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26 August 2014

Mr David Murray AO
Chairman
Financial System Inquiry
GPO Box 90
SYDNEY NSW 2001

By email: fsi@fsi.gov.au

Dear Mr Murray

Subject: Response to Interim Report of the Financial System Inquiry

Mercer is pleased to present its submission to the Inquiry.

Please contact myself or Dr David Knox (03 9623 5464) if you have any queries in relation to our submission.

Yours sincerely

David Anderson

Managing Director & Market Leader, Pacific

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TALENT • HEALTH • RETIREMENT • INVESTMENTS

THE FINANCIAL SYSTEM INQUIRY

MERCER RESPONSE TO INTERIM REPORT

26 AUGUST 2014

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1

Executive Summary

The Interim Report of the FSI covers a wide range of issues. Our response concentrates on superannuation and wealth management matters.

We consider the most appropriate manner to summarise our key views is to suggest a desired outcome with a series of underlying principles and the actions necessary to best achieve this outcome.

These are set out below.

Desired outcome

Superannuation should be an efficient and effective **life-time** vehicle for providing adequate and sustainable income in retirement, supported by the age pension where appropriate.

1. Default arrangements

Straightforward default arrangements should be available for those who are not engaged. The Australian system could be improved by:

1.1. Providing default income arrangements in the post retirement phase (also refer to principle 2 below and Section 8)
1.2. Ensuring the MySuper legislation focuses on net returns and long term outcomes rather than fees and costs. This should reduce the chances of MySuper resulting in sub-optimal outcomes because of an emphasis on fees (e.g. the adoption of low cost but less effective investment strategies and the removal or reduction of services such as education and helpline advice centres) (refer to Section 4).

2. Post-Retirement

There should be a simple transition from the employment or pre-retirement phase to the retirement (pension) phase (refer to Section 8). The Australian system could be improved by:

2.1. Enabling members to be switched from the accumulation stage on a default basis (currently most retirees need to transfer from one product to another and consider complex documentation and application forms which discourage this desirable outcome)
2.2. Providing greater flexibility to better enable product providers to develop retirement income products which protect against longevity, inflation and investment risks
2.3. Ensuring means testing arrangements for the age pension are fair, understandable and consistent across different retirement products.

3. Competition

Product providers should be able to compete on an equal footing. The Australian system could be improved by:

3.1. Removing provisions in the Fair Work Act which severely limit competition between superannuation funds as well as increasing costs (refer to Sections 2 and 4)
3.2. Ensuring, as far as possible, consistency in tax and social security policies so that certain superannuation arrangements are not unduly favoured over other superannuation arrangements (refer to Sections 3 and 8)
3.3. Removing barriers to fund consolidation (refer to Section 2)

4. Financial Advice

Australians should be able to trust the financial advice they receive. The Australian system could be improved by:

4.1. Improving the quality of advice by mandating higher education and CPD requirements for those providing personal advice (refer to Section 6)
4.2. Restricting the use of the terms financial planner and financial adviser to those who are members of an approved professional body and have met the specified education and CPD standards (refer to Section 6)
4.3. Replacing the term general advice with “product information” (refer to Section 6)
4.4. Mandating the provision of retirement projections (including in income stream format) subject to appropriate guidance and sign-off (refer to Section 4)
4.5. Providing greater flexibility for funds to make tools and calculators available without the output being classified as financial advice (refer to Section 6)

5. Cost effectiveness

Fees and charges should be reasonable, taking into account the cost of the services provided, compliance costs and appropriate profit margins. The introduction of MySuper and SuperStream are likely to reduce fees in the longer term (despite the significant implementation costs) and these initiatives should be given a chance to work. It should also be acknowledged that comparisons of fees with those in other countries have generally been based on OECD data which is either incomplete or does not provide a suitable basis for comparison as discussed in the Mercer report on fees commissioned by the Inquiry. The Australian system could be improved by:

5.1. Removing provisions in the Fair Work Act relating to default funds. Although these provisions are yet to take full effect, unless removed they will increase costs for many superannuation fund members, employers and superannuation funds (refer to Sections 2 and 4)
5.2. Providing greater flexibility to utilise electronic means for transactions, communications and disclosure (refer to Sections 2 and 9)
5.3. Simplifying disclosure requirements by freeing up content and delivery requirements in a manner which would provide more scope for providers to highlight key features rather than

the current emphasis on satisfying complex and often unhelpful legislative requirements (refer to Sections 4 and 6)

5.4. Reducing the currently high compliance costs. Appropriate changes to superannuation legislation could result in significant reductions to costs (and hence fees) without impacting the integrity of the system. Disclosure requirements (relating to content and method of delivery) and APRA reporting are examples of key requirements which result in significant costs without commensurate benefits (refer to Section 4 and Appendix A)

5.5. Leaving the active/passive investment management decision to the competitive market place and the discretion and preferences of fund trustees and their members

5.6. Reviewing the prudential requirements on trustee boards to ensure they do not draw boards into operational matters (refer to Section 5)

5.7. Greater continuity in superannuation legislation. This would reduce the current high costs of regular updating of administration systems and communication material to cope with continual legislative change (refer to Section 4)

5.8. Better design of legislative changes to reduce implementation costs

6. Coverage

Global best practice would mandate superannuation for all in the workforce. The Australian system could be improved by:

6.1. Extending Superannuation Guarantee coverage to the self-employed and to employees earning less than $450 a month, and those on workers compensation or parental leave and certain disability income benefits (refer to Appendix C)

6.2. Simplifying legislative restrictions applicable to contributions from age 65 (refer to Section 4 and Appendix A).

7. Flexibility

Members should not be restricted to using the default arrangements. The system should be flexible to allow members to choose arrangements best suited to their individual circumstances.

7.1. This is currently available through Choice of Fund and choice of investment and insurance options offered by superannuation funds. We consider it important for members to be able to choose a fund and products which best suit their needs. However it must be acknowledged that such choices may result in higher fee products due to their additional features and the provision of choice adds to the cost of the superannuation system (Section 4).

8. Social Security and Tax

The Tax and Social Security systems should support the above outcomes (Sections 3 and 8).

The remaining sections of this submission are numbered in a consistent manner to the Interim Report. When responding to an issue raised in the Interim Report, we have set out the question asked or observation made. These questions and observations have been shaded in our submission.

2

Competition

2.1 Superannuation – Fair Work

Mercer supports the four principles set out on page 2-5 of the Interim Report to facilitate competition.

The second principle is particularly relevant in the superannuation environment. "The Government should …… Remove regulatory impediments to competition, such as barriers to entry and distortions to level playing fields, subject to trade-offs with other policy objectives that the regulation seeks to achieve"

The Fair Work legislation, has, since 2008, severely curtailed competition and has limited the ability of employers to utilise the most appropriate superannuation fund for their default employees. Default funds have been restricted to those nominated in the relevant Award and to a fund being used by the employer before 12 September 2008 (or its successor).

Amendments to the Fair Work Act in 2012 and 2013 further limit competition. In addition, they will result in increased fees for many superannuation fund members and higher costs for many employers and superannuation funds. We elaborate more on the higher fees and costs in Section 4.

Under these changes, employers will generally be limited to using a default fund which is listed in the relevant Modern Award. Only funds offering a MySuper product can apply for listing in Modern Awards.

In Stage 1 of the listing process, applications are to be considered by an Expert Panel constituted by The Fair Work Commission. (Currently applications have closed but this stage has been stalled by a determination by the Federal Court that the Expert Panel which had been established had not been properly constituted.) The intention of Stage 1 is to produce a list of suitable funds from which the Full Bench of Fair Work can select (generally up to 15) funds for inclusion in each Modern Award (Stage 2).

In today's environment, this process is significantly flawed and adds considerable costs without adding to the protection of default employees. In fact it will potentially impact in an adverse manner over 1 million Australians by reducing their likely retirement benefits (refer to Section 4).

No longer a need for a quality filter.

We accept that, previously, a quality filter would have been a logical step in the process. However the need for such a step has been removed because of a number of legislative changes which have been introduced in recent years. These include:

1. The introduction of MySuper in 2013 including changes requiring any default fund to offer a MySuper default option. By restricting default funds to MySuper products, a quality filter is already in place as providers have gone through a strenuous process of justifying to APRA why their product satisfies the strict MySuper requirements including a member best interests test. APRA is continuing to monitor these MySuper products. We consider APRA is far more qualified to determine the appropriateness of particular funds than any Expert Panel which may be established by The Fair Work Commission due to the experience gained by APRA over many years of monitoring superannuation funds.
2. The banning of conflicted remuneration (including commission payments) in relation to MySuper products which limits the scope for advisers to recommend products based on their own interests rather than those of their employer client and its employees
3. A prohibition on trustees of a superannuation fund supplying or refusing to supply goods or services to a person on the condition that one or more of the person's employees are members or are not members of the relevant superannuation fund

The Fair Work process as legislated was originally drafted when it was not known how many funds would establish MySuper products. At present, there are only 118 MySuper products which have been approved by APRA, considerably less than was originally envisaged.

However not all of these funds were eligible to apply to the Fair Work Commission for inclusion in the default fund lists proposed for Modern Awards (e.g. Tailored MySupers and corporate funds set up for employees of a particular employer).

In fact, only 67 MySuper products have applied to the Fair Work Commission to be included on default fund lists. (A further 28 MySuper products which have been set up for employees of a particular employer applied for approval to be used by the relevant employer under a different process).

23 MySuper products did not apply to the Fair Work Commission. Some of these are likely to be corporate funds where there is a low incidence of Award based members. In some other cases the provider may have been deterred by the costs and effort required to make an application and considered it may be cheaper and easier to convince members to remain in their existing MySuper than going through the Fair Work process.

Competition is restricted

Although any fund offering a MySuper product (other than the Tailored and corporate funds referred to above) could have applied for listing in Modern Awards, the Fair Work Act does not allow the Fair Work Commission to consider the full circumstances of funds. In relation to fees, The Fair Work Commission is required to consider each fund's "rack rate" – not the fees actually charged to the majority of members.

Master trusts, which concentrate in the corporate market, deliver highly cost effective fee structures for employers which take into account the relevant economies of scale in dealing with a larger membership group, and the efficiencies of the relevant employer in providing accurate data. Discounts from the rack rate in corporate master trusts can be over 0.5% of account balances for large employer plans reflecting the economies of scale of the employer plan. The Fair Work Commission is required to ignore these discounts.

In other words, corporate master trusts, whilst they can compete, are unable to do so with their best offering for many situations.

This restriction applies in Both Stages 1 and 2 of the Fair Work process resulting in an un-level playing field.

We also note it is likely to be very difficult for any Expert Panel constituted by the Fair Work Commission to rank funds on quality. Any decisions are likely to be very subjective.

Stage 2 process

The Stage 2 process is heavily influenced by unions and employer bodies – i.e. those groups which have established and continue to sponsor a number of industry funds and who also have standing in the Fair Work Commission.

On the other hand, retail funds do not have standing in the Fair Work Commission.

Other issues

The Fair Work process is also likely to result in the following adverse outcomes:

- A much greater concentration of risk with some superannuation funds becoming too-big-too-fail
- Too much emphasis on low fee products providing vanilla products with conservative (and low cost) investment strategies which are likely to lead to lower retirement outcomes
- Major disruption to the industry. As indicated in Section 4, it has been estimated over 100,000 employers may need to change their current default fund.

Recommendation

Mercer recommends the provisions specifying default funds be removed from Modern Awards with employers being able to choose any fund offering a MySuper as their default. This will free up competition whilst applying the APRA MySuper approval process as a quality filter.

In Section 4 of our submission, we discuss the significant costs which will arise for funds, employers and employees if the Fair Work default fund provisions are not removed.

2.2 Restrictions in relation to consolidation

In any competitive system, there will be opportunities for rationalisation of providers. However, legislative issues can create significant barriers to the merger of superannuation funds. Legislative issues can also restrict the ability of providers to reduce costs by winding up legacy products.

In relation to fund mergers, the following barriers apply:

An inability to transfer deferred tax assets to a successor fund

This has been a major deterrent to fund mergers in recent years. Temporary changes in tax law have minimised the impact for specified periods. However the current temporary provisions terminate in 2017 when this will again become a major barrier.

Recommendation

The temporary rollover relief provisions need to be made permanent.

Deeming provisions for account based pensioners

From 1 January 2015, a deeming approach will be adopted for the income test for the Age Pension. The existing approach will continue for account based pensioners who are receiving the Age Pension as at 1 January 2015. However these grandfathering rules will cease if the account based pension is commuted and rolled over to another pension.

As the new deeming test is likely to result in a greater reduction in the Age Pension, any successor fund transfer of an existing account based pension from 1 January 2015 could have an adverse impact on the level of Age Pension received by transferring account based pensioners. This will restrict the ability of trustees to achieve better outcomes for those members who are not receiving an account based pension. At this stage we understand CentreLink will be adopting a pragmatic approach and, in cases where the transfer is trustee instigated rather than member instigated, CentreLink will consider the transferred pension is merely a continuation of the existing pension and not a new pension. This pragmatic approach is appropriate and will generally not result in an adverse impact on transferring pensioners

Recommendation

CentreLink should publicise its interpretation to minimise concerns and provide certainty to the industry.

ATO views on successor fund transfers

We understand the ATO considers a successor fund transfer results in the commutation of existing pensions and the crystallisation of tax components for non-pension members. If applied, such views can have a detrimental tax impact on some members. In particular:

- The taxable component of pensions which commenced before 1 July 2007 may increase for pensioners under age 60. These will generally be pensions resulting from:
  - the death of the original member
  - the permanent incapacity of a member

  (The impact on fund mergers is largely a transitional problem resulting from legislative changes in 2007. It does not arise in respect of pensions which commenced on or after 1 July 2007. This issue was much more serious in the period 1 July 2007 to 30 June 2012 where many retirement pensions which had commenced before 1 July 2007 were also impacted. By 1 July 2012, these pensioners would have reached age 60 - the age from which pension payments become tax free and the problem resolved. However in this period the ATO view significantly increased the cost of some fund mergers.)

- The tax free component of benefits for non-pensioners may reduce (although this is unlikely to impact many members unless there is a fall in asset values – for example as happened in 2008)

Recommendation

The ATO should reconsider its views on successor fund transfers or alternatively legislative changes should be made.

MySuper requirements

An unintended consequence of Section 29TC (1)(h) of the SIS Act is that successor fund transfers from one MySuper fund to another may well become difficult.

The problem

Section 29TC(1)(h) says that an interest in one MySuper product cannot be replaced with an interest in another fund unless

- "*the* replacement *is permitted, or is required, under a law of the Commonwealth; or*
- the *person …… consents …….*"

There is some legal debate whether "permitted" means "not prohibited" and so allows a member's benefit to be paid to a successor fund[1]. If Section 29TC(1)(h) is retained in its current form, it should be clarified to ensure that a member's benefit can be paid from a MySuper product to another MySuper product that is a 'successor fund'.

Successor fund transfers are the main mechanism for transferring employer sponsored members from one superannuation product to another (generally as the result of a competitive tender process by the employer).

A 'successor fund' must offer equivalent rights in respect of benefits of each of the transferring members. Because of the difficulty of applying this test to members individually, successor fund transfers generally proceed where the receiving fund offers the same (or better) fees, insurance, investment strategy and other features across the group of members being transferred. Usually, the receiving fund would tailor its offering to those members to ensure the same or better fees, insurance, investment strategy and other features. Under Section 29TC of the SIS Act, it will now be difficult to do this for MySuper members.

