Join us in Setting the Public Policy Agenda

17 January 2020

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee Secretary,

RE: TREASURY LAWS AMENDMENT (YOUR SUPERANNUATION, YOUR CHOICE) BILL 2019

We welcome the opportunity to comment on the *Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019*.

We are concerned that the Bill will not achieve any positive outcomes and the evidence available suggests it is more likely to undermine its core objectives, which as best we can tell from the Minister's second reading speech[1] is to maximise retirement savings:

> *"most of all, we want the settings that underpin the system to be focused exclusively on the interests of members—on maximising their retirement savings from the first contribution and throughout their working life."*

Overall, we found the fewer the restrictions or limitations placed on individual choice, either by employees or by employers, the worse the overall performance outcomes were for employees. Of the six main cohorts identified, employees under agreements with 'collective choice' or 'group choice' were the most likely to be placed in high-performing funds and almost the least-likely to be placed into under-performing funds.

The results show many employers are capable of selecting a good default fund for their staff. But there is evidence that with less restriction on employers comes an increased risk of a poorer selection being made. Unfortunately, the absence of adequate superannuation information in the least restrictive agreements, limits the extent to which we can determine whether the poorer outcomes for those employees are a result of their own decisions or the decision of their employer.

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[1] Commonwealth, *Parliamentary Debates*, House of Representatives, 27 November 2019, 5987 (Dan Tehan – Minister for Education). Accessed online: https://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/a7ce6cc1-21ba-4cac-bf80-f84a4f8caf08/0038/hansard_frag.pdf;fileType=application%2Fpdf.

If passed, the Bill would effectively inhibit one form of choice, collective or group choice, in favour of another, individual choice, without clear evidence that the latter is more effective in driving better outcomes. In doing so, it will put more Australians at risk of ending up in an underperforming fund and perhaps more importantly limit mechanisms for ensuring ongoing accountability of and improved performance by superannuation funds.

Should the Committee wish to discuss any of the issues or findings raised in this submission, please do not hesitate to make contact via [redacted] or [redacted]

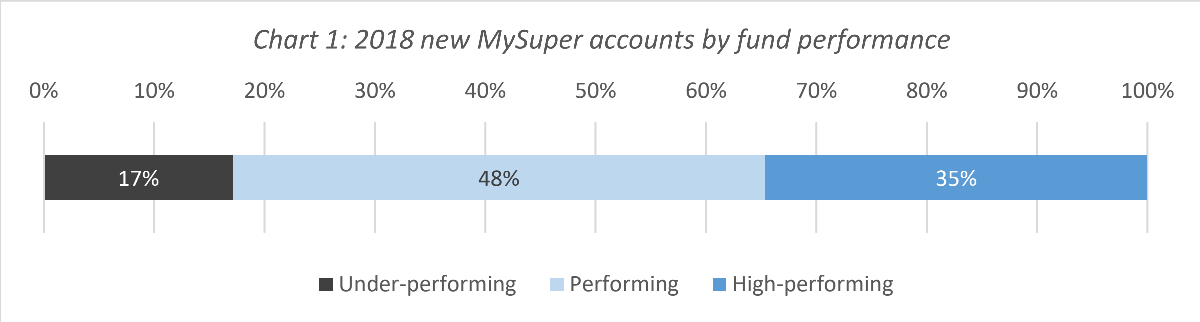
Yours faithfully,

[redacted]

James Pawluk
Executive Director
The McKell Institute Victoria

DETAILED ANALYSIS[2]

In its 2018 Inquiry Report on superannuation, the Productivity Commission described the superannuation default system as a "lottery" through which a significant minority end up with significantly less money in retirement, up to 45%, due to being defaulted into a poor fund[3]. Using APRA's recently released MySuper Heatmaps, we estimate that 17% of new accounts created in 2017/18 could be categorised as losing out in this lottery[4]:



Inspecting a random sample of 3,483 enterprise agreements spanning 2014 to 2019[5] as well as the 144 Awards[5], we have sought to understand which industrial instruments and the nature of their clauses determining fund selection lead to the lottery outcomes. In particular, we look to validate following key observation made by the Productivity Commission that seems to be a main assumption underpinning the Bill[6]:

> *"One of the main drivers of subpar outcomes is the way default funds are tied to employers and the workplace relations system, with employer choice constrained by lists of funds in modern awards and enterprise bargaining agreements"*

Using the data extracted from each agreement we segmented new account holders into the following six cohorts based on the restrictions imposed on their fund selection:

1. Collective choice – where an enterprise agreement mandates the use of a particular fund
2. Limited employee choice – where an enterprise lists a default fund but only allows employees to select from a limited list of funds

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[2] In order to be able to complete this analysis in time to meet the deadline for submissions we have had to make a number of simplifying assumptions as well as exclude some data points from the analysis. While we are looking into building out more sophisticated modelling but do not expect this to able to be completed before the committee is due to report. We have no reason to believe this will change the general findings.

