a similar effect, wouldn't it?

Ms Howes: Perhaps just to give some context on that, advertising is one that we don't charge directly to the members of the fund. That is actually paid out of, if you want to call it, that profit or revenue for the shareholders. Ultimately all those fees and expenses do work their way into what we require for the fee structure to run the fund. But that is an example where actually members are not being directly charged for those advertising costs; they're being paid for by the shareholder in the first instance. But yes, obviously any cost of the fund will impact eventually on the end results for members. And that is why we've invested so much shareholder capital in modernising our systems and bringing all of our members into this new digital environment where we can run this super fund very efficiently and provide a very strong outcome for members for a very reasonable total fee.

Recommendation: Measures should be sector neutral retail funds must be required to disclose the value of members' money paid to parent entities as profits and expenditure paid by related parties relating to super fund (e.g. advertising costs). Retail funds must be required to ensure that these payments are in the best financial interests of members.

Reversal of onus of proof

The Bill also proposes to reverse the evidential burden of proof so that the onus would be on trustees to prove they performed their duties or exercised their powers in the best financial interests of beneficiaries. There is no precedent for this approach in the regulation of corporate or public sector expenditure. Cbus opposes this proposal.

Recommendation: The proposed reversed onus of proof cannot be justified and must not be implemented.

Materiality

The proposals are not subject to any materiality threshold. Requiring Cbus and other funds to produce detailed analysis and reporting of immaterial expenditure would introduce an additional regulatory burden on the industry without any corresponding benefit to members. This is not in the best financial interests of members.

Cbus recommends that the new requirements be subject to a materiality threshold.

Recommendation: The proposals should be subject to a materiality threshold.

Overreach

The Bills propose to allow regulations to be made to specify that certain payments or investments made by trustees are prohibited or prohibited unless certain conditions are met. The Explanatory Memorandum states that *"*These payments are prohibited regardless of whether the payment is considered to be in the best financial interests of beneficiaries' (para 1.24).

The ability for a Government to ban any fund expenditure or investment that is in the best financial interests of members is by its very nature not in the best financial interests of Cbus members. It is unprecedented and the draft Explanatory Memorandum provides no explanation why it would ever be appropriate for a Government to override a trustee's decision. The proposal undermines centuries of established law which is at pains to prevent courts from overturning a trustee's considered decisions on subjective grounds. It is not clear who would make a decision to ban a trustee from incurring specific expenditure or making a specific investment, or on what grounds. It is not clear whether a Government that exercised that proposed veto would have to notify members or justify such a decision, given that it would be damaging to their financial interests. The proposal has the potential to undermine competition by subjecting a particular fund or group of funds to restrictions not imposed on competitors. The proposal would a Government to ban a fund from making an investment in a particular state, industry or sector, even where the investment is in the best financial interests of fund members to do so. This creates an ongoing risk of politically motivated interference in fund operations that is not in the best financial interests of Cbus members.

The ability to ban particular expenditure or investments that are in the best financial interests of members via regulations enables a Government to avoid full parliamentary oversight of the exercise of this unlimited power.

For these reasons, Cbus strongly opposes this proposal.

Recommendation: The proposed power to ban payments and investments that are in the best financial interests of members cannot be justified that should not proceed.

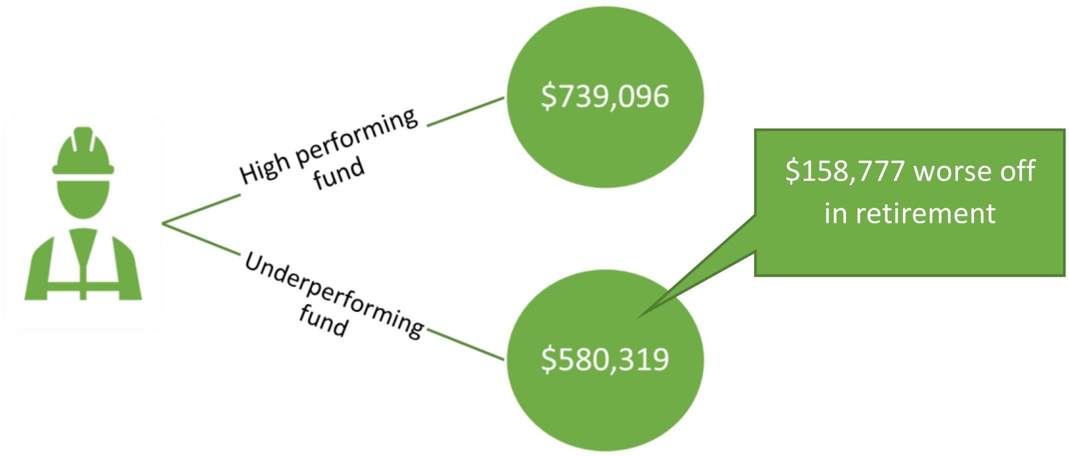
8 Guiding Principle - Prioritise removing underperforming funds from all sectors of the system first

The proposal to implement performance benchmarking and stapling at the same time significantly risks members being stapled to an underperforming fund – potentially for life. This will have a significant adverse impact on members final retirement balances and therefore their quality of life in retirement.

