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Independent Fund Administrators & Advisers Pty Ltd (IFAA)
Submission to Financial System Inquiry

Executive summary

This submission is made by Independent Fund Administrators & Advisers Pty Ltd (IFAA), a Brisbane based administrator of industry superannuation funds and a managed investment scheme.

IFAA appreciates the opportunity to have input into the deliberations of the Financial System Inquiry. IFAA is well placed to comment on the superannuation aspects of the Inquiry, being an administrator of small to medium size industry superannuation Funds. We strongly believe the Inquiry should recognise small to medium superannuation funds have a place in the industry and can add value to members and competition to large funds. Small to medium funds don't need to merge to gain economies of scale. These Funds can utilise organisations such as IFAA to secure cost savings through innovative collaboration.

The submission makes comment on the following aspects of the Inquiry:

1. Fee levels
2. Competition in the industry
3. Engagement and disclosure
4. Regulation
5. Comparisons to overseas models

A summary of IFAA's response to the Financial System Inquiry interim report, is set out below:

- *IFAA client Funds will continue to work co-operatively to explore cost saving opportunities;*
- *The Government should allow electronic communications to members to be a default. This may lower fees and assist in member engagement;*
- *The Government should not consider fees in isolation, but as one important component of member outcomes;*
- *The Government should have greater awareness of the cost impact of regulation;*
- *Government policy should not unduly impact the operations of smaller Funds, who serve a very valuable role in delivering competitive yet customised outcomes for members;*
- *The existence of smaller Funds offers competitive choices to members, and provides diversity in the industry landscape;*
- *Government policy should actively encourage member engagement;*
- *Disclosure should be consumer tested to promote engagement;*
- *The Government should undertake detailed cost benefit analysis on new regulatory proposals prior to implementation;*
- *The Government should actively consider whether all regulatory requirements serve the interests of members;*
- *The Government should endeavour to provide a more stable policy setting to allow the industry to flourish;*
- *The Government should apply caution in comparing overseas models to the Australian superannuation system.*

Further details are outlined in the body of the submission.

1. *Fee levels*

1.1 If fees in the superannuation industry are perceived to be high, this is significantly due to the highly intensive and evolving regulatory landscape. This requires very significant investment of resources in analysing requirements, upgrading IT systems, staffing to give effect to the requirements, upgrading disclosure documents and audit costs to review compliance.

1.2 It is recognised that keeping fees competitive is important in acting in the interests of members. However, the focus on fees should be balanced against the net returns and the services received by members. Lowest cost does not necessarily deliver on either of these objectives. If there is an exclusive focus on fees, there is a risk that net outcomes and provision of quality services will be overlooked, when in fact these factors should be of equal or greater importance.

1.3 If fees were the major concern of members, there would not be considerable leakage from industry funds to Self Managed Superannuation Funds and retail funds, where fees are generally higher. These members clearly are driven by factors other than fees.

1.4 The Government is moving the industry toward paperless processing via the Superstream reforms, with the objective of reducing costs over the medium to long term, but it is too early to assess the actual cost impact. There are likely further savings which could be extracted if electronic transactions / communications were mandated as the default in other areas. For example, provision of member communications can be conducted electronically, but it is not the default position and is subject to considerable regulatory requirements.

1.5 The expectations placed on the industry are sometimes in conflict. The Government has a focus on lowering fees, which could be achieved by changing to passive investment models. However, IFAA considers active management can deliver better long terms investment results. In addition, successive Governments have encouraged the superannuation industry to invest in alternative investments, including infrastructure. Such investment models require active investment management, which come with higher fees.

1.6 The Inquiry has perceived that fees are relatively high in the superannuation industry. However, some industry participants are taking active steps to try and minimise costs through innovative collaboration. For example, IFAA recently facilitated several of its clients in undertaking a joint custodian tender. This saved the participating Funds significant amounts of money compared to the conduct of separate tenders / appointment. Other combined Fund opportunities are also being explored with a view to achieving further cost savings for members.

Conclusions:

- *IFAA client Funds continue to work co-operatively to explore cost saving opportunities;*
- *Allowing electronic communications to members to be a default, may lower fees and assist in member engagement;*
- *The Government should not consider fees in isolation, but as one important component of member outcomes;*
- *The Government should have greater awareness of the cost impact of regulation*

2. *Competition in the Industry*

2.1 Competition does exist in the industry (performance and fee comparatives published by ratings agencies). IFAA client Funds genuinely try to maintain fee levels, while continuing to provide high levels of service to members and employers. However, the regulatory burden makes this increasingly difficult, and in some cases fee levels have increased, in direct response to regulatory requirements (ie. Stronger Super and additional APRA reporting).