Generally Section 29TC(1)(b) of the SIS Act requires the same features to be offered to all members of a MySuper product. There are only limited exceptions. This requirement to offer all MySuper members the same features limits the ability of the receiving fund to tailor its offering to the group of transferring members so that the receiving fund is a 'successor fund' for

[1] SIS Regulation 6.29

each of those members. This is likely to be a particular problem for transfers between MySuper products that have quite different investment strategies – eg life cycle instead vs balanced or growth – or quite different fee designs.

As a result, there is a real risk of existing account balances in some employer plans becoming trapped in their current MySuper products - lessening competition in the industry. This lessening of competition would clearly be an unintended consequence of the MySuper reforms and would act against MySuper driving down member costs.

Solution proposed

We propose that Section 29TC(1)(h) of the SIS Act be amended to permit any transfer between MySuper products without an additional "equivalence" test under the successor fund provisions. If that is not achievable, we propose that the requirements that must be met for the receiving MySuper to be a "successor fund" exclude those attributes of a MySuper product that the receiving trustee cannot replicate in respect of incoming MySuper members only.

Recommendation

Section 29TC(1)(h) should be amended to ensure benefits do not become trapped in existing MySuper products in a way that lessens competition between MySuper products.

2.3 Insurance

The group life insurance sector offers widespread life and disability insurance via members' superannuation. The industry is currently experiencing capacity issues, high levels of claims and premiums are rising significantly for many funds. Issues that need addressing are:

- The definition of permanent incapacity in for MySuper funds – many insurers and fund trustees are beginning to offer insurance on a more restrictive definition of permanent incapacity than the SIS Act definition, to improve the sustainability of the offering.

  Greater legislative clarity is needed in this respect bearing in mind the legislative requirements for MySuper products to provide death and permanent incapacity insurance.

- Changes to the SIS Regulations effective from 1 July 2014, placed restrictions on the definitions of permanent incapacity that are permitted to be included in insurance policies. Although existing definitions can continue to apply for existing members, more restrictive definitions must apply to new members. For example, it is no longer possible to provide insurance (for new members) covering the loss of two limbs (or sight) or the inability to perform normal activities of daily living unless it is also expected the member will be unlikely to work in any occupation for which he is qualified by education, training and experience. 'Loss of limbs' disability definitions have been a part of insurance policies for over 40 years. Daily living type definitions have been developed more recently to reflect the extension of superannuation to those not in the workforce. Such definitions are more relevant to those not working, those working on a casual basis and those working only a small number of hours a week. The new requirements have impacted virtually every fund and resulted in what we consider to have been totally unnecessary costs in negotiating changes to insurance policies, complicating communication material (with different definitions applying to different members depending on when their cover commenced) and changes to administration systems. The changes will also involve higher administrative costs on an ongoing basis due to the different definitions applied to different members and prevent super funds from providing best practice benefits.

- Income Protection in MySuper funds – this type of insurance covers an important need of members to protect their income and savings while they are temporarily disabled from working, and is being provided by a significant number of MySuper funds. However, restrictions on the benefits which can be provided, particularly for new members, result in less than optimal benefit design.

  Legislative restrictions prohibiting payment of benefits to members who are not currently in the work force and to those who can continue to work but in a reduced capacity are inappropriate and inconsistent with best practice in relation to income protection insurance. Further legislative restrictions discourage members returning to work on a partial basis while recovering.

  The requirements in the SIS legislation should be amended to enable funds to provide more appropriately designed income protection insurance.

- The considerable size of some funds and their insurance arrangements may also lead to concerns in the future. It may be difficult for some funds to be able to successfully remarket their insurance portfolio due to its size, the limited number of insurers willing to quote and the potential of inconsistent permanent incapacity definitions between insurers. The loss or gaining of an insurance contract with a very large superannuation fund is likely to cause stress on both the previous and new insurers.

Recommendation

Legislative provisions relating to the definitions of permanent and temporary incapacity benefits need to be reviewed to improve the ability of superannuation funds to provide best practice benefits on a cost effective basis. This would include the reinstatement of the ability for funds to provide permanent disablement insurance based on definitions commonly in place before 1 July 2014 and enabling a wider range of features in disability income products designed to encourage disabled members to return to work.

3

Funding

3.1 Household Saving

The Interim Report refers to the tax concessions available in respect of superannuation.

Without these concessions, we expect there would be very limited voluntary saving through superannuation. We also expect there would be major dissension in relation to mandatory superannuation. The reason is not the lack of tax concessions in isolation but the strict regulatory requirements and restrictions imposed on superannuation which would otherwise make superannuation an unattractive proposition unless accompanied by tax concessions. In particular the lack of access to superannuation savings due to preservation requirements would be a particular concern to the young and middle aged.

The Henry report on Australia's Future Tax System in 2010 provided further reasons for tax concessions in relation to superannuation in Part 2, Chapter A:

> "Superannuation is the main form of lifetime saving outside the family home. There is a bias in the current taxation system against long-term saving, particularly lifetime saving such as superannuation. There are at least two reasons for taxing superannuation more favourably than other saving (with the exception of housing) to reduce this bias.
>
> The first reason is that taxing superannuation earnings, like the earnings on most forms of savings, means that the effective rate of tax on the real value of saving increases the longer an asset is held (see Section A1 Personal income tax). This effect is more pronounced in superannuation than other savings as superannuation saving is generally held for a longer time. This justifies a more favourable tax treatment.
>
> The second reason is that superannuation is a form of deferred income. People should be taxed on superannuation at the rate that would apply if their income had been spread over their entire life rather than merely over their working life. This is an income-smoothing argument. As a person's retirement income is generally lower than their income while they were working it should be taxed at a lower rate."

In other words, tax concessions are vitally important to enable superannuation to compete against other investment opportunities for household saving. Without them, there would be a reduction in the level of superannuation saving which would be replaced by a combination of:

- Greater spending (which would likely result in lower retirement incomes and greater costs to Government due to higher age pensions)
- Greater investment in other savings vehicles, particularly tax-preferred options such as negative gearing

In Section 4.4 we comment on the appropriateness of the existing concessions and Mercer's views on how they can be improved.

4

Superannuation

4.1 Objectives of the retirement income system

The Interim Report notes there is no legislative or formal statement of the guiding objectives for the retirement income system.

Mercer believes superannuation should be an efficient and effective **life-time** vehicle for providing adequate and sustainable income in retirement, supported by the Age Pension where appropriate.

This desired outcome should be backed by the following guiding principles:

1. **Default arrangements**

   Straightforward default arrangements should be available for those who are not engaged.

2. **Post-Retirement**

   There should be a simple transition from the employment or pre-retirement phase to the retirement (pension) phase.

3. **Competition**

   Product providers should be able to compete on an equal footing.

4. **Financial Advice**

   Australians should be able to trust the financial advice they receive.

5. **Cost effectiveness**

   Fees and charges should be reasonable, taking into account the services provided, compliance costs and appropriate profit margins. Governments should acknowledge the huge costs resulting from legislative changes and future changes should take better account of the costs involved in the implementation of changes.

6. **Coverage**

   Global best practice would mandate superannuation for all in the workforce refer Appendix C.

7. **Flexibility**

   Members should not be restricted to using the default arrangements. The system should be flexible to allow members to choose arrangements best suited to their individual circumstances.

8. **Tax and Social Security**

   The Tax and Social Security systems should support the above outcomes.

Each of these principles is discussed in more detail throughout this report. We have a number of recommendations in relation to each of the above principles which would result in improvements in the Australian superannuation system. These are summarised in the Executive Summary at the front of this submission.

4.2 Efficiency

Observation

There is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards. This indicates there is scope for greater efficiencies in the superannuation system.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements and review the effectiveness of the MySuper regime in due course.

Many funds have only had a MySuper offering in place since 1 January 2014. The MySuper concept was developed after a very thorough inquiry and extensive consultation between Government, regulators and the superannuation industry. Many of the Stronger Super initiatives which accompany MySuper have not yet been implemented. APRA has not yet published MySuper league tables which will allow members to compare MySuper products.

Furthermore the superannuation industry has spent many millions of dollars implementing all of the MySuper and Stronger Super changes. For example the Financial Services Council has estimated that the Stronger Super and SuperStream changes (which were out workings of the Cooper Review), cost its members over $600 million in implementation costs.

There is no doubt that the introduction of MySuper has reduced fees, with some new products being introduced with very low fees. For established funds also there has been significant downwards pressure on fees.

This may not be entirely apparent from publicly available information for a number of reasons, including:

- Published fees in many cases include operational risk levies, a new legislative requirement
- In the short term MySuper providers have had to bear significant costs resulting from legislative changes which ultimately in most cases are passed on to members
- Published information does not reflect the much lower fees often applicable in Tailored MySuper products and corporate discounts in other MySuper products, where competition has been intense.

There are other reasons why MySuper is likely to result in future fee reductions, including the operation of the new scale test.

In summary we believe there are strong arguments that MySuper will lead to better outcomes for members over the next few years. Consequently we are strongly of the view that the MySuper framework should be given the chance to do the job it was designed for over the next few years, with only minor changes being contemplated in the short term.

The major danger with MySuper is the potential for an emphasis on low fees to lead to sub-optimal outcomes (e.g. the adoption of low cost but less effective investment strategies and the removal or reduction of services such as education and helpline advice centres). A more appropriate emphasis should be on net returns and long-term outcomes.

Recommendations

MySuper should be given the chance to do the job it was designed to do.

Regulators and Governments should ensure the main emphasis is on net returns and long term outcomes rather than fees in any assessment of super funds.

There have been a number of comparisons of fees in the Australian superannuation system with those of other countries. These include publications from the Grattan Institute and Treasury. We note these comparisons often rely on OECD data. This underlying data does not compare like with like and does not highlight the significant differences in the structure of the retirement system in each country.

There are a number of factors which contribute to Australia's funds appearing to have higher costs than some other countries. These include:

- A higher exposure to actively managed equities than most other countries, as well as higher exposure to international equities and alternative assets, contributes significantly to higher investment costs.
- A strong, but costly, regulatory regime with high compliance costs and levies to recover the Regulators' costs, and an independent dispute resolution body which is free to members but incurs costs for funds.
- The requirement for funds to calculate and pay a range of taxes – in most countries retirement funds are not taxed.
- The large size of the SMSF sector means that average account balances in other funds are lower than they would otherwise be, meaning that dollar-based fees represent a higher percentage of the average account balance, as well as affecting the ability of funds to benefit from scale (SMSFs are excluded from international comparisons).
- Australian members typically have more choice (of investment option, insurance arrangements and advice as well as the ability to choose the fund their employer contributes to) than in many countries. This prevalence of choice has a cost and has also contributed to multiple accounts for many members which has added to costs.
- A lower level of employer support through the provision, subsidisation or payment for administrative services.
- Finally, many countries do not provide death and disability benefits through retirement plans. This has been a valuable feature of Australian funds but adds to administrative costs (these costs exist in many other countries but are outside the retirement system).

Whilst there may be scope to continue to reduce costs (and therefore fees) in the Australian superannuation system, it should be noted there are some features in the system that are not replicated anywhere in the world. It is a system with extensive choice, very strong regulation, an extremely complex taxation system and compulsory insurance.

- Consider additional mechanisms to MySuper to achieve better results for members, including auctions for default fund status.

As discussed above, we believe it is important that the MySuper legislative framework be given enough time to properly make a judgement on whether it has been a success.

We believe any changes to MySuper should in the short term be limited to minor improvements to the existing system rather than revolutionary change. Some of the potential improvements to the system are set out elsewhere in this submission.

The most important of these by far is the need to allow any MySuper fund to be used as the default fund by employers under the Modern Award system. This is discussed further below Section 4.2.2.)

A further recommended change is the development of a MyPension concept, whereby the trustee is permitted to transfer MySuper members who have retired after a certain age, or where the trustee has evidence that they are likely to have retired (eg no contributions received for a certain period having reached a prescribed age), to an account based pension product that meets certain transparency rules. We believe this would be a significant step towards moving to a system which focuses on income streams rather than lump sums. This is discussed further in Section 8.

Recommendations

The Fair Work Act should be amended to allow employers to use any MySuper fund as its default fund.

Consideration should be given to the introduction of a MyPension default product.

4.2.1 *Auction system*

We do not believe the use of auctions for default funds will produce better retirement outcomes in Australia.

The use of an auction system is worthy of consideration for a newly established retirement savings structure such as took place in 2007 when the KiwiSaver system was developed in New Zealand. This system succeeded in keeping fees low. However part of why fees are so low in New Zealand is that a conservative investment structure was prescribed, with most of people's savings in cash and fixed interest securities, which have very low investment management costs.

Other reasons KiwiSaver fees are low include a very simple plan design, with limited investment choice, no insurance and a very efficient centralised electronic structure for remitting contributions.

Auction systems with a small number of providers being appointed are likely to inhibit competition and innovation, so that any auction system in our view would need to have a significant number of successful bidders to avoid the worst anti-competitive outcomes.

It is interesting to note the Inquiry expresses concerns about concentration in the banking system, and the potential for this to stifle competition, while at the same time canvassing an auction system for superannuation with a limited number of successful bidders, which would seem likely to result in even more significant concentration in the superannuation industry. We are strongly of the view that a highly competitive system will produce the best retirement outcomes for members.

Introducing an auction system to a well-established superannuation market, such as the one that exists in Australia, also has the potential to result in severe disruption to existing funds and to members.

For example an auction with a single successful bidder for default contributions for all new employees, like the Chilean system, could have a number of adverse systemic impacts including;

- Putting many funds in a negative cash flow position, leading to the need to redeem assets, which could cause problems with illiquid investments and lead to short term investment strategies
- Increasing the number of multiple accounts, a problem which is already resulting in average fees in the superannuation system being much higher than they would otherwise be
- Members seeking to consolidate these accounts would be faced with exit fees, buy/sell spreads and time out of the market resulting in potential investment losses
- Systemic concentration risk given the significant reliance on a single provider
- Any such auction is likely to be heavily based on the lowest fees, given the difficulty in assessing likely future investment outcomes. The lower fees may not result in better outcomes for investors if investment performance is poor.
- Many existing funds would need to reassess their viability given their cash flow position, leading to closure of many funds and unnecessary disruption to members of those funds

It is also likely there would be several second order effects affecting investment markets, insurance markets and post-retirement products which could have adverse effects on members who were not directly affected by the tender.

Recommendation

Given all of these risks an auction approach in Australia is not appropriate.

4.2.2 *Fair Work and Modern Awards*

The current provisions in the Fair Work Act are similar to an auction system with MySuper products "bidding" to be placed on default fund lists in each Modern Award. As indicated in Section 2 of our submission, the bidding process is significantly compromised as the playing field is not level.

However the problems resulting from the Fair Work process are much more serious than this. We are particularly concerned that many employees and other members of superannuation funds will be adversely affected financially by the new requirements.

Removing default fund requirements from Modern Awards will avoid a number of adverse outcomes which are likely to arise if the legislation is not amended. Research by Rafe Consulting (the Rafe

Report[2]) for the Financial Services Council has estimated 1.25 million new accounts may need to be established because the current employer default fund is not listed in the relevant Modern Award resulting in:

Higher fees

In some cases, fees in the new default fund will be higher than those in the previous fund. (This could be particularly significant in relation to employees of a large employer which may have been able to negotiate significant “large employer” fee discounts in their existing fund, which, as indicated in Section 2 can be over 0.5% of account balances.)

Multiple fees

Unless an employee “chooses” their existing fund, future contributions will be paid to the new fund. Past contributions are unaffected and remain in the previous fund unless action is taken to merge the accounts. The employee will potentially become a member of two superannuation funds (the new default fund in respect of future contributions and the previous default fund in respect of past contributions) and incur two sets of administration fees (until the accounts are merged). As most employees are not engaged with their superannuation, we expect many will not make any decisions and by default, could end up in two funds paying double fees.

