Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION SYSTEM: ASSESSING EFFICIENCY AND COMPETITIVENESS

MS K CHESTER, Deputy Chair
MS A MacRAE, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MERCURE HOTEL, NORTH QUAY, BRISBANE
ON FRIDAY, 22 JUNE 2018 AT 12.58 PM

INDEX

RESUMED **[12.58 pm]**

MS CHESTER: Welcome and good afternoon to the third and final day of public hearings for the Productivity Commission's inquiry into the superannuation system, its performance, its efficiency and competitiveness. I'm Karen Chester, the deputy chair and commissioner on this inquiry and I'm joined by my colleague and commissioner in crime, Angela MacRae. Before we get underway, first I'd like to begin by acknowledging the traditional custodians of the land on which we meet today, the Turrbal and Jagera people and I'd like to pay my respects to elders past and present.

Now as I'd suggested, today's the last day of our hearings following the release a couple of weeks back of our draft report on the superannuation inquiry. We had a full day of hearings on Wednesday in Sydney and a pretty full day of hearings yesterday in Melbourne as well. Let me just run through one logistic matter and then I'll talk a little bit about why we have hearings. If fire alarms sound, show some common sense, head out the door and find another door to get out of the building and follow someone with a strange helmet, you should be fine. Don't take the lifts. Right, done that.

So why do we have public hearings? Public hearings are a really important part of our consultation process. Unlike many other organisations, we can put out a draft report and let everybody kick the tyres on it. So you can tell us what we got right, what we got wrong, and what we missed altogether. We're hoping, now that we're at stage three of the inquiry process here, that we haven't missed anything. But I think we still need to get evidence base from people where they may disagree with where we're heading or where they think we could do things differently or better.

A full transcript is being taken and we are living streaming this event on YouTube which means we can't take questions from the floor. So the transcript itself that's being recorded today will go up on our website afterwards, but people can jump online and see the YouTubes of the filming. Participants may make opening remarks of no more than five minutes. Debater's bell will sound. You're not required to take an oath. We're the not so Royal Commission, but we simply just ask that you be truthful.

Media rules do apply, so please identify yourself to one of our wonderful staff members if you are gentle folk from the media. No video or audio recording for broadcast purposes, past the opening remarks, can be made by the media, but we're going live with YouTube thus nobody wants to do that anymore anyway.

So with no further ado, I'd like to invite our first participants, who've joined us from the Financial Services Council. Thank you very much for joining us today, for travelling to make our hearings today. If you could each just state your name and organisation, just for voice recognition purposes for the transcript, and then if you'd like to make some brief opening remarks, that'd be appreciated.

MS MACNAMARA: Jane Macnamara, Financial Services Council.

MR HANSELL: Allan Hansell, Director of Policy and Global Markets, Financial Services Council.

MR POTTER: Michael Potter, Financial Services Council.

MR KIRWAN: Nick Kirwan, Financial Services Council.

MR HANSELL: Thank you, Karen. The Financial Services Council would like to thank the Commission for the opportunity to give evidence here today and we commend you for a comprehensive draft report with many sensible and well-considered recommendations.

We welcome the Commission's comments that the superannuation system is working well for most members. That being said, there are still too many members that the current default system fails to protect from poor outcomes. We agree that more could be done to ensure all Australians are well-served by the default superannuation system and strongly support all ideas for improvement to be fully explored.

There are many elements of the Commission's report that we wholeheartedly support. The Financial Services Council has long advocated for decoupling the default system from the industrial relations system to give consumers greater control. We also welcome the proposal to prevent consumers ending up with multiple accounts by providing a default once mechanism. This would work alongside the recently introduced government legislation to clean up multiple accounts through consolidation of inactive accounts and those with low balances via an ATO sweep.

FSC members also support greater transparency, better disclosure and strong governance in all aspects of superannuation. There is no place in the compulsory system for consistent underperformers and the FSC welcomes the Commission's strong condemnation of funds which refuse to merge where it is in the best interests of members. Whatever the fund's stripes, the ones that generate poor outcomes for members would shape up, ship out or merge with better performing players.

The FSC also agrees with the Commission that high quality and comparable data that is meaningful for consumers should also be made available. The design of such a product dashboard should take learnings from behavioural economics and aim to be neither too simplistic nor too complex which, of course, is no easy task.

FSC members are confident they would be able to complete under the best in show shortlist approach recommended by the Commission and submit that this approach is an improvement on the status quo. However, in considering this proposal, our members have questioned why you would limit the short list to 10 funds. We need to very carefully think through the potential unintended consequences and market distortions that can flow from what would be a fundamental redesign of the system.

We share the view of others who have appeared in these hearings in asking how a truly independent expert panel would be selected. As long as super remains partisan, this cannot be guaranteed. Could suitable raising of the bar for MySuper authorisation by APRA be another way of achieving best in show on its own?

The Commission has undertaken a significant data collection initiative in preparing this report. We are still working with our members to review the Commission's analysis and will provide more detailed feedback as part of our submission.

Ultimately, we believe the Commission has identified clear policy problems with the superannuation system and a policy framework that might address these. There will need to be significant work done to understand how the proposal default system would operate and how it will impact consumer outcomes over the long term, and the FSC looks forward to working with you on these matters.

MS CHESTER: Great, thank you very much, Allan, for those opening remarks. We might start first with a Bernie Fraser quote, if I may? "The problems that the Productivity Commission have identified have been there for yonks, but there has been a hell of a lot of inertia". I guess, it does beg the question, why hasn't the industry done something before now about the two problems that we identified in our report of unintended multiple accounts and systemic persistent underperformance?

MR POTTER: Well, I guess, one of the things is part of it is not actually caused by the industry, it's caused by the default system. So it's not entirely the industry's fault, I would submit.

MS CHESTER: So I can understand that, Michael, for unintended multiple accounts, but persistent underperformance?

MR POTTER: Well, there are a range of issues there with underperformance. We are not entirely comfortable with the Commission's analysis so we are doing some work with our members on looking at the analysis of the data. But, I mean, naturally when you've got an average and a dispersion around that average, you're always going to have some funds which are above and some which are below. The question about the ones below it, is that caused by systemic problems, for example, lack of scale which is a problem that you have identified. So that's something which I think we need to be working through, and I understand that you're working through this as well.

You're going to be finalising some work on looking at economies and scale and the effect that that has. That would be an example of something which is systemic to the industry. But is also part of it just because you have a distribution around an average?

MS CHESTER: Well, it's not going to be a distribution around an average. The beauty of the portfolio benchmarks is it's not an average of the system. Indeed, we benefited very much in stage one from having a technical round table – and there's even a few people in this room who helped us out at that technical round table – by people able to create an individual portfolio benchmark by system, segment, fund and product. That means, what's your value add?

So it's a little like a performance attribution analysis, so we take (indistinct) strategic asset allocation. If you've persistently underperformed that benchmark over the 12 years by 25 basis points or more, which we thought was generous, that's not a normal distribution. That's persistent underperformance. A distribution around an average is that. That's not what this is. So we haven't had anyone suggest to us that – anyway, so in terms of the methodology that we've taken around the portfolio benchmarks, is that the question mark that you've got?

MR POTTER: Look, some of our members have raised that issue. We can't make a definitive statement of our position on this right at the moment. We're still working that through with our members.

MS CHESTER: So the FSC does or doesn't accept that there is evidence of persistent underperformance?

MR HANSELL: As I said in my opening statement, clearly underperformance is not acceptable and for those funds that are underperforming, they need to shape up or ship out.

MR POTTER: Sorry, so we do accept there is underperformance.

MS CHESTER: Okay.

MR POTTER: The question is about how you measure that and who it is applying to.

MS CHESTER: Indeed, going forward, we've suggested that the regulator would actually use the portfolio benchmark approach to help with an elevated MySuper, but we'll come back to that in a moment. We do appreciate that FSC is now on the record supporting, in general terms, the architectural changes that we're looking at. Let's look at unintended multiple accounts first. So I take from your opening remarks, that you are supportive of the default once and unless a member chooses to go somewhere else, that's - - -

MR HANSELL: That's correct.

MS CHESTER: Yes. That's one way of mopping up or stopping the creation of unintended multiple accounts. And you were right in pointing out that the government has a lot of other initiatives underway that we'd welcome as well, in terms of mopping up the existing legacy of unintended multiple accounts.

The other model that's been suggested, post the release of our draft report and I'm not sure if you've had a chance to look or think about this, is the one of balance rollover that's been suggested by Industry Super Australia, the ACTU and a couple of other folk from Melbourne. So instead of stapling the member account to the member every - and so that account follows the member through their working life. So that fund with that product follows them through their working life, unless they choose to go to another one or unless that fund or that account loses MySuper authorisation, they're recommending instead that the balance goes with the member. So you don't have the unintended multiple accounts, the balance rolls over wherever the member goes and whatever default product might apply to that award or that employment workplace. Are you aware that that's the other suggestion that's been put on the table?

MR HANSELL: No, I'm not.

MS CHESTER: Okay.

MR HANSELL: But I'd have to say, as I indicated in the opening statement, we're very supportive of the Commission's finding that we should be moving away from the industrial relations system. I think that particular policy proposition tends to bring everything back into the industrial relations system, such that it mimics arrangements that are there at the moment or accepts those arrangements that are there at the moment.

MS CHESTER: This is one of the reasons why we decided to have hearings before post-draft report submissions, because it helps us to get issues covered in the post-draft report submissions. So it would be helpful for us, for you to test with your membership the pros and cons of the two options.

MR HANSELL: Yes.

MS MACNAMARA: Yes.

MS CHESTER: We've already identified, and we've heard from inquiry participants in Sydney and Melbourne, some of the problems with the balance rollover, what do you do with someone with multiple jobs, admin costs will be higher; a member - how can you have engagement with a fund if you're going to be having five or six funds during your lifetime? So it would be good for us to hear from yourselves, given that you represent a large part of the industry, what your membership think about that idea.

MR POTTER: Can I make one observation which is, that doesn't seem to be move in a consumer driven direction. It seems to be moving in an employer or employment driven direction. I don't think our members will be particularly keen on that direction of movement.

MS CHESTER: I think that point's been made by others as well and I think it is a good point, particularly by some behavioural economists and academics. So we look forward to hearing back some more from you in your post-draft report submission.

So that then takes us to the best in show. You raised an issue about the why 10 funds. Two reasons with the why 10 funds, one of them we knew before we went into the stage three inquiry, and that is that behavioural economics tells us that for members, in a world of compulsion and complexity, to be able to make simpler and safer choice, about up to 10 works. Indeed, we tested that when we did our member's choice survey last year which we did, I think, about 2500 consumers and of which, I think, about 278 were 15 to 19 year olds. Low and behold, when we constructed a best in show arrangement where they had the up to 10, 95 per cent of them could actually make a meaningful choice. Only 5 per cent didn't make a choice, so they would still stay in a world of default. So that's the why 10.

Then, low and behold, we wanted to make sure that there was a competitive dynamic. So if you chose a best in 10 – and while investment performance is one of the principles, there's a whole bunch of others. Have you looked at the distribution of performance? Ten looks about right as well in terms of creating that competitive dynamic every four years, if we're just looking at long run net investment performance. So that's the why 10. I hope that answers that part of your question?

MR HANSELL: I mean, I just really touched on that in the opening statement. But, as I said, we haven't really formulated our views yet around this particular subject. But, I mean, some of the questions that we've had coming through, delve a bit more deeply into that comment that I made earlier.

MS CHESTER: Yes.

MR HANSELL: For example, what if you happen to find yourself as a member in a fund that's number 11 or 12 or 25 for that matter? Really, are the differences in ranking between each of the funds at the higher end really that materially different for you to be on the edges as opposed to in the top 10? The other question or observation that's been made is could this lead to members changing their own behaviours? So the way it was put to me was that you may well have members swinging to the fences. So it's sort of a baseball analogy there, where they're trying to get the home run by following the top 10 every four years. Is that really the sorts of behaviours that we want consumers to be exercising?

Funds themselves might also adopt similar behaviours in that they will end up, or they may end up, trying to mimic the investments strategies of those in the top 10 so that they can be in the top 10. So I think there are a lot of unintended consequences that would come from restricting the list in that way. I think some thought needs to be around how you would construct that.

MS CHESTER: So let's talk about a few of those. So with respect to those that are number 11 through to 25 - - -

MR HANSELL: Sorry, that was just arbitrary.

MS CHESTER: No, no, no. We'll keep the arbitrary list at the moment.

MR HANSELL: Okay.

