KPMG

Stapling of superannuation accounts

Industry Super Australia

3 July 2019

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Inherent limitations

This deliverable has been prepared as outlined in the Scope section in the Engagement Letter dated 18 March 2019 and the accompanying Addendum dated 1 May 2019. The services provided in connection with this engagement comprise an advisory engagement, which is not subject to assurance or other standards issued by the Australian Auditing and Assurance Standards Board, and consequently, no opinions or conclusions intended to convey assurance have been expressed. Any reference to 'review' throughout this deliverable has not been used in the context of a review in accordance with assurance and other standards issued by the Australian Auditing and Assurance Standards Board.

In relation to the views around the stapling of superannuation accounts provided by KPMG, Industry Super Australia ("ISA") acknowledges that KPMG:

- acted as a contractor in providing these services and has not undertaken to perform obligations of ISA, whether regulatory or contractual; and
- in carrying out our work:
    - KPMG did not act in a capacity equivalent to a member of management or as an employee of ISA;
    - KPMG's services were limited to assisting with providing a view on the stapling of accounts; and
    - ISA take full responsibility for all final decisions regarding our work.

In relation to assistance provided by KPMG relating to financial analysis using data, estimates and assumptions supplied by ISA and external information, it is not possible to predict future events or anticipate all potential circumstances. Market or other conditions and assumptions may change, and as such, future events may not unfold as expected and actual results achieved for the forecast periods covered will vary from the information presented and the variations may be significant.

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KPMG are under no obligation in any circumstance to update this deliverable, in either oral or written form, for events occurring after the deliverable has been issued in final form.

The findings in this deliverable have been formed on the above basis.

Third party reliance

This deliverable has been prepared at the request of ISA in accordance with the terms of KPMG's Engagement Letter dated 18 March 2019 and the accompanying Addendum dated 1 May 2019 and is not to be used for any other purpose or distributed to, or relied upon by, any other party without KPMG's prior written consent.

Executive Summary

The comments, analyses and conclusions set out in this Executive Summary are intended as a high-level overview only. To obtain a full understanding of our comments, analyses and conclusions, including an understanding of the data, key assumptions and bases underlying our report, requires an examination and consideration of our report in its entirety.

Scope

ISA has engaged KPMG to assist with the provision of a report summarizing:

- KPMG's views on the potential implications for the industry from a member and fund perspective in relation to account 'stapling'.
- Indicative cost and benefit modelling to estimate the fee and insurance savings to members as a result of the reduction in multiple accounts under different account stapling mechanisms.
- Indicative benefits of any uplift in average returns, the 'performance dividend', to members through the rollover to higher performing default funds as a result of the account stapling mechanisms.

Account Stapling Options

Commissioner Kenneth Hayne provided Recommendation 3.5 within his final report which outlined his findings in relation to the Royal Commission into Misconduct in Banking, Superannuation and Financial Services that:

> *"A person should only have one default account. To that end, machinery should be developed for 'stapling' a person to a single default account"*

The Final Report provided little guidance as to the mechanism by which this should be achieved. Industry discussion has suggested that there are two possible alternatives that could be utilised to provide the intended outcome in relation to default superannuation:

1. **Option 1 (Same fund account retained for life):** A single default account for new workforce entrants (where they do not actively choose an alternative fund) that would be retained by the member for their entire working life, regardless of the type of roles they may fulfil during their working career or the different industries within which they may work over this time.
2. **Option 2 (Automatic rollover of accounts):** The use of an automated rollover mechanism upon a change in employment, which would facilitate the swift transfer of a member's benefit to a new default fund (which is established upon a change of employment arrangements by default, unless the member actively chooses an alternative fund). Under this option, it is assumed that all existing unintended duplicate accounts would be consolidated over an initial phase-in period.

The key differences between these options are summarised in the table below.

Feature	Option 1 (Same fund account retained for life)	Option 2 (Automatic rollover of accounts)
When member changes employment:		
Future Superannuation contributions are directed to the member's existing Superannuation account by default	Yes	No
New Superannuation account is created by default, with funds in previous Superannuation account automatically rolled over	No	Yes
Prevents duplicate accounts being created upon changing employment	Yes	Yes
On implementation of Option:		
Consolidates any existing multiple accounts	No	Yes (over a phase-in period)

While both alternatives will achieve the intended outcome of reducing multiple accounts within the superannuation industry, each has a number of potential strengths and challenges as outlined in this report.

Protecting Your Super Package

In late February 2019, the Protecting Your Super Package ("PYSP") legislation was passed through both houses of Parliament. This legislation is likely to reduce the number of duplicate accounts and insurance cover, due to it mandating (along with other measures):

- The transferring of account balances under $6,000 which have been inactive for 16 months to the Australian Taxation Office (ATO) for consolidation;
- The removal of default insurance cover from accounts which have been inactive for 16 months (apart from defined benefit funds and Australian Defence Force Super Fund members); and
- The removal of exit fees (other than buy-sell spreads) on all Superannuation accounts.

On implementation, the PYSP legislation will bring about a significant reduction in duplicate accounts and insurance for members. Account stapling, through either of the options outlined above, will bring additional benefits through further account consolidation and prevention of future duplicate accounts.

Potential Impacts

Based upon our analysis, KPMG believes that Option 2 is feasible and under a number of key assumptions, is likely to provide the greatest benefits to the industry overall and deliver greater member outcomes.

Fee and insurance premium savings and implementation costs

Our modelling indicatively suggests that over a 25-year period, for existing superannuation members, net fee and insurance premium savings of approximately $47.8b could be achievable should Option 2 be adopted. Whilst we note that additional costs associated with Option 2 (related to the automatic rollover of funds), which have been estimated to be $0.5b, would be incurred over the same time, the net benefit to the industry would be approximately $47.3b (compared to $43.5b for Option 1). It is noted however that a significant part of these savings (around $38b) are already expected to be achieved through the recently passed Protecting Your Super Package ("PYSP") legislation.

Higher investment returns (performance dividend)

In a system where funds which do not meet a variety of performance hurdles are expected to lose their eligibility to receive default contributions, it is assumed that over time employers and industries which previously defaulted into lower performing funds will move to higher performing funds and ultimately underperforming funds may consolidate with other funds to improve performance.

As such, funds with underperforming investment returns could be expected to be gradually removed from the superannuation system. This is expected to have an effect of increasing the overall investment returns achieved across the industry. This is referred to as a "performance dividend".

It is expected that Option 2 may provide stronger momentum for the emergence of a performance dividend as the automatic rollover of members changing employer or industry, combined with eligibility criteria for default fund status that results in the promotion of better performing funds, would facilitate the faster transition of members to these funds. Under Option 1 the transition from under performing funds will rely more heavily on these funds being able to lift performance or ultimately consolidate with a better performing fund; this may be expected to be a slower transition and, depending on the selection criteria for default funds, may effectively allow a lower threshold for the definition of underperformance.

Our modelling suggests that if we assume there is an associated transition to higher performing funds over time, leading to an increase in average member returns of 1% p.a. for 25% of account balances with an average phased consolidation period of three years, there could be an increase in total investment returns of $416.3b (in real terms) over a 25-year period for current industry participants. The actual impact to member members would depend on the individual member circumstances and the performance of their current fund. It is noted that some members would benefit more whilst a small number of members may not benefit if they are already a member of a high performing fund.

As an example, a 25 year old member (with a starting salary of $58k and a current superannuation balance of $20k) could be 23% or $189k better off (in real terms) at retirement if they were transitioned to a higher performing fund (defined as 1% higher annual return). Averaged across all current industry participants, the $416.3b is equivalent to $23k per member.

Other impacts and considerations

Other impacts and considerations for Option 2 include:

- Much of the infrastructure required to achieve the automatic rollover of accounts already exists through the ATO, and reporting provided by superannuation funds, which would be expected to enable a reasonably efficient mechanism to be implemented to achieve the required outcomes.
- Additional liquidity is required, with our modelling suggesting around an extra $5b per annum which represents less than 1% of total system assets. However, it is acknowledged that the impact on liquidity can vary significantly by fund depending on member and account profiles.
- There are some potential challenges for an automated rollover method for account stapling related to the treatment of insurance or opting-out of automatic rollovers to maintain multiple accounts.

Conclusion

We believe it is important to implement a stapling model that will benefit the majority of members, rather than focusing on the potential challenges that may be experienced by a small minority.

Overall, we believe there will be material benefits to the superannuation system as a result of account stapling and that the model proposed by ISA (Option 2) remains a feasible solution.

1. Introduction

Based upon our discussions with ISA, we understand that the key premises upon which KPMG have been asked to base our advice are as follows:

- The 'stapling' of accounts would effectively allow a member's superannuation balance to be stapled to the member and would follow the member as they moved between different employment arrangements during their lifetime;
- In effect, this would require an 'automatic rollover' (on an opt-out basis, i.e. unless a member chooses otherwise) from the previous superannuation fund to the new default superannuation fund (which would continue to be nominated by the member employer, or any enterprise agreement/award that governed the employment and superannuation arrangements) at the time, or soon after, the member commenced a new employment arrangement; or alternately for their current superannuation fund to follow them as they change employment;
- The default fund arrangements would continue to operate through a merit-based process (whether through existing default arrangements or other potential selection mechanisms, such as the Fair Work Commission, or a similar alternative arrangement) with an appropriate quality filter to drive outperformance; and
- The mechanism by which the automatic rollover of accounts should be efficient and streamlined in order to minimise cost for the industry and, where possible, utilise existing capabilities across the industry to achieve this.

Specifically, in providing KPMG's view on stapling, we have been requested to comment on the feasibility of the following:

- With regard to the above premises, comment on the mechanics by which multiple accounts can be minimised, whilst connecting members with quality funds, by drawing upon our knowledge of the Australian superannuation system, complemented by our knowledge of, and previous work with, international pension systems, particularly New Zealand's KiwiSaver system;
- Overlay the above with the potential impacts of account consolidation, single touch payroll and service provider implications and provide key insights into how the stapling of accounts could work in a streamlined and efficient manner;
- Identify the key challenges associated with account stapling and provide an overview of potential ways in which these may be overcome (for example, the use of MAAS, MyGov, etc.) taking into account potential regulatory change that may be required to implement such a system; and
- Estimate the impact of consolidating pre-existing balances into higher performing default funds rather than remaining in poorer performing funds.

The remainder of this report provides a summary of KPMG's analysis.

2. Account 'stapling' – the alternatives

KPMG notes that Commissioner Kenneth Hayne provided Recommendation 3.5 within his final report, which outlined his findings in relation to the Royal Commission into Misconduct in Banking, Superannuation and Financial Services ("the Royal Commission") that:

> *"A person should only have one default account. To that end, machinery should be developed for 'stapling' a person to a single default account"*

Whilst the final report provided little guidance as to the mechanism by which this should be achieved, industry discussion has suggested that there are two possible alternatives that could be utilised to provide the intended outcome in relation to default superannuation. These options are:

1. A single default account for new workforce entrants that would be retained by the member for their entire working life, regardless of the type of roles they may fulfil during their working career or the different industries within which they may work over this time; or
2. The use of an automated rollover mechanism, which would facilitate the swift transfer of a member's benefit between funds upon a change in their employment.

We note that both alternatives will achieve the intended outcome of reducing multiple accounts within the superannuation industry, however, each has a number of potential strengths and challenges, as outlined in the following sections.

Further, we note that in late February 2019, the Protecting Your Super Package ("PYSP") legislation was passed through both houses of Parliament. This legislation is likely to reduce the number of duplicate accounts, due to it mandating (along with other measures):

- The transferring of account balances under $6,000 which have been inactive for 16 months to the Australian Taxation Office (ATO) for consolidation;
- The removal of default insurance cover to accounts which have been inactive for 16 months (apart from defined benefit funds and Australian Defence Force Super Fund members); and
- The removal of exit fees (other than buy-sell spreads) on all Superannuation accounts.