Merging the accounts will generally trigger the payment of a withdrawal or exit fee in the account being closed. Unless sufficient notice is provided, some contributions may be paid to the new default fund before the employee can advise they wish to choose their existing fund.

The Rafe Report estimates the total expected cost to maintain two accounts, exit fees and the additional insurance costs at $185 million for the 1.25 million members impacted.

Insurance

Insurance arrangements in the new default fund are likely to be different from the previous default fund. Premium levels and levels of cover may be higher or lower. Whether the new arrangements are more, or less, appropriate for an individual member will depend on the individual’s particular circumstances. However, unless the employee’s accounts are merged, there may be two sets of insurance premiums providing, in some cases, unnecessary insurance cover and a reduction in the amount of contributions financing the employee’s retirement. Further, members may not be eligible for insurance in the new fund (for example if they were not at work on the day of joining) and may eventually lose their insurance cover in their existing fund if the account balance is no longer sufficient to pay premiums.

Other

If the accounts are not merged and one becomes inactive, after five years, such accounts (up to a threshold proposed to be $6,000) may be classified as an inactive account and transferred to the ATO (incurring a withdrawal fee). Following the transfer to the ATO, the

[2] Impact Of Changes To The Fair Work Act On The Australian Superannuation Sector, Employers And Their Employees (16 June 2014)

account will only earn interest at the rate of CPI, potentially significantly lower than would have been earned if it had been retained in the superannuation fund. Once transferred to the ATO, members will also lose valuable death and disability insurance.

Impact on employers

Employers will be subject to additional costs and red tape in choosing a new default fund, advising employees and processing requests from employees who wish to retain their existing fund. The Rafe Report estimates 80% of 117,000 employers currently using Master Trusts will need to choose a default fund listed in a modern award which is not their existing fund.

Further costs and red tape will arise for employers who have employees covered by more than one Modern Award where it may be necessary to have different default funds for different groups of employees and potentially change an individual employee's default fund each time the employee changes roles and becomes subject to a different Modern Award. In such cases the adverse impacts on the employee will be repeated each time.

The Rafe Report estimates around 100,000 employers will be required to redirect superannuation contributions on behalf of some or all of their employees with a potential cost to impacted employers of $30 million.

Employers with employees covered by different Modern Awards may need more than one default fund to cover all of its employees adding further to costs and red tape.

Impact on superannuation funds

Significant costs will be incurred by superannuation funds in applying to the Fair Work Commission for listing under more than 100 Modern Awards.

We also expect many existing funds that do not obtain listing in a significant number of Modern Awards (and consequently see a major fall in their contribution income as well as losing assets to other funds) will not have sufficient scale. This may result in adverse outcomes for existing members of these funds.

The Fair Work provisions may also promote the survival of homogenous vanilla products and result in less competitive products with poorer long term outcomes for consumers.

Unless the provisions in the Fair Work Act relating to default funds are removed from Modern Awards they will increase costs for many superannuation fund members, employers and superannuation funds for no gain or improvement in circumstances. The Rafe Report conservatively estimates the cost to consumers and employers at $400 million due to the duplication of fees, insurance premiums and employer search costs.

Recommendations

The Fair Work Act should be amended to allow employers to use any MySuper fund as its default fund.

4.2.3 Complex and unnecessary legislative requirements

In responding to issues throughout this submission we have recommended a number of changes to minimise administration costs and avoid unnecessary requirements. We have also set out in Appendix A a number of other areas where removal or modification of existing requirements would reduce administration costs without impacting the integrity of the system. Some of these recommendations would have only an incremental impact whereas others (such as a reduction in the amount of data to be provided to APRA) would be more significant.

Recommendations

Our recommendations include the following:

- Making it easier to provide disclosure material in electronic form and removal of unnecessary disclosure requirements
- Replacing the three day portability period with a longer and more principles based test
- Modifying the Division 293 tax requirements in relation to defined benefit arrangements
- Simplifying a range of disclosure requirements
- Reviewing the requirements in respect of the transfer of KiwiSaver amounts to Australian funds
- Allowing temporary residents to leave their benefit in an Australian super fund on leaving Australia (with voluntary withdrawals subject to the current higher tax rate)
- Removing the restrictions on the size of transfers from other overseas funds
- Simplifying the complex age based restrictions on accepting contributions
- Reducing the requirements for providing data to APRA
- Removing the spouse contribution splitting provisions
- Removing the provisions relating to child contributions
- Removing the tax offset for contributions for a low income spouse
- Removing tax on death benefits
- Removing anti-detriment provisions
- Allowing greater flexibility for employers to provide additional benefits for some employees

4.2.4 *Portability*

- Replace the three-day portability rule:
  - With a longer maximum time period or a staged transfer of members' balances between funds, including expanding the regulator's power to extend the maximum time period to the entire industry in times of stress.
  - By moving from the current prescription-based approach for portability of superannuation benefits to a principles-based approach.

The Inquiry raises the three day portability rule in the context of leading to more short-term investment approaches, which may not be in members' best interest. Mercer administers around 1.3 million superannuation members in 30 different superannuation funds. We are involved with the investments of many of those funds. In our experience the three day portability rule has negligible impact on funds' investment strategies in practice, and so we see no reason on investment grounds for changing the rule.

Having said that, like many other prescriptive rules that are part of the legislative framework governing the rule we question whether it is necessary. Some of the main concerns are as follows:

- In some cases, further contributions will be received after the three day portability period. This will require the re-establishment of the member's account and a further rollover processed (resulting in the member incurring a further exit fee). Administrators can try and avoid this by contacting the employer to determine whether further contributions are expected but the receipt of any such contributions is likely to be outside the three day period.
- Three days is a very short period and results in considerable pressure to complete the various checks and processes (including contacting the employer in relation to further contributions). The pressure increases the likelihood of errors.
- There are many circumstances, for example relating to plan mergers and illiquid assets, where compliance with it is impossible, and trustees are forced to go through an onerous exemption process adding costs to funds and APRA.

We strongly recommend a longer period (such as 30 days) and a more principles-based approach.

Recommendation

Portability rules should be changed from prescriptive to a principles based requirements based on a longer time frame.

4.2.5 *Competitive pressures*

The Inquiry seeks further information on the following areas:

- Does, or will, MySuper provide sufficient competitive pressures to ensure future economies of scale will be reflected in higher after-fee returns? What are the costs and benefits of auctioning the management rights to default funds principally on the basis of fees for a given asset mix? Are there alternative options?

See our response earlier in this section.

4.2.6 *Vertical Integration*

- Is the recent trend of greater vertical integration in the wealth management and superannuation sectors reducing competitive pressures and contributing to higher superannuation fees? Are there mechanisms to ensure the efficiency of vertical integration flow through to consumers?

We have already responded to the first question under our response to the questions in Section 2 of the Inquiry's report. Our view is that vertical integration leads to efficiencies which are more likely to result in lower fees than higher fees. The significant number of vertically integrated organisations leads to strong competition in our experience. This is particularly evident in tenders for large corporate superannuation funds by retail corporate master trusts, where there is extremely strong competition, encouraged by a number of professional independent tender managers whose role is to secure the best deal for employers and their employees. However, competition is also strong in all segments of the superannuation industry.

This competition will be considerably lessened if the Fair Work provisions relating to default funds are not removed.

We note that vertical integration within the super industry is not the same as in other parts of the wealth management industry. This is because of the role of the employer in many cases, its long term focus and often, the absence of an adviser relating to individual members.

4.2.7 *Tailoring asset allocation and projecting retirement incomes*

- Are there net benefits in tailoring asset allocation to members and/or projecting retirement incomes on superannuation statements?

Tailoring asset allocation

Many default investment strategies are effectively a one-size-fits-all approach and by necessity must reflect the needs of some average member. In reality, default members cover a range of ages and circumstances. Younger members are able to take greater risks to achieve higher returns as they are unlikely to be able to access their super for many decades. On the other hand, those close to retirement are generally more risk adverse, as there may be little time for adverse investment performance to be recovered before cashing their benefit. (Of course, for those taking an account based pension, assets may be drawn down slowly.) Mercer considers lifecycle products can more adequately cater for different risk profiles of members taking into account their age and potentially other factors than products with static asset allocations.

Projecting retirement incomes

Mercer believes there are valuable benefits to be gained from projecting retirement incomes on superannuation statements. These include:

- Improved member engagement with their superannuation fund
- The means to represent retirement savings as an income to which members can relate
- The ability to use a standard comparator (eg. ASFA standard, replacement ratio) to assist with understanding adequacy
- The leveraging of a fund’s investment in retirement tools and advice services
- Driving positive action on retirement savings

A more educated and engaged superannuation membership will be more likely to take steps to meet their own retirement needs, by evaluating contribution levels, consolidating accounts, reviewing their investment strategy, assessing the value for money offered by their fund and seeking financial advice.

We believe the best way to promote these outcomes is to implement regular projections with the following features:

- An illustration of retirement income in today’s dollars should be mandatory on accumulation-phase periodic statements (DB members optional but preferred). Members should be able to translate a super balance into a retirement lifestyle that keeps pace with inflation.
- This might be as simple as a ready reckoner to show the level of income that $100K, $200K etc might generate in retirement, or as complex as a personalised projection showing the impact of retiring two years later, contributing $500 more etc. An age pension estimate may be included

based on prescribed assumptions. Subject to minimum principles based on content and disclosure guidelines, the format of the illustration should be at the discretion of the trustee.

- Projections of superannuation benefits and income streams should comply with the principles of Actuarial Practice Guideline 499.02 or equivalent, and be signed off by an appropriately qualified professional. Illustrations that comply with the Practice Guideline should not be deemed personal financial advice.
- Assumptions about fees, investment returns etc should be consistent with the provider fund's PDS, and appropriate for the member's circumstances.
- The illustration should link to an online calculator where the same result can be generated (within a reasonable timeframe after issuing the statement), so that members can model the impact of different inputs (such as contribution levels, retirement age) from a known starting point.
- Funds should be permitted to offer retirement income illustrations outside the periodic statement cycle, provided they comply with the guidance.
- Funds should have at least 12 months lead time to prepare systems for including the retirement income illustration.

Recommendation

Mandatory projections on the basis outlined above should be introduced following a suitable lead time for funds to adapt to the new requirements.

4.2.8 *Short term focus*

- Is there an undue focus on short-term returns by superannuation funds? If this is a significant issue, how might it be addressed?

The Inquiry refers to submissions suggesting a growing trend of superannuation funds chasing shorter-term returns, in turn leading to more homogenous asset allocations and lower after-fee returns. Mercer agrees that within the industry there is significant "attention paid to quarterly superannuation return 'league tables'", and that peer comparisons are a fact of life in an otherwise very competitive industry. As the industry continues to consolidate the possibility exists that sub-optimal "short-termism" may intensify both at the member level (such as more frequent switching), and at the provider level (unpreparedness to deviate from per average asset allocations), although it is difficult to quantitatively assess whether 'short-termism' has intensified to the point where longer term returns have been compromised.

However we note that despite the potential for "short-termism" the overwhelming majority of superannuation funds' default options' strategic asset allocations are demonstrably oriented toward growth assets such as equities (refer to APRA Annual Statistics), with stated investment objectives and time horizons consistent with longer term investment. Furthermore, while most superannuation funds permit members to switch options to more or less risky strategies at will, the evidence – including through stress periods such as the Global Financial Crisis – is that relatively few members exercise such flexibility.

One development that might reduce the influence of short term performance pressures would be to re-orientate member focus onto "outcomes" rather than simply short term investment returns. Thus, projections of retirement income are likely to be far more stable than the accumulation balances of member accounts, and reinforce the purpose of superannuation saving. As superannuation strategies become more diversified, for example by the introduction of "lifecycle" strategies, such data may provide a more meaningful form of comparison for members, as well as incentivising members to make additional contributions where shortfalls may exist.

Furthermore the emergence of differentiated superannuation offers as a result of the Stronger Super reforms including life cycle solutions – both active and passive - is evidence of innovation and heterogeneity among products.

4.2.9 *Active Asset Management*

- To what extent is there a trend away from active asset management within asset classes in superannuation funds? Is this a positive or negative development for members?

Mercer is aware of instances where MySuper has prompted some superannuation funds to shift away from active to passive management, as funds seek to offer lower-cost default options to members consistent with one of the Stronger Super reform objectives. Mercer believes much of the more recent growth in passive funds under management, and particularly exchange traded funds (ETFs), is linked to the development of the self-managed superannuation fund sector[3]. More broadly, however, Mercer believes there are likely to be limits to the shift towards passive management in Australia, and that active management remains a key means through which most superannuation funds will seek to deliver competitive after-fee returns.

In very general terms, it is accepted that the potential for successful active management tends to be very low in some investment markets, but quite high in others. Active management is likely to be less successful in more informationally efficient markets, or markets with more investors, more analysts and higher levels of institutionalisation. Such markets typically include large cap equities and global government bonds. However, research has shown there is still strong potential for active managers to outperform benchmarks in small cap equity, credit and emerging debt and some equity markets.

In addition to these broader market characteristics, at least three other major factors have emerged more recently to suggest superannuation funds will continue to place a strong emphasis on active management at the asset class level.

Firstly, there is a much greater awareness of the adverse biases implicit in market indexes or benchmarks, and to which passive investors are fully exposed. For example, equity market indexes tend to 'reward' historically successful companies, whereas many successful companies of the future are likely to be under-represented. In bond markets, it is the more indebted governments and

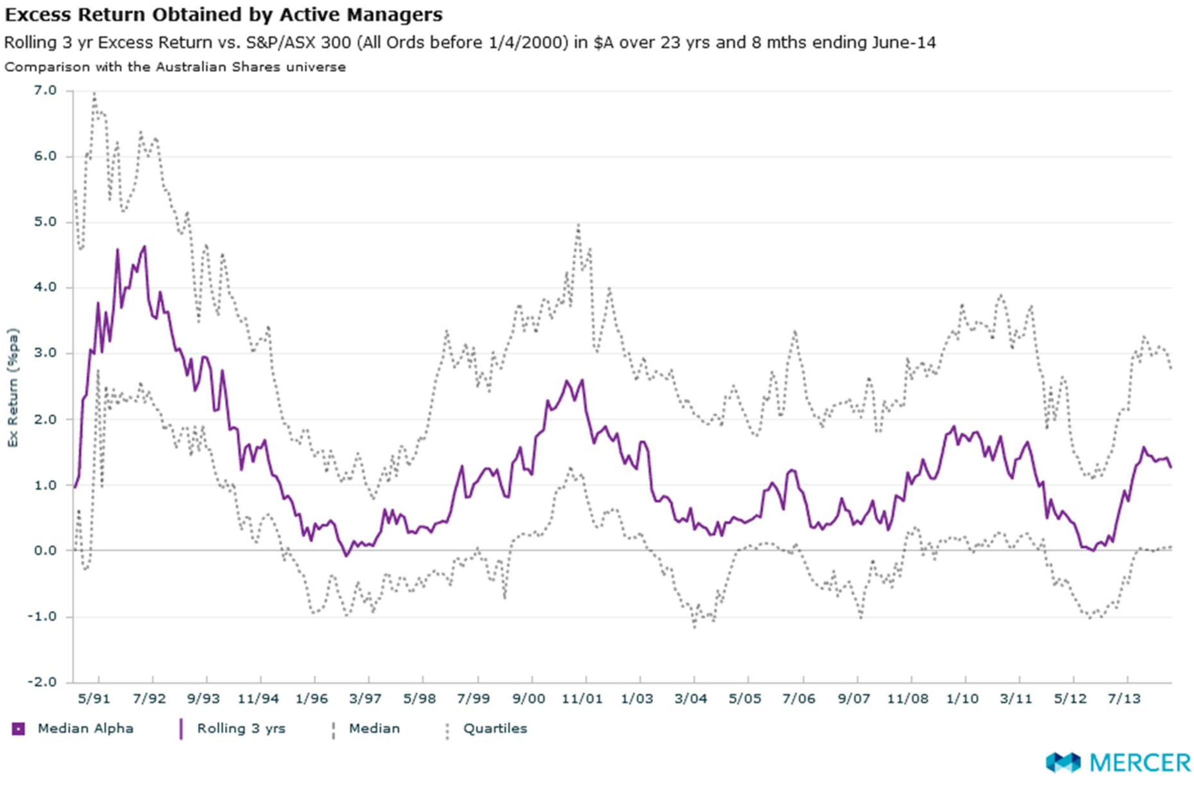
[3] See, for example, Bowerman, Robin "Fuelling the SMSF Boom with ETFs", http://www.asx.com.au/education/investor-update-newsletter/201305-fuelling-the-smsf-boom-with-etfs.htm, and Bowerman, Robin "More SMSFs Investing in ETFs", http://www.asx.com.au/education/investor-update-newsletter/201310-more-smsfs-investing-in-etfs.htm

companies (and thus those with a higher risk of default, all other things equal) that are over-represented. Key responses to these biases have included the development of ‘smart beta’ strategies and ‘fundamental benchmarking’, which could be considered a ‘lite’ form of active management.