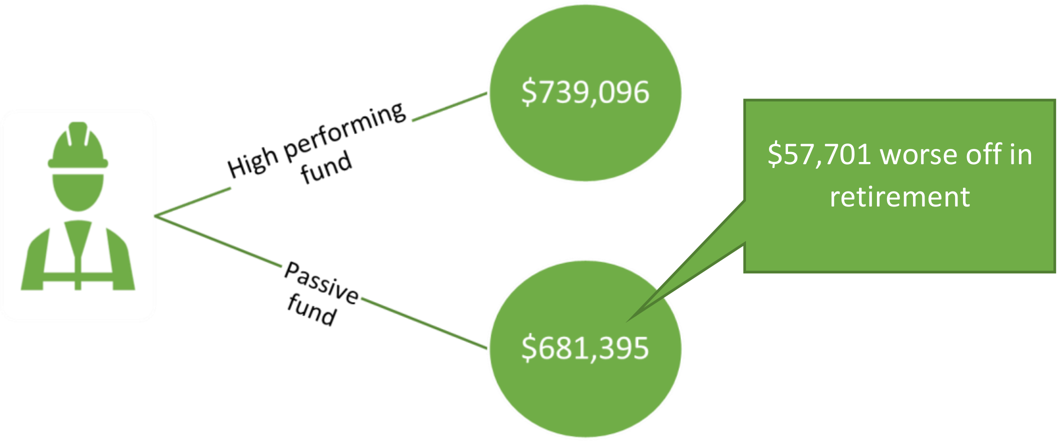
As identified by the Productivity Commission, the biggest risk to an individual's retirement balance is ending up in an underperforming fund. The Commission identified that being in an underperforming MySuper product could lead to $502,000 less in retirement, in contrast unintentionally holding multiple accounts could lead to $51,000 less in retirement.

To better understand the potential lifetime impact of a member to be stapled to different types of funds, Rice Warner compared retirement outcomes for a selection of sample members, using the Government's proposed underperformance benchmarks.

Cameo 1 – 25 year old stapled to an underperforming fund



Cameo 2 – 25 year old stapled to a passive fund



Source: Rice Warner

Assumptions: **Overperforming fund:** Net Investment Return (NIR) relative to Strategic Asset Allocation (SAA) of +0.50% **Passive fund:** NIR relative to SAA of 0.00% **Underperforming fund:** NIR relative to SAA of -0.50%

The results confirm that members greatly benefit by being in a high performing fund such as Cbus, which has a NIR relative to SAA of +1.37% according to the most recent APRA Heatmap.

The analysis assumed a high performing fund outperformed the benchmark by only 0.50% p.a. In contrast, APRA's Heatmap found the Cbus MySuper fund outperformed the benchmark by 1.74% p.a over the past five years. Rice Warner's findings are therefore conservative.

Productivity Commission, pg. 623

"Several structures need to be in place before switching from employer-chosen defaults to employee choice, so that making a choice is simple and safe for members. The process of cleaning up the 'tail' of underperforming MySuper products will need to have commenced (as described above), so that new members cannot join these products."

The difference of improving after-fee investment returns was confirmed by the Retirement Income Review which found that a 0.5 per cent increase in after-fee returns could boost replacement rates for the median earner by 4 percentage points[7]

"I don't think (Cbus being the default fund for the construction industry is) unfair because Cbus is a decent super fund. But if it was a low performing super fund, I would consider that unfair."

Given the significant detrimental impact of being stapled to an underperforming fund, we advocate that priority should be given to removing persistently underperforming funds. This approach is in line with the approach recommended by the Productivity Commission which stated that "The first stage is to remove underperforming funds and products from the system (by phasing in the elevated outcomes tests)."