MS CHESTER: And note that they are arbitrary. With the 11 to 25, it's a good thing that they do want to make the top 10, because that's what we're trying to do. We're trying to inject a competitive dynamic for the default market, which is totally non-existent at the moment. So again, we're looking at it purely from the perspective of members, not the perspective of funds. It's only if there was a perverse consequence in some behaviour that would harm members, that we would be concerned.

We've constructed it such that the way the best in show gets the keys to the kingdom, it's not keys to the entire kingdom, it's just the new job entrant money. So when you look at the metrics around the flows of contributions, which is about 150 million each year, only one billion in new job entrants and then, I think, there's about another $2 billion that's some turnover, then there's re-entrants of people returning to the workforce. So when you look at the system and the new job entrants, it's only about 19.7 billion of your 149.8 billion. So that's what they're getting access to. So you'd need to assume an exponential uplift in switching rates to your best in show for it to really, over time, impact the cash flows in a detrimental sense that we'd be concerned by a good fund.

I guess, the other thing is we're also doing it in a world where you've got your 10 every four years and, hopefully, that 10 might change. The behavioural economists that we've spoken to and some of the academics in this area, don't see that there's a real risk of members being with the top 10 and then if they're not a top 10 in three years' time, switching again. They actually think that if they think they're in a good fund and they've established a relationship with that good fund, they're unlikely to switch. But we've asked them to provide some more evidence and research basis for that.

So then, in conjunction with the elevated MySuper, we've gotten rid of the tail, so we've gotten rid of a bunch of funds that are underperforming. So we're in a world where a bunch of good funds, a bunch of top performing funds and, hopefully, there'll be an element of churn in and out of the top 10 every four years. But it'd be in your post-draft report, a chance for your members to have a closer read of how we've addressed that in the report and the discussion today, for you to raise any additional concerns.

MR HANSELL: Sure.

MS CHESTER: But I guess the only thing we ask is if people raise additional concerns, we don't just want polemic, we actually want an evidence base, so you'll need to give us an evidence base, because that's the only thing we really ask for, a couple of people (indistinct words) to convince us. We want to improve our draft recommendations and our findings where we can, but to do that we need an evidence base to be able to substantiate that.

MR HANSELL: Of course.

MS MacRAE: Just a final point in relation to the comments you made, where I think, where I think we've heard more than once the concerns about funds behaviour being distorted in a way to try and get into that top 10, I think that comes, importantly, to the criteria. If the panel that's making the decision looks at a set of criteria and can see that this behaviour is being undertaken for the wrong reasons, we would hope that that panel would be expert enough that they could see that.

There's misconception, I think, that what we've done in the report where we've got charts showing the performance of the funds that somehow we can identify the 10 off those charges we've done. We can't and we haven't done that work. So we do say net investment returns are very important, but they're not the only thing and they're long term. So what you do in this quarter or this year or even the four years beforehand will be important, but what you've done in years before that will also count.

So I think for a fund to think that they can somehow make a difference to their positioning in that top 10 by doing something in the quarter or the six months before the panel's going to make its announcement, I think, is misconceived. I think the expert panel would see that behaviour for what it is. So I think we just need to go a little bit below what seems to be some of the misconceptions around how the panel would work. We have about a page in the report about the criteria that we think the panel should look at. If you've got either concerns with what we've got there or additional criteria you think we should flesh out, that would also be very helpful.

MS CHESTER: Yes. Because, as Angela's pointed out, while net investments and a track record is important for a best in show, it's what will the expert panel look to, to think that investment performance historically that's been good is likely to continue going forward. We know that particularly in a high growth or even a balanced growth investment strategy, there are some years where you actually don't want to be top of the pops, if you're looking at maximising long-term net returns through cycles.

So we've got things in there like the governance of the fund. We've got things about investment strategy, about understanding the membership, managing risks, product innovation. We're not focusing just on the accumulation, we're looking at, at retirement and beyond retirement as well. So that is an area where we're really hoping that funds can give us more feedback so we can be far more prescriptive and have a lot more flesh on the bones of those criteria going forward.

On the issue of the expert panel and it's funny that when you go back historically and look at the informed narrative around politicised appointments, the one in Australia that's probably the most politicised is the FWC and I don't have time this afternoon to go through so many quotes, that we could do, about how politicised those appointment bases are. It's similar to appointments to your high judicial courts in the US.

So we want our expert panel to be accountable to the government of the day, because at the end of the day it's the government of the day that's compelled people to say when they otherwise may not have. It's also the government of the day and the taxpayers of that government of the day, who are also subsidising the superannuation system. So to be accountable to the government of the day means that there's got to be a government appointment. Then, to be accountable to the members, it's got to be an incredibly transparent and open process.

People have then suggested well, governments of the day will make those appointments and they'll be politicised appointments. So we, yes, (indistinct words) going to do a bit of kite flying. So we've come up with an idea of the selection committee for that expert panel beyond Caesar's wife, beyond reproach. So it would be a selection committee chaired by a statutory appointee who'd be seen to be able to make decisions without fear or favour of the government of the day and someone who would have knowledge of the financial system the financial markets plays in the history of super and the like. So we suggested that could be chaired by someone like the governor of the Reserve Bank with two other State appointees.

I'm assuming you've read the paper this morning and had a look at that media coverage. You may not have had time to have discussed it amongst yourselves. But what do you think of that as depoliticising the appointments to the expert panel?

MR HANSELL: Look, I think the government itself has struggled to find independent experts to fill the current vacancies for the expert panel in relation to the current process that is there for the selection of default funds on awards. I think there's a very good reason why those appointments have been vacant for a while, it's because it is difficult to find someone who is both an expert in superannuation matters and who is also independent/non-conflicted. I mean, in light of the government's not being able to fill those roles, I don't know if a personnel change at the top will necessarily improve the situation in terms of who makes those selections.

MS CHESTER: So I think the thing with the selection panel, say, chaired by the governor of the Reserve Bank, would need to take into account that the vote that they're thinking of appointing to the panel, who would apply for the position, would have a range of expertise. Again with seeking some feedback, but we would've thought some super expertise, but at the end of the day you want someone who's got investments expertise, financial markets expertise, consumer member expertise, understanding risks, supported by the government actuary expert panel, would be able to do their own analysis and form their own evidence base when they're assessing the proposals to the expert panel.

We've been paddling in this pool for a couple of years now and Angela and I, between the two of us, can think of 20 people who we think would be pretty good for an expert panel that have no conflicts at the moment. Indeed, some of those people have been helping us in our journey. So when we have had some expert round tables and when we have had some wise folk, including some people who are retired CIOs from super funds, some academics, some consultants that know this field. So we've identified a bunch of people that we think could be potential candidates in the future. So we're not struggling.

The main argument that people had against it was, not that you couldn't find those people, but that the appointment process would be politicised and thus the people that you would find and appoint, as was the case in the FWC, were considered to be not without conflict. Anyway, I'm just trying to explain our thinking around it to help inform your chance to discuss that with your membership and amongst (indistinct words).

MR HANSELL: Yes, sure.

MR POTTER: It's really valuable that you've brought that one forward. We'll need to consult further with our members on it.

MS CHESTER: Yes. That would be great, thank you. You mentioned product dashboards. Product dashboards didn't end up being very dashing in the end and we ended up in a world of regulators arm wrestling with funds such that perfection got in the way of possibility. So we've recommended that we want some competent pro-member regulators actually consulting with technical experts, behavioural economists, consumer experts and investment experts, to come up with a one page dashboard that is meaningful to members. Not so worried about it being meaningful for funds, but meaningful for members. Not from a legalistic disclosure perspective, but what behavioural economics would tell us members would then make a meaningful, sensible choice if provided with a simple safe list of best in show plus the dashboards associated with other elevated MySuper authorised products.

We've also suggested that it should not just apply to MySuper. Indeed, when we looked at the performance problems and some of the other issues around related parties and all the rest and fees, the choice segment really needs to have product dashboards as well. So when you said you were supportive of product dashboards, and hopefully we all get into a world of possibilities and not perfection, but possibilities that are meaningful to members as opposed to funds, are you comfortable then with that being extended – your members comfortable with that being extended to their part of the paddling pool, the choices segment?

MS MACNAMARA: Yes, absolutely. We think data that's meaningful for consumers is really important. It's quite difficult to achieve because we are looking at quite complex products. I think we saw, even trying to develop key fact sheets for home insurance, was quite a complex process and what's come out of that is not necessarily almost the meaningful information. So I think it's a process but definitely one that we need to undertake and certainly that needs the right behavioural economics and consumer testing involved in the process to make sure that we're getting done and that it's actually meaningful to a person on the street, rather than just to fund members.

MS CHESTER: Funds, yes.

MS MACNAMARA: To funds.

MS CHESTER: The process that we've set out with the regulator really taking the driver's seat on that and consulting with people that can do it from the perspective of what matters for members for them to make sound investment decisions?

MS MACNAMARA: We haven't gone down a route of really testing with our members exactly what that process would look like, but I don't think we have a conceptual issue with that.

MS CHESTER: Great. Your opening remarks didn't touch on insurance, unless I've - - -

MR HANSELL: No.

MS MACNAMARA: No.

MS CHESTER: We've got a bunch of recommendations on insurance.

MR HANSELL: Yes, aware of those.

MS CHESTER: The government had a bunch of things happening in the budget. Funnily enough, they were something similar to ours as well. Is there any views that you've got on the draft recommendations and findings on insurance, or is that something that you're still progressing your thinking about?

MR KIRWAN: We've got some initial thinking in that. I guess, our main thought on insurance about the budget and your recommendations is that the fundamental principle there is – the fundamental problem there is multiple accounts, and we believe the best way to address that is by addressing multiple accounts, not by tinkering with – and more than tinkering with – the insurance rules, because there will be unintended consequences to some of those proposals. But I won't list them here. We'll make a full response to the budget proposals.

But in terms of the disclosure recommendations, the erosion trade off, yes, that's a good idea if it can be done in a clear simple way. As you were saying before, sometimes perfection is the enemy of the good, so let's have something good. The best interest, again that makes perfect sense. The conditions of adopting the voluntary code of practice is a condition of keeping or getting authorisation from MySuper, that's no problem with that at all. The review, yes, but let's let the current reform zip ahead before we'd undertake that so that we could really measure the effect of those.

MS CHESTER: Yes. So I think bolstering the insurance code is like a "must have" from our perspective, particularly when we want mergers to occur, because at the moment, what we hear is sometimes the impediment to mergers can be well you have very disparate insurance offerings. We can understand there are some cohorts of high risk occupations where having some tailoring of insurance for those groups may be needed. But for the rest of the accumulation – members in the accumulation phase, we need to have more comparability of insurance offerings to make sure that transportability can happen over time as mergers occur, and that doesn't continue to be an impediment.

That said, we've got some feedback as to – from APRA and from others, about how APRA's clarified the equivalence test which should make it easier for insurance not to get in the way of those mergers around insurance. So it'd be good if we could hear back from you about making sure that insurance is no longer an impediment to mergers happening when it is clearly in the best interests of those members in an underperforming or a subscale fund.

The other thing that was interesting though, that we've only just learnt in the last couple of days, is a little bit more about the history of income protection insurance, in that historically it was really only meant to be two years. Where it's become expensive is where some of the policy offerings go beyond two years. So that's something that was news to us. Again, given your membership, you might be best placed to help us out with the prevalence of that because insurance was another area where the data was – I've run out of adjectives.

One of the other areas, and I don't think you did cover it off in your opening remarks, was around life cycle products. We were actually surprised to realise that life cycle products were 30 per cent of default or MySuper products. That seemed to be a pretty large number for us. We know that there's a spectrum of life cycle products, like there's some very vanilla, basic ones and there's some very smart ones that get dynamic efficiency happening.

I guess we did some funky stochastic modelling that we weren't planning to do but we did, thanks to some dedicated staff members on the team, and it did show us that – it did suggest that the more simpler life cycle products for most members just take way too much growth off the table and it's a big price for an insurance policy they don't really need. I think we had a finding – no, we had an information request that said, "Please explain why we should leave it in the MySuper world?" Is that something that you've got a view on or you will have a view on?

MR POTTER: Yes, we'll definitely be looking at that. A number of our members are quite interested in life cycle cracks. I think that some of them are concerned that the overall tenor of the PC's finding on this was a bit too negative, but we'll have to work that through with our members.

MS CHESTER: Okay.

MR POTTER: I guess the thinking is that there would be – let's say, for example, we were looking at this just after the GFC. Life cycle products would have actually looked quite good after the GFC. So there are a range of things which we will be looking at for more detail on this.