Secondly, following the Global Financial Crisis (GFC), many investors have recognised the need to diversify away from equity risk premia as a source of return, and have also sought ways to lower the overall volatility of investment portfolio. This has led many towards alternative asset classes, such as real assets (direct infrastructure and property), private equity, and ‘growth’ or ‘diversified’ fixed interest. Active management is essential in these asset classes.

Thirdly, some of the trend back towards passive management in more recent years most likely reflects the difficult environment for alpha generation, and which was reflected in a relatively long period in which active managers across many asset classes struggled to outperform market benchmarks. With the gradual abatement of the ‘risk on, risk off’ investment environment, and the subsequent increased dispersion of returns across individual securities and asset classes, there appears to have been a broad-based improvement in the performance of active managers. For example, the median Australian shares manager has now outperformed the market index by 1.0% per annum on a one- and five-year basis (before fees), and by 1.3% on a three-year basis.[4] These levels of “average” outperformance should be higher than the level of fees paid by institutional investors for such mandates, resulting in increased net of fee returns.

The following graph provides details of Mercer’s analysis of the outperformance of active Australian share managers:



4 Mercer Investment Surveys, June 2014.

At a somewhat higher level, and particularly since the GFC, there appears to be a shift away from 'set and forget' portfolio strategies, towards more active or dynamic management. While this typically applies more at the asset class level, with funds tilting away or towards asset classes deemed 'over' or 'under' valued, the general concept of more active portfolio management is now more widely accepted. Other factors that could also limit the continued shift towards more passive management include the high take-up already of such vehicles in Australia relative to other countries, and possible 'reputational' damage to the ETF sector in the event of a crash or 'liquidity event'.[5]

Accordingly, it is not clear to Mercer that there are significant after-fee return benefits to superannuation fund members from a further shift towards simple passive strategies.

> **Recommendations**
>
> The active/passive decision should be left to the competitive market place and the discretion and preferences of fund trustees and their members

- How could funds price switching properly and take into account differences in liquidity between asset classes?

We do not believe there are any systemic problems with member switching and funds already have the ability to "price" switching through activity-based fees and/or buy/sell spreads.

Most member switches these days are processed electronically and hence have minimal cost. In most normal circumstances the net impact of daily member switches on a fund's investments are negligible in comparison to other fund inflows and outflows, and therefore the ability of members to switch investment options on a daily basis has negligible impact on a fund's investment strategy.

The exception to this is members invested in illiquid investment options, where the trustee generally has the power to restrict switches where investments cannot be redeemed.

There may also be net member switching into cash at times of financial crisis, but funds generally manage such events well. There have been a small number of funds which were caught out due to excessive investments in illiquid assets during the GFC, but applying significant switching fees to members in illiquid investment options would have has no real impact on those circumstances. Since the GFC, management of illiquidity has been an area of significant scrutiny by APRA.

Overall we can see no reason for change in this area.

[5] Jacob Hook, "The Future of Australian Investment Management. Threats and Opportunities." Oliver Wyman Financial Services. November 2012.

4.2.10 *Asset transfers*

- Could other arrangements be developed to facilitate asset transfers between funds when members switch? Do funds require additional mechanisms to manage liquidity beyond the need for liquidity for portability and member investment switching?

In our view there will always be issues with difficulty in redeeming illiquid assets when members request net redemptions at times when assets cannot be liquidated. We do not believe there is any legislation that could be passed to prevent this, short of prohibiting investment in illiquid assets, which we believe is undesirable on investment grounds.

4.2.11 *Trust structure*

- Is the trust structure best placed to meet the needs of members in a cost-effective manner?

Mercer believes that the trust structure is best placed to meet the needs of members in a cost effective manner because the trust:

- is a recognised collective investment vehicle for holding property on behalf of others (the beneficiaries); and
- has inherent protective characteristics that operate in favour of the beneficiaries.

As a collective investment vehicle, the trust separates the assets of the fund from the assets of the employer sponsor or relevant financial institution. This separation means that the trust assets are not at risk if the employer sponsor or relevant financial institution becomes insolvent. This is an extremely important protection.

The irreducible fiduciary obligation of the trustee to the beneficiaries requires the interests of beneficiaries to be paramount.[6] The result is that every decision made by a trustee must be made in the interests of members as a whole[7]. Members can also enforce a trustee's obligations directly because those duties are owed *to the members.* Because the nature of a trustee's obligations are both personal and proprietary, members have a choice of remedies and are even able to 'trace' trust property if it has been improperly alienated to another party in breach of trust.

There is also an established body of trust law governing the trust structure, which means that any regulatory or statutory gaps can readily be filled by reference to trust law. From a cost perspective, there is no need to regulate every single aspect of a trustee's management and administration of the trust, except to the extent that there is a public policy reason to do so, because the flexible principles of trust law will apply as a 'default'.

[6] It is legally impossible for a trustee to 'contract out' of its fundamental duty of loyalty to the beneficiaries.

[7] It is important to recognize that while every decision must be made in the interests of members as a whole, there are a number of circumstances where the law entitles a trustee to exercise personal rights in its own interests. Preserving the capacity of a trustee to be able to exercise those personal rights is essential to the continued operation of a robust, competitive and sustainable superannuation industry.

The existence of the trust itself is not dependent on the continuation of a particular trustee, because trust law provides for a court to replace a trustee and for a court to provide other directions about the administration of the trust in cases of uncertainty.

While the trust structure may marginally increase some costs (due to the need to account and report to regulators in respect of two legal entities – the trustee and the trust itself), these costs are minor compared with the benefit to beneficiaries of an investment vehicle that has fiduciary obligations towards the beneficiaries at the core of its existence.

The trust structure has its origins in private law and has been criticised for the perceived lack of accountability of the trustee to the membership, particularly for decisions made about 'discretionary benefits' in the context of a compulsory retirement savings system. However, both case law and statutory overlay have evolved to increase the accountability of trustees in the more public superannuation context.[8]

Alternatives such as a contract-based structure may be simpler and more cost effective to administer, but have significant drawbacks from the perspective of protecting member interests. A contractual model would require at least two ongoing contracting parties (typically a 'manager' and the employer sponsor) with contract law being primarily governed by the commercial considerations of the parties. Contractual obligations of 'good faith' cannot compare to the fiduciary role of a trustee.

In a contract-based structure, there is no separation of assets to protect against insolvency and no body of 'default' law, as there is with the trust structure. The scope for a court to provide direction is generally limited to interpreting the provision of the contract. This means that significant legislative intervention would be required to replicate the protective nature of the trust. Such legislative requirements would add to the cost of the contract-based structure and therefore impact its apparent cost-effectiveness. In addition, in order to provide prudential security to support the contractual promise, there would likely need to be capital requirements imposed on the 'manager'. The cost of this capital should not be overlooked in assessing the comparative cost effectiveness of the trust and contract models.

In terms of continuity, if one of the contracting parties no longer wishes to be a party, it may be more difficult to find another party to assume the responsibilities and rights of the departing party. Despite the development of contract law to accommodate 'contracts for the benefit of a third party', it may also be more difficult for the third party 'members' to enforce the terms of the 'contract'. In addition, no tracing remedies are available for breach of contract.

We also note that the Cooper review recently considered whether the trust structure is an appropriate vehicle for the delivery of superannuation. The inquiry made some recommendations to strengthen the trust framework, including the introduction of explicit conflict management obligations, but in doing so, the panel implicitly endorsed the trust structure. These enhanced governance requirements have now been implemented as part of the Stronger Super reforms. To change from the trust structure now would be prohibitively expensive, with no consumer benefit.

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[8] For example, the High Court in *Finch v Telstra Super* [2010] HCA 36 has imposed more intense duties on the trustee and there is a new statutory duty under Section 101 of the *Superannuation Industry (Supervision) Act 1993* for trustees to give reasons for decisions made in response to a member complaint about decisions relating to death benefits and disability benefits.

We support many of those enhanced governance requirements that have now been implemented as part of the Stronger Super reforms. However, we have noticed that some of those reforms have led to confusion between the industry and regulators about when a trustee may continue to consider shareholder interests when exercising personal rights[9]. Preserving the capacity of a trustee to be able to exercise those personal rights is essential to the continued operation of a robust, competitive and sustainable superannuation industry and we recommend that the law be amended to remove any doubt that each trustee may continue to consider shareholder interests when exercising personal rights.

Recommendation

The trust structure, with its clear superiority in terms of protecting members' interests, is the preferred vehicle.

4.3 Leverage

The Inquiry would value views on the costs, benefits and trade-offs of the following policy option or other alternatives:

Restore the general prohibition on direct leverage of superannuation funds on a prospective basis.

Funds which borrow are subject to higher levels of systemic risk. Mercer generally does not support the use of borrowing to gear investment portfolios in superannuation funds. If borrowing is used to gear investments, retirement savings will be more severely affected by an investment crisis or credit squeeze.

In relation specifically to leverage by SMSFs, we have two areas of concern:

General concerns

While less than 4% of SMSFs have a Limited Recourse Borrowing Arrangement (LRBA)[10], some SME owners use a SMSF to own their business premises. This frees up working capital for their business and can have estate planning benefits. By using the capital held in a super fund, a business can more efficiently make use of its own balance sheet. As a result, many small business property owners are using these provisions to loan money to their super fund so it can purchase the commercial property.

Mercer is not expert in the matter of SME financing but it encourages the FSI to consider whether borrowing of this nature is consistent with the long term retirement purposes of superannuation.

We also note the use of LRBAs, particularly in relation to property, are very difficult to implement except in the case of SMSFs. This creates an unlevel playing field between SMSFs and other superannuation funds.

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[9] For example, the right of a trustee to discount its fees, or the right under the governing rules to set its fee for a new service or product.

[10] ATO: Self-Managed Superannuation Funds: A Statistical Overview 2011-12 (December 2013)

Any decision to prohibit or restrict borrowing by super funds should have transitional arrangements which take into account the difficulty of unwinding existing arrangements which comply with current law.

Advice concern

We are concerned that some SMSF trustees are making decisions to invest in large, long term investments such as property, which may be leveraged, without seeking advice from people with appropriate qualifications or experience.

This is relevant whether the assets are business premises used by the business of the SMSF members, or investment property (including residential property). Property is a lumpy asset and the strategy needs a long investment time horizon and careful consideration, particularly if leverage is involved. However, trustees are not required to seek advice when entering these arrangements.

Compounding this problem is the term financial planner/adviser. The use of this term is unregulated leading to a significant gap in consumer protection for those obtaining advice from unlicensed/unqualified "advisers", for example, "property spruikers". We cover this issue further in Section 6.

Recommendation

In Sections 4.5 and 6 we make recommendations regarding the education and qualifications for financial advisers and the need for a register of advisers. These recommendations are highly relevant to the consumer protection for SMSF members.

4.4 Stability of superannuation policy settings

Observation

Superannuation policy settings lack stability, which adds to costs and reduces long-term confidence and trust in the system.

We agree with the observation in the Interim Report. New policies or amendments to existing policies are made on a regular basis.

For example, consider the case of excess concessional contributions which commenced in 2007. Since that time we have seen the following changes in relation to that one measure:

- A halving of the concessional contribution limit
- A temporary freezing of indexation of the limit
- The introduction of higher temporary thresholds for those age 60+
- The introduction of higher temporary thresholds for those age 50+
- The introduction of special rules for first-time excesses of up to $10,000 and its subsequent removal
- The removal of excess contributions tax (replaced by treating excess contributions to be assessable income for the member together with an interest charge)

In addition to the cost related to reconfiguration of administration systems, each change needs to be explained to members increasing communications and advice costs and reducing long-term confidence in the system.

The industry has suffered as a result of regulatory overload, particularly in recent years with introduction of MySuper, SuperStream, enhanced governance standards, considerable increases in APRA's statistical data requirements and so on.

Recommendation

Greater continuity in superannuation legislation would reduce the current high costs of regular updating of administration systems and communication material to cope with continual legislative change.

Superannuation tax concessions

We note the current concessions result in a skewing of concessions to high income earners, however it must be recognised that limits on the concessional treatment have been reduced considerably since 2007. (In 2007, transitional concessional contribution limits of $100,000 a year applied. These were to reduce to $50,000 (indexed) from 1 July 2012. The current limit is $30,000 with a higher unindexed limit of $35,000 from age 50.)

At least from an equity perspective, consideration needs to be given to a realignment of the concessions. Mercer has recently released its recommendations in relation to superannuation tax. These include:

- an extension of Division 293 tax to all those on the top marginal tax rate (for practical implementation purposes, the current threshold for the imposition of Division 293 tax would reduce to the top marginal tax threshold plus the concessional contribution cap)
- the retention/improvement of the low income earners Government contribution (the Government is proposing to remove this)
- a greater ability to spread contributions over a person's working life by adopting a life time contribution cap (subject to a maximum contribution each year)
- a limit of $2.5 million (indexed) which can be held in pension phase (and eligible for the tax free status in respect of investment income)

The first and second points above would lead to the following concessions ignoring Medicare (up to the concessional contribution limit):

Income range	Marginal tax rate	Current concessions (assuming LISC removed)	Mercer proposed concessions (assuming LISC retained but not improved)
0 – 18,200	Nil	-15%	0%
18,201 – 37,000	19%	4%	19%
37,001 – 80,000	32.5%	17.5%	17.5%
80,001 – 180,000	37%	22%	22%
180,001 – 300,000	47%*	32%	17%
$300,000 and over	47%*	17%	17%

This provides a more consistent level of concessions on contributions. However we should mention earlier Mercer analysis has shown the overall costs to Government of superannuation concessions and the cost of the age pension over a person's lifetime are, even without the above adjustments, remarkably level across income ranges[11].

The third point results in fairer treatment of those who are out of the workforce for a period – in particular females who may not have full or part-time employment during their child rearing years.

The fourth point will restrict the application of tax-free investment income to reasonable levels of assets.

Any changes to tax concessions need to be introduced in a practical manner and avoid the huge costs which were incurred by superannuation funds in implementing the superannuation surcharge in the 1990s and which would have been incurred if the following initiatives had been adopted:

- the recommendations in the Henry Report to tax contributions at the member's marginal tax rate (less a tax offset)
- the previous Government's proposal to limit tax free investment income to $100,000

Our proposals build on the existing Division 293 tax by extending it to a wider income range. Although this has some cost implications for super funds, it is manageable – at least for accumulation members.

