Your Future, Your Super Review

Australian Council of Trade Unions submission to the Treasury Review of Your Future, Your Super measures

ACTU Submission, 14 October 2022
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ACTU
australian council of trade unions

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About the ACTU

Formed in 1927, the ACTU is the peak trade union body in Australia. There are 43 trade unions affiliated to the ACTU which together have over 1.7 million members engaged across a broad spectrum of industries and occupations in the public and private sector.

For over 90 years, the ACTU has played the leading role in advocating for and winning the improvement of working conditions and universal superannuation. During this time the ACTU has advocated for law reform on almost every Commonwealth legislative measure concerning employment conditions. The ACTU has also appeared regularly before the Fair Work Commission and its statutory predecessors, in numerous high-profile test cases, as well as annual national minimum and award wage reviews.

Summary of Recommendations

Performance Test

All products should be performance tested.

All products should be performance tested. The performance test should be consistent, match the risk objective of the product, and be net of fees.

The performance test should not undermine investment in nation-building projects

The performance test should be constructed so that it does not discourage investment in nation-building projects. Capital intensive projects with high upfront costs or a longer path to revenue but which are sound investments are discouraged by the performance test.

The performance test should not undermine trustee's obligation to consider all risks to their members

The consideration of environmental, social, and governance factors is a key part of best practice investing. The performance test should not discourage funds from making investment decisions which reflect ESG factors, including through the weighting and composition of the portfolio when responding to challenges from climate, reputation, labour risk, and the funds' social license.

Stapling

Money should follow the member

No worker should be stapled to their fund for life. The system of industrial defaults has served working people well before the introduction of stapling and an alternative system to ensure a workers' money is stapled to them and follows the member to their most industrially appropriate

fund should be enacted. This system would address the critical deficiencies of stapling as imagined by the former government. Namely:

- No worker should be stapled to a fund which has not passed the performance test,
- No high-risk worker should be stapled to a fund where there is a fund with industrially appropriate insurance, especially for those under the age of 25, and
- No worker should have their rights to bargain for a fund appropriate for their workplace precluded from them.

Best financial interests duty

Consistent with the recommendations of Commissioner Kenneth Hayne in the final report of the Financial Services Royal Commission, the best interests duty should be restored to its original form and did not need 'more specific elaboration'. Trustees have an obligation to act in the best interests of their members and should be held accountable to that.

Materiality threshold and reverse onus of proof

There should be a materiality threshold and the reverse onus of proof imposed under this legislation should be abolished. The reverse onus of proof and the lack of a materiality threshold has meant funds are spending more on needless compliance costs to justify business as usual expenses, rather than returning those expenses to members.

Performance Test

The Union Movement supports the performance testing of all superannuation products. There is no space for a persistently underperforming product and workers should not be consigned to products which persistently underperform

The legislation applies only to MySuper products, while there is an option for the Minister to issue regulations to apply to other products this has not been exercised. So far only MySuper products have been performance benchmarked while the subset of Choice products that are to be tested under legislation have escaped scrutiny. The Financial Services Royal Commission and Productivity Commission found the worst scandals of misconduct and underperformance in the for-profit choice sector. For-profit funds charged fees for no service, charged advice fees to the dead among a litany of gouging and rorts. 100% cash options and the like are excluded from benchmarking but products like an index fund from a third-party provider or a super wrap might also be excluded. It is in these products, though, that customers face significant harm. AMP was forced to refund more than 12,500 members of a 100%-cash-option superannuation product after members lost money on their investments due to excessively high fees. When questioned

on the performance of the product at the Financial Services Royal Commission, an AMP executive replied, "you'd have to ask the client."[1] It is a poor policy decision that the products which have done the most harm to consumers would be deferred or entirely excluded from consequential performance benchmarks. All products should be performance benchmarked and arguments made by for-profit superannuation funds that some products are not appropriate for performance benchmarking are self-interested.

The performance benchmarks should be net of fees, simple, risk adjusted, and ensure they do not inadvertently discourage investments in nation-building projects or innovative investment ideas. The measures chosen, categories deemed, and life-cycle of the performance test discourage active and direct investment into projects, vehicles and companies with high upfront costs but high potential. Funds' ability to participate in loss-leading, but ultimately beneficial, investments is hampered by the construction of the performance test.

The benchmarks chosen, as well, do not reflect a funds' broader obligation to invest in the long-term best financial interests of members. Consideration of environmental, social, and governance risks is ignored in the construction of the benchmarks, as sensible exclusions or decisions taken by the trustee to reduce their climate risk, social risk (like divestment from tobacco or controversial weapons), or governance risk (divesting from poorly run companies) are not taken into account.

Stapling

Stapling undermined the most successful aspect of Australia's superannuation system, industrially determined defaults. Industrially determined defaults delivered members into better superannuation funds with appropriate insurance. Since the law's introduction the impact of stapling has been to:

- Staple 3 million workers to an underperforming fund, potentially for life,
- Deny life-altering occupationally appropriate insurance to high-risk workers, in particular those under the age of 25, and
- Deny the rights of workers to collectively choose a superannuation fund.

When the Parliament considered the legislation, the then Opposition proposed amendments which would have at least partially addressed these issues. Amendments put by then Shadow Assistant Treasurer and Shadow Minister for Financial Services Stephen Jones (Mr Jones, revised) and then Shadow Assistant Minister to the Leader of the Opposition in the Senate,

[1] Gareth Hutchens, "AMP to Compensate Super Investors after Fresh Humiliation at Royal Commission," *The Guardian*, August 16, 2018, https://www.theguardian.com/australia-news/2018/aug/16/amp-admits-fees-were-so-high-100000-super-investment-made-a-loss.