[3] *Productivity Commission. (2018). Superannuation: Assessing Efficiency and Competitiveness, Inquiry Report. Accessed Online:* https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf.

[4] Based on the APRA's 5 year Net Investment Return per annum relative to Simple Reference Portfolio:
- Under-performing is -0.25% below the SRP or lower
- Performing is -0.25% below the SRP to 0.75% above
- High-performing is 0.75% above the SRP or higher

[5] Obtained from the Fair Work Commission website fwc.gov.au

[6] *Productivity Commission. (2018). Superannuation: Assessing Efficiency and Competitiveness, Inquiry Report. Accessed Online:* https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf.

3. Unrestricted employee choice – where an enterprise lists a default fund and does not place any limits on alternative funds an employee can choose
4. Limited employer choice – where an agreement provides some limited flexibility for the employer to choose the default fund from a list of funds named in the agreement
5. Award default – where the employee is allocated to a default fund listed in the award
6. Unrestricted choice – where the industrial instrument imposes no explicit restrictions on choice of fund by either the employer or employee, this includes agreements where the default fund is not named in the agreement (effectively the residual of all accounts we don't have data for).

The following chart shows the share of new accounts created in 2018 that can be attributed to each cohort. For simplicity, we have assumed that 100% of employees in the first 5 cohorts are defaulted. Repeating the calculations with a different assumption would not alter the risk profile for the first five cohorts but simply increase the share of workers left in the 'unrestricted choice' cohort (e.g. a 67% default rate would see it rise from 51% to 66% but not alter the risk profile of each cohort).

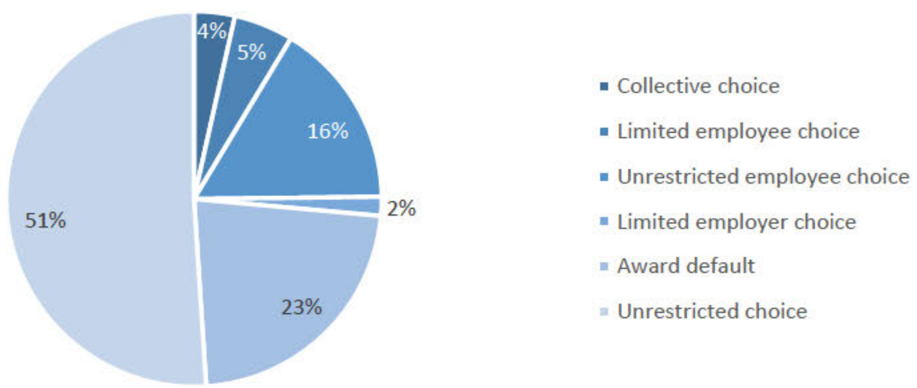
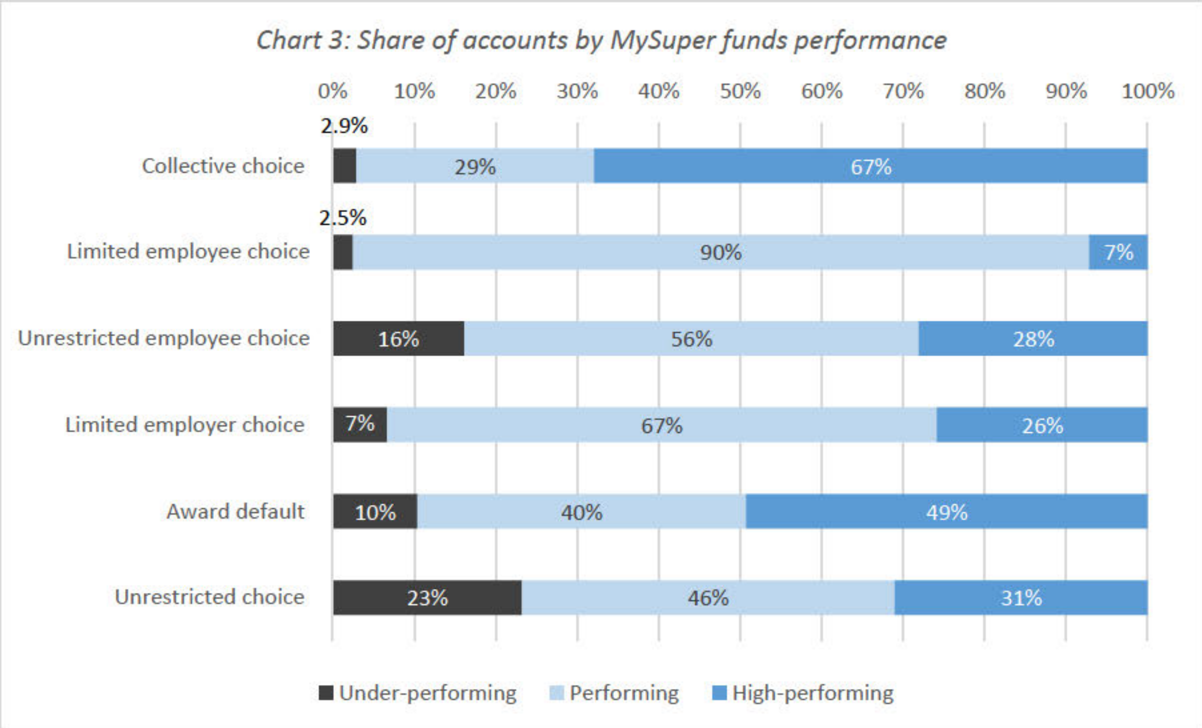