We do note however the Division 293 tax provisions in relation to defined benefit arrangements have not been adequately designed and will lead to significant costs for super funds and defined benefit members. The defined benefit provisions need to be amended to:

- restrict the triggering of payment of any deferred Division 293 tax to the time a defined benefit is crystallised. Currently the legislation can result in a number of inappropriate outcomes including:
  - the triggering of the payment of the deferred tax when a payment is made from a member's accumulation interest – even where the payment may be to pay a Division 293 tax assessment in respect of their accumulation interest
  - deferral of the payment of the deferred tax when the defined benefit has been crystallised but not rolled over
- better enable defined benefit members who have not retired to pay their deferred Division 293 tax from their superannuation account. Currently a member cannot use their super to pay the tax if they have rolled their benefit over either to another fund or internally within the fund
- remove the end-benefit cap provisions which restrict the level of deferred tax which can be collected but involve significant work for funds.

We expect such changes to the defined benefit provisions of Division 293 tax will reduce costs by $20 to $30 million dollars across the industry whilst having minimal impact (or a minor increase) in the tax collected.

[11] Refer to Tax & Superannuation: The Shortcomings of the superannuation Taxation Expenditures (Mercer – April 2013) attached to our First Round submission

Recommendation

Due to the legislative restrictions on superannuation, and to minimise long term social security costs, superannuation should continue to be subject to concessional tax treatment. However consideration should be given to some modifications to the existing concessions.

4.5 Self-managed superannuation funds

The Inquiry seeks further information on the following areas:

- To what extent should the Inquiry be concerned about the high operating expenses of many SMSFs?
- Should there be any limitations on the establishment of SMSFs?

Mercer does not believe that “one size fits all” limitations on the establishment of SMSF are practical. In addition, the large number of existing SMSFs means that future limitations will not address problems with existing funds. Our concern is the establishment and management of many SMSFs without receiving any professional advice, or receiving advice from people who do not have appropriate qualifications and experience.

The SMSF sector is the fastest growing sector with almost one third of all super assets, catering to 960,000 Australians. This growth is slowing, reflecting in part the reduction in concessional contributions limits as well as product innovation within industry and retail funds to counter the investment advantages of SMSFs.

It takes a high level of financial acumen and time to successfully manage a SMSF, while investors generally need about $500,000 in assets before SMSFs consistently offer better value than larger retail and industry super funds, according to a report by Rice Warner on behalf of Australian Securities and Investments Commission.

“The analysis clearly shows that SMSFs are an expensive alternative for members with small balances," the Rice Warner report says. However, it also notes that some small SMSFs do grow rapidly because of contributions or transfers of benefits from other funds, and the overall cost of the fund varies widely. Relative to larger funds, SMSFs have tax and estate planning advantages that appeal to trustees and they also offer transparency and control.

Although we do not believe there should be restrictions on the establishment of SMSFs, there are risks where those who do not seek appropriate advice transfer small balances into a SMSF without considering the overall costs of the administration and accounting, compliance and audit fees. About 22% of funds hold less than $200,000 in assets (ATO).

We note consumers are able to set up a SMSF on line without ever seeking advice from a professional lawyer, accountant or adviser, and take on onerous trustee obligations without an understanding of the consequences.

The 2014 *Self-Managed Super Fund Planner Report* produced by investment management company Vanguard and investment research provider Investment Trends showed 54 per cent of SMSFs are now open to using an adviser's expertise. However, of those respondents considering setting up an SMSF, only 20% had advice from a financial adviser (up from around 18% in 2013) and 30% used an accountant (down from 35%). This means half of the SMSF trustees do not seek advice around important issues such as inheritance planning and protection of assets through prudent investment selection or tax expertise.

Further compounding the issues is that when consumers do seek advice in relation to an SMSF it can be from someone that does not have the skills and knowledge to understand the complex nature of a SMSF and its unique taxation and estate planning benefits. Entry requirements for advisers are low, with ASIC minimum standards under RG146 inadequate for the delivery of specialist advice.

Recommendations

Limitations on the establishment of SMSFs should not be imposed.

All advisers and accountants that are able to give advice in respect of SMSFs should:

- meet minimum education standards
- be members of a professional body, as these bodies require significantly highly levels of training, education and competency.

The Government should raise the minimum criteria so that the term financial planner/adviser is restricted under the Corporations Act. To be able to use the term we believe the individual must have a membership of an ASIC approved professional body (similar to the accounting profession), hold minimum education standards of a relevant university degree and maintain minimum continuing professional development.

5

Stability

5.1 Corporate Governance

Observation

To contribute to the effectiveness of the financial system, sound corporate governance requires clarity of the responsibilities and authority of boards and management. There are differences in the duties and requirements of governing bodies for different types of financial institutions and, within institutions, substantial regulator focus on boards has confused the delineation between the role of the board and that of management.

Mercer agrees with the concern expressed about the blurred delineation between the role of the board and that of management as a result of superannuation funds transitioning to the new prudential standards. We agree that a board's role is to govern – meaning to set the strategy, approve a plan to achieve the strategy and review progress, while management's role is to manage – meaning to facilitate achievement of the strategy, create an operational environment for implementing the plan and report to the board on progress.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Review prudential requirements on boards to ensure they do not draw boards into operational matters.
- Regulators continue to clarify their expectations on the role of boards.

The new prudential standards for superannuation impose a number of requirements on superannuation boards, without any apparent ability to delegate responsibility for the requirements. For example, we have identified 44 matters under the prudential standards relevant to superannuation that must be either approved or satisfied by the board or for which the board is held to be responsible. These are set out in Appendix B.

While some of these matters are entirely appropriate for board responsibility and involvement, with this level of prescription it is not surprising that boards may be left with insufficient time to provide strategic oversight and direction. While stringent prudential regulation is necessary in the context of mandatory superannuation savings, Mercer shares industry concerns that the level of prescription has gone too far. We would support a review of the requirements imposed on boards under the prudential standards by an independent governance expert to ensure that the prudential standards do not draw boards into operational matters nor preclude delegation of appropriate matters to specialist board committees and other qualified people.

The Inquiry seeks further information on the following area:

Is it appropriate for directors in different parts of the financial system to have different duties? For example, differences between the duties of directors of banks and insurers and trustees of superannuation funds. Who should directors' primary duty be to?

Apart from the current level of prescription in the prudential standards, another reason for superannuation trustee boards becoming increasingly concerned with operational detail may be the recent imposition of direct duties owed by the directors to members and the consequent prospect of being sued directly by members, perhaps even by class action.[12]

The spectre of personal liability to members for a breach of the new covenant 'to exercise *in all matters affecting the entity* the same degree of care, skill and diligence as a prudent superannuation director would exercise …' has triggered a greater degree of board scrutiny of matters that might otherwise be considered the province of management. The fact that a 'prudent superannuation director' is defined objectively, without reference to the circumstances of the particular fund or the particular responsibilities of the director exacerbates the situation.[13]

In addition, there is no 'business judgment' rule available under Section 52A(2) (b) of the *Superannuation Industry (Supervision) Act 1993*.

Mercer does not believe that there is any public policy reason for directors of superannuation trustees to be subject to different duties than those applying to directors of other companies in the financial system, or indeed other APRA-regulated entities. Certain companies (acting as trustees or responsible entities) owe duties to fund members[14] and this will inform the way directors of those companies perform their duties.[15]

If there is a perceived need to further regulate director behaviour in a superannuation context to address discrete issues,[16] a statutory obligation with statutory penalties might be imposed. For example, directors of responsible entities have statutory duties,[17] but the relevant section does not create a civil right for scheme members to sue for loss. Rather, a breach of the statutory duties gives rise to statutory penalties only. Alternatively, under the *Life Insurance Act 1995*, directors owe statutory duties to policy owners, but their duty is fundamentally to see that the **life company** itself gives priority to the interests of policy owners (as a group) over those of the company's shareholders.[18] This means that a right of compensation only arises if a director's breach of duty results in a loss to a statutory fund of the company.[19]

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[12] See *Superannuation Industry (Supervision) Act 1993*, ss 52A(2) and 55(3)

[13] Compare the definition of 'superannuation entity director in Section 29VO(3) with the standard of care imposed under Section 180 (1) of the *Corporations Act 2001* – see also the business judgment rule under Section 180(2) of the Act

[14] For example, under Section 601MA of the *Corporations Act 2001* in the case of responsible entities and in both equity and under Sections 52 and 55(3) of the *Superannuation Industry (Supervision) Act 1993* in the case of superannuation trustees

[15] See *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1

[16] Such as conflicts of interest and duty that may be unique to the superannuation sector

[17] *Corporations Act 2001*, s. 601FD

[18] *Life Insurance Act 1995*, ss. 48(3) and 48(4)

[19] *Life Insurance Act 1995*, s. 48(6)

By comparison, by virtue of Sections 52A and 55(3) of the *Superannuation Industry (Supervision) Act 1993,* the directors of superannuation entity now owe a direct obligation to each member of a superannuation fund and can be sued directly by a member for personal loss suffered by the member (even if the loss is not suffered by the fund or by other members).

Some of the reasons why Mercer considers that it is inappropriate to 'single out' superannuation entity directors in terms of direct and personal liability to members are:

- Boards make decisions as a collective, rather than individually
- The threat of being personally sued by members drives 'peer focused' behaviour and unwillingness to take measured and justifiable risks in the interests of the fund as a whole
- Despite the fact that leave of court is required before action may be commenced against an individual director,[20] there is a risk that the litigation process may be misused to obtain settlements against a director's professional indemnity insurance. This in turn may increase the cost of professional indemnity insurance or make it prohibitive to obtain for superannuation entity directors[21]
- The prospect of personal liability may deter competent and experienced directors from accepting positions on superannuation entity boards.
- There are situations where a superannuation entity director should be entitled to consider the interests of the trustee company's shareholders (for example, in exercising personal rights of the trustee company and in making commercial decisions[22]) and the imposition of a fiduciary duty for directors to act in members' interests (as opposed to a duty to ensure that the **trustee company** exercises its powers and performs its obligations in members' interests) may only confuse the situation

Mercer is not aware of any compelling inadequacy in the previous statutory framework that would have required superannuation entity directors to be exposed to direct personal liability to fund members. If egregious breaches of a director's duty of care to the company had resulted in loss to the fund members, members could always have taken derivative action against the directors through the trustee company or sought to recover against the directors under principles of accessorial liability. These avenues of redress were and remain, in our view, sufficient to protect members from a lack of due care and attention on the part of superannuation entity directors. Alternatively, limited statutory mechanisms could be imposed.

Recommendations

The prudential requirements on trustee boards should be reviewed to ensure they do not draw boards into operational matters.

Individual directors of a superannuation trustee company should not be subject to different duties and liabilities to those of other companies.

[20] See *Superannuation Industry (Supervision) Act 1993*, s 55(4A)

[21] For example, one of the providers of trustee indemnity insurance, Chubb, has recently exited the Australian market.

[22] Please see paragraph 4.2.11 and footnote [9]

6

Consumer Outcomes

6.1 Assessing the regulatory framework

Observation

The current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services, and impose significant costs on industry participants.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.

We agree with the Inquiry's view that the current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services, and impose significant costs on industry participants.

Therefore we support the need to change the current legislative framework surrounding disclosure, and Product Disclosure Statements (PDSs) in particular.

In our view, whilst there are sufficient remedies available for consumers, the current framework is far too prescriptive, and the penalties (including criminal and civil) for issuing misleading PDSs too onerous, leading to a legalistic and risk-averse culture in the industry in relation to PDSs, which also adds costs to the system. In addition the legislation makes it unnecessarily difficult to provide disclosure in electronic form.

- Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.

We strongly support any initiatives which would encourage better investor communication along the lines proposed. Currently in many circumstances there is no practical way to issue investor communications in anything other than hard copy form.

Recommendations

The disclosure regime needs to:

- Be principles based and not involve any prescribed wording
- Have a less onerous penalty regime
- Adopt electronic distribution (in a range of acceptable forms) as the default, unless a member opts for paper
- Not prescribe the form of electronic distribution
- Permit product providers to charge an additional fee for members who opt for paper

The legislation specifying what constitutes advice should be reviewed to make it easier for providers to provide tools which help educate and inform members such as benefit projections and retirement income calculators.

- Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.

See our response to previous point.

- Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers.

We support limited prescription of product features for default members. Such prescription is a key part of the MySuper regime. We believe the current MySuper legislation strikes a reasonable balance between the competing aims of having enough prescription to allow members to compare products, and avoiding too much prescription which inhibits product development and innovation. As discussed earlier we believe the MySuper regime should be given time to work before it is significantly changed.

We do not support regulation of product features and distribution for choice products beyond the limited prescription in the current legislation. We believe further prescription would inhibit innovation, competition and the development of new products which better fit the needs of particular groups of members.

Recommendations

The MySuper regime should be given time to work before it is significantly changed

Further regulation of product features and distribution requirements for choice products should not be adopted.

- Provide ASIC with additional powers such as:
  - Product intervention powers to prescribe marketing terminology for complex or more risky products.
  - A power to temporarily ban products where there is significant likelihood of detriment to consumers.

In our experience in the segments of the superannuation industry in which we are involved, we see no evidence of the need to provide ASIC with additional powers to ban products or intervene to prescribe marketing terminology.

- Consider a move towards more default products with simple features and fee structures.

As discussed earlier in this submission, we believe the MySuper regime constitutes a sensible and adequate framework governing default products, with the exception that we believe a post-retirement MyPension product should be considered.

Recommendation

A post-retirement MyPension product should be considered.

The Inquiry seeks further information on the following areas:

- What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?

Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.

Increasingly, consumers need to take responsibility for their own financial decisions and be accountable for managing their finances effectively. Yet many individuals lack financial literacy skills. Affordable quality financial advice can bring significant benefits for consumers.
With relatively easy access to consumer debt, pressures on retirement savings as the population ages, and the exposure of individuals to sophisticated financial instruments, the need for financial literacy skills is important.

A feature of government policy over the past twenty years has been to transfer the responsibility for major financial decisions and significant financial risks to households.

There are gaps in financial literacy, especially among the younger and low income demographics and in relation to superannuation and related financial topics, limits some consumers' engagement with financial matters and could prevent them seeking advice.

Making simple superannuation advice accessible and cost effective is one of the most powerful tools we have, as an industry, to increase member engagement and maximise the benefits of Australia's retirement savings.

Analysis of member activity shows that individuals who access simple superannuation advice are more likely to take subsequent steps to boost their retirement savings.

Under Mercer's former general advice education model, 11% of members surveyed indicated they were likely to take action as a result of attending an education session. We then moved to 30 minute lifestyle briefings followed by one on one personal advice sessions, "Workplace Advice". Following this change we surveyed those that participated in a Workplace Advice program and 75% indicated they would take action, showing the power of having individual, guided advice discussions to improve the members' understanding of their superannuation.

We track activity of our members who have received limited superannuation advice in the workplace or over the phone and compare this with a group of members with similar characteristics who have not accessed advice. Analysis of data reveals that those who attended a one on one appointment were:

- five times more likely to make an investment switch
- five times more likely to update beneficiaries
- five times more likely to apply for additional insurance
- four times more likely to consolidate their super from multiple accounts
- three times more likely to make salary sacrifice contributions
- twice as likely to login to the website

Removal of the ability to include simple super related advice in the overall super management fees will see demand for advice drop dramatically and the cost of advice increase as a consequence. That is, although the superannuation fees would drop, the overall outcome for members would be worse.

Adviser Competence

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.
- Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.

Education of advisers

The entry requirements for providers of financial advice are too low across the industry. This has led to some incompetent and ill-equipped advisers being able to provide financial advice on sophisticated and risky products. ASIC's minimum standards under RG146 are inadequate for the delivery of quality advice and therefore create a risk of consumers acting on information provided by individuals who only meet minimum standards.