On implementation, the PYSP legislation will bring about a significant reduction in duplicate accounts and insurance for members. Account stapling, through either of the options outlined above, will bring additional benefits through further account consolidation and prevention of future duplicate accounts.

2.1 Option 1 – Same fund account retained for life

This alternative allows a new workforce entrant to maintain a single superannuation account with the same fund for their entire working life, where they do not actively choose an alternative fund for their superannuation to be directed to **(Option 1)**. As noted above, this would reduce the potential for multiple (duplicate) default accounts being established for a member, resulting from the possible defaulting of a member into an additional new account each time they commence a new employment arrangement.

An argument has been mounted by some within the superannuation industry that this alternative would provide for a more efficient (and potentially lower cost) outcome for members and funds within the industry as it would limit the rollover of balances between funds each time a member moves to a new employment arrangement, which would be the case under Option 2 below.

Conversely, the possible challenges associated with this option include:

- There remains the potential for a member to be tied to an underperforming fund for their entire working life, particularly where the fund is unable to improve overall outcomes for members;
- The design of many superannuation funds remain tailored to the specific industry within which the members are employed. With changing work patterns and the greater fluidity of employment, a member may initially be defaulted into a fund that caters to a specific industry that they have no affinity with for the majority of their working life;
- There remains the potential for greater disengagement if a member is retained in a single fund for their entire working life, particularly where the fund offers limited engagement strategies or less than ideal communication capabilities or outcomes delivered by the fund are poor, such that any engagement may have the effect of driving members out of their initial default fund; and
- This option does not resolve the multiple account issue that exists for current members within the superannuation system, who currently maintain more than one account. This reflects that such a proposal would:
    - For new entrants into the superannuation system, prevent multiple accounts being created.
    - For current members, not include an automatic consolidation of multiple accounts (unless consolidation is specifically legislated), but would prevent further additional accounts from being created in the future.

2.2 Option 2 – Automatic rollover of accounts

Option 2 provides for the automatic rollover of a member's balance where a new default fund is established upon a change of employment arrangements (unless a member chooses otherwise). As under Option 1, this option also provides for a reduction in multiple accounts for new members entering the superannuation system, but also affords an additional benefit in that the prevalence of existing members with multiple accounts could also be addressed through an ongoing auto-consolidation process.

A further advantage of this proposal is that it retains the most similar mechanism to the existing default system as defaults would continue to be tied to employment and/or award/enterprise bargaining agreements.

An argument could also be mounted that such a mechanism provides for a fairer distribution of superannuation accounts across a range of funds generating continued competition, rather than segregating new employees to a smaller number of default funds that cater to industries that garner the majority of first time employees.

Based on our understanding, we recognise that certain mechanisms that could provide the operational requirements needed for an automatic rollover model either exist, or are being developed, which would result in the potential for existing practices to be utilised, thus minimising the costs of implementation to some extent.

Based upon our research, we believe evidence exists from an international perspective (the New Zealand KiwiSaver system) that such a mechanism can be highly efficient and provide for strong outcomes for members and funds. This is discussed in more detail in Section 3 of this report.

Conversely, we note that some challenges with this alternative also exist, including:

- The manner in which data is shared between funds, the regulator and employers in order to understand when an member has changed an employment arrangement and commenced membership of a new default fund (albeit with improvements to reporting and data sharing, this could be eliminated in the near future);
- There is a perception that greater costs could be attributed to this model given the requirement to rollover benefits between funds on a regular basis (depending on the level of inflows and

outflows of each fund);

- There is the potential for greater liquidity constraints being placed upon funds as a result of the requirement to consolidate members between funds more regularly; and
- The manner in which insurance benefits are transferred (or are not transferred) upon the automatic consolidation of accounts could result in a member being worse off under the new default arrangement than in the previous fund.

Under Option 2, it is assumed that all existing unintended duplicate accounts would be consolidated over a phase-in period, and any future movements by an member between industries would lead to them maintaining only a single account (being an account with their new industry's default fund, with all balances from the previous account rolled over into this account).

2.3 Key differences between Option 1 and Option 2

The key differences between the options are summarised in the table below

Feature	**Option 1 (Same fund account retained for life)**	**Option 2 (Automatic rollover of accounts)**
When member changes employment:		
Future Superannuation contributions are directed to the member's existing Superannuation account by default	Yes	No
New Superannuation account is created by default, with funds in previous Superannuation account automatically rolled over	No	Yes
Prevents duplicate accounts being created upon changing employment	Yes	Yes
On implementation of option:		
Consolidates any existing multiple accounts	No	Yes (over a phase-in period)

2.4 Option 1 and Option 2 illustration

The following scenario is designed to illustrate how the PYSP legislation, Option 1, and Option 2 would each respectively affect a member.

Description	**Initial impact** **Dillon is a member currently with two default superannuation accounts, one which he obtained working in a previous industry: 'ABC Orange', and the other he obtained working in his current industry: 'XYZ Blue'.**	**Ongoing impact** **Dillon decides to change industries. His new workplace's default fund is the: '123 Green' superannuation fund.**
No change to current system (not including impacts of PYSP legislation)	With no changes to the system, Dillon would retain both his accounts, and he would continue to pay fees and insurance premiums (as applicable) for both these accounts. 	Dillon would continue to retain his two previous accounts, 'ABC Orange', 'XYZ Blue' and now also become a member of '123 Green'. Dillon would be paying fees and premiums (as applicable) for all three of these accounts. 
PYSP legislation	Under the passed PYSP legislation, Dillon would retain his 'XYZ Blue' account and may retain his 'ABC Orange' account, depending on the account balance and his account inactivity period. If both are retained, he would pay fees for both these accounts and potentially insurance premiums for both these accounts, again depending on the inactivity period of his 'ABC Orange' account. Insurance on Dillon's ABC Orange account may be cancelled after an inactive period of 16 months. 	Under the passed PYSP legislation, Dillon would become a member of '123 Green', and may retain his 'XYZ Blue' and 'ABC Orange' accounts, depending on the respective account balances and his account inactivity periods. If all three accounts are retained, he would pay fees for all three of these accounts and potentially insurance premiums for these accounts, again depending on his respective inactivity periods of his 'ABC Orange' and his 'XYZ Blue' accounts. 

Description	Initial impact **Dillon is a member currently with two default superannuation accounts, one which he obtained working in a previous industry: 'ABC Orange', and the other he obtained working in his current industry: 'XYZ Blue'.**	Ongoing impact **Dillon decides to change industries. His new workplace's default fund is the: '123 Green' superannuation fund.**
Option 1	Under Option 1, Dillon would retain both his accounts, and he would continue to pay fees and, subject to activity, insurance premiums for both these accounts. 	Under Option 1, Dillon would retain his current 'XYZ Blue' account, and any superannuation contributions from his new employer would be paid to this fund. Dillon would also continue to retain his 'ABC Orange' account. Dillon would be paying fees and, subject to activity, premiums for both accounts. 
Option 2	Under Option 2, funds within Dillon's 'ABC Orange' account would be consolidated at the end of a phase in period into his current industry's default fund: 'XYZ Blue'. Dillon would then have one account. 	Under Option 2, Dillon's current balance within 'XYZ Blue' would be consolidated into a new '123 Green' account. Dillon would only be paying fees and premiums (as applicable) for one account. 

* * * * *

On the basis of our analysis above, Option 2 with the automatic consolidation of accounts (with an opt-out option) is likely to achieve the greatest benefits for the industry as a whole in terms of removing duplicate accounts, albeit we recognise that some potential challenges do exist with its implementation, which are considered below.

KPMG recognises that, in spite of any possible challenges, the potential solution must consider the benefits afforded to the majority of members within the system, rather than focusing on any difficulties with a solution that only affect a small minority of members.

3. An international perspective

From a global perspective, the multiple account issue is not unique to Australia, many countries around the globe continue to deal with the multiple account issue, such as the UK (which remains dominated by corporate fund style pension schemes that often do not allow a rollover between funds), the US as well as a number of European countries.

Nevertheless, the Australian system has been criticised in recent times for its inefficiency due to the large number of members with duplicate accounts across a number of funds. This has led to duplicate and unnecessary administration fees and the potential for duplicate insurance premiums.

Based on our research, the New Zealand KiwiSaver system remains one of the most efficient pension systems in the world in terms of operational costs, having considered the issue of multiple accounts at the creation of the system in 2007, and choosing to avoid the potential for this problem by implementing the automatic rollover of accounts principle, as described within Option 2 in Section 3 of this report.

3.1 The mechanics of the KiwiSaver system

The KiwiSaver system was established in 2007 and was modelled closely on the Australian superannuation system. KiwiSaver however, implemented a range of amendments, which provided for a highly operationally efficient retirement system. One of these key amendments was that a member was only ever allowed to maintain a single KiwiSaver account.

Specifically, the key driver of many of these efficiencies was the use of the Inland Revenue Department ("IRD"), which is the Australian Taxation Office ("ATO") equivalent in New Zealand, as the key 'integrator' for the KiwiSaver system. The IRD in New Zealand plays the role of the 'contributions clearing house', whereby employers (and members on occasion) pay contributions and provide supporting data to the IRD, who then 'clear' the funds and data to the member KiwiSaver schemes. The IRD's second role is to act in a similar manner to an Australian 'Gateway' by collecting data and facilitating the automatic rollover of a member's benefit out of one KiwiSaver scheme into their new scheme, which generally occurs within 30 days of the new scheme being established.

This process is particularly efficient given the IRD maintains contribution data and hence is able to match a member with their new account as soon as it is created in order to initiate the automatic rollover process. We note a further operational benefit afforded to the KiwiSaver system is that unlike the Australian system these schemes do not contain insurance benefits, such that these are not a consideration in terms of the automatic rollover process.

On the basis that the ATO is beginning to play a greater role within superannuation in terms of its MyGov portal, which now offers a straight through, member initiated rollover process (via SuperMatch), this may be a potential consideration in respect of the automatic rollover option, with the implementation of some additional data collection. This is discussed in more detail below.

4. Application for the Australian system

As alluded to within Section 3 above, KPMG believes that some of the existing superannuation infrastructure could be utilised in order to achieve the potential policy outcomes associated with an automatic consolidation approach to account stapling. This would need to be supported by some additional functionality and data capture, potentially through the ATO, as well as legislative amendment in order to implement Option 2. Our analysis of each of these is outlined below.

4.1 Existing infrastructure utilisation

KPMG recognises that there have been material improvements in the functionality offered through the ATO's MyGov website, which now provides a facility for members to initiate the consolidation of their superannuation accounts. This functionality has also recently been improved to display more information for members to enable them to understand their balances held within each superannuation fund as well as any insurance cover currently offered.

Once a member opts to consolidate their superannuation accounts into a single fund, the MyGov site utilises the SuperMatch technology to send electronic messages through the Gateway to each fund to commence the benefit payment process in order to consolidate the accounts into the selected fund. We believe that this functionality, which already exists within the system could be utilised for the auto-consolidation of accounts in relation to stapling as noted within Option 2.

Additional functionality may be required in relation to the reporting of the opening of a new account within a superannuation fund back to the ATO, to enable a trigger to be raised in order to commence the process of auto-consolidation of the previous account.

We note that the introduction of the Member Account Attribute Service ("MAAS") will provide this data to the ATO in real time, however, there remains a question as to whether this information will be fully integrated into the ATO database and how this could be utilised going forward.

On the basis that the concept of account stapling is still relatively new and will require a reasonable period of consultation before it can be implemented, we believe that this could provide sufficient time for the ATO to be able to implement any potential changes in order to facilitate the auto-consolidation process.

4.2 Continuation of default framework

We note that ISA has suggested that the maintenance of some form of default framework is required to ensure that appropriate funds are approved to receive default contributions to ensure strong member outcomes can be delivered. Whilst we have been critical of the Productivity Commission's "Best in Show" recommendation given it is unlikely to drive increased competition or efficiency within the system, we believe a raising of the bar for default funds is required to protect member's best interests.