2.2 The Government policy settings can make the operations of small Funds difficult (due to high levels of regulation and cost). This assumes that bigger Funds produce better outcomes for members and IFAA and its client Funds do not accept that proposition. Smaller Funds play a very valuable role in allowing greater levels of personalised member contact, resulting in outcomes more customised to the needs of the member, as well as delivering very competitive returns. In addition, consolidation of the industry detracts from the competition that the Government wants to achieve, which is likely to reduce pressure on remaining Funds to reduce fees.

Conclusions:

- *Government policy should not unduly impact the operations of smaller Funds, who serve a very valuable role in delivering competitive yet customised outcomes for members;*
- *The existence of smaller Funds offers competitive choices to members, and provides diversity in the industry landscape.*

3. *Engagement and disclosure*

3.1 It is acknowledged there are relatively low levels of member engagement in superannuation. This is considered to be due to a number of factors, including:

- consumers require certainty in investing, and superannuation does not provide that due to complexity and ever changing rules;
- the default nature of the system, which does not encourage active decision making;
- the fact superannuation is unavailable until retirement.

3.2 It is acknowledged that the move to 8 page PDS' was an improvement on the previously voluminous publications which were issued. However, the requirements for the 8 page PDS are highly prescriptive and technical. It is also unclear if the Government undertook sufficient member testing of disclosure documents of this nature, to ensure maximum effectiveness.

3.3 Benefit Projections are a key tool in aiding member understanding of retirement outcomes, yet regulators have not assisted Funds in having completely aligned assumptions. In particular, until a final regulatory guide is produced which ensures each Fund takes into account standard Centrelink assumptions, benefit projections for some members may be misleading.

Conclusions:

- *Government policy should actively encourage member engagement;*
- *Disclosure should be consumer tested to promote engagement.*

4. Regulation

4.1 The regulation of the superannuation industry is onerous and imposes significant costs on Funds which in turn are passed to members. It is recognised that regulation has contributed to the stability of the industry, but it is considered that the Government should undertake detailed cost benefit analysis on new proposals prior to implementation.

4.2 The Government's policy positions can be contradictory. MySuper was announced as having the goal of being simple and low cost. For Funds having to implement the myriad of associated Stronger Super requirements, it has proven to be anything but simple and low cost. In fact, a number of Funds have had to increase member fees in response. Similarly, regulators have recently given indications of being amenable to considering industry cost savings, yet there has been no material shift in regulatory position to give effect to that.

4.3 Some regulatory requirements impose costs with no apparent benefit to members. For example, the highly prescriptive APRA reporting has added a layer of cost to Fund operations which has been borne by members, with no corresponding benefit. Much of the data required by APRA is available in PDS' and other Fund publications, but resources have needed to be employed by Funds to obtain, analyse and submit a huge amount of data to APRA. The data is used for statistical and analytical purposes, but this process arguably serves no benefit to members. It is also noted that the complexity of APRA reporting is increasing, while lodgement timeframes are reducing.

4.4 Some of the Government policy positions do not assist member understanding and engagement. For example, the MySuper dashboard requires disclosure of a 'Return Target'. This is entirely different to the MySuper 'investment objective' which members are advised of in PDS' and other publications. It is difficult to see how the disclosure of these different concepts will not cause confusion and further disengagement.

4.5 The industry lacks a stable policy setting. Major restructuring of Fund operations occurred following the Simpler Super reforms in 2007. The Cooper review then materialised into the MySuper reforms. On top of that, the Government then proceeded with the extensive Stronger Super reforms. Now the Financial System Inquiry is considering further structural change to the industry. The industry is suffering from reform fatigue and each raft of new requirements comes at additional cost to Funds and therefore members. It should also be noted that the industry is sometimes expected to make implementation decisions on particular reforms based on draft legislation. For example, this occurred with the MySuper reforms, with some requirements changing after MySuper licence applications were lodged with APRA.

4.6 Due to the necessary focus on implementing regulatory requirements and the associated cost, the industry gets to invest less in product enhancement than would otherwise be the case.

Conclusions:

The Government should:

- *undertake detailed cost benefit analysis on new regulatory proposals prior to implementation;*
- *actively consider whether all regulatory requirements serve the interests of members;*
- *endeavour to provide a more stable policy setting to allow the industry to flourish.*

5. Comparisons to overseas models

5.1 The Inquiry has raised the possibility of default fund auctions, as occurs in some overseas jurisdictions. As outlined above, this again assumes that lowest cost is best, when that may not necessarily provide the quality required to ensure appropriate administration of member accounts and adherence to regulatory requirements. It also raises the question of the impact on those funds that do not attain default fund status. This may bring their viability into question, which would not serve the interests of members.

5.2 Further, comparison to overseas models should be undertaken with caution. There are doubtless very significant differences between the industries and regulatory settings that would not necessarily translate to successful transplanting of policy settings in the Australian system.

Conclusions:

- *The Government should apply caution in comparing overseas models to the Australian superannuation system.*

Contact: *Adam Lewis*
Position: *Policy and Compliance Manager*
Phone: *07 3238 1411*
Email: *adam.lewis@ifaa.com.au*