[7] Pg. 182, RIR

The Government proposes that products which fail the performance benchmark will be required to notify members in writing, and products that fail the benchmarks twice will be banned from accepting new members. This will not stop members remaining in underperforming products given:

- Difficulties in member engagement, particularly for younger members – as found by the Productivity Commission levels of member engagement are persistently low, particularly for younger members and members with low balances. In addition, many members lack the financial literacy needed for informed engagement. This is particularly the case for many Cbus members – around three quarters of our members report average to poor levels of financial literacy and more than one third do not know their superannuation balance. Given these difficulties, the onus should not be on individuals to leave an underperforming fund. Priority must be given to safeguarding members from being stapled to an underperforming fund.

- Disclosure has been well and truly proven to be an ineffective in influencing consumer behaviour. We are concerned that the proposals expect disclosure of underperformance alone to be sufficient in protecting members. As found in the recent ASIC Report 632 Disclosure: Why shouldn't it be the default: 'when disclosure is used to address problems it is ill-suited to solve, it can place an unrealistic and onerous burden on consumers'. This report found that:
    - Disclosure does not solve the complexity of financial services markets – For example, the report found that consumers focus on price to the exclusion of other factors when choosing home insurance.
    - Disclosure must compete for consumer attention – the report also found that 'firms with misaligned incentives may have the incentive, opportunity and means to work around and undermine disclosure.
    - One size does not fit all – the report found that no universal approach to disclosure can meet the needs of all.
    - Disclosure can backfire in unexpected ways - for example the report found conflicts of interest disclosure increased rather than decreased trust in conflicted advisers.

  In the case of the proposed underperformance measures there is a risk that a similar pattern may occur whereby by notifying members of underperformance, trust in the underperforming fund is actually increased.

Retirement Income Review, pg. 57

"The retirement income system is complex and hard to navigate."

"This complexity and uncertainty, combined with a lack of assistance, guidance or advice, and low financial literacy, makes it hard for people to make well-informed choices about their retirement income."

Recommendation: Performance benchmarks must be implemented before the proposed stapling measure to ensure that members are not stapled to underperforming funds. Reforms to the successor fund transfer process to facilitate industry consolidation must also be made before stapling is introduced.

Regulatory reform to facilitate mergers of underperforming funds

Under current regulatory settings, removal of underperforming funds depends on costly and time consuming successor fund transfers which also involve significant operational risk and administrative effort.

Cbus has current experience of a merger process through a merger with Media Super which is underway (although it should be noted that Media Super is not an underperforming fund). We expect that this merger process will take around 2 years to complete. Assuming there are 25 underperforming funds that should be consolidated, and acknowledging that there is a small number of destination funds then under current regulatory settings, it will take the equivalent of 50 years to remove underperforming funds from the system through consolidation. Even if the pace of mergers is increased so that a merger can be completed within 1 year, the process will take the equivalent of two decades.

Minimise disruption to members currently in high-performing funds

As shown above, being in a high performing fund such as Cbus makes a significant difference to a member's retirement balance and therefore quality of life in retirement. Consequently, in addition to removing underperformers, Government must ensure that its proposals do not limit the ability of funds to deliver high quality returns – over and above the proposed benchmarks.

Cbus has a proud history of strong long-term performance, helping our members build a secure future. Since Cbus' inception in 1984 we have been one of the very best performers, throughout all market conditions and time periods. A key driver of this strong long-term performance is our ability to actively invest in a wide range of investments, including unlisted assets such as property and infrastructure. This diversification is important in protecting the retirement savings of Cbus members and was reflected in the Retirement Income Review which stated:

> "Superannuation funds help protect members from investment risk through prudent and diversified investment strategies. As a result, **falls in superannuation fund returns are typically significantly lower than those in equity markets."**
>
> **Retirement Income Review, pg. 188**

Productivity Commission, pg. 6

"Investment returns, after all fees and taxes, matter most for members' retirement incomes"

We fundamentally believe in our existing investment strategy and approach. We are concerned that the proposed benchmarks may interfere with asset allocation and security selection by successful funds such as Cbus. In particular, we are concerned that applying a listed strategic asset allocation benchmark to private market assets could lead to funds favouring passive listed exposure over investment in actively managed unlisted assets, which provide key diversification benefits and longer-term investment opportunities including essential infrastructure. The proposed benchmark will disadvantage Cbus and other funds holding unlisted assets which have a higher divergence in risk profile and returns compared to listed markets.

The performance benchmarks should be expanded to cover additional time periods and metrics, including risk-adjusted measures.

Recommendation: Proposed benchmarks must reflect the specific characteristics of the asset class, including the market structure and risk profile, so to avoid unintended consequences on asset allocation and security selection decisions.