KPMG supports the concept of an 'elevated MySuper license' for funds that meet the broad requirements outlined within APRA's Member Outcomes Prudential Standard ("SPS515"). Funds that do not meet the variety of performance hurdles would no longer be eligible to receive default contributions, which will have the impact of 'raising the bar' for default funds.

We note that ISA has also suggested the concept of a return to the Fair Work Commission assessment of eligible default funds, which could be another alternative to the 'elevated MySuper' model, albeit the challenges of panel constitution would need to be resolved to ensure this structure could be effective.

Regardless, an enhanced default framework which ensures strong member outcomes can be delivered should be operationalised in advance, or in parallel, to any account stapling mechanism. Given under Option 1 members retain the same account for life, only new workforce entrants would benefit from a default fund framework, this contrasts to Option 2, where members automatically rollover accounts, meaning both new workforce entrants and existing members changing employer or industry would benefit from an enhanced default fund framework.

4.3 Legislative amendments required

KPMG recognises that the proposal for the stapling of accounts through some form of auto-consolidation will require the force of supporting legislation. On the basis that Regulation 6.29 of the Superannuation Industry (Supervision) Regulations specifies that a member's benefit can only be transferred to another fund without their consent via a successor fund transfer or to an Eligible Rollover Fund, legislative amendment will be required in order to facilitate the auto-consolidation process.

In addition to this, we would envisage that appropriate technical amendments may also be required to govern the manner in which communications will be required to be sent to members informing them of the consolidation and the potential impact on their benefits within superannuation.

5. Impact on the Australian system

Given the intention of the concept of account stapling is to remove multiple accounts from the superannuation system for default members, we recognise that the impact on funds, service providers as well as other industry funds is likely to be material.

5.1 Impact on the industry and competition

Similar to the changes announced with the PYSP legislation, it is likely that the removal of duplicate accounts will place further upward pressure on administration fees, given many funds continue to hold duplicate inactive member accounts with balances above $6,000. That said, from an overarching industry perspective, we believe that the 'stapling' of accounts will improve efficiency within the system and provide greater opportunities for funds to better engage with their members.

From a member perspective, however, particularly those members with a large number of multiple accounts, there is likely to be a material cost saving in terms of administration fees and potentially insurance premiums, which will benefit overall member outcomes and improve retirement adequacy.

The potential reduction in duplicate accounts resulting from the introduction of account stapling may also assist in driving fund consolidation, as funds try to maintain a sufficient revenue base while also spreading fixed costs across a smaller membership. Where a default fund model continues to be utilised in order to assign member to funds (whether this is an elevated MySuper test, the use of the Fair Work Commission Panel or another alternative completely), we do not believe that the introduction of account stapling will detract materially in terms of competition within the industry and if anything, may increase competition, as funds are compelled to better engage with their members in order to retain them, particularly at the time of a change in employment where the automatic rollover stapling model is implemented.

5.2 Impact on industry infrastructure

Based upon our analysis within Section 4.1, KPMG suggests that much of the infrastructure required to implement an automatic rollover stapling mechanism already exists between employers, funds and the ATO, albeit some changes may be required in order to streamline some processes and collect all necessary information.

Whilst we referenced the New Zealand KiwiSaver system as an example of an existing system for the automatic rollover account stapling model, we recognise that the efficiency of the KiwiSaver system is built on the use of the IRD as the central clearing house for contributions for members and employers.

There may be the potential for the Australian Government to consider a similar model to KiwiSaver in relation to contributions in Australia should a decision be made to implement an automatic rollover account stapling methodology. Given the impact that this may have on the existing SuperStream and Gateway infrastructure, which the industry has incurred significant costs to date, as well as the interactions with the key services providers within the industry, this alternative requires careful consideration.

5.3 Impact on savings/costs within the industry

KPMG has considered the impact of the automatic consolidation of accounts as having two key aspects, namely:

- Creating savings (due to reductions in fees and premiums) and costs (at the points of consolidation), under both Options 1 and 2; and
- The potential for higher investment returns (the 'performance dividend') experienced across the industry as members in underperforming funds, and underperforming funds themselves, are potentially consolidated into better performing funds over time.

It is expected that Option 2 may provide stronger momentum for the emergence of a performance dividend as the automatic rollover of members changing employer or industry, combined with eligibility criteria for default fund status that results in the promotion of better performing funds, would facilitate the faster transition of members to these funds. Under Option 1 where members remain with their original default funds the transition of members from under performing funds will rely more heavily on these funds being able to lift performance or ultimately consolidate with a better performing fund. This may be expected to be a slower transition and, depending on the selection criteria for default funds, may effectively allow a lower threshold for the definition of underperformance.

It is noted that our analysis presented below considers existing superannuation members and **does not consider future entrants into the superannuation system.** Future members may experience different outcomes compared to those currently within the industry.

The methodology and assumptions which have been used for this analysis can be found in Appendices A and B respectively.

Savings/costs from multiple accounts

As mentioned above, the implementation of the changes set out in the PYSP legislation, is expected to result in the removal of some duplicate fees and insurance premiums. Therefore the incremental savings under each option, Option 1 and Option 2, have been determined by:

1. Calculating the expected savings the option would bring compared to the current operation of Superannuation (before the effects of PYSP). This is referred to as the **Total Savings**.
2. Calculating the expected savings the option would bring compared to the operation of Superannuation after PYSP is implemented. This is referred to as the **Savings in addition to PYSP**.

The difference between item 1 (Total Savings) and item 2 (Savings in addition to PYSP) then gives the **Savings due to PYSP**:

Savings due to PYSP = Total Savings – Savings in addition to PYSP

The cumulative impacts of savings (due to a reduction in fees and insurance premiums) and costs (at the points of consolidation under each option) were analysed over a 25-year period for current Superannuation industry participants (i.e. the analysis does not consider future entrants into the Superannuation industry).

One of the areas of concern for some should an automatic consolidation account stapling methodology be implemented is the potential this may have to actually increase costs across the system, based upon the belief that funds will be required to process more rollovers to other funds than if a single default account is retained for life.

Whilst KPMG recognises that rollovers will be greater under Option 2, we also recognise that significant improvements in straight through processing via the Gateways (as well as better automation within administration processes), would likely ensure that the overall cost to the system is reduced and could be more than outweighed by the benefits gained from the removal of multiple inactive accounts from the system.

As described, PYSP also removed the charging of exit fees, which will also ensure that members will not explicitly bear any cost burden (while the fund may) should the automatic rollover stapling methodology be implemented.

Based upon our modelling, KPMG estimates that the potential benefits associated with the automatic rollover account stapling methodology are material, driven by overall fee and insurance premium savings associated with multiple, inactive accounts. KPMG notes that, based upon the June 2018 APRA data, the industry contains in excess of 7.76 million inactive accounts[1], with a high proportion of these expected to be duplicates, given that members in employment would be receiving contributions that would automatically activate the account.

Our analysis suggests:

- Option 1, inclusive of the impact of the PYSP legislation, will reduce fees and insurance premiums leading to an estimated saving of $43.5b over a 25-year period.
- Option 2, inclusive of the impact of the PYSP legislation, will reduce fees and insurance premiums leading to an estimated saving of $47.3b over a 25-year period.

Note these estimated savings are:

- Based on an assumption that automatic rollover consolidation under Option 2 occurs immediately. While in practice we would expect that there would likely be a phased transition period (e.g. 3-5 years) as members move employers with some final consolidation of remaining duplicate accounts at the end of this period, this is not expected to materially change the total amount of savings over the 25 years.
- Expressed as the total dollar savings over the period. This simplified approach makes no allowance for assumed level of fee inflation or any downwards pressure from efficiencies.

Option 1 and Option 2 are expected to lead to the same reduction in the fees and insurance premiums payable for any future industry movements by current members as no additional duplicate accounts would be created and, for this part of the analysis, there are assumed to be no material differences (on average) between the funds which members begin with in Option 1 and those which members move to in Option 2. In reality, there may be differences between the fees and insurance premiums between these funds and these differences could increase or decrease the amount of saving per member.

Whilst under the PYSP legislation members are not able to be charged exit fees in respect of rollovers between funds, we note that under Option 2 there will be a cost borne by funds associated with processing regular consolidation of accounts to a single fund. Based on assumptions as outlined in Appendix B, KPMG estimates that under Option 2 this cost would be approximately $0.1b in the first year that accounts are consolidated. The ongoing consolidation of accounts under Option 2 is estimated to cost a further $0.9b over a 25-year period, based on assumed labour force movements between employers[2]. It is noted that ongoing rollover costs would not be incurred under Option 1 since members do not change funds upon movement between industries.

We note that within our analysis we have not quantified any further transaction costs, tax realisation or tax inefficiencies, as a result of the changes in the movement of funds.

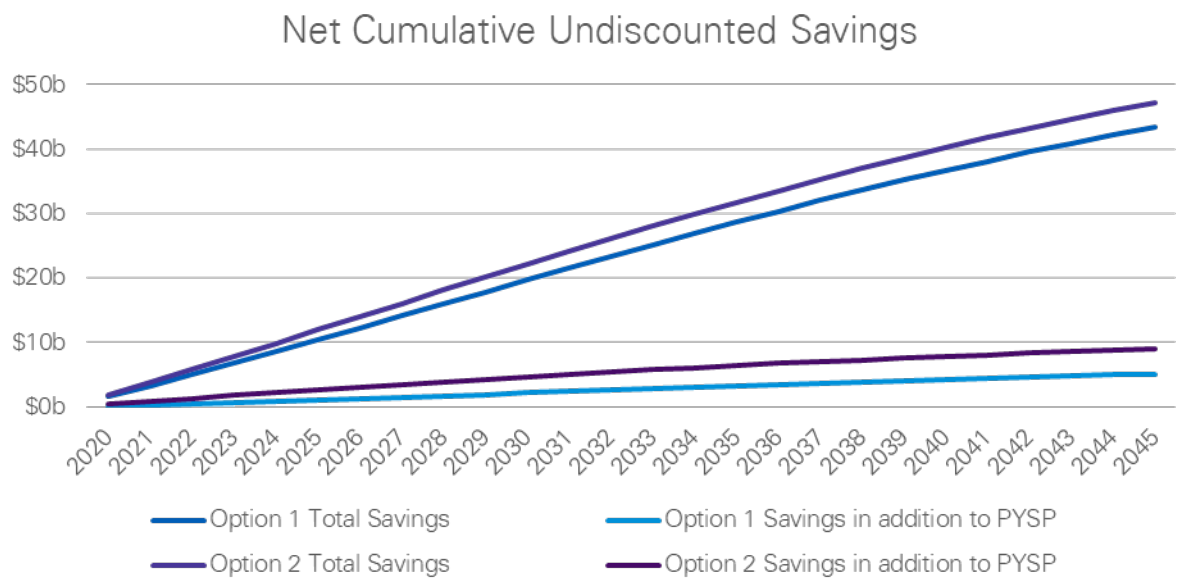
[1] APRA definition of an inactive member account is: "Inactive member account represents a member account that has not received any contributions, rollovers or transfers, or made any benefit payments within the last two years but which has not been closed as the member is contactable..."

[2] Based on labour force movement analysis performed by ISA

The estimated impact over a 25-year period for current industry participants is summarised in the table below. Note these results are expressed as the total dollar savings over the period without adjustment for the time value of money; investments returns on the savings; or allowance for any inflation (or reduction) in administration fee or premium rates.

		Option 1			Option 2		
		Total Savings	**Savings in addition to PYSP**	**Savings due to PYSP**	**Total Savings**	**Savings in addition to PYSP**	**Savings due to PYSP**
		1a	**1b**	**1c = 1a – 1b**	**2a**	**2b**	**2c = 2a – 2b**
Initial consolidation impact	Fee & insurance premium saving	$23.4b	-	$23.4b	$27.8b	$4.3b	$23.4b
	Costs	-	-		($0.1b)	($0.1b)	
	Net Savings	**$23.4b**	**-**		**$27.7b**	**$4.3b**	
Future duplicate prevention impact	Fee & insurance premium saving	$20.0b	$5.1b	$14.9b	$20.0b	$5.1b	$14.9b
	Costs	-	-		($0.4b)	($0.4b)	
	Net Savings	**$20.0b**	**$5.1b**		**$19.6b**	**$4.7b**	
Total	**Net Savings**	**$43.5b**	**$5.1b**		**$47.3b**	**$9.0b**	

A summary of the estimated cumulative undiscounted impact over time is shown in the graph below:



Sensitivities of the results to changes in key assumptions used in this analysis can be found in Appendix C.

