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18 March 2021

Your Future, Your Super exposure draft legislation

Prime Super

Prime Super is an independent, profit-to-members superannuation fund. Our core purpose is to achieve the best possible retirement outcome for members. We offer superannuation solutions to grow, manage and protect the wealth and retirement income of our members.

Prime Super has provided super and retirement solutions to Australians for close to 25 years. We have over $5.3 billion funds under management and 125,000 members who work in industries including agriculture, horticulture, health, education, aged care and recruitment.

Prime Super makes the following comments in relation to the proposed legislation.

Single default account

Prime Super supports the concept of stapling a superannuation account to an individual to prevent the creation of duplicate accounts in the system.

Addressing underperformance in superannuation

Superannuation fund performance should be measured by net investment performance and operational efficiency.

Net investment performance

The cost of investing relates to investment performance outcome. It has no bearing on the administration of a fund. Investment costs should only be included in net investment return comparisons. This provides a fair comparison of the returns of various styles of investing including the cost of those strategies. A higher cost investment strategy can deliver a superior after-cost return.

Investment costs need to be separated from administration fees, but the current APRA Heatmap compares total costs which includes both administration and investment costs. This comparison gives an advantage to funds that use indexed management styles and do not reference the actual return generated from those strategies. In addition, investment costs are

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counted twice in the Heatmap, first in net investment return comparisons and second in total cost comparisons.
One further complicating factor is that the Heatmap is compiled from data and financial information that APRA requires from funds. The content of this information can be interpreted differently by different funds, which results in a lack of consistency of information.

Operational efficiency
If the administration costs of a super fund are expressed as a percentage of overall funds under management (as is the case with the APRA Heatmap) this gives an advantage to funds with a higher average account balance, rather than reflecting their underlying operational efficiency.

The administration fees of a superannuation fund relate to managing transactions and engagement with members. Whether a member has a balance $1 or $1 million, the fund must still process contributions, generate statements and provide member services, like the call centre. Administration costs should, therefore, be more correctly measured on a per member basis.

If administration costs are based on funds under management, in an environment with mandated contributions, long-term investment returns between 6-8%, funds under management growth of 10% per annum, and inflation at 3% per annum, administration costs could increase at twice the rate of inflation and show a cost reduction when measured against account balances.

The cost of administration measured against the number of members is a true comparison of how efficiently a fund provides a superannuation service. Where this comparison shows funds have continuous excessive costs to administer superannuation funds, those funds should be required to merge.

Underperformance and diversity in the super system
A strength of the current superannuation system is the diversification in the performance of the underlying superannuation strategies in place. This ensures that there is a range of outcomes across the total market. The key objective is to deliver to members an amount in retirement that minimises pensions payable by the Government.

If there is an objective for funds to avoid 'underperformance', asset allocations will converge to minimise the risk of underperformance. This will lead to periods of a system-wide underperformance and a greater requirement for future governments to meet pension liabilities. Consequently,

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the use of risk-adjusted, net investment returns as a comparison tool is a positive initiative, as opposed to simple comparisons of actual returns.

However, the move to close underperforming funds to new members will make the outcome worse for members that remain in that fund, which is not the aim of this legislation.

The key requirement must be that superannuation funds provide appropriate information to members to enable them to make informed decisions. For example, a fund that has a membership age profile close to 60 years of age can have a more conservative investment strategy than a fund with a younger age profile. In the latter case, there may be periods of time where underperformance will occur, and may be significant, but this is suitable for that particular member cohort. Members can make informed decisions when they are informed of their fund's investment performance.

It must also be noted that removing the bottom quartile of funds is too simplistic. There will always be a bottom quartile until there are only three funds in existence. Measures need to be established on a range of administration costs based on the number of members of the fund and the minimum level of services to be provided.

Comparisons of superannuation funds must also consider other measures, such as climate change, an issue closely monitored by regulators and consumers. A fund should not be penalised for making decisions driven by these other considerations or community expectations, even though these decisions may not always be in the best financial interests of members collectively or individually.

Best financial interests duty

The draft legislation proposes that the Trustee must demonstrate that all individual fund expenses are in the best financial interests of members.

There are many expenses incurred, particularly in marketing and business development, where the totality of activity delivers a positive outcome. It is not possible to consider each expense in isolation to identify its positive contribution to the business. For example, through brand recognition members develop trust, awareness and understanding of their fund and their superannuation.

As noted above the appropriate comparison of total expenses is on a per member basis. Regulation that prohibits expenditure on new opportunities or

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requires preconditions, will curtail innovation. Innovation occurs where it is possible to try new things to gain an advantage in the market-place. If this expense is included as part of the total administration costs, based on the number of total members, then expenses can be benchmarked to ensure costs are managed and innovation and evolution of businesses continues.

Insurance in superannuation

While not specifically addressed in this legislation, insurance cover is a requirement within superannuation legislation, and the cost of which is deducted from individual member accounts.

From a superannuation point of view there is no difference between members based on race, gender, occupation or any other criteria. Contributions are made, invested for the long-term for members and paid at retirement as an income stream or a rollover benefit.

Insurance coverage is fundamentally different. It takes into account different risks associated with individuals, such as their occupation. Those funds with a high number of members from blue collar industries will have a higher cost for the insurance offered. This risk is not associated with superannuation, it is an insurance risk.

We are of the view that a superannuation fund should not be responsible for the provision of insurance cover for members. Superannuation funds currently provide a minimum level of insurance cover for the majority of working-aged Australians. If this level of insurance cover is to be maintained, then a broad-based insurance scheme should be established that is separate to superannuation.

This will provide a better solution through a large pool of diversified members in which individual member risks can be balanced through a large pool. In addition, the financial outcomes for members in superannuation will improve as the number of deductions from accounts will reduce.
Prime Super would be happy to discuss any aspects of this submission further, and I can be contacted on [redacted]

Yours faithfully, [redacted]

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