All advisers should belong to a professional body as required by accountants, actuaries and lawyers. These bodies require significantly higher levels of training, education and competency.

While a professional body will have a minimum level of ongoing training, ASIC do not require a minimum number of hours of Continuing Professional Development for advisers. The best outcome for consumers is to increase the level of education required to be an adviser, enshrine the term in law and introduce mandated continuing professional development.

This would be a preferable outcome for consumers rather than a national exam that only tests the knowledge of an adviser at a point in time. Regulation, legislation and the economic environment are constantly changing and mandated ongoing education through CPD would ensure that advisers are more up to date.

We have also made recommendations in Section 4.5 in relation to the training and skills of those advising in relation to SMSFs.

The term financial planner/adviser

The use of this term is unregulated leading to a significant gap in consumer protection for those obtaining advice from unlicensed/unqualified “advisers”.

Register

A national register of AFS Licensees (and their individual Authorised representatives) expanding on the current ASIC register would be beneficial for the consumer. The current register does not include employee financial advisers. A register should include licence status (banned, compliant, enforceable undertaking), professional affiliation, education credentials and delegations (CFP, CPA) and years of experience. Currently, salaried advisers can move from one dealer group to another without the new licensee being aware of former issues.

This register would assist consumers in researching and selecting advisers that are appropriate for the advice that they are seeking. If ASIC and the professional associations collaborated on the register it would improve consumer protection and ensure inappropriate behaviour is identified and addressed in a more timely manner.

This will increase the professionalism of the industry and gives consumers who seek advice, confidence they are dealing with someone who will act in their best interests.

Cost of advice

Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. However, legislating for onerous requirements for advisers means that comprehensive financial advice will remain costly to provide. This, in turn, means there will continue to be consumer demand for lower cost scaled advice and on line tools.

Simple advice offered by super funds is limited in scope. It is popular with members. The younger demographic need intra fund or scaled single issue advice. It is leading to a greater take up of advice and it is a cost effective way to engage. It assists those with small account balances and low value investment assets.

In the 2011 Mercer Super Sentiment Index Survey 54% of members said they wanted to have a strong knowledge of super while only 14% said they already had this. Financial advice is an opportunity to engage with members and help them maximise their finances and prepare for a secure retirement. It also provides an opportunity for funds to communicate the benefits they offer to members.

The ability to charge for intra fund advice through the fund opens up access to more consumers to receive advice easily and cost effectively.

Even limited advice provided by funds will assist members to make appropriate decisions on both their level of super contributions and asset allocation based on individual risk appetites. In 2010, ASIC produced research[23] which indicated the real demand for financial advice was at the simple end of the spectrum, attached to superannuation. Approximately one-third of Australians prefer to obtain simple advice as required.

The majority of respondents (approximately 75%) feel they should pay less than $250 for this type of advice. By amortising the cost of simple superannuation advice across a broader membership, thus reducing the annual cost per member very significantly, more members are likely to access regulated advice and receive the assistance they need. Removing this benefit will prevent individuals from accessing advice because of the cost barrier.

The Government should allow the preparation of an initial financial plan that is normally charged on a fee for service basis to be tax deductible. The precedent of tax deductibility of professional fees is already set and allows consumers to deduct fees paid to registered tax agents and lawyers. From 1 July 2014, financial planners will be required to register with the TPB as tax (financial) advisers and adhere to the requirements of the Tax Agent Services regime.

Concessional tax treatment of expenditure is an incentive to influence consumer behaviour.

The educational value for consumers by the provision of advice is well documented and demonstrates that access to affordable financial advice is a critical element of Australia’s economic environment. However, the cost of delivering advice is high due to the strict regulatory regime, limiting the ability of many to access affordable advice, particularly those will lower incomes.

This would broaden the access to advice beyond superannuation and consider overall retirement savings.

[23] Report 224 - - Access to Financial Advice in Australia December 2009

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:

- No change to current arrangements
- Rename general advice as ‘sales’ or ‘product information’ and mandate that the term ‘advice’ can only be used in relation to personal advice.

The lack of clear differentiation between financial advisers and product advisers and providers of general advice, confuses and misleads consumers in terms of services offered and standards of professionalism.

General advice should be re-termed “product information” and be limited to the provision of factual information relating to financial products. It should not be termed sales as this may make consumers reluctant to seek product information.

Consumers are increasingly asked to take responsibility for their own well-being in retirement. Many consumers are ill prepared for the risk. To make informed decisions consumers need information about a financial product they are not able to generate themselves and for which joint production with other consumers is not easily coordinated.

There is a significant legal and technical difference between general and personal advice. Defining financial product advice on this basis makes it more difficult for investors to distinguish personal financial advice form marketing material or product sales. The risk is confirmed by ASIC’s Report 384 – Regulating Complex Products. It states “marketing information plays a strong role in product distribution and may influence investors’ decision- making more than other product disclosure”.

Framing general advice as financial advice plays into the behavioural aspects of financial decision-making by giving the impression that the advice has a reasonable basis or is appropriate for the client, and thereby exposes the retail investors to decisions made under uncertainty about the regulatory framework for that advice. Anecdotal evidence shows it is common for consumers to interpret general advice as personal advice because it is relevant to their circumstances at the time it is provided. “FPA White Paper on the future of the financial planning profession – May 2014”. In other words, the consumer takes the general conversation about a single topic and implements it without considering the implications and how it might fit in with his or her overall situation.

Digital and on-line advice

The personal advice definitions restrict the use of tools and calculators. We recommend they are exempted from personal advice. The perception is if you use your own information the output is personal advice. It is not, it is simply a factual calculation based on information the user has keyed and a set of assumptions.

Disclosure alone is not enough to engage and the rules don’t deal with online methods.

Change in the advice industry is being driven by consumers. The FOFA legislation is enabling deeper engagement with consumers and analytics are providing a bigger role in consumer intelligence. Barriers to scaled advice are the cost and volume of regulation and the scale to provide efficient platforms and pricing.

Easy access to information means consumers are better informed, better able to evaluate the advice they receive and better able to connect to their adviser and other financial services providers.

The financial services industry (and banking in particular) was an early adopter, launching internet banking sites in the '90s. Today, their customers are making a comfortable transition to mobile banking, with approximately 6 million mobile banking apps being downloaded.

Many Australian financial service providers aim to meet their intra-fund advice obligations through basic online tools. Some have invested in online advice tools that prompt further action by generating Statements of Advice.

More innovative companies are investing in video call appointments with advisors, as well as tightly integrated click-to-transact capabilities within their advice tools. Others have Integrated intra-fund advice calculators with click-to-transact, click-to-chat or click-to-book an adviser capabilities.

Current software enables members of a superannuation fund to independently project their current superannuation savings through to retirement and beyond, while also exploring alternatives including investment choice, salary sacrifice and insurance options. Where appropriate, the member's exploration of advice options can be replayed back to them as online advice through an automatically generated statement of Advice (SOA).

Recommendations

- Minimum education and competency standards for financial advisers should be increased
- Minimum continuing professional development standards should be applied
- A register of AFS Licenses and their Authorised Representatives should be established
- The costs of preparing an initial financial plan should be tax deductible
- General advice should be renamed "product information"
- The term "advice" should be restricted to "personal advice"
- Legislative requirements should be reviewed to better enable funds and advisers to use tools and calculators in a cost-effective manner

6.2 Other significant consumer issues

Observation

Technological developments have the potential to reduce insurance pooling. This will reduce premiums for some consumers; however others will face increased premiums, or be excluded from access to insurance. Underinsurance may occur for a number of reasons including personal choice, behavioural biases, affordability, and lack of adequate information or advice on the level of insurance needed.

The Inquiry seeks further information on the following areas:

- Does Australia have a problem with underinsurance that warrants some form of policy response? Specifically:
  - How does Australia compare internationally on adequacy of insurance coverage?
  - Has the issue of underinsurance been increasing over time?

- What evidence and data are available to support a conclusion about our level of underinsurance?
- What evidence and data are available to assess whether more granular risk-based pricing will lead to exclusion or further underinsurance?

- If warranted, what are possible approaches to lessen the existence of, or mitigate the impact of, underinsurance?

Underinsurance in relation to death and lump sum permanent incapacity is increasingly being addressed by group life insurance offered via members' superannuation.

Many superannuation funds also provide income protection insurance. This is an important offering for superannuation funds however restrictions on the benefits which can be provided, particularly for new members, result in less than optimal benefit design.

Legislative restrictions prohibiting payment of benefits to members who are not currently in the work force and to those who can continue to work but in a reduced capacity are inappropriate and inconsistent with best practice in relation to income protection insurance. Further legislative restrictions discourage members returning to work on a partial basis while recovering (refer to Section 2.3 for further comments in this area).

Recommendation

The requirements in the SIS legislation should be reviewed to enable funds to provide more appropriately designed income protection insurance.

The Inquiry seeks further information on the following area:

Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?

Mercer agrees that the purpose of professional indemnity insurance is not to provide compensation to the consumers of a financial institution, but rather to provide protection to principals of a financial institution who are exposed to legal risks in the operation of the institution's business.[24] As such, there may be little or no correlation between the amount recoverable from a professional indemnity policy and the loss suffered by consumers.

Further, the policy will only respond to certain events, which may not correspond to the causes of consumer loss.

Options explored in the past for addressing the issue of consumer loss more directly have included a statutory fidelity scheme, funded by industry.

However in the context of the superannuation industry, Mercer would like to highlight some features of the current prudential framework that already provide a source of compensation to members:

[24] A form of professional indemnity insurance (known as trustee indemnity insurance) also provides protection to the financial institution itself.

- The introduction of compulsory operational risk financial requirements provides a means of compensation to members for operational errors that may occur in the operation of a superannuation fund.[25]
- The financial assistance provisions under Part 23 of the SIS Act enable the trustee of a regulated superannuation fund (other than a self-managed superannuation fund) that has suffered an 'eligible loss' causing substantial diminution of the fund leading to difficulties in the payment of benefits to apply to the Minister for a grant of financial assistance for the fund. Grants of financial assistance are then funded by an industry levy, as recently occurred as a result of the Trio Capital failure. 'Eligible loss' is currently defined as 'a loss suffered by a fund as a result of fraudulent conduct or theft'. However, it would be open to the Government to expand this definition to include losses suffered as a result of other form of serious wrongful conduct.

[25] See *Superannuation Industry (Supervision) Act 1993*, s 52(8)(b) and SPS 114

7

Regulatory Architecture

7.1 Regulatory Perimeters

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Align regulation of APRA-regulated superannuation trustees and funds with responsible entities and registered management investment schemes.

Mercer believes there is a valid public policy reason for superannuation to be prudentially regulated (because it represents compulsory retirement savings) and therefore we would not support a removal of prudential regulation for superannuation.

On the other hand, managed investment schemes are conduct regulated. However, they are used by many SMSFs and larger superannuation funds as investment vehicles for compulsory superannuation savings. This suggests a need for greater alignment of the regulation of superannuation and managed investment schemes.

Recommendation

Superannuation should continue to be prudentially regulated. The regulation of managed investment schemes should be modified to align more closely with superannuation.

7.2 Execution of mandate

Observation

To be able to perform their roles effectively in accordance with their legislative mandate, regulators need to be able to attract and retain suitably skilled and experienced staff.

Mercer agrees with this observation and would support measures to facilitate the regulators improving the skills and experience of their staff. Staff with a deep knowledge of the industries they are regulating should result in more efficient and effective regulation.

Anecdotally however, it would seem that new talent is often lured away from the regulator by financial services organisations that are not constrained by the public sector bargaining framework and that can offer more competitive remuneration and better prospects of advancement. Mercer therefore agrees that the public sector framework tends to put regulators at a disadvantage in competing with industry for the pool of talented financial services personnel.

Recommendation

The proposed option of exempting ASIC and APRA from the public sector bargaining framework and instead requiring information on remuneration and staffing metrics to be included in their annual reports should be adopted.

Observation

ASIC has a broad mandate, and the civil and administrative penalties available to it are comparatively low in relation to comparable peers internationally.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Strengthen competition considerations through mechanisms other than amending regulators' mandates.
- Refine the scope and breadth of ASIC's mandate.
- Review the penalty regime in the Corporations Act.
- Review mechanisms to attract and retain staff, including terms and conditions.

Mercer supports an effective conduct regulator for the financial services sector and agrees that ASIC's regulatory mandate has increased to an unwieldy level with the introduction of financial services regulation in 2002, the transfer of market supervision from the ASX and the introduction of credit licensing in 2010 and the addition of business names registration to its corporate registry functions in 2012.

Options canvassed in the interim report to address ASIC's extended mandate include transferring consumer issues to the ACCC (or a new financial services consumer agency), creating a new financial services conduct regulator, creating a new specialised market supervisor, moving ASIC's insolvency functions to AFMA and removing ASIC's registry function.

Of the options canvassed, creating a new financial services conduct regulator seems most advantageous to the financial services sector, because it would enable the regulator to enhance its in-depth knowledge of the financial services industry and further develop the specialist expertise required to effectively supervise the industry.

In Mercer's view, consumer protection of the financial services sector should form part of the mandate of a financial services conduct regulator, since the consumer issues arising from the sector are likely to be closely aligned to the market conduct of the sector. Having a single financial services conduct regulator with the power to address both market conduct and consumer issues is therefore likely to be a more efficient model than a separate financial services consumer agency.

To enhance disincentives for wrongdoing, Mercer would also support the availability and level of civil penalties available to ASIC being aligned to those of international regulators.

We do note, however, that some of the powers available to international regulators (such as disgorgement in non-criminal proceedings to remove any financial benefit to the offending party) may not be constitutionally permitted in Australia due to the fundamental requirement that property may only be acquired on just terms under Section 51(xxxi) of the Australian Constitution.

Recommendation

To reduce the regulatory burden on ASIC, consideration should be given to the creation of a new financial services conduct and consumer regulator, with specialist expertise in the financial services sector.

The level of monetary penalties in the Corporations Act should be reviewed to ensure that they are comparable with international securities regulation however all penalties recovered should be applied to consolidated revenue as opposed to funding the prosecuting regulator.

8

Retirement Income

Observation

There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests.
- For product providers, streamline administrative arrangements for assessing the eligibility for tax concessions and Age Pension means-tests treatment of retirement income products.
- Issue longer-dated Government bonds, including inflation-linked bonds, to support the development of retirement income products.

The Inquiry seeks further information on the following areas:

- Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees? Are there examples of other potentially suitable products?
- If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?
- Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?
- Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?
- What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure?

The retirement income system

Recently released Mercer analysis has highlighted the importance of an appropriate legislative structure in relation to the post-retirement stage.

We have analysed the mortality rates of public sector pensioners and revealed (allowing for continued improvements in mortality) most retiring white collar workers are likely to live much longer than the current average life expectancy of 84.1 for men and 87 for females:

Proportion of 65 year olds expected to live to at least the age shown in Columns 2 or 3	Males	Females
50%	88	91
35%	91	93
20%	94	96
5%	99	100+

Mercer’s research is the most comprehensive research of life expectancies for superannuation scheme members in Australia. It highlights the serious risk of planning finances, career, retirement, and health, including aged care services, based on the expectation of average life expectancies.

To date, successive Governments have mainly concentrated on the accumulation stage of superannuation rather than the retirement phase. The introduction of MySuper has created products which are appropriate in the pre-retirement phase for members who are not engaged with their superannuation.

However, once a member retires, there is a gap – particularly for disengaged members.
In order to commence a retirement pension, it is generally necessary for the member to obtain a PDS (perhaps 60 to 100 pages) for an account based pension, an application form and lodge the application form. Few members would have the ability to properly understand the complex documentation without obtaining financial advice.