MS CHESTER: Okay. Well, hopefully we have more evidence from your members than just, "It looked good at a particular point in time" to suggest that it's a good product. We would need evidence and we've got our stochastic modelling on the table. I think there's a lovely technical supplement that details it. We had to review it ourselves and so your experts can have a look at that.

Michael, if your members are going to come back anti what we're saying on life cycle in MySuper, we need evidence to show that we've either got the stochastic modelling wrong or there's another way of viewing it. We are very conscious that there are different products and, indeed, I think we're going to hear a little bit more about some of the smarter life cycle products a little bit later on this afternoon.

MR POTTER: Yes. It might be also more about the lumping them all together and where is the diversity of performance within that.

MS CHESTER: I think the key thing for us is what do you need to know about the member to do any life cycle product and do you have that knowledge in a default segment or can you do it in the absence of not having had a communication with that member. Again, I think that's the area that we're flying through with.

MS MacRAE: The other point from the model, if I'm reading it correctly at this stage, would sort of be your preferred model of, "Let's not worry about the top 10 and let's put all our faith in an elevated MySuper threshold. We've got some ideas about how to bolster that and we think it's important that it does get bolstered. I'd be interested if you had any views about what we've recommended there and/or if you're likely to have any suggestions around how it might be further enhanced if you were to put a lot more emphasis on that really having to do more of the work on its own.

MR POTTER: Okay. We'll do that.

MS CHESTER: Is there anything else that you wanted to say this afternoon that our questions didn't allow you to get to it? We do appreciate it's been a lot to digest in a couple of week and you've got a broad church of members to consult with.

MR POTTER: There were quite a lot of recommendations in the report that we're pretty happy with and I'll give you one example, it is your recommendations about encouraging funds to merge. We don't need to go through that now because we're pretty happy with what you're recommending.

MS CHESTER: Great. Thank you very much. We really appreciate you being able to make it here in person to the Brisbane hearings and we look forward to getting your post-draft report submission in a couple of weeks' time.

MR POTTER: Thank you.

MR KIRWIN: Thank you.

MR HANSELL: Thank you.

MS CHESTER: I would like to invite our next participants from Sunsuper to come and join us. Good afternoon. Thank you very much. I'll just give you a moment to get yourselves settled there and get yourselves a glass of water. So we came to Brisbane.

MR HARTLEY: Thank you. It's convenient for me but not for Jason.

MS CHESTER: Just for the purposes of the transcript, if you could each both state your name and the organisation that you represent and then if you'd like to make some brief opening remarks.

MR HARTLEY: Scott Hartley, I'm the CEO of Sunsuper.

MR SOMMER: Jason Sommer, I'm Executive General Manager at Sunsuper.

MR HARTLEY: Thank you, Karen and Angela. Thanks for coming to Brisbane and thanks for the opportunity to appear and chat about the report. We congratulate the PC on a robust report, particularly given the complexities of the system, the superannuation system that we operate in. We agree with the PC findings, that there's great divergence in outcomes for members across the system and this needs to be rectified; we absolutely agree with that.

Whilst the proposed model was perhaps not our preferred after the first round, we believe it should work in the best interests of consumers and promote consumer engagement in their retirement journey, which we think is very valuable.

Adoption of the default model will absolutely transform the industry we think, and it's not without its risks, both in implementation and operation. All funds will be affected, including Sunsuper, which at the moment, we're currently skewed towards the employer sponsorship of default funds, rather than consumer direct choice.

Broadly, we support the recommendations in the report. The first default, last default, as I call it, is good policy if the risks of poor selection and poor legacy defaults are mitigated. Overall, the 'best in show' consumer choice model should work if consumers are forced, we think, preferably forced or given a very strong nudge to make a choice before obtaining a TFN when they start their first job.

The independent panel and selection criteria that are set are critical to the model's success. We've heard your earlier comments about the expert panel and note those but we actually think there are some very experienced superannuation experts in the industry that you can draw on and we think that they are very independent, and that is the existing research houses, the Chant West, Heron, Rice Warner and SuperRatings, in particular, but also some of the specialist superannuation experts within the big four accounting firms like PwC, Deloitte, KPMG and the like.

We think there are people there who are expert. They understand the system, they understand how it works and they've got a point of view which they'd bring, and those points of view I think would be different and that would add value. Obviously, having a superannuation lawyer expert would be valuable, also potentially an actuary - you've always got to have an actuary apparently; is that right? - and perhaps a consumer advocate. That was our thoughts on the makeup of the panel.

Support recommendations. We support recommendations relating to the MySuper authorisation as a means to reduce the legacy risk of the old default system for consumers, following implementation of the new model. We broadly support insurance recommendations but do not necessarily support an independent review of insurance in super as necessary at this point. They were the opening comments. Thank you.

MS CHESTER: Great. Thanks very much, Scott. I should say on behalf of the Commission we also did want to thank Sunsuper for two things. One, that you've helped us along the way with the consultation that we did in stage 1, stage 2 and now today, but also for your Board to allow you to appear at our hearings, both in stage 2 and now.

MR HARTLEY: Sure.

MS CHESTER: That's quite a rare phenomenon for us and I think I referred to you last time as unicorn. We now have a couple of unicorns.

MR HARTLEY: Well, that's good. Good to hear we've got friends.

MS CHESTER: The system's getting better as we go. Let's just work through maybe some of the little working agenda of your opening remarks. With the twin problems that we identified in the system, just going to unintended multiple accounts first, you might have heard me say before that the default once, unless a member chooses to do something else, which you support. The other option that's been put on the table by another inquiry participant or participants is the balance rollover model. I don't know if you've had time to think about that.

MR HARTLEY: It's the first time I've heard it this afternoon. My first blush reaction is that I don't think it's a good idea. I think members would be being dragged by their new employer into something new each time they changed jobs. I think that would actually lead to some disengagement and disenchantment in super. I don't think that would be necessarily helpful.

MS CHESTER: Okay.

MR SOMMER: I think it's probably fair to say it may be an improvement over today's system but I guess one of the things that sort of seems apparent is that there's costs in moving members and money between funds on a regular basis and I guess what the purpose of incurring those additional costs would be. That's perhaps my initial thoughts on that particular model but I think it's fair to say it would be an improvement over what we have today.

MS CHESTER: Yes. You're right. If the counterfactual is today it does look like an improvement, but if the counterfactual is another option on the table that maybe doesn't have the downsides of the balance rollover.

What would be helpful for us is in terms of some of the costs that might be attached to the balance rollover is if you've got any handle or could give us any guidance on the degree that you think that that sort of turnover might be happening within the system, based on your knowledge of your membership base. Also, just the admin costs side of it and whether or not it might have any implications for the investment strategy of a fund if that churn remains in the market, as opposed to you getting a member as a new job entrant and knowing that you've probably got them for a while unless you lose sight of good purpose and endeavour and ending up losing your MySuper authorisation.

The other thought we had, and we know it's only a modicum of risk, but every time a balance rollover could occur, if you're in a situation of a market event, think of GFC or even earlier, major moves in equity markets that we've seen, whether a rollover at that time, if you're going from one strategy to a different strategy, could actually trigger a little sequencing risk event and crystallise a loss.

I know there's swings and roundabouts. While one member might gain in that circumstance, another might be harmed. At the end of the day, it's not a summation of those two to see if they cancel out. A member harm is a member harm. It would be good to see if your smart investment folk at Sunsuper could give us a little bit of a steer on that.

MR HARTLEY: Sure.

MS CHESTER: The other thing that Angela touched on a bit before which is really important is any unintended consequences of the 'best in show' list in terms of impacting the behaviour of funds. Now, we've tried to address that with the principles that we've established for what the expert panel might take into account for a 'best in show' selection process. It would be great for us if you could have a look at that. It's one page. It's actually quite a good one page I thought the team drafted. Have a look at those principles. We want to make them a bit more prescriptive and add a bit more flesh to them.

You'll be mindful of what perverse incentives that could potentially create. We hope we've addressed most of them but it would be good to get your feedback on if we have, how might that be detailed a little bit further to be quite prescriptive, so we give the expert panel as much nudge and help as possible in that direction.

MR HARTLEY: Yes, sure.

MS CHESTER: The other thing that's been suggested in the industry that we kind of struggled in and I went through the metrics before so I won't go through them again now about the flows, is a suggestion that the 10 'best in show' might be a cosy oligopoly. That kind of just didn't intuitively make sense to us because of the flows and what you have to assume is switching rates, but also a cosy oligopoly isn't subject to competition every four years.

MR HARTLEY: Yes, sure.

MS CHESTER: So again, if we could get your feedback in your post-draft report submission on how it would look with those flows over time. We did some transition modelling in our report that the good regulator, APRA, had a look at and they seemed to think it was all pretty sensible and reasonable. The reason that we got them to have a look at it is because at the end of the day, by elevating the MySuper authorisation and then creating a 'best in show' for the true underperformers, it is going to have an impact on their cash flows, but we wanted to have an impact on their cash flows.

MR HARTLEY: We do.

MS CHESTER: So they start to go more net negative than they are at the moment and thus nudging those trusty boards to merge when they should be merging. It would be good for you to have a look at that in terms of what matters for us is what it means for members, and what it means for members is the exits of those funds is digestible by the system. APRA has gotten back to us that they think it is. Our transitional modelling suggests it is, but it would be good to have some folk kick the tyres on that.

MR HARTLEY: Yes, sure. Our initial view on that is that it probably is when you look at it in isolation or when you look at what's already happening in the context of the system. You've just got to be careful that things don't compound. The budget changes in themselves we think will have a big impact on funds and a big impact on activity and consolidation in the industry already.

MS CHESTER: Yes.

MR HARTLEY: You add to that whatever might come out of the Royal Commission as well in terms of recommendations that could add to that context. So I think it's looking at all of the change that's being imposed in the system in context and deciding if that's manageable.

MS CHESTER: Okay.

MR HARTLEY: There will be we think a limit to how much consolidation activity can occur in the market in the system in a particular year.

MS CHESTER: Yes, and we acknowledge that. I guess what we would like to hear back is if you have a look at what the transition modelling looks like, give us a sense of whether you think that's digestible. The regulator is saying it is but it would be good to hear it from some of the larger funds as well.

MR HARTLEY: Sure.

MS MacRAE: And I guess pertinent to your point is the regulator might be saying, "Yes, these people come through and it's all digestible". What you're saying is there's constraints on your side as well, so there's got to be parties willing to negotiate in the timeframe it works and all those things. So from the other side of the table, you might have extra views that you could put to us on that issue.

MR HARTLEY: Yes, sure. Transitions do take time and cost.

MS CHESTER: I guess we're also getting a little bit of mixed evidence about what the impediments are to mergers remaining. I guess the area that we're interested in now is not the impediments for the trustee board that does need to merge making that decision, because we think we know what they are, but for a larger top performing fund or a top performing fund, from taking the membership from those underperforming funds that are exiting. Are there any impediments there at the moment around the equivalence test or making sure that the denominator of the fund that's taking those members can actually take those members that's not a cost impost upon their own membership base.

MR HARTLEY: Sure, that's correctly important. We can't allow existing members to be paying for mergers of new members.

MS CHESTER: Yes.

MR HARTLEY: We don't think the impediments are that great but we will come back in some more detail. Jason might have some initial comments.

MR SOMMER: Yes, I think there's largely the mechanisms within the existing system to enable us to facilitate and execute mergers once a decision has principally been made. I think it then fundamentally comes down to things like legacy product and to what extent that is, its continued capacity of the receiving organisation and capacity of the outgoing organisation to be able to execute on these mergers successfully. Of course, the last thing anyone in our system wants is for a merger to be executed poorly which would be a very bad thing for trust in the system.

MS CHESTER: The other area that we touched on was the elevated MySuper. One aspect of where we've taken it further (indistinct 1:49:27) at the moment, outcomes test coming through in proposed legislation and we've added some more teeth to the outcomes test. One of our suggestions there, and it's really just an insurance policy to make sure the tail doesn't regrow over time, is to say that going forward if a fund persistently over a five-year period can't meet its own portfolio benchmark and underperforms it by 25 basis points or something like that, so you can't even sort of meet the market performance for the index for each of those asset classes, that would be a basis for APRA saying, "Please hand back your MySuper authorisation".

I don't want to put you on the spot today if you haven't had time to think about it, but we're just trying to make sure that that's reasonable. When we kind of think about it, we kind of think that if there's a market event, then the indexes for the different asset buckets wouldn't do as well. It would have to be something about the investment calibre and the investment performance of that fund that's meant that it's persistently underperformed over those five years.