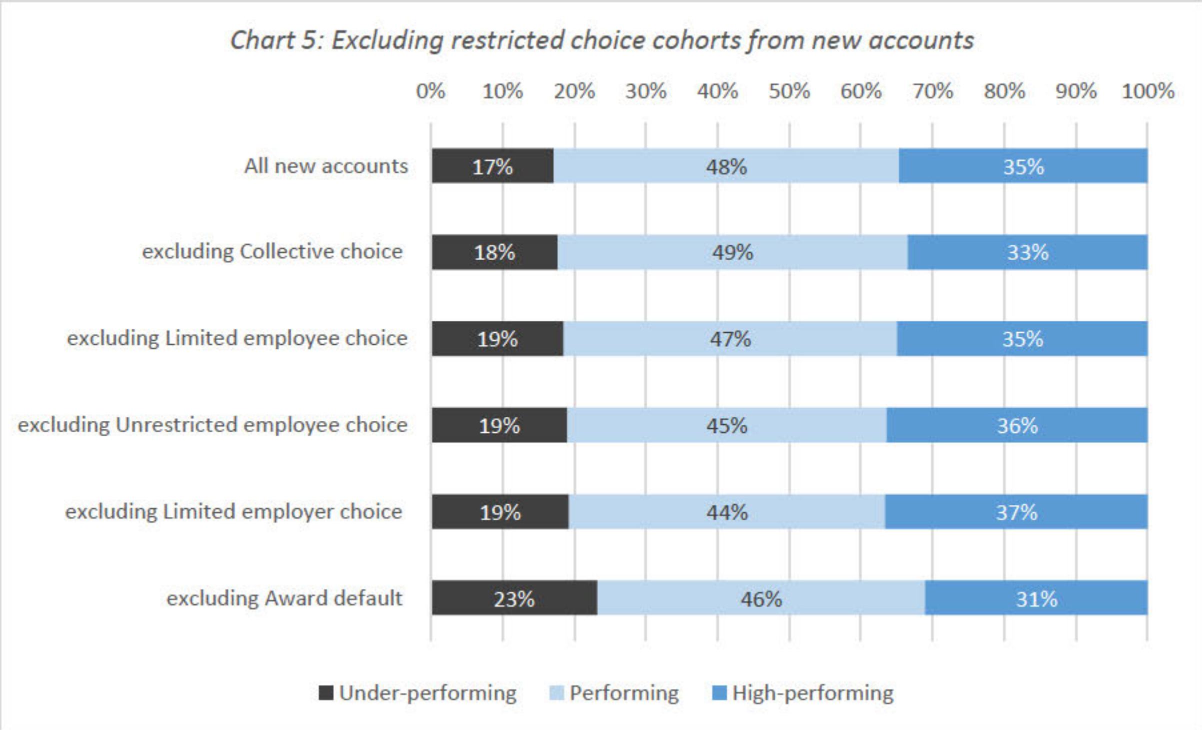
Chart 2: Selection of fund by mechanism

By once more pairing the data with the APRA MySuper Heatmap we are able to see that all cohorts where choice by either the employer or employee are restricted in some way outperform the overall population. Critically, it shows that employers and employees/unions who agree collectively bargain for a fund, are most likely to select a high-performing fund (the Award process is the second most likely).