Higher investment returns (performance dividend)

Background

As discussed in Section 4.2, KPMG believes that encouraging ongoing improvement in default funds is required to protect member's best interests. In a system where funds which do not meet a variety of performance hurdles are expected to lose their eligibility to receive default contributions, it is expected that over time employers and industries which previously defaulted into underperforming funds will move to higher performing funds and ultimately underperforming funds may consolidate with other funds to improve performance.

As such, funds with underperforming net investment returns relative to industry benchmarks could be expected to either lift returns or be gradually removed from the superannuation system; and this is expected to have an effect of increasing the overall investment returns achieved across the industry. This is referred to as a "performance dividend".

Indicative analysis

The impact of the performance dividend depends on the extra investment return achieved as a result of members being moved away from underperforming funds. For example, current account balances can be segmented into three performance bands based on average historical investment returns:

- Underperforming – bottom 25%
- Average performing – middle 50%
- Over-performing – top 25%

To illustrate the possible impact of a performance dividend, account balances within the underperforming band could be assumed to be transferred to a better performing band. This transition may occur through loss of default eligibility and fund consolidation over time.

We have considered historical 10 year rolling average annualised nominal returns for balanced options for superannuation funds within the industry[3] as a simple illustration of the potential difference in the weighted average returns expected between each performance band. We note these annualised returns only consider what has occurred historically over the past 10 years and have not be updated to reflect current economic conditions and outlook. If current economic conditions and outlook are considered, the expected returns could be lower. The sensitivity of results to a change in the assumed investment return (and other key assumptions) used in this analysis can be found in Appendix C.

In the following illustrations, the historic nominal returns have been reduced by a 2.5% p.a. assumed inflation rate to determine assumed historic real investment returns.

Using these assumptions, a summary of the proportion of total member account balances between the performance bands, and the assumed investment return on each band, is shown in the table below.

Performance band	Proportion of account balances assumed to fall into band (without performance dividend)	10 year average annualised nominal investment returns[3] for account balances in the band	Assumed real investment return for account balances in the band
Underperforming account balances	25%	8.4% p.a.	5.9% p.a.
Average performing account balances	50%	9.1% p.a.	6.6% p.a.
Over-performing account balances	25%	9.4% p.a.	6.9% p.a.

The impact on investments returns due to the performance dividend would then further depend upon:

- The magnitude of the performance dividend;
- The proportion of account balances subject to the performance dividend; and
- The average phased consolidation period.

[3] Based on SuperRatings data at 31 March 2019

The average phased consolidation period represents the time delay before a performance dividend is gained, reflecting the time it takes for account balances within lower performing funds to be consolidated into higher performing funds. Under Option 2, existing account balances would move to an employee's new default superannuation fund upon them changing industry. Given that the ABS labour force survey in November 2015 found around 40% of all employed people have had duration of two years or less with their employer/business; this average phased consolidation period is expected to be within 10 years, and likely to be at the shorter of this assumed range. However, emergence of the performance dividend also relies of the period of time for lower performing funds to be removed from the industry. Results based on a range of average consolidation periods are presented below.

For illustration purposes, it is assumed that the 25% account balances within the underperforming band would be subject to a performance divided (i.e. uplift in future assumed investment returns). The total investments earnings over 25 years for **current Superannuation industry participants** could then be compared with and without the performance dividend illustrated in this scenario.

Using these assumptions, the impact of the performance dividend (i.e. uplift in future assumed investments returns) for different average phased consolidation period assumptions and different performance dividend magnitudes is shown in the table below. Note these results are expressed as the total additional investment returns over the period without adjustment for the time value of money.

Time until Performance Dividend takes effect (Representing average phased consolidation period)	**Aggregate Performance Dividend**	
	0.50%[#]	**1.00%[&]**
3 years	197.9 b	416.3 b
5 years	179.9 b	376.8 b
10 years	133.2 b	275.6 b

[#] The underperforming account balances are assumed to earn 6.4% p.a. instead of 5.9% p.a.
[&] The underperforming account balances are assumed to earn 6.9% p.a. (i.e. the same as the over-performing account balances) instead of 5.9% p.a.

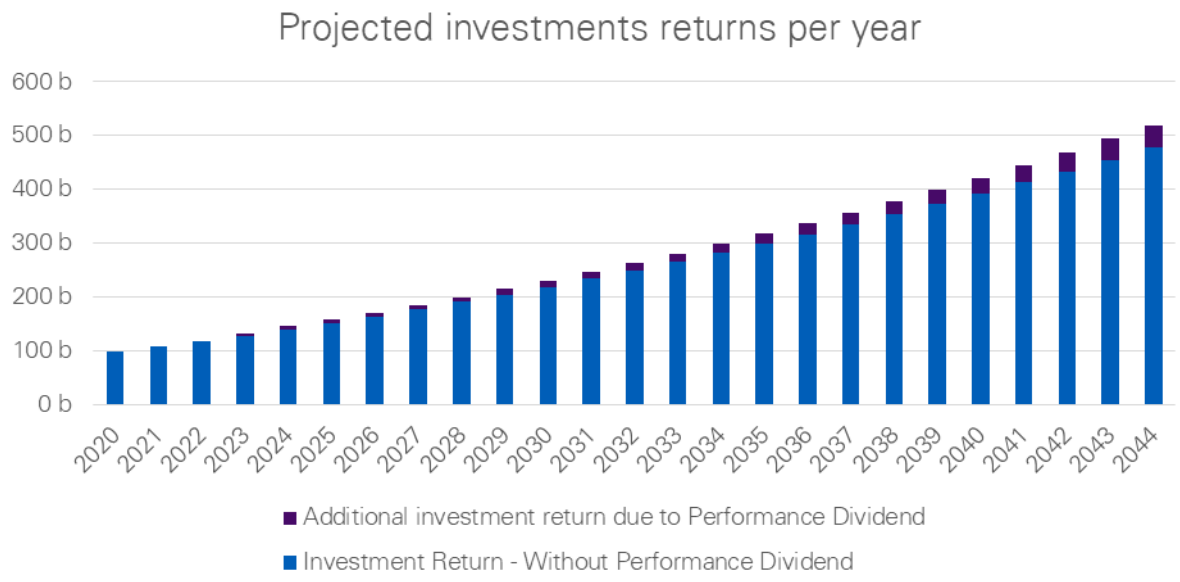
Note these figures only account for the dollar savings in today's dollars (ie. on a real basis) over the period, and do not consider the time value of money (i.e. are not discounted).

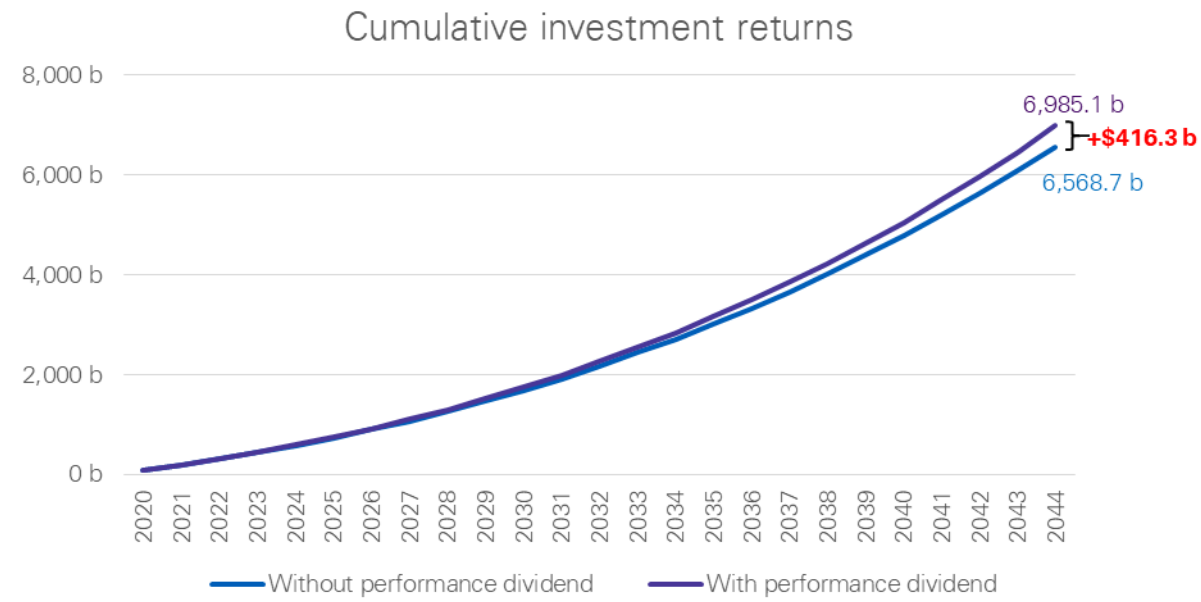
Considering scenario with 3 year phase consolidation and a performance dividend of 1% p.a.

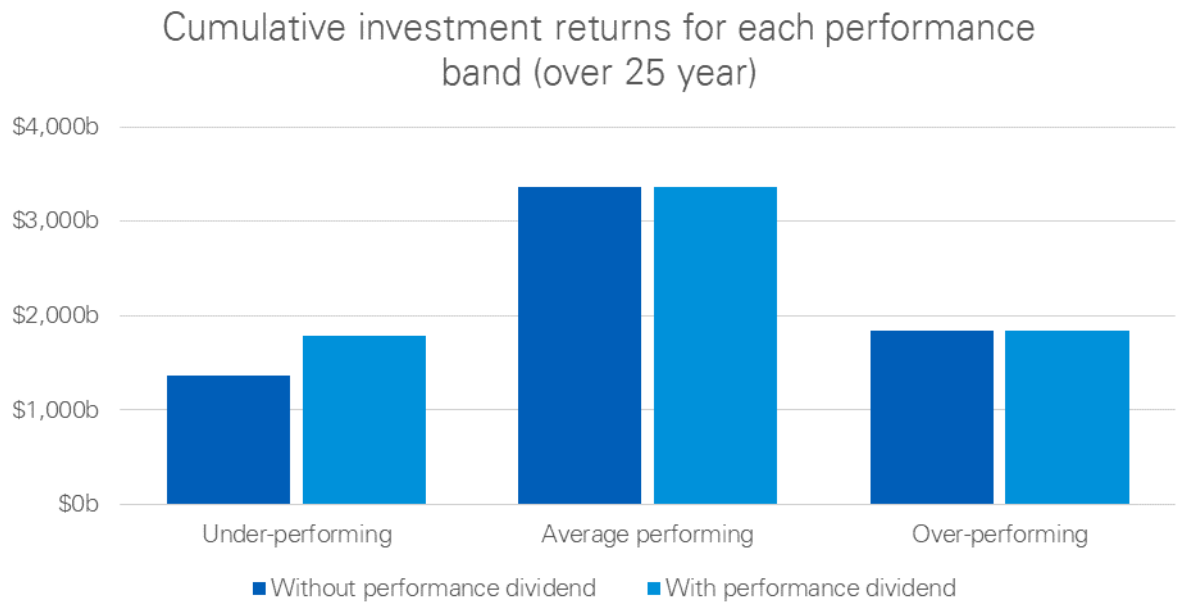
For an average phased consolidation period of three years and a performance dividend of 1.00% p.a. (giving a total estimated dividend of $416bn), a more detailed breakdown of the possible effect on investment returns over 25-years is shown in the table below:

3 year phased consolidation with performance dividend of 1% p.a.	**All performance bands**		
End of Period Account Balance:			
(i) Without performance dividend	6,569 b		
(ii) With performance dividend	6,985 b		
Difference ($) over 25-year period	416 b		
Difference (%) over 25-year period	6.3%		
Investment returns over a 25-year period	**Under-performing account balances**	**Average performing account balances**	**Over-performing account balances**
Without performance dividend	1,365 b	3,368 b	1,837 b
With performance dividend	1,781 b	3,368 b	1,837 b
Difference ($) over 25-year period	416 b	0 b	0 b
Difference (%) over 25-year period	30.51%	0.00%	0.00%

Sensitivities of the results to changes in key assumptions used in this analysis can be found in Appendix C.