9 Guiding principle Maintain a laser focus on net returns after all fees

Cbus is concerned that the proposed performance measure omits the impact of administration fees on member retirement outcomes. Administration fees make up a significant component of the total fees paid by members. APRA data shows that in 2018/19 administration fees made up 43% of total fees paid[8]. This is similarly supported by Rainmaker data which found that in 2019/20 about one third of the average fee paid by super members was for administration and product related fees.

The way in which fees are charged is not consistent across the industry. For example, Rainmaker estimates that Not for Profit Super funds charged on average 0.32% less than retail funds for administration[9]. In addition, for many platform products, the administration fee charged to members varies depending on the investment choice selected by the member.

Long-term net returns (after all fees) is what determines retirement outcomes for members. This is what a member receives and this should therefore be the foundation for any comparison of superannuation funds.

Any benchmark or comparison that does not include all fees and costs charged to members will be misleading and will incentivise gaming behaviour by unscrupulous industry participants. This type of behaviour could include charging higher administration costs and the establishment of low-cost entry products which will be deisgned to and be used to funnel members into more expensive products.

These concerns are not merely hypothetical. The Royal Commission[10] provided a numberof examples of this type of behaviour whereby the interests of a parent company where given priority over the interests of beneficiaries, including:

- Selling of superannuation through bank branches
- Delays in transferring accrued default amounts (ADAs) to MySuper products – as a consequence of the delay, members paid high fees for longer than they would have had their ADAs been transferred earlier
- Switching members out of existing default products into Choice products in order to avoid being transferred to a MySuper product
- Deliberately making it difficult for existing members to find out about or access lower fees

[8] https://www.apra.gov.au/annual-superannuation-bulletin
[9] https://www.rainmaker.com.au/media-release/annual-superannuation-fee-revenue-experiences-second-consecutive-decline
[10] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-2-final-report.pdf

The risk of this behaviour is particularly acute for Choice products. For MySuper products, administration fees must relate to the costs of operating the fund. There is not such restriction in place for choice products.

Recommendation: Proposals must compare products by long term returns net of all fees including administration fees.

10 Guiding Principle - All members are equal and deserve equal protection regardless of the sector, fund, product or option where their retirement savings are invested.

The Productivity Commission noted that only 24% of system assets are currently held in MySuper products, in contrast the choice segment (excluding SMSFs) accounts for 41% of total assets. We are concerned that Choice segment (which includes the entire retirement segment) is not initially included in the proposed performance measures, despite the Productivity Commission findings that this is where many of the worst member outcomes occur.

Specifically, in relation to the Choice segment, the Productivity Commission found:

- That there is a wider variation in performance in the Choice sector than the default sector
- Approximately 36 per cent of the choice investment options delivered returns more than 25 basis points below their tailored benchmark
- Choice products offered by retail funds account for almost all the 'tail' of higher-fee products — those with fees above 1.5 per cent of assets.

Whilst we acknowledge the need for strong protections for default members, we are concerned that the significant number of members in choice funds are not receiving adequate protection against poor outcomes by the proposed measures. Given the compulsory nature of the system, and that many members who hold Choice products do so as a result of financial advice, the Government has a responsibility to provide equal protection to all members. The Terms of Reference for the Royal Commission reflected this, stating that 'All Australians have the right to be treated honestly and fairly in their dealings with banking, superannuation and financial services providers'.

The proposal to not include Choice products continues an unacceptable trend of carve-outs for Choice products. These include:

- Performance Heatmaps - The heatmaps provides a comparison of performance across investment returns, fees and costs and sustainability. Although APRA intend to extend this to Choice products so far this has only been released for MySuper products.
- Product dashboards - The product dashboard is intended to provide members with key information about the product. Requirements for Choice super product disclosure dashboards were meant to apply from 1 July 2015, however ASIC delayed the start date until 2016, then 2017, then 2019 and now have delayed until 1 July 2023. Furthermore, when implemented they will not include platforms or legacy products.
- Fees and cost disclosure - New fees and costs disclosure under Regulatory Guide 97 do not apply to superannuation held via a platform. Almost all choice products provided by retail funds are held via a platform.
- Data collection - APRA does not currently collect or publish statistics on Choice products/investment options, platforms or legacy products equivalent to the comprehensive statistical collection derived from the MySuper reporting standards. Whilst we acknowledge

that APRA is currently undertaking a project to increase their depth and granularity of data reporting, as identified during the consultation phase a number of concerns have been raised regarding need for APRA to collect balanced data.
- Annual outcomes assessments - MySuper products have prescribed comparison metrics methodology whereas in contrast there are no prescribed 'comparable choice products' in SIS Regulations and therefore the approach to be taken is at the discretion of each trustee.