MR HARTLEY: We haven't discussed that in great detail but just listening to those comments, we saw it in the report and the analysis in the report was very good, but the more you analyse the performance of a fund down to an asset class or sub-asset class level and look for benchmarks of comparison, you're actually starting to remove recognition of the investor skill in the investment portfolio. Asset allocation can add a lot of value in terms of outperformance and if you're sort of removing asset allocation as a source of alpha, I think that's perhaps a mistake.

MS CHESTER: We wouldn't remove it as a source of alpha and, indeed, that would be reflected in the absolute returns within the market.

MR HARTLEY: Sure.

MS CHESTER: But it is looking for the lack then of the investor skill, so by providing a benchmark of what's the value add above and beyond asset allocation that the fund is bringing. So if you can't meet the market with the same asset allocation of the collection of the market indices, should you still be practising.

MR HARTLEY: Sure. I think we'll come back on that.

MS CHESTER: Yes, that would be good.

MR HARTLEY: I like to keep things simple. I'm a CEO, not a CIO.

MS CHESTER: Yes, okay.

MR HARTLEY: So whatever you put on the tin in terms of the risk profile of your product is what you should be compared against. So a reference portfolio that applies to the growth profile or the risk profile that you put in your PDS and being compared against that, I think is the right way to go, because if you start breaking things down, investors have an incredibly good way of demonstrating they're outperforming.

MS CHESTER: Yes.

MR HARTLEY: You break things down and demonstrate you're outperforming on a certain basis, so I think just keeping it – when it comes to 'best in show', I mean I understand the analysis you've done for the report, but when it comes to 'best in show', what do you say you're going to do and how you're performing against that in terms of the real principal player.

MS CHESTER: Yes, and really what we're thinking is, is the portfolio benchmark the right way to nip in the bud someone heading back into the tale of woe and taking the MySuper authorisation off them before we end up with a 12-year period of entrenched underperformance. So that's where we're focusing it, and you're right, it's not at the rocket science end of performance attribution analysis that we know that a lot of the funds are doing. It's a very simple form, by just taking SAA off the table. Could you actually meet the market?

MR HARTLEY: Sure.

MS CHESTER: You did mention more than a modicum of hesitation about a future insurance review and we kind of understand that you guys feel like you're reviewed to death, whether it's a Parliamentary Committee, a Productivity Commission or a very Royal Commission.

I guess what was behind our thinking was we were pretty unimpressed with the insurance code of conduct. That for us was kind of too little too late, to put it pretty bluntly. There was a lot of good endeavour and good effort by the industry to try to get there, but when we saw where it started and where it finished, we thought if we leave this with industry in three years' time, government will be having the same conversation.

Thus, we thought it was healthy to have the discipline of a review, and not just a review in terms of how the industry has done it, improving things in insurance, but also has the regulator done what we've asked them to do in working with the industry to make sure that insurance is value for money for members going forward. So that's kind of our motivation. I can understand reluctance for any future reviews but given that's the motivation.

MR SOMMER: Perhaps a couple of comments?

MS CHESTER: Yes.

MR SOMMER: Your draft recommendations really call out two areas of review. One is around the effectiveness of the code and that recommendation we're supportive of. I think it might be recommendation 18 or 19 which is a further review which talks to the value of insurance in super, 'opt in' versus 'opt out' model. Our view is that with the code of conduct changes, the Federal budget changes likely to come over the top, a lot of the core parts of the weakness of insurance in super will be addressed.

MS CHESTER: Yes.

MR SOMMER: We have concerns that the 'opt in' model potentially for all is one that continues to float out there and we believe 'opt out' insurance in super is fundamentally a social good for the country. So anything that really looks to put that on very shaky ground with another review is something we couldn't reasonably support.

MS CHESTER: Yes, and I can understand that from the industry's perspective, but it's kind of interesting when you go back and look at the history. Nobody has ever asked and answered that question. Nobody has ever really asked and answered, "Is dealing with underinsurance in the Australian workforce best addressed by putting insurance in super. That said, we did say in our report that we think on the whole it does deal with underinsurance in a very cost-effective way, as long as they're getting value for money. We agree that if you fix up the value for money piece and see where you get to in three or four years' time, that's a health check tick.

MR SOMMER: Yes.

MS CHESTER: That part of the scope of the review you're fine with in terms of have you guys done what we hoped you would do.

MR SOMMER: Yes, we're supportive of that.

MS CHESTER: But nobody has ever asked and answered or done the analysis around is doing it through super the best way and what is the degree of underinsurance in Australia and is this the best way of doing it. It's kind of just evolved historically.

MR SOMMER: Sure. There have been a number of reports by a number of consultants over the years that have looked at that issue.

MS CHESTER: Yes, and we've looked at those reports and nobody has really fulsomely asked and answered that question.

MR SOMMER: I guess in our summation from those reports, experience of our membership, there's very few commentators which are suggesting that there's an over insurance problem. It is typically an underinsurance problem and the system going at least part of the way to address that in a low cost, effective, comprehensive way is a very good thing and we should protect it.

MS CHESTER: Yes, okay. We're probably not disagreeing with that but some have suggested that we should have moved to a world of 'opt in' for everybody and that's not what our terms of reference took us to. Ours was, "That's the architecture. Let's make it work as best as possible". I can take it from your comments then, you're okay with the health check part of it?

MR SOMMER: Absolutely.

MS CHESTER: But not the – and that's fine, we can totally understand that.

MS MacRAE: Do you have some views about IP because that's been one of the other issues. I mean we call it out in the report as a bit of a culprit and it's mainly the multiple accounts issue that comes up there, but also a diversity of offerings within funds that we know about with IP sometimes not being offered, sometimes for a two-year period, and sometimes for up to the age of retirement. Do you have views about the appropriate role of IP in super and whether or not that part of it should be 'opt in' or 'opt out'?

MR SOMMER: Our view is that IP does have a role. We do think it should be 'opt in', even though it might be not the majority of cases. In fact, it's probably a small minority of cases where the risk of duplicate policies or offsets in IP can mean that when it comes to claim time, members might get a shock that they cannot claim, and we think that there's a risk there around erosion of trust. So that's why we believe an 'opt in' approach is appropriate and we wouldn't pursue an 'opt out' approach.

MS CHESTER: That's the current policy for Sunsuper for your devolved products?

MR SOMMER: Yes, we offer IP by a variety of benefit periods and waiting periods but 'opt in'.

MS CHESTER: Okay. Would you be able to share with us, when it's done on an 'opt in' basis across your membership cohort, how many people took it up, age groups and then what the premiums were compared to the default IP products that are on an 'opt out' basis with some of the larger funds that would kind of be comparable to you guys?

MR SOMMER: Yes, sure.

MS CHESTER: That would be really helpful. Terrific, I love setting homework.

MR SOMMER: We've got a fair share.

MS CHESTER: I know. We're not doing any more inquiries.

MS MacRAE: You're not taking any holidays, are you?

MS CHESTER: Actually, indeed Commissioner MacRae and I when we talked about that recommendation at the Commission meeting about doing another one on insurance down the track, we said that we're conflicted, we can't do it. I think we've covered all the bases. Is there anything else that we haven't allowed you to say that you hoped our questions might get to this afternoon?

MR SOMMER: I think it might be good to perhaps make a couple of comments on life cycle.

MS CHESTER: Thank you. Good one.

MR SOMMER: We have read obviously the report and we are supportive of life cycle arrangements as a principle. We do acknowledge that not all life cycles are created equal and there are some life cycle products there which could be better designed. Why we think life cycle is so important is there is a fundamental risk that applies when members approach retirement, being sequencing risks, which is quite different from investment time risks. Sequencing risks is if members do see that large fall, get a GFC-type event, their retirement income can be irreversibly damaged and they just don't have either the timeframe or the ability to stop payments to recover. So we think sequencing risk is very real. It can have a significant impact. It will not be too often it happens, but when it does happen to members, it will have a big impact throughout their retirement, which is something we should reasonably look to reduce that risk.

Our view is that as people approach retirement, typically their risk tolerances may reduce. They don't have as much runway, they don't have much human capital. That tends to decrease, so they need their financial capital to hold up. Frankly, members may have no idea that a balanced option could drop substantially the year or two before they approach retirement.

We think there's a place for life cycle funds. We do think it's really important that they're well designed, including features like don't derisk too early because you leave too much money on the table, so our approach is from 55. We think products which have big step downs in growth assets is something that really shouldn't occur. It should be incremental over time to minimise the timing risk. We think some can lack transparency, so do members really understand what it is.

MS CHESTER: Yes.

MR SOMMER: And comparability, some lack comparability. We think if you can design life cycle products which address those issues, do risk into release step changes, lack of transparency comparability, then they are fundamentally a good thing. That would be our feedback on life cycles, and we believe our approach, of course, does just that.

MS CHESTER: In default or in the choice world?

MR SOMMER: No, in default, because these are members who are not engaged. They will not necessarily understand the volatility of markets, the volatility of investment returns within super funds and to naturally taper to some extent towards a retirement age takes a little risk off the table, but it's worth it for that event which means their retirement income will be irreversibly damaged forever, which a balanced option does inherently do.

MS CHESTER: Okay, a couple of things then. One thing it would be good to get feedback on is the stochastic modelling that we did because we did it at derisking at different age profiles. Ridiculously, some start at 30 but we did it across a number of age profiles, I'm assuming including 55 which is like a natural one in mind. The thing that had struck us and, indeed, this followed some earlier discussions in our previous work, is that the sequencing risk at the time of retirement depends on what's drawn down from the account.

Based on what we did about post-retirement super and, indeed, housing decisions of older Australians, the cohort that tended to have the biggest sequencing risk were those that had the lower balances that were doing a big lump sum drawdown. So if you don't know – you would know the balances of your members projected for retirement so you've got a bit of an idea of their proclivity to do that. If members have got large balances, and so they're not going to do a lump sum drawdown, you don't know actually what sort of drawdown behaviour you're going to see from a member. You can sort of imagine for some cohorts with a balance of under $80,000, we know that they're more likely than not to do a large lump sum drawdown, based on the data that we've looked at previously.

MR SOMMER: Yes.

MS CHESTER: How do you kind of know across the whole cohort that you're dealing with in a default segment product, in a default MySuper product, that what that drawdown risk is, if you don't know the risk appetite and the needs of the member to do that sort of drawdown?

MR SOMMER: We do know some things. We obviously know past pattern behaviour from members, be it rolling over to account-based pensions or cash withdrawals at retirement.

MS CHESTER: Yes.

MR SOMMER: But we also do know they're going to at least take the minimum and we know some members take more, and it is that regular drawdown in addition to the lump sum at the retirements which basically produces the sequencing risk.

MS CHESTER: Okay.

MR SOMMER: We have and we can model on minimum drawdowns, other type of drawdowns, lump sum up front and minimum drawdowns, and we can see where the modelling kicks in to irreversibly damage those retirement accounts.

MS CHESTER: Okay. What would be helpful for us in the post-draft report submission and this won't require further homework because you've already done the analysis for the business case that obviously went to your trustee board when you designed this product, is what you've shown to be the net benefit, based on the way that you've designed the product. Then it becomes an issue of is it an appropriate product or not for your cohort, and you've made that business case.

MR SOMMER: Yes.

MS CHESTER: Whereas, when we looked at a whole bunch of the – well, the team looked at a whole bunch of the policies that are out there at the moment and did stochastic analysis, they didn't look they were value net benefits for most but only a small number of members. So that would be good for us to get a handle.

MR HARTLEY: We definitely agree with the comparability point, the difficulty comparing some funds. The way that we've done it is we've got building blocks, so we've got a balanced fund and we've got our retirement fund in cash, and basically, we have the life cycle at the administration level by member. So each individual member moves each month a little bit between those portfolios.

MS CHESTER: Yes.

MR HARTLEY: Those portfolios, the flagship portfolios that are comparable, is all the other funds.

MS CHESTER: Okay. And how they move individually is a function of the balance and their age and what you're anticipating will be their drawdown in retirement during that transition period, based on what you've seen historically across your membership.

MR SOMMER: That's based upon very much age and the targeted landing position at age 65, yes.

MS CHESTER: All right. That would be helpful.

MR HARTLEY: So we have our homework.

MS CHESTER: Thanks for reminding us to ask you about life cycle.

MS MacRAE: The one very last thing, and we didn't mention this with some of the others where perhaps we should have, is just your views around mandatory CIPRs and the offering and whether or not you think that that's a good thing and if you are offering one, ultimately would you see it is as a positive or a negative in making it a mandatory take up, as well as a mandatory offering. I'm quite happy for you not to take the question now if you want to consider it.

MR HARTLEY: No, we've got some views.