Given the performance dividend assumed in this scenario (as described above), over the 25-year period, the $416.3b is equivalent to $23k per member when averaged across all current industry participants[4]. However it is noted that some members would benefit to varying degrees, while other members would not benefit at all.

Sample case studies

To further illustrate, we have included sample case studies for member accounts to show the effect of the assumed performance dividend.

The case studies consider members at different ages, with certain starting salary and superannuation balances. As seen through the case studies the difference in investment returns impacts retirement outcomes differently; generally speaking those with a longer investment horizon (i.e. longer time to retirement) can be expected to experience a larger effect of an increased investment return. A summary is shown in the table below.

Projected balance at retirement (age 67)	**Case Study 1 – 25 year old**	**Case Study 2 – 35 year old**	**Case Study 3 – 45 year old**	**Case Study 4 – 55 year old**
With investment return of 5.9% p.a.	$0.82m	$0.73m	$0.55m	$0.39m
With investment return of 6.9% p.a.	$1.01m	$0.87m	$0.63m	$0.43m
Difference ($)	+$0.19m	+$0.14m	+$0.08m	+$0.04m
Difference (%)	+23%	+19%	+15%	+10%

Each case study shows the impact of the member receiving the full performance dividend over the investment horizon (i.e. they are assumed to default into a higher performing account immediately, as opposed to a lower performing account). In reality members may benefit from the performance dividend over part of the investment horizon.

The methodology and assumptions which have been used for this analysis can be found in Appendices A and B respectively.

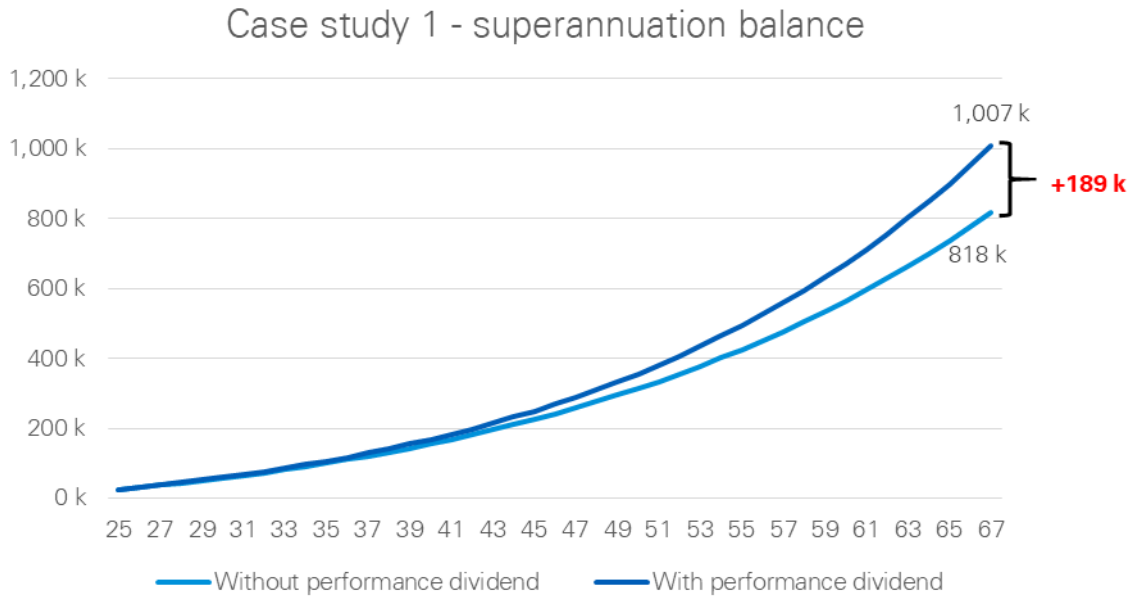
[4] Total increased investment return divided by number of active accounts $416b / 18m = $23k

Case study 1 – 25 year old member

The following case study considers a 25 year old member with the following characteristics:

- Current salary of $58,000 p.a.
- Current superannuation balance of $20,000

Their projected superannuation balance is shown in graph below:

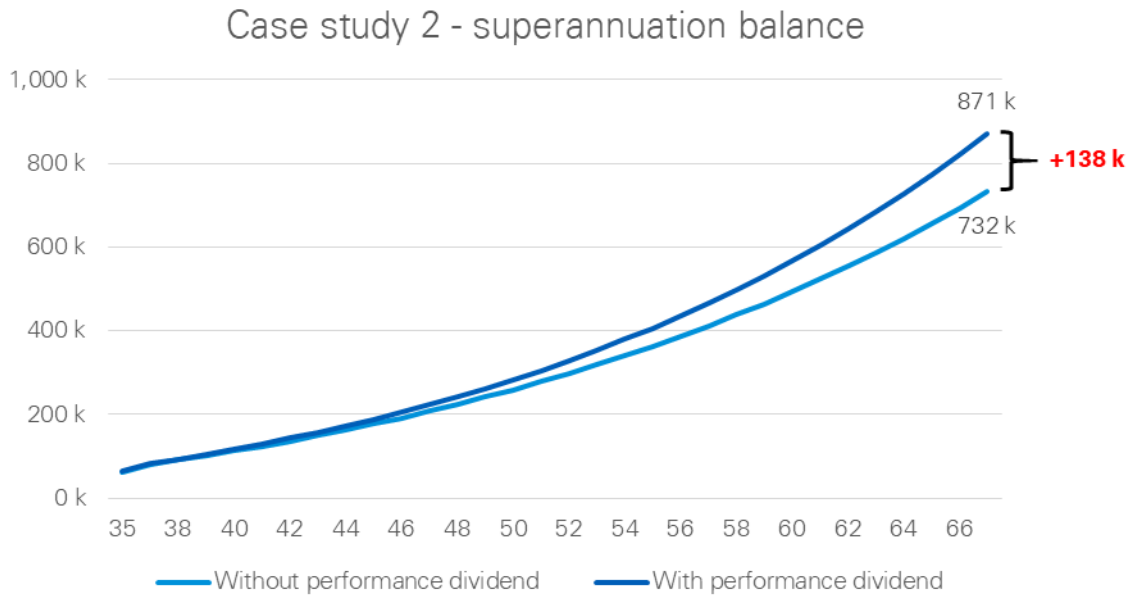


Case study 2 – 35 year old member

The following case study considers a 35 year old member with the following characteristics:

- Current salary of $78,000 p.a.
- Current superannuation balance of $55,000

Their projected superannuation balance is shown in graph below:

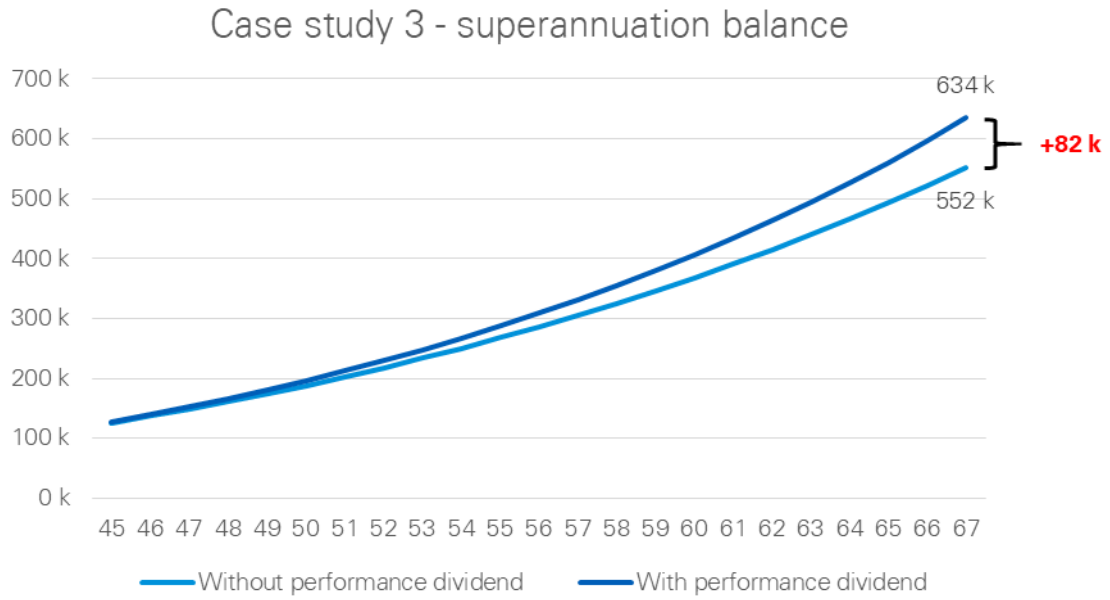


Case study 3 – 45 year old member

The following case study considers a 45 year old member with the following characteristics:

- Current salary of $80,000 p.a.
- Current superannuation balance of $115,000

Their projected superannuation balance is shown in graph below:

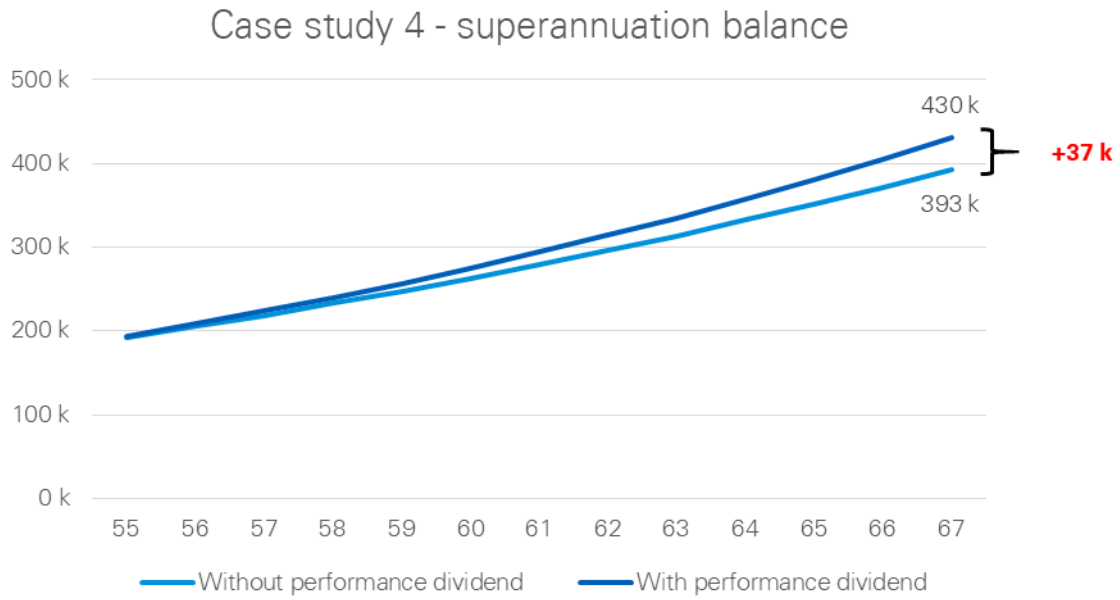


Case study 4 – 55 year old member

The following case study considers a 55 year old member with the following characteristics:

- Current salary of $71,000 p.a.
- Current superannuation balance of $180,000

Their projected superannuation balance is shown in graph below:



5.4 Impact on fund liquidity

A further area of potential concern for some industry participants is that under Option 2, the liquidity requirements of some funds may be higher than under Option 1.