In our view, it would be more logical for the legislation to allow an automatic transition to the pension phase. If there is a smooth transition process, there is a greater chance superannuation savings will be used for their prime purpose – i.e. to finance income during the retirement years rather than being withdrawn in cash. There are a number of legislative barriers to this at present:

- Amounts cannot generally be transferred out of a MySuper account to a pension product without the consent of the member
- The legislation requires members to apply for a pension account
- Pensions generally do not provide insurance benefits (if a member’s account is transferred to a pension account, any insured benefits would be lost)
- Further amounts cannot be added to an existing pension which complicates the process of amalgamating multiple accounts in pension phase

There is also a practical barrier as superannuation funds will not generally be aware of the member’s bank account details. Such details will be necessary to enable the fund to cost effectively make pension payments. In a significant majority of cases, the member’s employer will have been provided with details of the member’s bank account for the purpose of salary payments. The SuperStream requirements could be amended to also require employers to provide these details to the relevant super fund. (This could be restricted to, for example, employees who have reached preservation age.)

Recommendations

Legislative provisions to more readily allow members to be transferred to default retirement income products, as chosen be each fund's trustees, should be made.

Requirements for default pension products should be "principles based" and should enable a range of products to be offered by trustees.

The overall default pension product (but not necessarily each component) should have an element of flexibility to allow for different personal circumstances whilst also recognising the range of risks that must be considered in the design of any default income product.

Retirement Income Products

This section considers impediments to the development of income products with risk management features that could benefit retirees.

We discuss a number of impediments below:

Impediments to longevity protection

- A general reluctance of Australians to purchase products where the value would be lost on early death. Although deferred products can be designed to return capital on death, such provisions increase the cost and/or reduce the mortality profits which could otherwise be used to provide higher benefits to the survivors
- The tax treatment of deferred annuities and deferred pensions – higher tax is payable on investment income of deferred products
- The Social Security treatment of deferred annuities and pensions – even though they are not accessible, deemed income is assumed when assessing for the age pension income test

Although the above issues create difficulties for those retirees seeking longevity protection, the impediments are not insurmountable.

We note that the Government already provides some level of longevity protection via the age pension which will come into play either initially or once a person's savings have fallen to the relevant level.

We see no need for the Government to provide additional longevity protection.

Recommendation

The Government should ensure that the private sector has appropriate freedom to develop such products in a tax and social security environment which does not discriminate against them. In particular, amendments to the tax law should be made to provide the same tax treatment for deferred annuities and deferred pensions as is provided for current pensions.

Impediments to inflation protection

Two impediments are

- The limited availability of long term index linked bonds to provide protection against inflation
- The method of determining the minimum drawdown requirements

Investing in long term indexed bonds is one way for an insurer to immunise against inflation. However there is limited availability of such bonds in the Australian market.

For account based pensions, such bonds, if there was a suitable market, could also provide some protection however the minimum draw down rules can inappropriately disrupt an orderly draw down with significant variations in draw down requirements from year to year.

For example, consider an account based pension which is fully invested in long term inflation linked bonds. This could generate a steady income stream supported by a gradual selling down of the original capital. However the market value of such bonds can fluctuate considerably with changes in interest rates. A reduction in interest rates could see a significant increase in the market value of the bonds, even though they are producing a regular stream of income. The increase in market value would result in a higher drawdown requirement even though the income being generated by the assets has not changed.

Recommendation

The Government could assist the development of products in this area by:

- Issuing long dated inflation linked bonds as part of its normal borrowing activities
- Providing more flexibility in the valuation of assets that provide regular income products (such as bonds) for the purpose of the minimum draw down rules.

Legislative impediments

There are a number of other legislative barriers to the development of an appropriate pension system. These include the following:

Some pensions are not pensions

One example of inappropriate outcomes relates to disability income benefits.
Where an income stream is payable due to a member's temporary incapacity, the benefit is taxed as normal income. This is reasonable taking into account the nature of the benefit.

Where however an income stream is payable due to a member's permanent incapacity, the ATO has informed some funds the benefit must be taxed as a series of lump sum payments because the income stream fails one of the pension tests, despite it being potentially payable on a monthly basis for 30 years or more. This leads to more complex tax calculations each month resulting in increased costs and an outcome which is inconsistent with common logic.

Confusing legislative requirements

Changes to legislation in 2007 significantly complicated pension requirements. Definitions of pension for tax purposes were linked to certain definitions in the SIS Regulations.

The SIS Regulations set out numerous rules which must be complied with in order for a benefit to be classified as a pension.

In some cases these rules are internally inconsistent and use terminology which can be interpreted in a number of different ways. Further, the rules envisage that a pension will be only of one type – account based or lifetime, which appears to inhibit the development of hybrid solutions. In other cases the restrictions include overly prescriptive requirements which are impractical and would rarely be satisfied by any existing pensions. Replacing existing requirements with “principles based” requirements would assist in this regard.

Pension commutation

TR 2013/5 indicates that a pension ceases to be a pension when the member requests it be commuted in full. This appears to be an illogical conclusion as the trustee would appear to have a continuing obligation to satisfy the minimum pension draw down requirements until the pension is commuted. Further, those who are aware of the requirements can readily get around them by requesting a partial commutation, potentially leaving $1 in their account. The ATO decision has created confusion and additional costs for members and trustees for little or no gain to Government revenue.

Means testing

The current asset test for the age pension encourages the spending of retirement savings. The Interim Report has identified the example of Fred which we raised in our preliminary submission to the FSI.

> Fred is a single (home-owner) retiree with a $500,000 account based pension. He is drawing down the minimum 5% of the account each year.
> By spending $100,000 of his superannuation account on an overseas trip, Fred increases his age pension by $150 a fortnight ($3,900 a year).
> If he continues to draw down the minimum allowed from his account based pension, his withdrawals reduce by $5,000 a year meaning he is only $1,100 a year (or $21 per week) worse off after his $100,000 overseas trip.

We should point out this is not a problem restricted to superannuation assets. The same result would have resulted if Fred’s assets were invested in shares or other financial investments. It is not a problem which would be fixed by restricting drawdowns from super. Rather the rate of reduction in the age pension is too high for each additional dollar of assets.

Recommendations

Either the legislation or the ATO interpretation of the legislation should be reviewed to ensure:

- Permanent disability pensions are considered to be pensions rather than a series of lump sums
- The rules relating to pensions are clear and internal inconsistencies removed
- Pensions should continue to be treated as pensions in the period between a member instructing the provider to commute the pension and the commutation

The assets test should be modified so there is greater encouragement to use superannuation and other savings on a gradual basis throughout retirement rather than drawing down significant amounts to finance items such as an overseas trip.

9

Technology

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Amend regulation that specifies using certain technologies with the aim of becoming technology neutral. Amendments should enable electronic service delivery to become the default; however, they should include opt-out provisions to manage access needs for segments of the community.
- Adopt a principle of technology neutrality, for future regulation recognising the need for technology-specific regulation on an exceptions basis. Where technology-specific regulation is required, seek to be technology neutral within that class of technologies.

The Inquiry seeks further information on the following area:

- What specific regulatory and legislative requirements should be prioritised for amendment in relation to technology neutrality?

Mercer strongly supports the suggestions in the Interim Report relating to:

- Amend current regulation to make it technology neutral and enable electronic service delivery to be the default. This would result in significant savings for superannuation products
- Adopt a principle of technology neutrality for future legislation

Key points relating to this issue are:

- Appropriate opt out arrangements can be made to protect those customers (such as senior Australians) who may not have access to internet.
- To maximize efficiencies and minimize cost, a provider of a choice product should be able to nominate that choice product as "electronic only"
- Customers who receive information and transact electronically should receive the benefits of doing so and not subsidise the cost of those customers that choose paper. Therefore, product providers should be able to charge customers that choose paper a reasonable fee to reflect the additional cost of paper based interactions. This is already operating in the banking sector.

Further detail on this issue is set out below.

Mercer supports the observations of the FSI Interim Report

> "Some Federal and state-based legislation and regulations require (implicitly or explicitly) the use of certain forms of technology. For example, they may specify certain delivery mechanisms or products, or use terminology that assumes a paper-based environment. That is, they are not technology neutral. In other cases, new technologies put in doubt the operation

> of certain provisions of legislation or regulations. These circumstances can prevent the uptake of new technologies that could provide better outcomes for consumers, businesses and Government."

We also agree with the statement from submissions in the Interim Report "Government should aim to enable transactions and business to be carried out digitally end-to-end: regulation should not make it more difficult and expensive to conduct business through purely digital channels".

The cost efficiencies just from electronic delivery are significant. For example, on average, each regulated document costs more than $2 to produce and post to a member. However the same document costs less than 5 cents if given electronically to the same member. For a large superannuation business, this results in a potential saving of millions of dollars each year.

We share the FSI's concerns that some senior Australians may be less able to access digital channels. However, we believe that can be managed by retaining an opportunity for those customers to choose to receive paper communications and transact by paper or through a call centre.

Customers who receive information and transact electronically should receive the benefits of doing so and not subsidize the cost of those customers that choose paper. Product providers should be able to charge customers that choose paper a reasonable fee to reflect the additional cost of paper based interactions.

A product provider should also be able to nominate any choice product it offers as 'digital only' where there will be no right for any customer to choose to receive any paper communications or transact by paper.

Recommendation

- Current regulations should be amended to make them technology neutral and enable electronic service delivery to be the default.
- Adopt a principle of technology neutrality for future legislation

The Inquiry seeks further information on the following area:

- What specific regulatory and legislative requirements should be prioritised for amendment in relation to technology neutrality?

The regulatory requirements identified on pages 4-41 to 4-44 of the Report should be prioritised and, in particular, the regulatory requirements relating to disclosure and transactions.

Example - disclosure - chapter 7 of the Corporations Legislation

Broadly, the disclosure regulation should be amended to:

- remove any paper bias;
- remove need for customer consent;
- ensure all regulated communications can be given by any electronic means; and
- ensure consistency across each type of regulated communications.

Examples of key provisions requiring amendment for technology neutrality

Document	Act/Regulation	Sections/Regulations
FSG	Corporations Act 2001 (Cth) Corporations Regulations 2001 (Cth)	Section 940C(1),(5) Regulations 7.701(2),(2A,)(3),(4)
PDS	Corporations Act Corporations Regulations	Section: 1015C(1)(a)(ii) Regulations: (7.02.02A) (7.9.02A(1)(a)) (7.9.02(B))
Member benefit statements	Corporations Act Corporations Regulations	Regulation: 7.9.75A(2)
Significant events notices	Corporations Act Corporations Regulations	Regulations 7.9.75A(1)

Recommendation

Regulatory requirements relating to disclosure and transactions are among the regulations that should be prioritised for amendments to provide technology neutrality.

Managing Information

The Inquiry seeks further information on the following areas:

- What options could be explored for providing consumers with more control over use of their data and/or better access to their own data in useful formats to improve decision making and consumer outcomes?

Digital interactions with a customer that harness personalised information a provider holds about that customer can both empower the customer to make better choices and encourage the customer to engage with the provider about their financial products and services. In the superannuation industry, where such a large proportion of customers are disengaged, enabling providers to use technology and harness big data to help guide a customer through otherwise complex decisions should encourage more customers to make decisions and make better decisions.

These interactions with customers would often be personal advice under the Corporations Act and so attract all the regulatory obligations of personal advice. A licensee or representative need only take into account one of the customer's objectives, financial situation or needs, or refer to information or assumptions specific to the client in that digital tool, for the relevant personal advice provisions in the Corporations Act to apply.

More needs to be done to ensure that the requirements around personal advice are sufficiently flexible to not discourage the development of and use of new digital tools that can assist customers to make better decisions.

While the Corporations Act generally supports the delivery of financial advice in a digital environment, there remain some inconsistencies between the provisions of the Corporations Act, Corporations Regulations and ASIC Regulatory Guides that can be interpreted as discouraging digital innovation and there are a number of provisions that still have a paper bias. For example, the content requirements of Financial Services Guides (Corporations Act, Section 942A) and Statements of Advice (Corporations Act, Section 947A) still refer to the 'cover' of those documents. That terminology implies a bias towards producing a document in paper form, or traditional PDF format. This unduly limits how information could be provided to customers in a digital environment.

Recommendation

The legislation should be sufficiently flexible to enable the benefits of big data to be harnessed to create value experiences for customers.

10

International Integration

Foreign Accounts Tax Compliance Act (FATCA)

US legislation (FATCA) imposes significant withholding tax obligations in respect of income payments from US investments. We are pleased to note the Australian Government was able to enter into an intergovernmental agreement with the US which will minimise reporting and costs for Australian superannuation funds and some other financial products.

Globalised version of FATCA

It is of some concern that other overseas jurisdictions may develop similar legislation to the US FATCA legislation. If this occurs, Australian super funds and other financial products could potentially incur significant costs unless it is possible for intergovernmental agreements similar to that with the US to be put in place.

> **Recommendation**
>
> The Australian Government needs to be proactive to minimise potential costs on Australian financial institutions if FATCA type legislation is enacted more widely.

Superannuation – Transfer of benefits to Australia

We have set out in Section 4.2 some impediments relating to financial integration in respect of superannuation where Australian regulations make it difficult for persons moving to or returning to Australia to transfer their overseas superannuation benefits to Australia:

- Limits on the maximum amount which can be transferred as a single amount
- Overly complex requirements for the transfer of amounts in New Zealand KiwiSaver schemes

The relevant regulations are currently resulting in significant barriers to those who have worked overseas from consolidating their retirement savings in Australia. In the KiwiSaver case, we understand only one fund is prepared to accept such transfers due to the costs involved.

Recommendation:

- Regulations relating to the transfer of KiwiSaver to Australia should be simplified to remove the significant costs which would be incurred by funds agreeing to accept such transfers.
- Regulations prohibiting the acceptance of large transfer amounts from overseas funds should be reviewed.

Superannuation – Temporary residents

Temporary residents are significantly disadvantaged. Similar disadvantages apply to those on permanent visas if they allow their visa to lapse and they have previously been in Australia on a temporary visa.

Such members are only able to access their benefit on leaving Australia (or death/terminal medical condition/permanent incapacity). In other words they cannot access their benefit on retirement or reaching age 65 unless they have left the country. They are not eligible for tax free benefits after age 60 (benefits are subject to 35% tax on top of the 15% contribution tax). They might also be liable for tax in their home country or new country of residence. In effect, temporary residents cannot effectively use super as a means of retirement saving (due to the compulsory cashing requirement on leaving Australia).

As SG contributions are generally mandated for temporary residents, the contributions are effectively a component of remuneration which is taxed far more heavily than any other income.

This makes it less attractive for temporary residents to work in Australia.

However a bigger concern is the compliance costs borne by Australian super funds. This issue is covered in more detail in Appendix A.

Recommendation

- Regulations specifying different conditions of release for temporary residents should be repealed
- Temporary residents should be allowed to voluntarily withdraw their super on leaving Australia (subject to the higher rate of tax) or retain their benefit in Australia in which case standard preservation and tax rules would apply. In addition, the standard lost member account rules would apply resulting in some small accounts being transferred to the ATO. Such amounts should be accessible based on standard superannuation tax rates when accessed following satisfaction of a retirement condition of release.

Appendix A

Proposed Changes to reduce costs

The following measures would each result in an incremental reduction in costs:

Disclosure requirements

Many disclosure requirements are inappropriately drafted and result in costly and often unnecessary disclosure material. These include:

- Requirement to include product dashboards on periodic statements adds additional complexity and cost. Dashboards can be readily accessed on fund websites. Requirements to include them on exit statements is particularly unhelpful
- Original proposals in relation to the provision of portfolio holdings were far too complex and would have resulted in high costs and disclosure which few stakeholders would be likely to find useful or understand. Appropriate disclosure requirements have not yet been finalised
- The requirement to provide a summary of all Significant Event Notices (SEN) on web-sites. It will often be cheaper and more appropriate to include the full SEN. Where a SEN relates to only a small number of members, it is unclear why such material should be made publicly available.