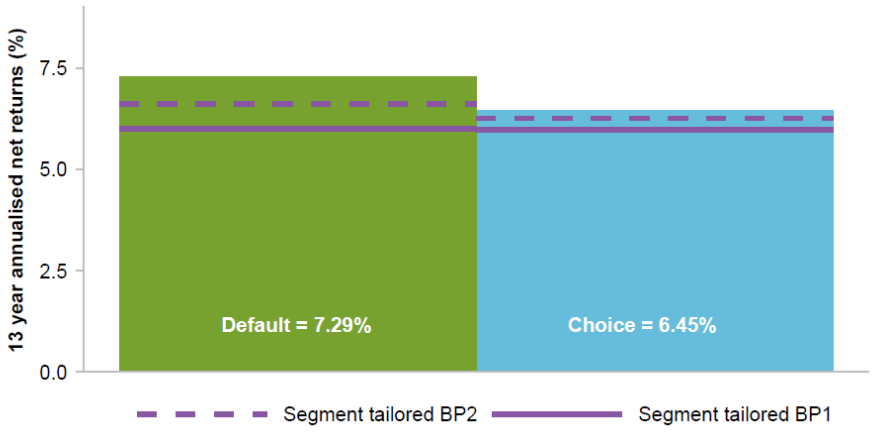
Senator McAllister (sheet 1308) provided exceptions for stapling in limited circumstances. These amendments would have ensured that workers in high-risk occupations would not be stapled to a fund with inappropriate insurance for their industry needs, nor would a worker be at risk of being stapled to an underperforming product.

A better alternative: stapling money to the member

Industrially determined default funds are successful. Workers in industry funds can expect to retire, on average, with a larger balance at retirement due to better performance and lower fees. A key objective of the union movement when campaigning for universal superannuation was the establishment of superannuation funds which are transparent, have workers' representatives governing the funds in their interests, and ensure that the funds perform well and minimise fees. This model is in stark contrast to the existing and current for-profit funds, which exist to skim workers' retirement savings through profit and the use of vertically integrated service providers. The result is that for-profit super funds are opaque, poor performing, and as the Banking Royal Commission found – ridden with scandals and conflicts.

Figure 2.7 **Products by segment: default beats choice and its benchmarks, but selection bias materially lifts results**[a,b,c]

Benchmarks adjusted for asset allocation, 2005–2017



The success of default funds is in no small part to the diligence of unions favouring industry super funds in industrial instruments, like Awards and Enterprise Agreements. Industry funds are favoured by unions in industrial instruments, such as Enterprise Bargaining Agreements and Awards due to their transparency, investment returns, fees, and insurance. The democratic representation of workers in the process of choosing funds has been an outsized success and this should be reinforced, rather than essentially legislated away.

The ACTU supports Industry Super Australia's proposal to staple money to the member. This would have the synergistic benefits of creating a quality filter for industrially determined default funds, progressively remove unintended multiple accounts from the system, and ensure that the superannuation fund a worker is defaulted into is appropriate for their industry.

Figure 1 Productivity Commission figure on default fund outperformance

Best interests duty

> *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. – Commissioner Hayne[2]

The Government ignored a key finding of the Financial Services Royal Commission which explicitly considered the Best Interest Duty obligation and recommended against further explanation or changes to it. While the insertion of 'financial' into the Best Interest Duty may actually narrow the obligation of trustees to act in their members' best interests, the application of case law to this duty makes it clear trustees are required to act in their members' best financial interests anyway. Industry funds have always acted in the best financial interests of members. For-profit funds, however, do not. Dividend payments to shareholders in the form of profit are *never* in the interests of members. Trustee directors have a fiduciary duty to their members that whenever there is a conflict of interest between shareholders and the member, they defer to the member.

Early in consultations and since the application of the law, Treasury confirmed through industry consultations that dividend payments to shareholders by trustees will not be required to pass a best financial interests test. Any level of dividend paid, no matter how high, is essentially deemed in the best financial interests of members. The specific and warrantless exclusion of dividend payments to parent companies is shockingly hypocritical and unfair. These payments, no matter how they are used by the parent company, are not required to pass the best financial interests test. This significantly reduces the compliance burden of for-profit funds as dividend payments to their shareholders can offset marketing, distribution and other expenses. This allows for-profit funds to advertise without obligation, engage in political advocacy or make political donations without passing the Best Financial Interests Test.

Materiality threshold and reverse onus of proof costing members' money

Due to the imposition of the reverse onus of proof and the abolition of a materiality threshold for expenses trustees are wasting money on legal, unnecessary processes, and performative compliance exercises in order to comply with the law. This is money which would otherwise be returned to members but is serving a needless compliance burden. Trustees should be held accountable for the use of members' money and should be required to deploy it in members'

[2] Commissioner Kenneth Hayne, "Final Report of the Financial Services Royal Commission" (Canberra: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019), 235.

best interests. However, the abolition of the materiality threshold and the introduction of record keeping obligations, both separately and in combination, have created significant expenses for funds to continue to operate.

While explanatory memorandum to the Your Future, Your Super bill has some commentary about 'core' and 'discretionary' expenditure, this is never firmly defined, nor is core expenditure exempt from an assessment against members' best financial interests. The introduction of core and discretionary expenditure concepts to the operating of superannuation funds has not assisted funds in complying with the law. All expenses should, as a matter of course, be in members' best interests no matter if they're core or discretionary. The concept of a 'discretionary' expense, too, is difficult to nail down. Explanatory materials suggest advertising might be a 'discretionary' expense, but the need to achieve scale in a choice-dominated legislative environment necessitates advertising to current and potential members. By its own guidance, 'core' expenses should make up the vast majority of expenses by the fund. The suggestion that these should attract a relatively lower level of compliance attention, but without making that clear is deeply unhelpful.

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