Whilst this may be a consideration, it's our expectation that the majority of funds already maintain sufficient liquidity to be able to support some level of rollover activity. Similarly, the majority of funds also maintain a range of investments that could be liquidated within short timeframes to meet any additional cash drawdown requirements.

Based on APRA data, approximately $83.5b of benefit payments (excluding pension payments) were made from superannuation funds in the 2018 financial year. Of this, approximately $10.8b resulted from the consolidation of accounts, whilst approximately $46b was in relation to rollovers out of one fund into another.

Should account stapling be implemented through an automatic consolidation methodology, our analysis indicates, based on ISA data, that approximately 556,000 members would change industry on an annual basis, resulting in a potential rollover between funds assuming a new default fund is established. On the basis that 65.7% of members that move between industries are below age 35[5], and using APRA account data, we expect that the average balance that would be moved by these members would be approximately $14,500. The remainder are between the ages of 35 and 55 and maintain an average balance of $54,900 using the APRA data.

Based upon our modelling, and the assumptions noted above, we estimate the automatic consolidation of accounts on an annual basis would require additional liquidity of $15.7b per annum. This represents an increase of less than 19% of the total current benefit payment liquidity requirements for superannuation funds. Further, assuming the existing amounts paid by funds for the consolidation of accounts would no longer be required, the additional liquidity requirement (over and above the current $10.8b mentioned above) would be $4.9b per annum, which can be considered immaterial based on overall current fund flows (less than 1% of total system assets). However, we acknowledge that the impact on liquidity on individual funds can vary significantly depending on membership and account profiles. We also note the $4.9b will be an inflow for the recipient funds, which will assist in managing annual liquidity requirements given rollovers between funds remain cash flow neutral from an overall industry perspective.

The methodology and assumptions which have been used for this analysis can be found in Appendix A and B respectively. Further, sensitivities of the results to changes in key assumptions used in this analysis can be found in Appendix C.

Overall, we do not believe that there will be significant impacts on liquidity arrangements of funds in aggregate as a result of the introduction of account stapling under the automatic consolidation method.

These liquidity requirements are not relevant for Option 1, given under Option 1, members would not move funds upon changing industry.

[5] ISA industry change and multiple accounts research

5.5 Impact on insurance

One of the key challenges that will need to be considered should an automatic consolidation stapling methodology be implemented is how insurance will be managed. Given every default superannuation fund is required to offer insurance on an opt-out basis when a member joins a fund, an automatic rollover will result in the insurance that was held within the previous fund being cancelled upon rollover, and insurance in the new fund will be triggered automatically upon joining.

The main issue that may arise is where the member was entitled to a higher level of insurance cover in the previous fund compared to the level of cover in the new fund, given the insurance cover in the previous fund will be cancelled at the time of the rollover. On the other hand, we note that the auto consolidation methodology will facilitate members to continue to receive insurance tailored to the industry in which they are employed.

Two alternatives that could be considered to resolve this:

- Provide sufficient communication to the member to ensure they are aware of the removal of cover in the previous fund, such that they can actively choose to utilise that fund as their ongoing fund, resulting in the new account being closed (this may result in a mechanism change allowing members to actively choose their previous fund and close the newly-established fund); or
- Allow a window (say 90-days as per some fund's current practice) for the insurance cover to be transferred between default funds in a streamlined manner to enable the higher level of cover to be maintained (albeit this option may result in the need for additional data transfer within the rollover process).

We note issues relating to the continuation of equivalent insurance need to be further considered. We also recognise that there continues to be Treasury consultation on measures that will somewhat homogenise the default insurance coverage provided to members, which may mitigate the potential challenges associated with this structure.

5.6 Additional considerations

We note that there are some challenges associated with an account stapling model such as the impact of members that may maintain multiple employment arrangements at the same time or issues surrounding whether members should be offered the ability to continue to maintain two accounts by opting out of an automatic consolidation model (noting that the KiwiSaver system does not afford members this ability) for insurance purposes for example. We note however that these matters may be dealt with via the use of rules underpinning the auto consolidation methodology for example the selection of the fund with the largest balance and/or most regular contributions.

Whilst we recognise that there are challenges associated with each of the above, we believe that these issues are not insurmountable and are likely to affect a small proportion of total members within the system and hence should not be the focus for the initial policy position.

6. Summary and conclusion

Based upon our analysis of the premises outlined by ISA in relation to account stapling via an automatic consolidation between funds (similar to the KiwiSaver system model), KPMG believes that this is feasible and could be undertaken largely utilising the existing infrastructure recently in place with the ATO, albeit with some further enhancements and minor changes being required.

KPMG also recognises that minor legislative changes may be required to facilitate this model, given there is not currently any mechanism by which a member can be transferred between funds without their consent, other than a successor fund transfer (which requires a legal equivalency test to be undertaken).

Further, KPMG has considered the two different options which could be implemented in relation to account stapling: Option 1, where a member retains their first account for life, and Option 2, where any current duplicate accounts consolidated when members default into new funds their account balances would also transfer with them. Whilst both of these options would lead to the avoidance of duplicate accounts being created in the future and thus lead to fees and insurance premium savings (in addition to that savings generated by PYSP); Option 2 is expected to also lead to further savings due to the consolidation of existing duplicate accounts as members change employer/industry with an assumed consolidation of remaining duplicate accounts after a transition period.

We expect that Option 2 would also provide stronger momentum for the emergence of a performance dividend within the superannuation industry. Under Option 2, the automatic rollover of members changing employer or industry combined with the eligibility criteria for default status would be expected to result in the stronger promotion of better performing funds and thus an expected increase in investment returns (i.e. performance dividend).

Finally, our paper considered the issues currently being debated in the industry, such as potential greater cost or the requirement for more liquidity. Our modelling indicates that significant benefits arise from the account consolidation model, which are expected to outweigh the costs. Whilst insurance could present challenges, we believe that this issue can be resolved through better engagement with members or policy changes to cater for the transfer of insurance.

Overall, we believe there will be material benefits to the superannuation system as a result of account stapling and that the model proposed by ISA remains a feasible solution.

A. Appendix - Methodology

This appendix outlines the methodology used in the analysis as stated in the report.

Savings/costs from multiple accounts

Methodology

Overview

The costs and savings due to Option 1 and 2, are split into two impacts:

- **Initial consolidation impact** – the costs and savings due to the consolidation of existing duplicate accounts under the option (if applicable to the option).
- **Future duplicate prevention impact** – the costs and savings due to the prevention of duplicate accounts being created for current members in the future who switch industries.

For each impact, the following are considered:

- A fee saving, i.e. a saving due to no longer paying account keeping fees on inactive accounts.
- An insurance premium saving, i.e. a saving due to no longer paying insurance premiums from inactive accounts.
- Costs associated with consolidation of accounts.

This is illustrated in the following table.

		Option 1			Option 2		
		Total Savings 1a	**Savings in addition to PYSP 1b**	**Savings due to PYSP 1c = 1a – 1b**	**Total Savings 2a**	**Savings in addition to PYSP 2b**	**Savings due to PYSP 2c = 2a – 2b**
Initial consolidation impact	**Fee & insurance premium saving**			Same as Option 2	[A]	[B]	
	Costs				[A]	[B]	
Future duplicate prevention impact	**Fee & insurance premium saving**	[C]	[D]		Same as Option 1		
	Costs	-	-		[C]	[D]	

*[**A**] Initial consolidation impact – total savings*

The initial consolidation impact due to the options are split into three impacts:

Fee saving

1. The first year impact of paying account keeping (administration) fees on inactive accounts which are duplicates is calculated as the assumed annual account keeping fee multiplied by the total number of inactive accounts initially; less an assumed number of intentional inactive accounts.
2. This is run off for each subsequent year (years 2 to 25, of the 25-year period) reflecting some inactive accounts would stop paying fees over time in the absence of Options 1 and 2 (e.g. due to death, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account).

Insurance premium saving

3. The first year impact of paying insurance premiums on inactive accounts which are duplicates is calculated as the assumed annual insurance premium multiplied by the total number of

inactive accounts initially; less an assumed number of inactive account expected to already not paying insurance premiums.

4. This is run off for each subsequent year reflecting some inactive accounts would stop paying fees over time in the absence of Options 1 and 2 (e.g. due to death, reaching the age at which default insurance ceases to be offered, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account).

Cost

5. A one-off cost associated with the initial consolidation of duplicate accounts is calculated as the assumed cost per account associated with a bulk exit multiplied by the total number of inactive accounts initially; less an assumed number of intentional inactive accounts.

*[**B**] Initial consolidation impact – savings in addition to PYSP*

The initial consolidation impact for the Savings in addition to PYSP (applies to Option 2 only) has been determined as follows:

Fee saving

1. The first year impact of paying account keeping (administration) fees on inactive accounts which are duplicates is calculated as the Total Savings first year impact, i.e. Item 1 in [A] above; less an assumed number of inactive accounts that have account balances of less than $6,000, as these accounts would be subject to being swept to the ATO under PYSP.
2. This is run off for each subsequent year reflecting some inactive accounts will stop paying fees over time in the absence of Options 1 and 2 (e.g. due to death, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account), and that some proportion of inactive accounts with more than $6,000 account balance at the beginning of the year that reduce to below $6,000 over the year.

Insurance premium saving

3. There is no material additional savings in addition to PYSP determined due to paying insurance premiums from inactive accounts which are duplicates. This reflects all inactive accounts will stop having default insurance applied under PYSP.

Cost

4. A one-off cost associated with the initial consolidation of duplicate accounts is calculated as the Total Savings cost associated with the initial consolidation, i.e. Item 5 in [A] above; less an assumed proportion of accounts that would have an account balance of less than $6,000, as these accounts would be subject to being swept to the ATO under PYSP.

*[**C**] Future duplicate prevention impact – total savings*

The future duplicate prevention impact applies to both Option 1 and Option 2, and the Total Savings has been determined as follows:

Fee saving

1. The first year impact of paying account keeping (administration) fees on the tranche of duplicate accounts which will be created in the year following implementation of the option is calculated as the assumed annual account keeping fee multiplied by number of members estimated to move industry each year; less an assumed number of members moving industries who would not have had a new account created.
2. This is run off for each subsequent year reflecting some inactive accounts will stop paying fees over time in the absence of Options 1 and 2 (e.g. due to death, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account).
3. This is repeated for each tranche, with the number of members estimated to move industry each year running off over time to reflect the number of current industry participants reducing over time.

Insurance premium saving

4. The first year impact of paying insurance premiums on the tranche of duplicate accounts which will be created in the year following implementation of the option is calculated as the assumed annual insurance premium multiplied by number of members estimated to move industry each year; less an assumed number of members moving industries who would not have had a new account created.
5. This is run off for each subsequent year reflecting some inactive accounts will stop paying insurance premiums over time in the absence of Options 1 and 2 (e.g. due to death, reaching the age at which default insurance ceases to be offered, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account).
6. This is repeated for each tranche, with the number of members estimated to move industry each year running off over time to reflect the number of current industry participants reducing over time.

Cost

7. A cost associated with the consolidation of duplicate accounts for the each year's tranche (for Option 2) is calculated as the assumed cost per account associated with an exit multiplied by the number of duplicate accounts expected to be created each year; as consistent with Item 1 and 3 this section [C] above.

*[**D**] Future duplicate prevention impact – savings in addition to PYSP*

The future duplicate prevention impact applies to both Option 1 and Option 2, and the Savings in addition to PYSP has been determined as follows:

Fee saving

1. The first year impact of paying account keeping (administration) fees on the tranche of duplicate accounts which will be created in the year following implementation of the option is calculated as the Total Savings first year impact, i.e. Item 1 in [C] above; less an assumed number of inactive accounts that have account balances of less than $6,000 where the savings would be capped at 16 months' worth of fees, as these accounts would be subject to being swept to the ATO after 16 months of inactivity under PYSP.
2. This is run off for each subsequent year reflecting some inactive accounts will stop paying fees over time in the absence of Options 1 and 2 (e.g. due to death, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account), and that some proportion of inactive accounts with more than $6,000 account balance at the beginning of the year that reduce to below $6,000 over the year.
3. This is repeated for each tranche, with the number of members estimated to move industry each year running off over time to reflect the number of current industry participants reducing over time.