Provisions relating to the transfer of benefits in KiwiSaver in New Zealand should be reviewed

Provisions in relation to the transfer of KiwiSaver amounts were introduced in 2013 following an agreement with New Zealand. It is voluntary for Australian funds to accept such amounts.

However the requirements on funds, if such amounts are accepted are very onerous. They include maintaining records of the amounts transferred and applying different preservation rules to such amounts. To satisfy the requirements, funds would need to make significant changes to administration systems as well as complicate communication material and administrative processes. We have estimated costs of $750,000 in amendments to systems and processes if the Mercer Super Trust were to accept transfers from KiwiSaver. In addition there would be ongoing costs each year.

Due to the complexity and costs involved, we are aware of only **one** Australian fund which is currently prepared to accept amounts from KiwiSaver. Admittedly, Australian funds have been extremely busy coping with the myriad of other new requirements introduced in recent years and more funds may eventually be prepared to spend the money necessary to accept KiwiSaver amounts.

This is a clear example of Governments coming up with policy without proper consideration of the costs involved to the superannuation industry. One of the main areas of complexity in the current legislation is the need to apply different preservation rules in relation to the component of the member's benefit which was transferred from New Zealand.

Conditions of release for temporary residents should be the same as for Australian citizens

Under preservation requirements, members must satisfy a condition of release before their benefit can be paid in cash (or as a pension). These conditions vary between members with currently three different sets of rules applicable to:

- Australian and New Zealand citizens and permanent residents
- Australian and New Zealand citizens and permanent residents who have transferred an amount from KiwiSaver (different rules only apply to KiwiSaver component)
- Temporary residents (some exceptions apply)

This adds significant complexity. As indicated above almost all Australian funds have not been prepared to incur the costs of system and process changes necessary to cope with the rules in relation to KiwiSaver transfers.

However it is mandatory for funds to comply with the different preservation rules for temporary residents. This increases compliance and communication costs and effectively requires funds to be satisfied a member is not a temporary resident before paying a benefit.

Compliance costs would reduce if temporary residents were subject to the same rules as Australians. This would enable temporary residents to leave their accrued benefits in the Australian system. It should still be possible to allow temporary residents an option of taking their benefit (subject to a significant tax penalty as currently applies) when they leave Australia. Evidence of leaving Australia would be required. This would simplify the payment process for the vast majority of fund members who are Australian or New Zealand citizens or permanent residents.

Restrictions on amount of benefits transferred from an overseas superannuation fund should be removed

Transfer amounts in excess of $540,000 (under age 65) or $180,000 (age 65+) cannot be accepted in a single payment (due to the fund-capped contribution requirements in SIS Reg 7.04(3)). Splitting transfer amounts into more than one payment is often not possible due to rules in place in the overseas country or fund.

Further, splitting the transfer into more than one payment may have a significant adverse impact on the Australian tax payable on the transfer, potentially making the transfer uneconomic.

The restriction on accepting such amounts appears to be illogical and acts as a deterrent to Australians returning home and to new Australians from bringing their retirement savings to Australia.

Transfer amounts will generally be subject to contribution tax or alternatively be treated as non-concessional contributions. We acknowledge the acceptance of larger transfer amounts could result in the imposition of excess non-concessional contribution tax and members would need to take this into account in deciding to transfer larger amounts.

Complex age based restrictions on contributions should be reviewed

There are few restrictions on contributions for members under age 65. (Restrictions apply to some contributions where the member has not provided their TFN to the fund and to single contributions in excess of $540,000.)

However for those who are age 65 or over, the rules are more stringent and more complex creating additional compliance costs for funds.

Different rules apply to the three age bands (65-69, 70-74 and 75+) and to different contribution types within each age band. SG contributions can be accepted at any age without having to satisfy a work test.

For other contributions to be accepted, different rules (within each age band) apply to voluntary employer (including salary sacrifice contributions, after tax member contributions, contributions by the member's spouse). In some cases a work test must be satisfied (at least 40 hours work in a consecutive 30 day period in the financial year). Funds must generally check with the employer or member to obtain verification the work test has been satisfied. Even where the member is continuing to work, this test can create problems, particularly early in the year. For example consider a person who is working 10 hours each week. The employer pays salaries for each month in the middle of the month.

Superannuation contributions (including salary sacrifice contributions and member after-tax contributions are paid at the same time). However for the employee working 10 hours a week, any voluntary employer contributions, salary sacrifice contributions and member after-tax contributions for July cannot be accepted as the work test has not been satisfied.

The problem is magnified when it is unclear whether an employer contribution is an SG contribution or a voluntary employer contribution. For example, an employer may contribute 9.5% of earnings for a member who earns less than $450 a month. Such a contribution would be classified as a voluntary contribution as it is not necessary to make the contribution under SG legislation. An employer may also contribute 9.5% of earnings without restricting the contribution to 9.5% of the maximum contribution base as allowed under the SG legislation. These excess contributions would be considered voluntary contributions and it may not be possible to accept them.

These issues create additional costs for funds and employers. Although the costs are difficult to quantify, the costs will increase as the number of members continuing to work past age 65 increases.

We accept some rules may need to be in place to restrict some contribution types at high ages to minimise the use of superannuation as an estate planning devise. However costs could be reduced by any of the following options:

- Allowing all employer contributions to be accepted without the need to satisfy a work test
- Applying a more appropriately designed work test which should be consistently applied to all superannuation contributions for those over age 65 (or age pension age)
- Allowing all transfers from overseas superannuation funds to be accepted irrespective of age or size (excess non-concessional contributions tax or contribution tax may apply)

Requirements for the provision of data to APRA should be considerably reduced

Significant increases in the amount of data which funds need to provide to APRA on a quarterly and annual basis have increased exponentially. In the case of the Mercer Super Trust the costs of preparing these returns has now reached approximately $ 1.5 million per annum after initial costs to modify systems of around $3 million. We understand much of the data will not be used by APRA for its prudential regulation purposes but is required for the purposes of other Government bodies.

Whilst some of this data is clearly important, the costs involved in preparing the APRA returns is now so great, it is time for the requirements to be reviewed.

Provisions enabling contributions to be split with a member's spouse should be removed

These provisions add complexity to administration systems and communication material. They are not used by a significant number of members and other than enabling couples to more evenly split their superannuation assets have little practical impact.

They originally had value when there was a limit on the amount of benefits each member could take on a concessional tax basis but these limits were removed in 2007.

The contribution splitting provisions should be removed.

Provisions enabling contributions to be made on behalf of a child should be removed

These provisions add complexity to administration systems, communication material and reporting to the ATO.

Their use is extremely rare. We expect a significant majority of funds would never have received such a contribution.

Provisions enabling a tax offset to be obtained by a person in respect of contributions the person makes in respect of their low income spouse should be removed

These provisions add complexity to communication material. The maximum tax offset available is $540.

Generally, we expect this is claimed by high income individuals in respect of a spouse who is either not working or working very little (it cuts out where the spouse earns more than $13,800 a year.

Tax in respect of death benefits should be removed

Tax on death benefits appears to apply to restrict the use of superannuation as an estate planning device. However it results in costs to:

- Members – obtaining advice, cashing benefits and recontributing them in order to minimise the eventual tax on the death benefit
- Superannuation funds (communication material, determination of whether tax applies in particular case etc)

It can also result in additional strain and worry for the member and their family in what is already a time of great stress. For example a member may learn they have only a short time to live. Tax can be avoided if they act quickly and cash their benefit before death (if an appropriate condition of release has been satisfied e.g. Retirement or Terminal Medical Condition). On the other hand, if their death benefit would be eligible for an anti-detriment payment (see next point) then a death benefit may be financially more advantageous than a retirement or terminal medical condition benefit. It should not be necessary for dying members to consider such issues in such stressful times.

Anti-detriment provisions should be removed

These provisions were introduced in 1988. This followed the introduction of contribution tax which was to be offset by a reduction in the tax on benefits.

It enables a fund to make an additional death benefit payment to offset the impact of contribution tax. The fund can then obtain a tax deduction which offsets the cost of the additional benefit.

The provisions provided compensation for those eligible to receive a death benefit on a tax free basis (where no reduction in tax was possible to offset contribution tax). The provisions were however badly drafted and resulted in additional tax benefits in some cases where there had been a reduction in tax payable.

Changes to the legislation effective from 1 July 2007 inappropriately removed the anti-detriment provisions for some beneficiaries who should logically have received the anti-detriment benefit.

The ATO's interpretation of this legislation also makes it very difficult if not impossible for SMSFs to utilise these provisions creating different tax treatment between funds.

MySuper rules

In general, the same provisions must apply to all members of a MySuper product, including the same fees. In some cases, employers have been prepared to subsidise fees or insurance costs for some but not all employees however the MySuper requirements do not allow this to occur. Such arrangements include cases where:

- Fees or premiums have increased for some members (perhaps due to a previous successor fund transfer instigated by the employer) and the employer wants to meet any additional cost
- Insurance premiums for some employees engaged in hazardous occupations are subject to an occupational loading and the employer wants these employees to effectively pay the same premium as other employees

Admittedly the employer can meet these additional costs by the payment of additional contributions in respect of the relevant employees however this is generally a more complex and costly process merely to ensure the correct level of subsidy is achieved.

Appendix B

Prudential Standards

This Appendix sets out matters under the prudential standards relevant to superannuation that must be either approved or satisfied by the Board or for which the Board is held to be responsible.

Matter	Prudential Standard
Business plan	SPS 220, paragraph 18
Maintaining solvency and ensuring adequate resources	SPS 220, paragraph 8
Sound and prudent management of business operations	SPS 510, paragraph 8
Risk Management framework	SPS 220, paragraph 7
Risk appetite statement	SPS 220, paragraph 20
Risk management strategy	SPS 220, paragraph 22
Declaration to APRA on risk management	SPS 220, paragraph 33
Ensuring outsourcing risks and controls and business continuity risks and controls form part of risk management framework and risk management declaration	SPS 231, paragraph 14; SPS 232, paragraph 11
Investment strategy	SPS 530, paragraph 6(b)
Investment objectives for each investment option	SPS 530, paragraph 6(a)
Monitoring and assessing whether investment objectives are being met	SPS 530, paragraph 6(c)
Taking action in response to information contained in investment reports	SPS 530, paragraph 6(d)
Investment governance framework	SPS 530, paragraph 10
Measures to monitor performance of each investment	SPS 530, paragraph 24
Investment strategy review policy	SPS 530, paragraph 27
Justification for amendments to investment strategy	SPS 530, paragraph 28
Liquidity management plan	SPS 530, paragraph 32
Business continuity management	SPS 232, paragraph 8
Appropriateness of approach to business continuity management	SPS 232, paragraph 9
Business Continuity Management Policy	SPS 232, paragraph 15
Target amount for Operational Risk Financial Resources (ORFR)	SPS 114, paragraphs 9 and 12
ORFR strategy	SPS 114, paragraph 18
ORFR replenishment plan	SPS 114, paragraph 21
ORFR transition plan	SPS 114, paragraph 30
Outsourcing of material business activities	SPS 231, paragraph 13
Outsourcing policy	SPS 231, paragraph 15
Insurance Management Framework	SPS 250, paragraph 11
Board charter	SPS 510, paragraph 9

Use of group policies	SPS 510, paragraph 18; SPS 530, paragraph 7; SPS 250, paragraph 7; SPS 220, paragraph 9; SPS 114, paragraph 13; SPS 160, paragraph 9; SPS 231, paragraph 4; SPS 232, paragraph 5; SPS 520, paragraph 10
Adequacy of director and management skills	SPS 510, paragraph 11
Processes for assessing board performance	SPS 510, paragraph 19
Board renewal policy	SPS 510, paragraph 20
Remuneration policy	SPS 510, paragraph 22
Satisfaction of auditor independence	SPS 510, paragraph 59
Fit and proper policy	SPS 520, paragraph 7
Conflicts management framework	SPS 521, paragraph 10
Staff understanding of conflicts	SPS 521, paragraph 11
Appointment procedures for responsible persons	SPS 521, paragraph 12
Conflicts management policy	SPS 521, paragraph 18
Defined Benefit shortfall limit	SPS 160, paragraph 10
Shortfall monitoring process	SPS 160, paragraph 13
Defined Benefit restoration plan	SPS 160, paragraph 32(d)
Determining whether self-insurance continues to be in the best interests of beneficiaries	SPS 160, paragraph 36(c)
MySuper transition business plan	SPS 410, paragraph 7

Appendix C

Improving Adequacy by removing some of the large gaps in the superannuation guarantee system

The Superannuation Guarantee system does not apply to those who are:

- those earning under $450 a month
- self-employed
- unemployed
- disabled
- on workers compensation
- caring for others (including those on parental leave, those looking after young children or elderly relatives)

Those who fall into the above groups for long periods of time are significantly more likely to need to rely on the age pension. Consideration therefore needs to be given to additional initiatives to assist these groups in their retirement.

Those earning under $450 a month

Employees who earn less than $450 a month are excluded from the SG system. Whilst we understand that these employees were initially excluded due to the concerns about the net benefits to employees being outweighed by the administration costs, we note that the $450 a month limit has not varied in 22 years, during which time the SG rate has increased from 3% (small employers) to 9.5%. This means the foregone contribution for a person earning $400 a month (for example) has increased from $12 a month to $38 a month.

In today's environment, with the expansion of e-commerce, the introduction of Choice of Fund and the fact that virtually all workers now have a superannuation fund that can be used, we consider that there is no longer a need for such an exemption.

We note that those most likely to not have a superannuation fund would be part-time workers under age 18. These workers would generally be covered by another existing exemption and the removal of the exemption for those earning less than $450 a month would not affect this younger age group.

Self-employed

Whilst the self-employed can now access full tax deductibility for superannuation contributions up to $30,000 a year (higher transitional amounts apply to those over age 50), contributions for the self-employed are purely voluntary.

Whilst many self-employed make some provision for retirement, either through superannuation or by building up their own business, we believe that it is time for a greater level of compulsory saving to be considered for this group.

When the Superannuation Guarantee system was introduced in 1992, it was based on contributions of 3% or 5% of earnings with the level of contributions being increased gradually over a 10 year period.

A similar phased implementation for the self-employed would eventually result in this significant portion of the community being more self-reliant in retirement.

A possible implementation programme would be to commence from, say 1 July 2015 at a 3% level. The contribution level would then increase by 1% every second year until it eventually reaches the level applicable to the employed.

Workers compensation, paid parental leave and disability benefits

Currently workers compensation payments (where no work is performed) and payments in respect of parental leave are not included in the definition of Ordinary Time Earnings on which Superannuation Guarantee contributions are based.

In respect of workers compensation, this appears unfair as, if the person had not been injured or had not become ill due to an incident at a workplace, superannuation contributions would have been paid. Obviously this would add to the costs of employers. We would suggest that the contributions be paid by insurers and funded by higher workers compensation insurance premiums.

Similarly, coverage could be extended to those in receipt of salary continuance benefits and Government disability benefits.

Recommendation

To address the above issues, we recommend that:

- the exemption for those earning less than $450 a month be removed;
- the self-employed be gradually phased into the Superannuation Guarantee system;
- the Superannuation Guarantee system be expanded to cover workers compensation benefits and paid parental leave as well as those receiving salary continuance and disability benefits.

Appendix D

Who is Mercer?

Mercer is a global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have $55 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust, the Mercer Super Trust, has over 240 participating employers, 226,000 members and more than $18 billion in assets under management.

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