From a risk mitigation perspective, Chart 3 also shows that for the 9% of accounts where employers and employees/unions agree to place some form of limitation on individual employee choice, they have been able to reduce the 'lottery' risk to employees from 17% down to less than 3%. In stark contrast, when employees deviate from the arrangements in one of the restricted agreements the probability of ending up in an underperforming fund increases to 23%.

The following chart shows how the likely performance outcomes for the Unrestricted Choice cohort were derived by removing each of the restricted choice cohorts from the total population of new accounts This cohort is effectively made up of the 37.5% of the workforce that are on individual agreements, rather than enterprise agreements or awards, and the approximately one third of workers on enterprise agreements where there was no clauses governing fund selection or no default fund named.



All of the preceding cohorts limited the employer to the default fund or funds named in the agreement. We next look to understand what happens when an agreement gives them discretion to change the default funds without requiring agreement of the other parties. It shows that where an employer has explicit freedom to change the nominated default fund, the risk of that nominated fund being an underperformer does not increase by much when only one fund is named (the likelihood of it being a high-performing fund does decrease substantially).

However, when more than one fund is listed in the agreement the chance of the employee being defaulted into an underperforming fund increases to almost 49% (while the chance of the employer being placed in a high-performing fund increases to 40%). When we isolate the first fund listed in the agreement from any others, we see the chance of being defaulted into an under-performing increases to 64% and there is no prospects of being placed into a high-performing fund.

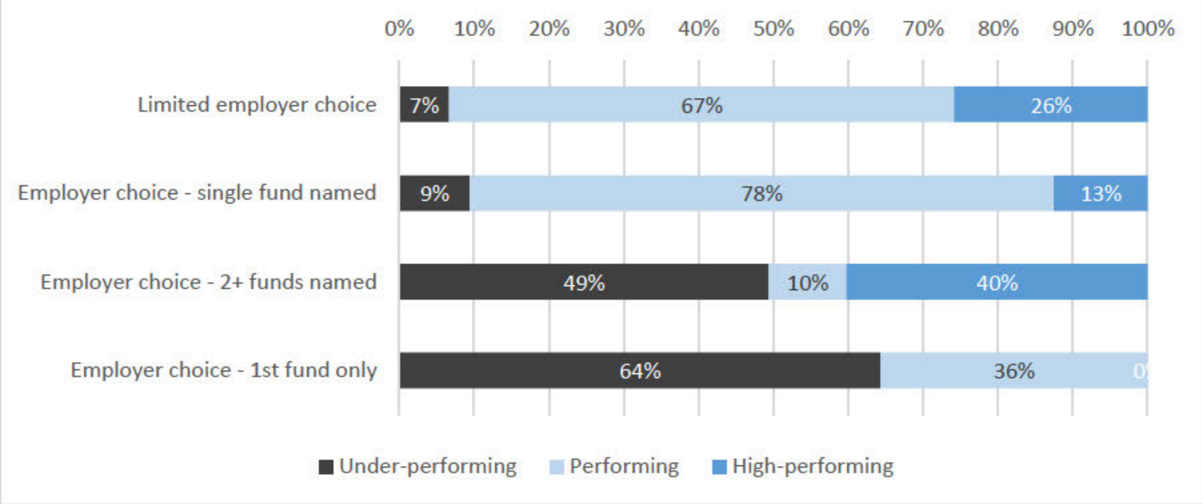


Chart 6: Impact of employer choice on performance

One possible explanation for this is that this represents a scenario where the employer has resisted changing their longstanding default, but at least agreed to having other funds named in the agreement (88% of which happen to be profit-to-member funds) so that staff know they have the right to choose those funds.

CONCLUSION

We find no evidence to back up the Productivity Commission's suggestion by that constraints on employer choice in either awards or agreements are one of the main drivers of subpar outcomes in default. In contrast, the data demonstrates that where such constraints are currently in place that superior outcomes tend to occur.

Still, the highly varied outcomes in default arrangements do point to the need for ongoing improvement in those arrangements, but any changes should be grounded in evidence of what works. Critically, in the case of superannuation, consideration of what works should not just the improved allocation of more employees to performing and high-performing funds but the extent to which they will strengthen or weaken scrutiny of superannuation fund performance. Both employee and employers in a workplace with concentrated fund membership will be better placed to engage effectively with their fund than a workplace where membership is fragmented.

On this basis, the evidence would suggest policymakers should be exploring how to make collective choice mechanisms more effective and possibly more accessible, particularly when it comes to addressing under-performance. In contrast, the Bill's aspiration of putting the small minority of the workforce that currently use these mechanisms "on an even footing with the majority of workers"[7] is to increase the risks that they will end up worse off.

[7] Tehan, op. cit.