Insurance premium saving

4. The first year impact of insurance premiums on the tranche of duplicate accounts which will be created in the year following implementation of the option is calculated as the Total Savings first year impact i.e. item 4 in [C] above, rescaled to 16 months' worth of savings, as insurance coverage would cease after 16 months of inactivity under PYSP.

Cost

5. The one-off cost associated with the initial consolidation of duplicate accounts is the same as the one off cost under Total Savings (i.e. items 5 and 6 in [C] above).

Higher investment returns (performance dividend)

Overview

To determine the effect of a 'performance dividend', we a cash flow projection was developed based on assumed member behaviours and investment returns.

The cash flow calculations relied upon:

- Current funds invested within superannuation funds, which we have sourced from APRA's 'Annual Fund-level Superannuation Statistics June 2018';
- Illustrative superannuation fund investment returns; based upon historical data derived from the 'SuperRatings Fund Crediting Rate Survey' for Balanced assets allocations as at March 2019 [**A**]; and
- Assumed net contribution rate (contribution less withdrawals and other movements such as fees, and insurance premiums). This assumption varies over time to model a changing contribution / withdrawal pattern as current Superannuation industry members age, and thus change their account behaviour [**B**]

The future expected funds under management for the superannuation industry for current participants is calculated by:

1. Dividing the current industry funds under management ("FUM") into three performance bands (top 25%, middle 50% and bottom 25%).
2. For each performance bands, applying derived investment return (explained later in subheading A), calculating the expected investment returns.
3. Calculating net contributions (contributions less withdrawals and other cashflow items) within each performance band using a set of net contributions projection assumptions (explained later in subheading B).
4. Thus calculating an end of period expected FUM.
5. Repeating this process over a 25 year period, to give a 25 year FUM projection.

This estimates the industry cashflows, including the investment returns, without a performance dividend.

This process is repeated with the proportion of accounts within each performance band changed to reflect the effect of a performance dividend..

*[**A**] Expected investment returns by performance band*

The expected future superannuation fund investment returns are derived by:

1. Obtaining historical superannuation fund nominal return data, from the 'SuperRatings Fund Crediting Rate Survey' for Balanced asset allocations as at March 2019 (this contained 228 funds)
2. Removing funds without rolling 10 year average investment returns data (132 funds remaining)
3. Removed duplicate funds within the dataset (121 funds remaining)
4. Dividing the funds into three bands (under-performing, average performing and over-performing) dependent on the historic rolling 10 year average investment returns, where: the underperforming, average performing, and over-performing bands each contain around 25%, 50%, and 25% of total assets, respectively.
5. Calculating the average annualised investment return of each band, weighted by the current funds under management.
6. Using these calculated weighted average nominal investment returns for each performance band.
7. Reducing these nominal investment returns by 2.5% p.a., to obtain real investment returns (i.e. net of inflation).

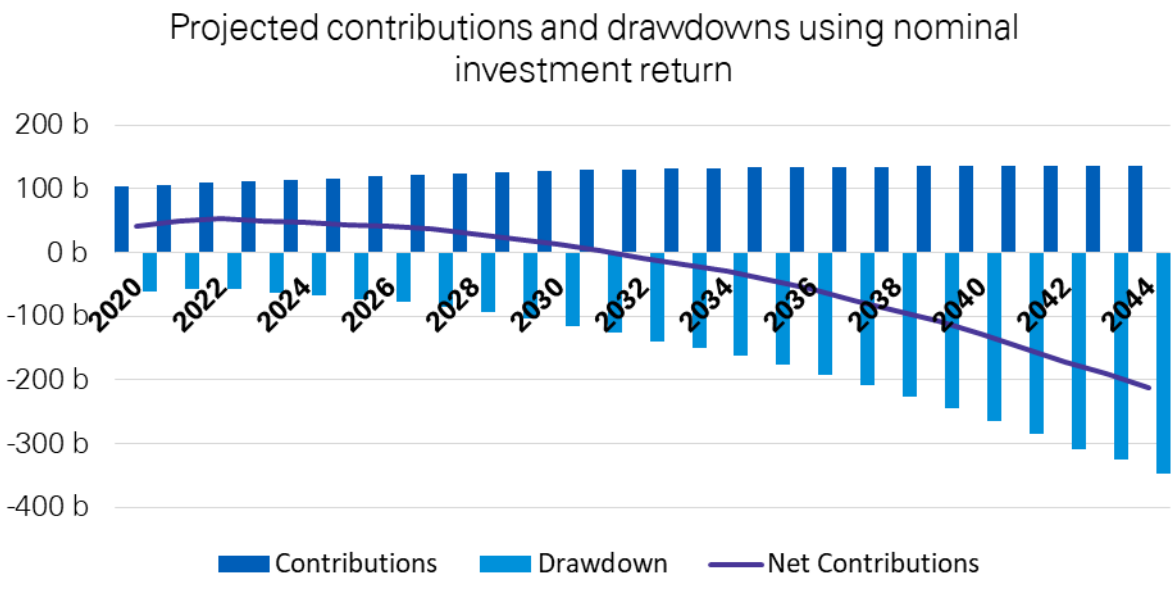
Note the data source, 'SuperRatings Fund Crediting Rate Survey – Balanced (60-76)', only contains the historical performance of "balanced" options in each superannuation fund, i.e. those with 60% - 76% of their FUM invested in growth assets. Though in reality there are other options available to members, the 'balanced' options represents a large proportion of funds invested within the superannuation market (more than 40% of funds), and has been used as a proxy for the future performance of the industry.

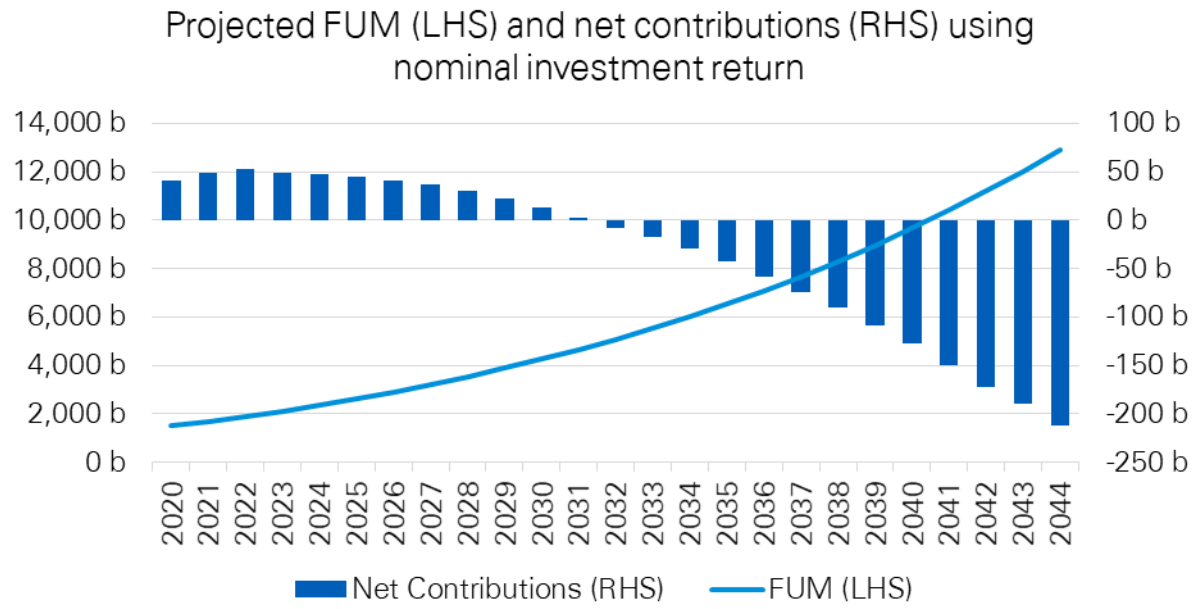
*[**B**] Net contribution rate*

The assumed net contribution rate is calculated by:

1. Obtaining the level of assets in the superannuation industry held by different age bands from APRA's 'Annual Fund-level Superannuation Statistics June 2018'.
2. Splitting these assets within each age band into member ages, thus creating a profile of beginning of year FUM for each age.
3. Assuming a profile of expected net contribution rates, which are positive values at younger ages, gradually decreasing to negative values at the point of retirement, replicating expected changes in contribution and withdrawal patterns for different ages.
4. Calculating a weighted average net contribution rate for that projection year, weighted by the FUM between each age.
5. Calculating expected investment returns for each age, using the assumed investment returns for average performing funds.
6. Calculating an end of year FUM for each age, by taking the beginning of year FUM, adding net contributions and adding net investment returns.
7. Creating a new projection for the subsequent year, where prior year's end of year FUM is equal to this new year's beginning of year, but increasing the age by one to signal the population having aged by this projection year.
8. Completing the same process as above, to generate a weighted average net contribution rates for this subsequent year.
9. Repeating this process to generate the expected weighted average net contribution rate for the next 25 years.

The following graphs illustrate the projected nominal (i.e. including inflation) contributions and withdrawals for the industry without a performance dividend (note this is for current Superannuation participants only, with no new entrants).





Case studies

The case study analysis replied upon:

- Expected real superannuation fund investment returns; before and after a performance dividend;
- Fee, account behaviour, and demographic assumptions;
- Assumed profile (age, salary, superannuation balance) of case study members

A member's superannuation balance, at the age of retirement, with and without a performance dividend, is calculated by:

1. Beginning with an assumed current superannuation balance for a given member.
2. Adding their expected superannuation contribution over a year given their salary, where the salary is indexed to grow at a salary inflation assumption (2.5% p.a.).
3. Deducting assumed administration and investment fees; insurance premiums; and taxation.
4. Adding expected investment returns; where the expected investment returns are either:
    a. The historic returns for the bottom performing funds, as per the same methodology used to calculate the performance dividend, when considering a member's balance without a performance dividend.
    b. The historic returns top performing funds, as per the same methodology used to calculate the performance dividend, when considering a member's balance with a performance dividend.
5. Calculating an end of year projected superannuation balance.
6. Repeating this projection until the age of retirement (67); and then observing their superannuation balance.

Fund liquidity

To determine the estimated fund liquidity under Option 2, the following was relied upon:

- ISA assumptions regarding the number of members expected to move industry per annum; and
- ISA assumptions regarding the split of these members between the age bands '34 or less', and 'between 35 and 54'

The estimated fund liquidity under Option 2 is calculated by:

1. Obtaining the number of members aged: 34 or less, and between 35 and 54; from APRA's 'Annual Fund-level Superannuation Statistics June 2018'.
2. Obtaining the total accounts balance for members aged: 34 or less, and between 35 and 54; from APRA 'Annual Fund-level Superannuation Statistics June 2018'
3. Calculating an average member balance for these two age bands (34 or less, and between 35 and 54) by dividing the total account balance each age band by the total number of members within each age band.
4. Using an assumed number of members within each age band expected to move each year, calculating the total expected funds expected to change between superannuation funds each year, thus the estimated additional liquidity required under Option 2.

B. Appendix – Assumptions

This appendix outlines the assumptions used in the analysis.

Savings/costs from multiple accounts

Fee assumptions

- Administration fee: $78 p.a.
- Insurance premiums: $230 p.a. per account.
- Note our analysis does not consider any increase in insurance premiums to other members as a result of inactive members no longer receiving default insurance.