MR SOMMER: We do have some views. Broadly, we are supportive of availability, importantly, availability of longevity products. For our particular membership which typically have lower balances, for most of our members they may not serve a need and there will be some members with very high balances where it may not be necessary either. But there is certainly a significant group in the middle where they can and potentially should serve a purpose. We certainly wouldn't be supportive of a mandatory take up; we don't believe that's consummate with the principles of our system.

In our experience, the temptation for the industry is to go to product for a solution. We actually believe advice and service in the lead up to and in retirement is much more important and we do agree with the PC's view around the availability of products is generally there and can meet the needs of most members. It's really about advice and service. So that would be our initial views. We're supportive of the development of CIPRs and developing a market, but compulsion, certainly not. We think it will serve a need for some members, even though they can be a little bit pricey, particularly at the moment where interest rates are at.

MS CHESTER: It would be great if you could capture that in your post-draft report submission as well. In particular, and I guess we flagged it in this report and we flagged it back when we did post-retirement super when CIPR was just sort of starting up post Murray as a concept, we're concerned about a MyRetirement being a soft default when we know in a world of nudges a lot of folk might end up there in the absence of advice saying that that's not appropriate for you. We're doing a little bit of a "Warning, Will Robinson", around this.

MR SOMMER: Yes.

MS CHESTER: To some extent, if those concerns are shared, we'd love to hear about those and the evidence that's informed your thinking about it, based on your membership, and what's appropriate and what's not.

MR HARTLEY: Yes, and we are working on a CIPR solution but the market is very thin right now. I mean the market is not ready for CIPRs just yet, so there needs to be more development product.

Ms MacRAE: Thank you. I think we really will let you go now, sorry.

MS CHESTER: I think we've promised and nearly let you go a few times.

MR HARTLEY: That's all right. I'm happy to take those last questions.

MS CHESTER: No, thank you very much. That was terrific.

MR HARTLEY: All right. Well, thank you. Thanks very much.

MS CHESTER: We've got the Queensland Fund tag team happening here. I'd like to welcome our next inquiry participants from QSuper. We'll just let you get settled there and have the great luxury of a glass of Brisbane water.

MR HOLZBERGER: Warmer than water elsewhere.

MS CHESTER: Come to warm Melbourne. Thank you very much for joining us this afternoon and also for QSuper's help along the way. You've been one of what we refer to as technical experts that we've reached out to on occasion and, in particular, when we were doing a lot of the heavy lifting back in stage 1, which then did allow us to come up with the evidence base that we've got now for stage 2. For the purposes of the transcript, if you could each just say your name and organisation and then if you'd like to make some brief opening remarks.

MR HOLZBERGER: Sure, Brad Holzberger, I'm the Chief Investment Officer of QSuper.

MR HIPWOOD: And Glen Hipwood, Executive General Manager of Strategy at QSuper. Firstly, thank you for the opportunity to share our experience and insight, particularly around life cycle investing. I think it's been the topic of the last couple of days, so hopefully we can add to that debate for you.

QSuper wholeheartedly supports the PC's intent to lift the standard of default products and, in fact, we contend the criteria for assessing default fund status, when you combine it with the requirements of the fund's default investment option, will fundamentally shift members' retirement outcomes. We therefore support the holistic approach in proposing a diverse range of measures as part of the default selection process.

We do note though, as others do, that any 'best in show' criteria presents a comparability challenge. The ultimate goal is to protect members and elevate members' best interests and so therefore, while comparability is important, it should not be simplified and come at the cost of member outcomes.

We would like to call out the interplay between providing a suite of products to members and ensuring they get the best out of the ones that are provided. Embedding advice in products is important and certainly better than one size fits all solutions, but as the Commission notes, so is providing access to assistance and advice services. QSuper would contend that early advice is just as critical as advice closer to retirement, in particular, close to 55 that is contended by some.

Our experience indicates that across our various channels and QSuper has services from telephone base services, digital advice, as well as face to face, provided in-house, that the use varies with age, but the outcomes are no less critical, depending on when you get that advice. For example, the majority of those seeking face-to-face advice, more than 75 per cent are over 55, but there is just as many 25 to 29-year old's using our digital advice service as there are to age 60 to 64-year old brackets. Likewise, our contact centre takes more than 350,000 calls a year, but from about 200,000 unique clients. So the majority of our membership or 40-odd percent, close to 40 per cent of our members use our services each year.

Now to the topic of the last two days regarding life cycle products, QSuper contends that modern life cycle products, using more than one cohort factor, do not forego returns across a member's working life. We put to the Commission that opportunity cost exists in all defaults investment options when using the hindsight argument. For example, why is the default benchmark for a balanced fund 70/30, rather than 100 and zero. With hindsight, the more aggressive portfolio would have derived the best asset-based return over a number of time periods in the last decade.

All would agree that the product needs varying across ages and circumstances and so the challenge of default products is how best to meet the extremes and everything in between. The question is, therefore, how can we best meet our fiduciary duty in that default environment if we are not utilising what we know about the member, age, gender, account balance, to either customise our investment strategies to devise a retirement income.

We have been working towards the next generation of our product for a number of years. We do have experience over the last five since our Lifetime products went to market in 2013. But given our experience, we are more than happy to take questions from the Commission and we do note some of the homework that you've provided today for a number of the other funds.

MS CHESTER: So if they're doing it, you don't need to; is that what you're suggesting?

MR HIPWOOD: Well, no, we're more than happy to answer those questions.

MR HOLZBERGER: We've already done it.

MS CHESTER: No, no, no, just a moment of jest, a moment of jest. Maybe we might start with life cycle then and this is the topic that we had discussed with you a while back as well as we were sort of shimmying our way up the exponential part of the learning curve. As I said a little bit earlier this afternoon, life cycle wasn't an area that we expected to get into in the inquiry and it was only when we realised it was 30 per cent of most super products that we thought we'd better have a closer look at it to make sure it is an appropriate product.

MR HOLZBERGER: Sure, yes.

MS CHESTER: We do appreciate that it's a huge spectrum, but across that spectrum there might be some good smart life cycle products, but in MySuper there's a lot of life cycle products that aren't.

MR HOLZBERGER: Sure.

MS CHESTER: How do we deal with that in a world of default. I guess there's a couple of issues. Firstly, it would be good for us to understand what data or knowledge you need of your cohort, your membership, to be able to do as smart a life cycle as you've done it over time. In that context, I note that QSuper is a rare beast in terms of you do have access to much better data on your membership than other typical super funds would have.

MR HOLZBERGER: Sure. All that you said is true. The life cycle product and we actually will ascribe to the life cycle word, but we don't see our life cycle product anything like the product, for example, that's tested in your report. So while those conclusions might be sound, they're just not relevant to what we do. As Glen was saying, we would expect our life cycle style of management to actually improve the risk adjusted returns, not sacrifice them.

MS CHESTER: Yes.

MR HOLZBERGER: In terms of the data, you would be aware of the MySuper prescribed factors and they give a guide to the first level of data that's required. The current generation of life cycle management at QSuper will take into account age, account balance and gender. All super funds have that data. It's about getting access to it, but in addition to those simple prerequisites of data, we also look at a lot.

We've done deep analysis of 20,000 financial planning records to show what members thought, what financial planners thought in different circumstances, almost the start of an AI type approach. We've looked at our members' activity, both choice members and also surveying members and getting their behavioural responses.

In addition to the wealth of literature in the behavioural finance and economics world, we've looked at what academics and others are saying. We combine all of that to try and get a sense of what the risk tolerances and expectations of members can be. That will be imperfect.

One thing I would stress and I hope I get the chance to say it more than once, we see this as a continuous improvement path. We do not think that the life cycle fund or QSuper Lifetime that we first initiated in 2013 was good. We think the one that's about to be done, and our trustees have commissioned us to go to the next phase, will be better. The one that our successors bring forward in another 10 years' time will be better again. It will be better because our technology and our understanding will be better.

What we hope is that the industry, and we hope spurred by your recommendations, engages in this life cycle debate and their learning, together with our learning and the work that academics and others are doing, will just lead the industry forward. We're well short of anything optimal here and the only thing we can say is we're getting better with each iteration. We know where we want to go. I could define success, but to get there. So we use a lot of data, lots and lots of it. It's amazingly available if you philosophically apply the view we need to know about these things.

MS CHESTER: The way that you've approached it then, going to understand the risk tolerance of the member and the risk tolerance of the member behind that is informed by what they might want to do with that money in retirement as well, like how to set them up to draw down.

MR HOLZBERGER: Yes.

MS CHESTER: You can understand when we see people just doing it on age, gender and balance, absent what might be the risk preference of the member and their circumstances, that takes us to a world of choice and financial advice and not a world of default.

MR HOLZBERGER: Sure.

MS CHESTER: It sounds like in your world of default, you've been able to replicate that through the analysis that you've done, the surveys that you've done, drawing on the 20,000.

MR HOLZBERGER: Yes.

MS CHESTER: Who else in the industry is doing that though, Brad, across the life cycle providers?

MR HOLZBERGER: I can't authoritatively say who's doing it. Not enough, Karen, is the answer. As I said before, we would love to see more in-depth work done so we can learn from it. We're happy to contribute but it is very unlikely that a group of people, even guided by trustees and investment committees and academics who are very skilled, we're not going to get the right answer.

We will be much, much better able to get it if this philosophy of member centricity, if this philosophy of trying to understand and then manage risks, if we could bring all - and all the different spheres of knowledge. I am an investment specialist. I am not the only person who works on QSuper Lifetime. We bring a whole range of expertise to bear.

If I could, I will mention the comment you made about choice. We are a little at odds there. We actually see these types of products as far more applicable to the default. In choice, members take their own initiative. They do what they think is best.

Financial planners, good financial planners working with the wealth of information that a member can provide about their very own circumstances is probably great. Not every Australian has that. As Glen was saying, they tend to do it later in life once everything's done. They are almost trying to recover circumstances. We would much prefer that they start getting advice early to create the right circumstance. To the extent that we can perhaps poorly represent that but at least attempt to represent it through a default, we think is absolutely applicable.

If members choose to do their own, I hope, and I would challenge members who do their own to do it as well as we do it, they should be able to do it better. But what we lack in precise member information, we make up a little bit with investment expertise, asset liability modelling, all of that wealth of experience we can bring about the markets they operate in, academic literature about their risk. We sort of know where they're going to end up, whereas they may have a great sense of where they are.

MR HIPWOOD: I think the challenge is about the comparability of the alternative as well in terms of the single asset class or the single multi-sector class as a default. So while we're talking about Lifetime and where the evolution of Lifetime will go, we actually start at the base.

MS CHESTER: Yes.

MR HIPWOOD: What is the primary starting point and is it a balance as the most appropriate single multi-sector class.

MS CHESTER: The only reason why we were saying, "Why put it in default?" and why we ended up thinking, "Shouldn't it belong in a world of choice?", it was really because understanding the risk tolerance and the preferences of members at retirement to know what insurance policy they might need through life cycle, to us seemed to only happen in a world where people were proactively getting financial advice in the choice segment. It wasn't the choice segment in and of itself, it was answering that question about what the member needed at the point of retirement.

You show us a world of where you're able to replicate that in a different way, without it being about individual members getting financial advice, which means there is a possibility of it working in the default segment. We're then faced with a situation where you might be a unicorn in the way that you do it, and how do we deal with the inappropriate products that members are unwittingly and unknowingly defaulting into today that could be grossly inappropriate looking at our stochastic modelling.

MR HOLZBERGER: It depends on how you position the criteria for your selection. You have already gone out on a limb I think as the Commission and said that you feel there should be an expert panel that selects the 'best in class'. I think what you've just described is the start of the criteria.

We would be very happy to work in an industry where the better funds, be they 10 or be they more, fewer, or whatever, meeting all the other standards of criteria, hygiene about the various things to get in this, they then adopted the highest standard of investment strategy setting. And not reverse that onus to say, "Well, we've got to get everybody a choice, so we just want to get rid of the bad ones". I mean set the standard the other way, aim for the best.

You, yourselves, have spoken about it and your report has made it quite clear that you expect a dynamic approach to this, that there will be rotation. Well, let's use that. I think you've got a challenge. The legislators have already legislated MySuper criteria. They've thrown the gauntlet down to trustees to pick up the opportunity that's presented.

Even today in your comments to others, you've hit upon some of the really interesting challenges. Commissioner MacRae mentioned about low account balance members. Absolutely. Opportunity cost falls differently on different folk, and if you've got a large account balance and a small account balance – you laid it out perfectly. You could have been in our investment committee. Our simple response to that was recognise the problem, and we have the ability to adapt strategy to those different account balances.

