Super Guarantee Australia

FSC Submission

September 2021

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. FSC submission

The FSC is pleased to provide the following comments on the proposal for Super Guarantee Australia (**SGA**).[1] This proposal is similar to a number of other proposals that have been made for a National Default Fund (**NDF**), which involves a government sponsored fund that has the monopoly on mandatory superannuation contributions in cases where an employee has not exercised choice.

The FSC has a keen interest in this issue as a representative of Australian superannuation funds. We consider there are a substantial number of issues that warrant consideration in relation to the proposal, particularly the following:

- The SGA proposal states the Australian superannuation system has higher costs than other comparable systems. The FSC has many concerns with the data purporting to show this is the case. In particular:[2]
    - Australia has a number of inherent features that increase costs compared to other jurisdictions, but are largely or entirely outside the control of the industry, such as having individual portable accounts with complex tax rules.
    - Australia's superannuation system invests much more in property, infrastructure and private equity which have higher fees but provide substantially higher returns after fees.

[1] The comments in this submission are based on previous FSC submissions to the Productivity Commission's inquiry into Assessing Efficiency and Competitiveness of the Superannuation System, and the FSC's submission to Government's Retirement Income Review.
[2] For more details see FSC's submission to the Government's Retirement Income Review, section 6.9.2

- There are gaps and inconsistencies in the OECD data, while the data for Australia is 'poor' and 'heavily compromised'.[3]
- The SGA may have a perceived government guarantee. While there may not be an *actual* government guarantee, there may be a perception of a guarantee.[4]
  - A perceived or actual Government guarantee could distort the superannuation industry, by SGA having a competitive advantage (the implicit guarantee) that the rest of the industry does not have
  - The implicit guarantee could result in a large contingent liability for the Government.
  - On the other hand, the FSC has noted[5] that increased superannuation assets can have a one-for-one offset in lower pension expenditure – so any Government 'top up' of returns in the SGA could result in a near equal reduction in pension spending.
  - Any consideration of an implicit guarantee should consider why this argument doesn't apply to other Australian super funds, that is, address the argument that all large Australian super funds have a perceived government guarantee at the moment, and the SGA would be no different.[6]
- The overseas experience with default funds was explored by the Productivity Commission in its Draft report on Alternative Default Superannuation Models at page 64 and following. This report indicates that some of these international default systems imply or specify a government guarantee, and most defaults are accumulation only, with no retirement phase offering (discussed further below).
- The SGA may opt to have an investment strategy that is particularly conservative, as a result of the political risks from it having poor or negative returns over a short time horizon. The Productivity Commission also argued a conservative investment approach may be more likely if SGA had a perceived government guarantee, to avoid the budget costs of the implied guarantee.[7]
  - A cautious investment approach for the SGA is likely to result in both reduced risk and returns, and could also mean lower retirement balances and higher reliance on the Age Pension.
  - As SGA would also likely be fairly large, a cautious investment strategy will affect financial markets, possibly reducing demand for unlisted assets, equities (including venture capital) and property, while boosting demand for bonds.

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[3] Productivity Commission Final Report of Inquiry into Superannuation System, page 182
[4] Various commentators have argued the SGA should have a guarantee; this heightens the *perception* of a guarantee even if one is not explicit. See for example: http://www.afr.com/opinion/columnists/peter-costellos-future-fund-could-revolutionise-super-20171102-gzdyo1
[5] See FSC submission to Retirement Income Review at p73–4.
[6] As far as we are aware, the government faced no pressure for any sort of capital guarantee of superannuation during previous market downturns such as the GFC. This could easily be different under an SGA.
[7] Productivity Commission Final Report of Inquiry into Superannuation System, page 572.

- Reduced investment in equity (listed and private) from the superannuation system (including SGA) may have adverse effects on the economy.
- On the other hand, the size of the SGA may mean it could invest in unlisted investments that have higher longer-term returns.

- There is potential for political interference in the SGA, including through directing its investments. While the SGA may not have significant interference at commencement, there would be a risk that this interference would increase over time.
- One of the main issues that SGA would address, account proliferation, is already being addressed through many other reforms, particularly the superannuation stapling reforms, Protecting Your Super (PYS), Putting Members' Interest First (PMIF), the wind-up of Eligible Rollover Funds (ERFs) and the introduction of Trustee Voluntary Payments. These changes mean the policy argument in favour of the SGA is reduced.
  - The FSC's preferred model for superannuation default builds on the stapling reforms and removes superannuation defaults from the award completely, with customers choosing their own fund, and employers (if they so choose) nominating any MySuper product for employees that do not exercise choice. This reflects the MySuper system, with Your Future Your Super benchmark testing, means all MySuper products should provide good outcomes to members.[8]
- The potential economies of scale of SGA. It is unclear whether SGA would have substantially greater economies of scale than larger existing funds, particularly as the system matures and smaller funds exit. We note that there exist forecasts for larger funds to have multiple hundreds of billions of funds under management under the current system. While SGA might be larger than this, it is unclear if the economies of scale for a (say) $2 trillion fund would be materially larger than for a (say) $500 billion fund under the current system.
  - In fact, it may be the case that an extremely large fund would face diseconomies of scale, for example it might have investment difficulties in Australia as almost all decisions it would make would move markets.
  - We note a separate Parliamentary Inquiry is examining potential issues with the concentration of capital ownership in Australia.[9] While the FSC considers the issues with concentration of capital ownership are overstated, this may no longer be the case with the SGA proposal which is likely in the long term to manage assets many times larger than the largest superannuation fund under the current system.
- The potential net returns of SGA if it had been run by the Future Fund. It has been argued that SGA, if it were run by the Future Fund, would produce the strong returns

[8] The FSC's preferred default model is detailed in the FSC's submission to the Productivity Commission inquiry into Superannuation: Alternative Default Models, see: https://www.pc.gov.au/__data/assets/pdf_file/0003/209982/sub038-superannuation-alternative-default-models.pdf

[9] House of Representatives Standing Committee on Economics, Inquiry into the implications of common ownership and capital concentration in Australia.

that the Future Fund has achieved, possibly above the return on most existing super funds.