For both the annual performance benchmark test and the ranking of superannuation of products, the Exposure Draft legislation does not prescribe Choice products to be included, instead it allows any other class of beneficial interest to be identified in regulations.

Given the underperformance in this sector and the significant number of members invested in these products, they must be included in both the YourSuper comparison tool and the annual performance benchmark. This must be included in the legislation and not left to be prescribed in future regulations as this will simply continue the unacceptable trend of carveouts of Choice products which has led to significant member harm.

Recommendation: Proposals must apply to every superannuation product, starting on the same date, as recommended by the Productivity Commission

11 Guiding principle - Guarantee no member will be left languishing in an underperforming legacy product.

The consequences of missing performance benchmarks will result in a new generation of members remaining in legacy products, significantly impacting their retirement outcomes.

According to the Productivity Commission, legacy products (those closed to new members) comprised an estimated 10 per cent ($162 billion) of assets and 12 per cent of member accounts (3.2 million) in the APRA-regulated funds in 2017. These products accounted for just under half of assets in the high-fee tail (46 per cent). Retail funds account for all legacy products in the high-fee tail.

Given low levels of member engagement it is unacceptable to merely require underperforming funds to notify members of this fact and rely on members switching out of underperforming products. This measure must be strengthened, as recommended by the Productivity Commission. As noted previously in our submission there are significant discrepancies between what is proposed, and the annual outcomes test recommended by the Productivity Commission. In contrast to the proposals, the Productivity Commission recommended much stronger underperformance consequences and breadth:

- That the benchmarking requirements apply for all MySuper and Choice investment options (including legacy products)
- An underperforming fund cannot launch new investment options or accept new members
- Options that fail the benchmark be subject to a 12-month period of remediation and if remediation is not possible, be withdrawn from the market.

If the underperformance measures are not strengthened, we are concerned that underperforming funds may actively discourage or make it difficult for members to switch out of the products. This has historically been an issue when there is a conflict with what is in the best interests of members and the best interests of a parent company. This issue is not new. The Royal Commission revealed instances where trustees avoided closing legacy products (or avoided moving members to products that would leave them better off) because this would mean removing commissions and/or higher fees flowing to a related party business.

> *"Taken as a whole, the evidence shows that NAB and NULIS (and before NULIS, MLC Nominees) did not move with all deliberate speed to effect the transfers. I consider that they did not do that for fear of how advisers would react to the loss of commissions that would follow from the transfer"*[11]

The issue of legacy products was also acknowledged as part of the Super System Review Final report as far back as 2009 "in some instances providers with legacy products actually prefer to keep the products in existence because the fees are quite high and are used to subsidise lower fees in other products. The high fees are then justified by reason of the personal attention and manual processing that is required."[12]

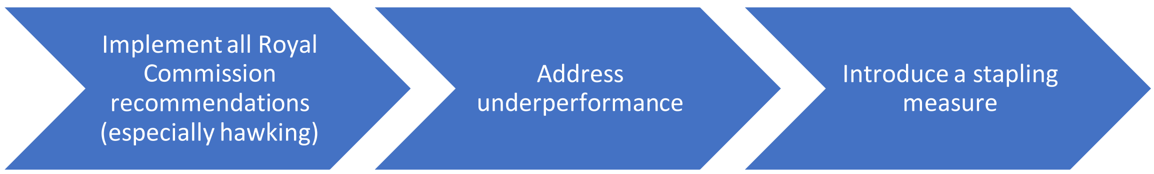
Recommendation: The consequences of failing to meet the proposed performance benchmark must be strengthened to protect existing members and avoid a new generation of members being left to languish in legacy products as recommended by Productivity Commission.

Commencement

All of the proposed measures are all due to commence in six months on 1 July 2021. Adequate sequencing is needed with the introduction and full implementaton of measures to remove underperforming funds first, to ensure that members are not stapled to an underperforming fund.

This approach would align with what was envisaged by the Productivity Commission. The Productivity Commission stated "Making sure this happens in an orderly manner will require a considered transition and implementation strategy that delivers outcomes that are in members' best interests — and that is manageable for the regulators (especially APRA) to oversee and for industry to digest." Consequently, the Productivity Commission recommended that the transition should occur via a staggered approach within three years (following the passage of legislation) and that the final step in the transition is to implement a 'default once' model.

We recommended the following commencement stages:



Recommendation: The commencement date should be 1 July 2022 for performance benchmarking.
followed by later commencement dates for other measures once it is clear that underperforming funds have been removed from the system.

[11]Page 60, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-2-final-report.pdf
[12] https://treasury.gov.au/sites/default/files/2019-03/R2009-001_Final_Report_Part_2_Chapter_10.pdf