MS CHESTER: Okay, so homework then. Our principles at the moment for 'best in show', do look at product innovation and investment strategy. Give us your suggested guidance on how the expert panel could look at these sorts of elements as well.

MR HOLZBERGER: Of course.

MS CHESTER: That still leaves us with the problem that's 'best in show'. How do we deal with the existing legacy of the not so clever life cycle products that members are currently defaulted into, given that the stochastic modelling that the team did does apply to a bunch of those, Brad?

MR HOLZBERGER: No, no, and it does. I think there's work that can be done to improve that modelling and we've talked about this and we're happy to talk about that. Indeed, one of your people who will testify later

I know is one of the people around the world who is best regarded in this area and published extensively on this. We're not without guidance as to how to do that. We've got our own way.

Just recently, in fact, I finished a paper. Our board called for a review of our work, our QSuper Lifetime outcomes over the five years or so that it's been going and took as the counterfactual where we were, which was essentially a balanced fund, and asked that very question. How good or bad has this been compared to the balanced option? Now, a short period, one fund, but I can tell you the results of that and we're happy to share the very detail of the results with you. It is that 80 per cent of the members were better off, even in a period where risk was heavily rewarded. So 80 per cent of the members were better off.

Everyone in our default fund under the age of 50 has 100 per cent in growth assets. These issues that you're bringing up – so how do you stop the underperformance? I would say show them what you regard and what the expert panel would eventually regard as best practice. That's how we do it. We don't make it up. We sort of try and find best practice and try and get there.

MS CHESTER: No, no, demonstration effect.

MR HOLZBERGER: Exactly.

MS CHESTER: Because otherwise we're in a world of ASIC using product intervention powers against inappropriate products.

MR HOLZBERGER: Yes. One of the things that your expert panel if empanelled, if your recommendations are accepted I suppose, but one of the things that they will do, they will have an enormous power to influence standards. They will make a decision about 10 but they will give a signal that will rocket around the place and every CIO in the country, every CEO in the country, will try and emulate that. You've already alluded to it. You're not just going to go and pick the ones that did a good job last year but, presumably, what that criteria, your own criteria, your draft criteria says. Show us leadership, and if you create leadership, sound research, a willingness to experiment – this is not science, it's art – I'd like to see the rest of the world following us.

The rest of the world sort of is following us. Australia leads. Our academics are the leaders in the research on this. Our legislators are the leaders through the MySuper legislation and prescribed factors. The industry, fledgling, and we may be the example but in terms of actually saying this is more than research, this is more than theory, you can actually do this.

We can list more effectively the shortcomings of what we're doing than the advantages. It's not hard. It's just a matter of changing that mindset and that philosophy. Your Top 10 panel made it clear that that's the standard to aspire to. The industry will go past us and we will be but one of many, hopefully, chasing perfection, never getting there but chasing it. We'd love to do that.

MS CHESTER: Well, that's what injecting competition for a market should do.

MR HOLZBERGER: I think that's what you're trying to do.

MS CHESTER: It should spur innovation, yes.

MR HOLZBERGER: By getting rid of the bad ones, I think you've got it, if it works as it's designed to work.

MS CHESTER: We touched on earlier getting rid of unintended multiple accounts, not just mopping up for legacy but stopping them from arising. We came up with the default once unless a member going forward chooses to go to another product. The other option on the table, and you probably heard me before, was suggested that the balance rollover. It would be good to get your thoughts on what might be the costs and unintended impacts of that in a world of trying to get member engagement, or member interest as we're told is probably a better word, and to bring the costs as low as possible?

MR HIPWOOD: Yes. We certainly acknowledge the point you said before about exit costs, even employment patterns, future employment patterns. If you're looking to invest through a life cycle investment, what does that do when members are continually changing products and services across different investment suites. So we'll certainly take that away and give it more consideration about the multiple options that are out there and the implications for members and funds.

MS CHESTER: Yes, and it would be helpful in doing that to give us a bit of the evidence base from your perspective about what the costs might be to a member of that shifting pattern behaviour.

MR HIPWOOD: Sure.

MS CHESTER: For us the counterfactual is default once, unless they choose to go somewhere else, as opposed to the benchmark being today where we do have a lot of members already kind of doing that with auto consolidation.

MR HIPWOOD: Yes. From the data, what we probably don't have is the inertia of members once they've made a choice at a system level.

MS CHESTER: Yes.

MR HIPWOOD: We talked before about individuals if they are in the Top 10, what is the inertia for them to stay and not make a choice ever again. So that's probably a challenge, as opposed to the inverse that they will make a choice.

MS CHESTER: Yes. We just hope that we've mitigated the risks of them not making an ongoing choice based on they're either in a top performer or they're in a good performer if we've lopped off the tail.

MR HOLZBERGER: Sure. As a general observation, never underestimate the ability of the superannuation industry to find solutions to these challenges. It's about testing. These things that you've brought up, many of them are real and legitimate challenges. The industry should rise to it. I think there's a lot of skill. We have a depth of expertise and in some ways the homogeneity of the industry dampens that. Some of the things that are doing this just do not allow that innovation and technology is improving enormously. I would keep the challenge and the bar high.

MR HIPWOOD: I guess that's the challenge where if it's a homogeneous Top 10, how do you spur that to the points before of are the 11 to 15 to 25 the only ones playing in that space to position in the Top 10.

MR HOLZBERGER: Yes, you've basically got to keep the bar high.

MS CHESTER: No, and we do see that the envelope is going to exponentially go forward with data, and the use of algorithms and the like, to better understand the needs of members going forward.

MR HOLZBERGER: I've got data scientists in the investment team that work with me. I've got actuaries. These people are really skilled. It's amazing, like an investment team and suddenly a data scientist arrives and you just change your mindset. You can unlock it. Again, our data is not perfect and there's a bit of hair pulled out at times by the data scientists, but the only way is to set the bar high and allow the industry to run at it. If you don't do that, then they won't do it themselves.

MS CHESTER: Given QSuper does have this sort of home-grown advantage, given your membership you do have a little bit more than the vanilla data points on your members, is that a constraint to other funds, Brad, going forward, in terms of being able to push that envelope that we're talking about?

MR HOLZBERGER: Well, it may be. I mean it shouldn't be. There's nothing particular about QSuper that really causes us to have better access to these things. I think it's the philosophy that's been brought to bear and I don't mean only in our investment in life cycle funds. The financial planning that was done at QSuper was done very early. Our work around insurance has been very innovative. We've got our own insurance subsidiary. All of these things stem from a culture and a philosophy of trying to understand the member.

Now, was QSuper somehow encouraged or advantaged? It might have been, but I can tell you that the philosophy is pervasive and it springs from that. What you're doing in general is attempting to focus, rationalise and raise the bar in the industry. Just be clear about the criteria you're looking for and data and understanding of the member has got to be central to it. You've said it yourselves.

MS CHESTER: Just on insurance and I know it's not something you raised in your opening remarks but we know that you've done a lot of work around insurance, including having ownership in substance and form of insurance products for your members.

MR HOLZBERGER: Sure.

MS CHESTER: Our recommendations and findings around insurance, do those agree, disagree or any issues with them?

MR HIPWOOD: I think we are one of the ones that does have IP as an 'opt out'. So we take our trustee and fiduciary duties seriously and when we reviewed our insurance proposition, we talked to all stakeholders. We went internationally and worked on trends about what people are looking for in terms of holistic claims management. Believing in the philosophy that getting a member back to work is good for their retirement outcome.

MS CHESTER: Yes.

MR HIPWOOD: You can see that in our product design. Talking to unions and employers about what's best in terms of rehabilitation. They're the things that we sort of put into our insurance product. I guess in terms of the findings and in terms of the multiple accounts, I guess that's how you do it. For example, you might have multiple accounts in QSuper. I know that's just a dynamic, but we count it as an individual member. We take into account our data to actually make recommendations on that.

We concur that there might be people with multiple insurance covers across the board. But I do think some of the things in the ISWG and the multiple account issues that are being resolved, do resolve the majority of those. We don't have I guess a strong adverse finding against those.

MS CHESTER: We do understand and indeed it was really well articulated by one of the inquiry participants – was it John Berrill in Sydney?

MS MacRAE: Yes.

MS CHESTER: Yes, about income protection. It's got quite a good link to the objectives of retirement incomes in superannuation. Is your policy in the default for income protection, is that for a two-year period?

MR HIPWOOD: It has been for two years and the last couple of years, we moved that to three years. So again, based upon what our members and employers, and also the trends in the industry about do you give a member a lump sum. When are they totally and permanently retired? If that's a 25 or a 30-year old, how can you actually them? Is the best thing for that member to get a lump sum at that point or to actually find it?

MS CHESTER: Yes.

MR HIPWOOD: Just like most practices, there is some signs behind why you actually do that. We do offer flexibility, I would say. They can choose 65 or waiting periods that they choose.

MS CHESTER: When you've put a case to your trustee board on what the insurance policy should be for default product, is there that element of the business case also includes the trade-off between - - -

MR HIPWOOD: Yes, they do.

MS CHESTER: The value for money is about the trade off with what impact it has for retirement balance?

MR HIPWOOD: Absolutely. That was one of the criteria that we've used for many, many times. That will differ, depending on the cohort of membership as well.

MS CHESTER: Yes.

MR HIPWOOD: It's well publicised that things like emergency services would probably in value, insurance more than others, but we do look at the erosion of the retirement funds.

MR HOLZBERGER: We have a dashboard which converts the lifetime asset strategy into a retirement income outcome. So the stress testing and the risk is measured in terms of stability of retirement outcome, not asset returns. One of the elements on that dashboard and we'd be happy to show it to you, is insurance premiums.

MS CHESTER: Yes.

MR HOLZBERGER: We can stress test it. We can actually quantify it. It's not a major contributor but it's one of those things, if we start to capture it, and we start to look at it and people like me see it, you start to respond. What gets measured, gets managed. Our dashboards, internal dashboards, have all of that on it. Again, imperfect, and it's a learning curve but those that follow us down the track, it's just going to be second nature to ask that very question. We see insurance as a lifetime continual. People insure against dying and then they insure against living. It's all there in our modelling.

MS CHESTER: Well, I know which side I'm getting on now.

MR HOLZBERGER: Yes well, but if you think about it in that as we do, it's just all one challenge.

MR HIPWOOD: You consider it a member for life and then you look at the risks, not asset-based risks but income risks, protection risks, then you do have different risk - - -

MS CHESTER: We would be interested in getting a better understanding of what you've done there. I guess the thing is we've wanted the trade-off to be better understood by the member.

MR HIPWOOD: Sure.

MS CHESTER: We talked about an online calculator. Given you guys have done some work in that area, it would be good to get some feedback in terms of is that workable and, if so, what would be the best way to do it. Not that we should be overly prescriptive. It's up to a fund to work out the best way to do it for their members, but we want to give some guidance as to what we're trying to get out of it.

MR HIPWOOD: I think there's some constraints already with the class order around calculators and so on and that's the same thing that people raise with the super sort of debate about where that line between information and advice is.

MS CHESTER: Yes, we got some findings in that area as well.

MR HIPWOOD: So I think working with the industry to find the balance between that because that's about informed decision making. How can we find – like my comment before about, yes, it's good having products but if individuals don't know how to use them for their benefit, we need to do better at that.

MS CHESTER: Yes.

MS MacRAE: Do you have just lastly anything to say about CIPRs and where you've going with those and how you feel about the mandatory offering?

MR HOLZBERGER: We're still developing our case. To be honest, we've been looking a lot at the development of the accumulation space because that's been unclear. As we've seen, we're sympathetic with the broad – well, we think the design of the CIPR as it stands could be improved. As a Chief Investment Officer, I would not like to undertake the challenge of producing a CIPR in this period or any other.

We had worked in parallel with alternatives. Perhaps we're biased, but we thought the alternatives that we were developing were probably superior to a CIPR, again a little more complex, but longevity and those sorts of things. The CIPR seems to be a good start. It's a good start but I would be very disappointed if the industry couldn't come up with something a bit better. We would probably be a little critical and we are not yet going to launch a CIPR or design a CIPR. We'd like to see a bit more debate about it. But it's a problem, we've got to get there.

MS CHESTER: The notion, Brad, though of it being like a soft default, like a MyRetirement product, we've flagged that we've had some reservations about that, albeit they're probably not as well informed as many of the industry participants might have about it. What's your thought on that?