  - However, the SGA would have added costs of dealing with members, additional taxes, additional regulatory costs, and reduced certainty about cashflow compared to the Future Fund, meaning the SGA would have to invest in more liquid assets with lower returns. The investment strategy of the SGA is also likely be much more conservative than the Future Fund, given the implicit guarantee point raised above.
  - A comparison of superannuation fund returns with Future Fund returns is quite misleading if an adjustment for taxation is not made, as superannuation funds (generally) pay 15% tax on investment earnings in accumulation while the Future Fund does not.

- Competitive pressure on the SGA from superannuation fund members. It is well known that a substantial number of existing fund members are disengaged; these members will not apply competitive pressure to the SGA if it performs poorly, manages risk poorly, provides poor customer service and so on, because they would be unlikely to move to an alternate fund.
  - The benchmarking approach being implemented in the current superannuation system is applying pressure on default funds to improve returns, and reduce fees, over time. By contrast, the SGA proposal would not involve the same level of incentives to improve returns and reduce fees over time.
- It is unclear if SGA would provide life insurance. If it did not, this would result in a large increase in the underinsurance gap in Australia, making many Australians worse off when they are injured or disabled, and removing significant financial protections for families when their loved ones die.
- The potential impact of the SGA on supplier markets. If the SGA becomes very large, its decisions will make or break suppliers, particularly life insurers (assuming the SGA provides insurance – see previous point).
  - The SGA proposal would in time concentrate the financial services industry around one nationalised fund and change the dynamics of the industry around this one fund so that the SGA to a substantial extent determines what the rest of the industry does.
  - It also isn't clear that the SGA proposal would assist with Australia being a financial centre, as many businesses would be focussed on their ability to work with the SGA rather than being focussed on other opportunities such as options to supply financial services to the region.
- The Future Fund is required to outsource its funds management operations. We would consider it essential if the SGA option to be further developed that it would take the same approach, as it will ensure that SGA results in competition at the wholesale level for investment management, even though the SGA will likely result in reduced competition at the retail level (as argued above).
- The Productivity Commission has highlighted that a Government-run default fund would face substantial conflicts of interest from the Government being a sponsor,

regulator, service provider and fiduciary agent at the same time.[10] We note that mandatory outsourcing of investment management, life insurance, and other aspects of the SGA operations could substantially mitigate this particular risk.

- It is unclear what the SGA would do for members who reach retirement.
  - If the SGA provided retirement products, there could be political interference in the design and management of these products. There could be particular difficulty in the SGA designing longevity products. The SGA retirement products may be poorly designed for individual circumstances and the SGA may have to become involved in financial advice which it may not do well.
  - If the SGA does not provide retirement products, will there be mandatory rollover into another provider? If the member refuses to rollover, will the funds remain at the SGA with no ability to withdraw?
- An argument for a national default fund is that existing funds are not operating efficiently. However, it is unclear whether or not the addition of a government-sponsored competitor will improve efficiency in the sector. In many other markets, privatisation of government-owned businesses combined with increased competition have resulted in industries becoming more efficient. For example, it could be argued that this applies to CBA, Qantas and Telstra, where privatisation, together with pro-competition policies, delivered more efficient markets.
  - In this context, it would be unusual for the Government to introduce pro-competitive policies (such as MySuper benchmarking) into the superannuation sector and at the same time introduce a Government-run business into the sector.
- The SGA proposal raises two legislative changes that would be required to implement the proposal – establishing a retail entity, and addressing tax issues. There are other legislative changes that will also need to be addressed, including changes to the superannuation law and the rules for superannuation default.
- The SGA proposal may involve the transfer of large amounts of accumulated default balances from existing funds into SGA. This would be time consuming, and quite costly as many billions of dollars of assets would have to be liquidated by the old funds, and asset similarly acquired by SGA (in some cases, the same assets that were sold by the old fund).
  - If accrued default balances were not transferred into SGA, this would reduce cost and disruption but would reintroduce account proliferation, which the SGA proposal is meant to be addressing.
- In almost all situations, the government has privatised businesses operating in markets with private sector participants, even when the markets are quite concentrated. This includes the privatisation of Qantas, Commonwealth Bank, and more recently Medibank Private (there are also clear intentions to privatise the National Broadband Network at some future stage). The SGA proposal would run counter to this trend.

[10] See page 572 of Productivity Commission (2018) *Superannuation: Assessing Efficiency and Competitiveness*, Report no. 91.

- Given the process to date of privatising Government-run businesses, it would be likely that the government sponsored fund under this proposal would be privatised at some stage, which raises the question of why introduce it in the first place.