Costs assumptions

- Costs borne by a fund upon a member's exit: $60 per exit
- Costs borne by a fund at the point of establishing Option 2, i.e. consolidating all existing duplicate accounts: $15 per exit (representing a reduction in unit costs due to a large number of exits occurring simultaneously)

Account behaviour assumptions

- The following table outlines:
  - The runoff of accounts exposed to duplicate fees; reflecting accounts stopping paying fees over time (e.g. due to death, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal of account)
  - The runoff of accounts exposed to duplicate insurance premiums; reflecting accounts stopping paying premiums over time (e.g. due to death, reaching the age at which default insurance ceases to be offered, changing to a Self-Managed Superannuation Fund, account depletion or full lump sum withdrawal); and
  - The runoff of current superannuation industry members available to change industries; reflecting a reducing number of members each year (e.g. due to death, reaching retirement age, changing industry less frequently as they age)

Year	Rundown of accounts exposed to duplicate fees	Rundown of accounts exposed to duplicate insurance premiums	Rundown of members changing industry each year
2020	1.00%	5.00%	2.50%
2021	1.10%	5.25%	2.65%
2022	1.20%	5.50%	2.80%
2023	1.30%	5.75%	2.95%
2024	1.40%	6.00%	3.10%
2025	1.50%	6.25%	3.25%
2026	1.60%	6.50%	3.40%
2027	1.70%	6.75%	3.55%
2028	1.80%	7.00%	3.70%
2029	1.90%	7.25%	3.85%
2030	2.00%	7.50%	4.00%
2031	2.10%	7.75%	4.15%
2032	2.20%	8.00%	4.30%

2033	2.30%	8.25%	4.45%
2034	2.40%	8.50%	4.60%
2035	2.50%	8.75%	4.75%
2036	2.60%	9.00%	4.90%
2037	2.70%	9.25%	5.05%
2038	2.80%	9.50%	5.20%
2039	2.90%	9.75%	5.35%
2040	3.00%	10.00%	5.50%
2041	3.10%	10.25%	5.65%
2042	3.20%	10.50%	5.80%
2043	3.30%	10.75%	5.95%
2044	3.40%	11.00%	6.10%

- Percentage of inactive accounts assumed to have more than $6,000 in funds under management: 60%

Higher investment returns (performance dividend)

Economic assumptions

- Long term real investment returns (based on 10 year historical returns, less 2.5% p.a. for inflation):
  - Underperforming account balances: 5.9% p.a.
  - Average performing account balances: 6.6% p.a.
  - Over-performing account balances: 6.9% p.a.
- Time for performance dividend to materialise: 3 years

Account behaviour assumptions

- Assumed net contributions (as a percentage of beginning of year FUM) representing contributions, withdrawals and other movements (administration fees, insurance premiums, etc.):

Year	Net contribution rate
2020	2.8%
2021	2.8%
2022	2.7%
2023	2.3%
2024	2.0%
2025	1.7%
2026	1.4%
2027	1.2%
2028	0.9%
2029	0.6%
2030	0.3%
2031	0.1%
2032	-0.2%
2033	-0.3%
2034	-0.5%
2035	-0.7%
2036	-0.8%
2037	-1.0%
2038	-1.1%
2039	-1.2%
2040	-1.3%
2041	-1.4%
2042	-1.5%
2043	-1.6%

2044	-1.6%

- Of the inactive accounts in the industry, 5% of these accounts have opted to maintain multiple accounts, and therefore will not be consolidated.
- Due to eligibility criteria, duplicate insurance within superannuation only applies to 70% of duplicate accounts.
- Approximately 555,693 people changing default fund annually due to changing industries.
    - This assumption is provided by ISA, based on research conducted using data on workforce movements from 2011-2012. While this figure has not been increased to allow for growth, Appendix C contain the sensitivity results which includes varying this assumption.
- Contribution and investment returns are modelled to occur annually in arrears.

Case study assumptions

Economic assumptions

- Long term real investment returns (based on 10 year historical returns, less 2.5% p.a. for inflation):
    - Underperforming account balances: 5.9% p.a.
    - Over-performing account balances: 6.9% p.a.

Fee assumptions

- Administration fixed fee: $78 p.a. (inflation indexed at 2.5% p.a.)
- Administration variable fee: 1.5% p.a. of account balance
- Insurance premiums: 4.5% of the superannuation contribution.

Account behaviour assumptions

- Contribution and investment returns are modelled to occur annually in arrears

Demographic assumptions

- Salary growth assumption: 2.5% p.a.
- Superannuation guarantee contribution rate (% of salary): 9.5%
- Retirement age: 67
- Tax on contributions and investment returns: 15%

Fund liquidity

Account behaviour assumptions

- Approximately 555,693 people changing default fund anually due to changing industries
    - 65.7% of these people aged 34 or less; and
    - 34.3% aged between 35 and 54.
    - This assumption is provided by ISA, based on research conducted using data on workforce movements from 2011-2012. While this figure has not been increased to allow for growth, Appendix C contain the sensitivity results which includes varying this assumption.

C. Appendix - Sensitivity results

Savings/costs from multiple accounts

The following table outlines the sensitivity of results to key assumptions used in the modelling of savings/costs from multiple accounts.

Note these estimated savings are expressed as the total dollar savings over the period. This simplified approach makes no allowance for assumed level of fee inflation or any downwards pressure from efficiencies.

Sensitivity	Case	Assumptio	Change	Option 1		Option 2						
Total net savings				Total Savings	Savings in addition to PYSP	Total Savings	Savings in addition to PYSP	Diff. Between Option 1 & 2	Change Option 1 ($)	Change Option 1 (%)	Change Option 2 ($)	Change Option 2 (%)
Number of current duplicate accounts	Base	7,760,620		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	8,924,713	+15%	$46.9b	$5.1b	$51.6b	$9.8b	$4.7b	$3.5b	8%	$4.3b	9%
	Down	6,596,527	-15%	$39.9b	$5.1b	$43.3b	$8.5b	$3.4b	-$3.5b	-8%	-$3.9b	-8%
% of current accounts chosen to be duplicates	Base	5%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	7.5%		$43.2b	$5.1b	$47.0b	$8.9b	$3.7b	-$0.2b	0%	-$0.3b	-1%
	Down	2.5%		$43.6b	$5.1b	$47.6b	$9.1b	$4.0b	$0.2b	0%	$0.3b	1%
% of current duplicate accounts without insurance	Base	30.0%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	35.0%		$42.3b	$5.1b	$46.2b	$9.0b	$3.9b	-$1.1b	-3%	-$1.1b	-2%
	Down	25.0%		$44.5b	$5.1b	$48.4b	$9.0b	$3.9b	$1.1b	3%	$1.1b	2%
Individuals changing industry	Base	555,693		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	666,832	+10%	$45.4b	$5.6b	$49.5b	$9.7b	$4.0b	$2.0b	5%	$2.2b	5%
	Down	444,554	-10%	$41.4b	$4.6b	$45.5b	$8.7b	$4.1b	-$2.0b	-5%	-$1.8b	-4%
% of individuals changing industry who would have consolidated	Base	30.0%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	35.0%		$42.0b	$4.7b	$45.9b	$8.6b	$3.9b	-$1.4b	-3%	-$1.4b	-3%
	Down	25.0%		$44.9b	$5.5b	$48.7b	$9.3b	$3.8b	$1.4b	3%	$1.4b	3%

KPMG

Sensitivity Total net savings	Case	Assumptio	Change	Option 1 Total Savings	Savings in addition to PYSP	Option 2 Total Savings	Savings in addition to PYSP	Diff. Between Option 1 & 2	Change Option 1 ($)	Change Option 1 (%)	Change Option 2 ($)	Change Option 2 (%)
Rundown of individuals who would experience fee saving (starting %)	Base	1.0%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	2.0%		$42.0b	$4.9b	$45.5b	$8.4b	$3.5b	-$1.4b	-3%	-$1.8b	-4%
	Down	0.3%		$44.7b	$5.3b	$48.8b	$9.4b	$4.2b	$1.2b	3%	$1.5b	3%
Rundown of individuals who would experience insurance saving (starting %)	Base	5.0%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	7.5%		$38.5b	$5.1b	$42.4b	$9.0b	$3.9b	-$4.9b	-11%	-$4.9b	-10%
	Down	2.5%		$50.1b	$5.1b	$54.0b	$9.0b	$3.9b	$6.7b	15%	$6.7b	14%
Rundown of industry turnover assumption (starting %)	Base	2.5%		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	4.0%		$41.3b	$4.5b	$45.2b	$8.4b	$3.9b	-$2.1b	-5%	-$2.1b	-4%
	Down	1.0%		$46.0b	$5.9b	$49.8b	$9.7b	$3.8b	$2.6b	6%	$2.5b	5%
Bulk exit cost incurred by fund	Base	$15		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	$30		$43.4b	$5.1b	$47.2b	$8.9b	$3.8b	$0.0b	0%	-$0.1b	0%
	Down	$5		$43.5b	$5.1b	$47.3b	$9.0b	$3.9b	$0.0b	0%	$0.1b	0%
Ongoing exit cost incurred by fund	Base	$60		$43.4b	$5.1b	$47.3b	$9.0b	$3.9b				
	Up	$90		$43.4b	$5.1b	$47.1b	$8.8b	$3.7b	$0.0b	0%	-$0.2b	0%
	Down	$30		$43.4b	$5.1b	$47.5b	$9.2b	$4.1b	$0.0b	0%	$0.2b	0%

Higher investment returns (performance dividend)

The following table outlines the sensitivity of results to key assumptions used in the modelling of higher investment returns (performance dividend).

The base case stated for each sensitivity assumes a 3 year average phased consolidation period, and a performance dividend of 1.0%. If either of these two assumptions were to be changed, the impact on the sensitivity results below could be approximated by scaling the sensitivity results by the change in the impact of the base performance dividend (resulting from changing the average phased consolidation period or the performance dividend).

Note these figures only account for the dollar savings (in today's dollars, i.e. on a real basis) over the period, and do not consider the time value of money (i.e. are not discounted).

Sensitivity Cumulative Investment Returns	Case	Assumption	Without perf div	With perf div	W/ and w/o perf div (dif $)	W/ and w/o perf div (dif %)	Impact (dif $)	Impact (dif %)
Average phased consolidation		3	6,569 b	6,985 b	416 b	6.3%		
period (years)		5	6,569 b	6,946 b	377 b	5.7%	-40 b	-9.5%
		10	6,569 b	6,844 b	276 b	4.2%	-141 b	-33.8%
Investment Returns (p.a.)	Base	6.6%	6,569 b	6,985 b	416 b	6.3%		
	Up	8.6%	11,432 b	12,082 b	649 b	5.7%	233 b	56.0%
	Down	4.6%	3,454 b	3,719 b	265 b	7.7%	-152 b	-36.4%
Contribution / Withdrawal Rates	Base	Calibrated	6,569 b	6,985 b	416 b	6.3%		
(% of FUM)	Up	+1%	7,572 b	8,043 b	471 b	6.2%	55 b	13.1%
	Down	-1%	5,714 b	6,082 b	369 b	6.5%	-47 b	-11.4%

The contribution / withdrawal rate (% of FUM) assumption is used calculate the projected net contributions within the industry; the base assumption varies over time to model a changing contribution / withdrawal pattern as current Superannuation industry members age, and thus change their account behaviour. The sensitivity results above shift this set of assumptions up and down by 1% at all future projection years.

Fund liquidity

The following table outlines the sensitivity of results to key assumptions used in the modelling of additional liquidity required per annum under the automatic consolidation of accounts.

Sensitivity	Case	Assumption	Change	Liquidity Requirements	Change ($)	Change (%)
Proportion aged 0 - 34 (as opposed to aged 35 - 54)	Base	66%		$15.8b		
	Up	71%		$14.6b	-$1.1b	-7%
	Down	61%		$16.9b	$1.1b	7%
Members changing industry each year	Base	555,693		$15.8b		
	Up	611,262	+10%	$17.3b	$1.6b	10%
	Down	500,124	-10%	$14.2b	-$1.6b	-10%

The 'Proportion aged 0 – 34' assumption refers to the proportion of members under the age of 54, who are also assumed to be under the age of 35. Therefore, 100% minus this assumption is equal to the proportion of members under the age of 54 who are also assumed to be 35 or older.