MR HOLZBERGER: The evidence we have is that our members at and approaching and through their retirement, all unilaterally almost start to choose. They become involved and they start to make choices and you have to respect that. I've seen sort of the MyRetirement concept or the CIPR concept as being an obligation on the trustees to perhaps put into the world a product or a system or a service that would recognise their best thinking, and maybe then members do – it's not sort of nudging them into it, they might actually be led by it and say, "Gee, that makes sense". We have no plans to offer a default or a soft default just yet, but these things are swirling around. We'd be happy to share the debate with you but it wouldn't be conclusive. What do you think, Glen?

MR HIPWOOD: Yes, I guess we're using our data of what members do at perceived retirement as well. There's a lot of our members that continue in the accumulation style account long after we think they will retire.

MR HOLZBERGER: Yes, absolutely.

MR HIPWOOD: That compulsion at times and dates around what is retirement is a challenge, likewise funding. It's an assumption that people get at the end when they've got a lump sum to contribute to a product. If people are making choices beforehand how they fund into those products in the longevity is just as big an issue as what am I going to do with the lump sum at the end.

MR HOLZBERGER: We're often surprised by this data and if you would accept our invitation to have a look at it and we'll walk through it. The actions of people in retirement is interesting. I mean it really is interesting. It may not be totally rational but it's modellable and we see a lot of consistencies in what they do.

Of course, as you know, we are very strong advocates and we're right now trying to split by gender, so we split up men and women where they are different and where they are similar. We all look at it and go – and you look at it two or three or four times and you start to see patterns in it and rationality in it. We are encouraged by that because we think the more patterns we can see, the more rationality, the easier it will be, that continuous journey again.

MS CHESTER: Yes, to tailor for that.

MR HOLZBERGER: To just start to learn and start to adapt. I don't want to overstate our ability to do that but there's certainly a desire to do it.

MS CHESTER: Okay. I think we've covered a lot of very good ground here this afternoon.

MS MacRAE: We have. Thank you.

MS CHESTER: Unless there's anything else that you wanted to say that we haven't allowed you to get to.

MR HOLZBERGER: No. I think you'd invited us to give you our best thinking and I think you understand the spirit of what we're saying, to set the bar high and allow innovation to lead the industry, as opposed to perhaps settling for something a bit second best.

MR HIPWOOD: Risk adjusted return.

MR HOLZBERGER: Risk adjusted, yes, absolutely.

MS CHESTER: Well, you've sort of demonstrated what we're looking for, possibility and realising that perfection shouldn't get in the way of it.

MR HOLZBERGER: No, no, absolutely.

MR HIPWOOD: And likewise, not just in life cycle investment options as well. That applies to your entire investment philosophy, that risk adjusted return.

MS CHESTER: Yes. I can feel a technical round table coming on but the team is not going to – will be throwing things at us shortly.

MR HOLZBERGER: No, we love it because again, I bet you we'll learn something.

MS CHESTER: I think you might have to have you come visit us again in Melbourne, QSuper, please.

MR HOLZBERGER: Sure, not in the middle of winter though.

MS CHESTER: Thanks very much.

MS MacRAE: Thank you.

MS CHESTER: All right, folks, I think we will now take a well-earned caffeine break and let's aim to resume just after 3 o'clock and then we'll be a little bit ahead of schedule which will be a lovely thing because I know a bunch of people need to fly out this afternoon.

ADJOURNED [2.45 pm]

RESUMED [3.01 pm]

MS CHESTER: Our next participant is going to join us by phone, so I'll just check the technology's working and I'm hoping that Matthew Englund from BT Financial Group is on the line?

MR ENGLUND: We are, thank you, yes.

MS CHESTER: Great, thank you. I heard a royal "we", is there anyone else with you, Matthew, who'll be hoping to speak this afternoon?

MR ENGLUND: So it's Lucas McKay here as well.

MS CHESTER: Terrific. So welcome, gentlemen, and thank you so much for being able to join us. I know that it's a busy time and you've been able to sort of squeeze us into your schedule and be flexible about doing this by phone while we're in Brisbane doing the final public hearings for our inquiry. Just for the purposes of the transcript, if you could just say your name and organisation that you represent, and then if you'd like to make some brief opening remarks, we can then head into some Q and A.

MR ENGLUND: Thank you. Matthew Englund, BT Financial Group.

MR McKAY: Lucas Mackay, BT Financial Group.

MR ENGLUND: So thank you, Deputy Chair Chester and Commissioner MacRae for the opportunities here today, albeit back home. BT would like to also thank the Productivity Commission team for their detailed consideration and evidence based assessment of the superannuation history in all of its complexity. I imagine this was no simple task.

BT would like to be on record to say it supports the Commission's key recommendations (1) that an informed and engaged membership base should be the goal for all participants in the superannuation system; (2) that the government should establish an expert panel to select the best in show funds to help guide or nudge consumer choice; (3) that the expert panel should sit outside of the industrial relations system; and (4) that consumers should only default once and then take their funds with them between jobs until such time as they choose otherwise.

It is well known that until now BT has supported an open market model in which any APRA approved MySuper product was (indistinct words) default status. We have been concerned that an independent body responsible for selecting default funds is potential perceptible to political input. The PC's report, however, provides compelling analysis and has led BT to conclude that a different model is necessary to protect consumers from identified negative policy outcomes of account duplication causing balance erosion and the defaulting of consumers into underperforming incumbent default funds.

BT also recognises that the Commission's report is breaking new ground in what is an otherwise tired political debate around default superannuation and therefore presents a unique opportunity for the different industry sectors and both sides of politics do agree a partisan model. I'd like to use this opportunity to call on the industry to put the interests of consumers first. BT has moved from its entrenched position, however encourages others to also giving the Commission's recommendations genuine consideration. Debate should now focus on how best to implement the Commission's recommendations. The weight of evidence presented by the Commission is compelling. If its recommendations are implemented consumers would save $3.9 billion each year.

BT does, however, note that the implementation of the Commission's recommendations is not without its challenges. Important questions remain to be answered including: how do we ensure the expert panel remains genuinely independent and only select the funds on basis of merit or the criteria that the panel will apply when selecting those funds; how do new products or new market entrants compete; and should the criterion assessment be prospective to ensure future tender processes remain competitive?

These challenges, however, are not beyond the Commission and Parliament to solve. For example, government panels and boards, such as the Foreign Investment Review Board, and the Future Fund Board of Guardians, consistently navigate the potential conflict of interest inherent in any commercial tender process that requires expert assessment.

Further, objective criteria that sets a different product, a like to like basis, are a feature of every tender in both the public and private sector.

In this context, BT will welcome the opportunity to enhance the design of our MySuper product capturing the illiquidity premium for our members that comes from default status. We would also welcome the capacity to configure our MySuper products to the lower distribution costs inherent in the government providing a free distribution network and to leverage our significant scale to deliver a more efficient product than current incumbent funds. Until the benefits of incumbency are equally acceptable to all market participants tendering for a position in the top 10, it's difficult for any player in the sector to genuinely claim they outperform the market on a like for like basis.

BT have continued to take a leadership position in the superannuation industry and we are confident we'd be a strong contender for a top 10 listing. To name a few recent initiatives, BT were the founding participant and adopter of the Insurance and Super Code of Practice. BT has had a majority of independent directors and an independent fare on all of its trustee boards, and this week BT announced that we'll rebate the customers of BT Financial Advice grandfathered conflicted remuneration that acts as a drag on the performance of legacy products.

We already offer some of the lowest wholesale cost arrangements in the marketplace to employees of large companies, and BT have taken the initiative to rationalise our legacy products which are often targeted as proof of poor performance. In fact, by June 2020, we plan to have rationalised three superannuation trustees to one, six super funds to one, and by consequence have moved half a million members into contemporary and market leading products. BT are also calling on the government to help the industry become more efficient by removing barriers to allow us to rationalise products where we are currently legal and able to do so, such as where there are personal security or such impediments.

Soon there will be a generation of Australians who will contribute 12 per cent of their income to superannuation for their entire working lives and BT is conscious that if the industry is to continue to be trusted with the responsibility of managing these Australian's retirement savings, consumers must be able to have absolute faith that we have designed the most efficient superannuation system possible. Thank you. I welcome any questions you may have.

MS CHESTER: Great. Thanks very much, Matthew for that very concise but broad opening remarks. We might start first then with, I guess, the twin problems as we identified in the system were those of unintended multiple accounts and entrenched underperformance. On the unintended multiple accounts, I note that you'd identified support for our default once unless a member chooses to move to another fund or another MySuper product.

The other option that's been put to us since releasing our draft report, by a couple of inquiry participants - and it is another way of preventing unintended multiple accounts from emerging for new job entrants, is the balance rollover or the auto-consolidation model going forward where, instead of the member account attaching to the member as they go through their working life, and we know from the modern workforce context that when members do change jobs more than half of them change industry sector and thus unintended multiple accounts will only grow in number going forward unless we just stop them from being created - instead of it being the member account attaching to the member, the balance attaches to the member, so the member takes that balance with them to every fund or default product that's on offer at their next port of call for a job.

It would be good for you to talk us through whether or not you've had a change to think about that as another option to solving the agreed problem of unintended multiple accounts from arising and whether you see that there are any pros and cons around the second option?

MR ENGLUND: Yes, thank you. It is early days in our thinking on this one, but I would make a couple of comments. The first thing is that as a system and a community, it's beholden on all of us to actually work towards helping consumers develop long term relationships and a clear engagement of focus with superannuation. We all know that people are better off where they're deeply engaged and invested in something which is some an important asset for them long term. That's the first comment.

The second comment I make is that currently over, as the Commissioner's pointed out, over 2 million unintended accounts are created every single year. The risk of moving the balance with the member when they change jobs is, in fact, that we further entrench the issue of disengagement. So one of the things that that model would need to think about how it overcame is how we have helped shift back to the consumer a desire to participate fully and early in an informed and educated way with the very aspect that's going to help make sure that they have a meaningful and enjoyable retirement. The risk of a process where it simply follows the member around is, in fact – so it serves primarily to continue the disengagement.

The second challenge that that model would need to think about how it overcame is the way in which funds would then think about the longevity of the relationship with a member and the level of investment that they would place in the engagement that they attempt to do. We know, through our own experience, that members want to be informed and engaged more often with their superannuation funds. We know that being able to see their superannuation, a great asset for them on their phone or via an app is really important. We know that members make more informed choices when they're engaged or communicated with more regularly by their super fund.

The question would be, the environment where there's an expectation that the client will move at their next job, how much super funds would be prepared to invest or, in fact, able to invest in building a relationship, which we know is good for the member?

MS CHESTER: Thanks, Matthew. Indeed, I take it from your opening remarks that BT's clearly positioning yourself going forward to run for the best in show list and, indeed, it sounded like a little bit of an early dress rehearsal in terms of the aspirations and plans that BT has going forward to be able to establish their credentials to a best in show process.

A couple of thoughts there, so firstly the issue of the selection and appointment of the expert panel, I'm not sure if you're aware but yesterday Commissioner MacRae and I decided to dare a little greatly and kite fly an idea on how we could try to depoliticise the appointment of that expert panel with a selection committee that could be not construed as anything but independent, chaired by statutory appointees that might be familiar with the financial system and investments world, so chaired by the governor of the Reserve Bank. I don't know if you're aware that we floated that idea and, if so, if you're have time to think about it in terms of addressing some of the concerns of folk about it being a politicised process?

MR ENGLUND: Yes, I certainly have. Again, whilst it's early, I make a couple of comments. The first, I'm not sure that the governor of the Reserve Bank will be all that comfortable being called Caesar's wife because I think you did in your early engagement, Caesar's wife needing to be above reproach. But nonetheless, I think that this process actually needs to start with an agreement of the skills required to do the job.

I was heartened to see in the Commission's report very clear articulation that trustees of funds needed to have a very clear view on the skills required to run that fund, and that every year and regularly, there needed to be a publication of the matrix of skills and the way in which independent directors came together to deliver on the skills required to run that fund. I think the first step in this process is to ensure that the panel which actually selects the funds, follows the same process. So publication and debate on the skills required, the imminent, that the individuals are required to complete this very important task, I think is the first important step.

The second thing is to ensure that the appointment process is transparent to all Australians and by doing so, I agree that the use of somebody like the governor the Reserve Bank and others who are appointed by government but independent of, I think is an issue that is certainly worthy of further consideration and merit. It does help to depoliticise.

The third comment I would make is that independent of that process, the process for managing of conflicts must be clear and unambiguous. But the thing that I say over all of this is, that actually this isn't the first time that government and members, like ourselves, have actually had to consider this. I mean, the government does this today in the way in which it constitutes things like Foreign Investment Review Board or the Guardians of the Future Fund. These are problems that are not without being in the realms of Parliament and experts to be able to solve. So we're fundamentally of a view that this is an important process, but it's only one part of the process and we should ensure that we come back to concentrating on ensuring quality outcomes for more Australians.

MS CHESTER: Thanks for that, Matthew. I guess part of the purpose of our inquiry will be to give government guidance around supporting our recommendations and our final report on what we would see as being the skill set that would be required of the expert panel. We've got some initial suggestions in our draft report. So we're looking at hearing back from inquiry participants on that proposed skill set and whether we've got the mix of that right and whether we need to be more prescriptive.

So we wouldn't be contemplating a further round of consultation post our final report, unless that's something the government felt was merited, because we'd be quite keen for the government to, as we always are at the Productivity Commission, quite keen for the government to just get on with implementing our recommendations if they think that they are of merit. So that's something that we'd be looking at getting feedback from BT and from other funds and representative organisations, but also organisations that represent the interests of members, and we've heard from some of those as well.

On the other point that you raised about the selection criteria that would be applied by the expert panel in choosing the best in show, again, we've got about a page in our report which is relatively high level, but it does set out what sort of criteria we would see the panel applying. Indeed, we've had some very good feedback from inquiry participants today about how the best in show could also be a way of also allowing the expert panel to reward other good innovation and endeavour of the truly top performing funds and partly, that would be through net investments returns.

But what gets you to net investments returns is the smarts of the investment folk within a fund that not only understand markets and get asset allocation right and getting choosing fund managers right and getting costs and fees low, but also get product innovation right to make sure that members, when they retire, have a large retirement balance, but then after retirement they have access to good products that make sure that those retirement balances help them to manage the risks they face in retirement, but also get good retirement income streams or access to good drawdown as needed.

So the other thing we're looking for then is feedback on the criteria that the expert panel should be applying in deciding best in show. So we would welcome, in a post-draft report submission from BT, we've already been setting homework for others and we'd like to do the same for you if we may, if you could give us some feedback on that, because we'd really like to progress and advance that for the purposes of our final report.

MR ENGLUND: Yes, sure. We'd love to (indistinct words) there. If I can make just a few quick comments on that? We'd absolutely love to further allude to our answering the submission. What I would say is that as to what the Commission has put forward, member outcomes, we believe, are fundamentally important. We're very big on governance and we welcome the opportunity to comment more, as we do submit our report on that on that. We believe that governance is a crucial criterion. We think that insurance coverage and sustainability is something that will be incredibly important for the future model and importantly also engagement of members.

Thinking about all of those things and I like, Commissioner, your comments, we believe that fundamentally the criterion needs to both look backwards, so be retrospective, but have a really important focus and lens on the prospective. That will allow industry participants and competition amongst the industry to drive innovation. It will allow members, like ourselves, who are looking to participate in the top 10 to think about how we would consider a product structure and product design that's fit for the cohort that comes with participating in the top 10, and think about the cost structure that's associated with that would allow us to drive innovation and engagement with both our existing members and importantly those with income. So we welcome the opportunity to put that in our submission.

MS CHESTER: Great, thank you. That would be most welcome. Just touching on another couple of other things that you commented on. You referenced, and I may've misunderstood this so it'd be good for you to expand it a little bit, the best in show resulting in someone becoming best in show then being able to project some uplift in their performance going forward from the illiquidity premium. Just talk us through a little bit what you meant by that, Matthew.

MR ENGLUND: Sorry, Commissioner. There are a couple of things that come from this. The first, in terms of participating in the top 10 would, as it does for default funds today, guarantee cash flows for participants in the top 10. What that allows individual participants to do is to access different asset classes and, by consequence, with different investment horizons. We see that with some market participants today.

The second thing that this process would enable is that participation in the top 10 actually shifts potentially the cost of acquisition and, importantly, the costs of service. What that would enable us to do, what that would enable participants to do, if you think about how they shift their operating cost model to actually deliver that additional returns to members. So not only are you accessing additional access classes, not only is the cost of delivering your acquisition potentially lower and the costs of service spread over a broader client base, but all of that then contributes to being able to offer back to members that outcome through enhanced investor services and improved investor returns.

MS CHESTER: So I'm sure that that's something that, if we get the right expert panel, they can test the efficacy of those claims when it comes to choosing best in show, if people are going to ascribe an investment performance uplift from accessing the illiquidity premium. I'd just be mindful that we do set out in our report the inflows that would flow to the best in show, given that its new job entrants, switching and re-entrants and all up, unless we see an exponential change in switching rates, it's about $20 billion of $150 billion of new contributions each year that flow into the system. So anyway, we would leave it up to the expert panel to judge the efficacy of that.

But, by all means, in your post-draft report submission, if you wanted to set out the evidence base, as you see it, we would find that of interest and of value in terms of what guidance we might provide to the expert panel in terms of the selection criteria.

The other thing, Matthew, that you touched on was around making sure that the best in show was an open show for new entrants. I take it to that, you mean, new entrants to the Australian Superannuation System. So we do have an information request around that in terms of wanting to make sure that the expert panel would be able to – and if we get the right expert panel they should be able to do this readily – look at an investment track record of another institutional investor, wherever they may reside in the world, if they're looking at coming to Australia and competing for best in show. Again, investment track record is one of a number of criteria that would apply. But we want to just make sure that there are no barriers to entry, if there are good institutional investors that do want to come to Australia and compete for best in show in the superannuation system.

That information request was a little bit broader than we anticipated. We did also allow it to contemplate a possible entrant to that system being a government run or a government owned fund. That was not something that we thought we contemplate, but it's been put to us during the course of this inquiry, perhaps not directly but – well, directly by some academic experts, Professors Barr and Diamond, who are very well respected in the field, albeit a lot of their experience is in pension systems and very different sort of pension systems to what we have here in Australia. But it was certainly raised in the media in Australia as a potential idea.

We put it forward in terms of not a monopoly default but a government fund, perhaps, being able to compete for access to the best in show. So it'd be good to get your thoughts on that information request either now or in the form of your post-draft report submission.

MR ENGLUND: I think that would be one that we would take on notice.

MS CHESTER: I thought you might say that and sensibly so on a Friday afternoon.

MR ENGLUND: Yes.

MS CHESTER: The other thing – sorry.

MR ENGLUND: If I could, Commissioner, what I would like to say is in regard to the new entrants, we also shouldn't discount the opportunity for existing entrants to rethink the way in which they would look to serve the constituent that would be available in the marketplace as a result of participating on the top 10. So I think the process for inclusion, the process for consideration will considerable innovation right across the market.

MS CHESTER: We would hope so and indeed we've heard that thematic very clearly from some inquiry participants a little bit earlier this afternoon in our hearings. Again, it then comes to the criteria that the expert panel would be applying and an expert panel would want to make sure that they demonstrated evidence that's provided by participants in the best in show selection process.

You touched on before barriers to rationalising products. Given we're in a world where we've identified a bunch of products that, perhaps going forward or even historically, may not be in the best interests of members, it'd be good to understand what you see as the existing impediments to rationalising of those products or cleaning up products such that, going forward, the products are much more suitable to the members.

MR McKAY: (Indistinct words) . It's Lucas McKay here. We'll take that on notice and put it in the submission. We've certainly made submissions for governance in the past, but they're too broad to cater for this issue. There are some tax - sorry, the previous – some tax impediments and government often introduce the CGT really to support that. There's also issues in the SIS definition when you're trying to merge entities and the test of the benchmark is quite high around trying to make sure that most, if not all, aspects of the members benefit is improved. So we've submitted on that previously. So we'll include those thoughts in our written submission. There can be social security issues, but that's mostly in the retirement space for old products that are now closed.

MS CHESTER: We'd heard from APRA that they've given new guidance around the equivalence test there, so we'd need to get some evidence as to how that guidance and the equivalent test may still not be going far enough in removing those impediments. So that would be really helpful to get that in your submission.

MR McKAY: Okay.

MS CHESTER: The other thing, and we're very careful what we read in the papers, but we did read in the papers that BT had made a decision around trailing commissions. Is that reporting correct?

MR ENGLUND: Yes, that is correct. So earlier this week Brad Cooper, the CEO of BT Financial Group, confirmed to the market place that for the BT Financial Advice business, so our salary financial advisors, from 1 October 2018, where any grandfather trailing commission is currently connected to products that the clients of that device are using, that those trailing commissions would be turned off and would be placed at the benefit of or to their benefit of the some 140,000 account holders that are part of that financial advice network.

MS CHESTER: So I note you were very careful in how you explained how that would apply. Does that mean that going forward once that's implemented, BT would then have no trailing commissions in superannuation products?

MR ENGLUND: The entity in question is our financial advice business and our financial advice business is in a position where it has been able to go to the market place - our salary finance business, that would go to the market place and ask all market participants that it interacts with, to turn off trailing commission. BT, as a parent entity, has legal contractual obligations with other licensees, other advice businesses which, at this stage, mean that trail commissions from our products would continue to be paid to those.

MS CHESTER: Yes.

MR ENGLUND: We have made the offer to the marketplace that where advisors or licensees believe it in their clients' best interests to also follow BT's lead, that we would welcome the opportunity to work with them on that.

MS CHESTER: That makes sense to us, given we didn't go as far on trailing commissions in our draft report, because we'd understood that there would be, perhaps, some contractual barriers for folk like yourself, to actually implement that across all of your products where you've got financial advisor arrangements in place historically. So on what you've announced, if it's just your salary financial advisors, what percentage of your products that then have trailing commissions, will have training commissions? I'm just trying to understand.

From our perspective it's not what BT has done, although we welcome the removal of trailing commissions when you can do so. It's just trying to understand what are the barriers to removing trailing commissions going forward, getting rid of the historical legacy of them. So understanding what percentage of the problem you are able to solve, or the removal of trailing commissions, through the salary financial advice compared to those where you've got other contractual arrangements that you can't undo.

MR ENGLUND: I'll need to take that question on notice, Commissioner, in terms of the percentage of the overall BT superannuation portfolio, or the book. What I will say in terms of barriers to execution are rife in terms of the contractual obligations. What BT is doing is looking to rationalise and simplify all of its product structures. We've always been a supporter of making sure there is transparency for all fees charged to clients, but the clients are making informed decisions about the value of financial advice and we are big supporters of the value of financial advice. And, as we continue rationalise our product suite for our superannuation entities, that will continue to be a focus.

MS CHESTER: So of your financial advisors, in-house and external, so the externals, I'm assuming, are the ones that you have contractual obligations that you can't undo, the in-house being your salaried financial advisors, what's the percentage across all your advisors of the in-house folk that are salaried that you've got control over what you can do versus the external?

MR ENGLUND: The vast majority of advisors who use BT Financial Groups product are not salaried advisors to BT. So they sit in the 10,000 or so financial advisors that are currently operating in the market place. So the vast majority are external to the salaried advice network. I think a key point is that this is an important change for BT and the way our advice operates. But it'll be up to the rest of the market to decide how it responds and potentially up to government to decide whether or not it wants to try and cross the bridge around whether or not to make a change here to sunset at some point those payments.

MS CHESTER: Yes. No, no, look, we totally understand, which is why we didn't go further in our draft report because we thought there'd be these contractual barriers. So in a layman's terms, you've got to convince people that have got contracts in place with you to change those contracts in a way that aren't financially in their short term best interests.

MR McKAY: Yes, that's 100 per cent. I think that's where we clearly think advice is going and we support a fee-for-service model so that consumers 100 per cent understand what they're paying for and it's hyper-visible for the step or the decision that we've made.

MR ENGLUND: Yes. BT was a leader in this at a point in time where FOFA came in, we ensured that all of our clients opted into a process of ongoing fee advice where that was appropriate. There was an opportunity for some to be grandfathered. But we believe transparency and authenticity in delivery of and articulation of value of the financial advice was crucial.

MS CHESTER: Good. Our report also had a bunch of recommendations around insurance, and we also appreciate that there were some precursor policy decisions made in the budget around insurance, albeit there was quite a bit of overlap. There were some areas where the budget went further and there were some areas where we went further. It would be good to get your feedback on those recommendations and findings around insurance and how they might impact BT going forward.

MR ENGLUND: So overall, we support the moves that are predicated both in your report and in the budget. Again, we'll come back to we firmly believe that there is a role for insurance in superannuation. There are many benefits, which your report outlines associated with holding a group insurance in superannuation. But we also recognise that the zombie insurance that you call out is a challenge and does erode member benefits and long term savings.

What we need to make sure we continue to focus on, is that the pool of insurance is able to manage the risk premia that is associated with the market place. So if we overtly shrink the pool to a point where it becomes unsustainable then that will provide some challenging - in terms of pricing. So there's more thinking to do there. But we do agree that the insurance, particularly where there's a small balance, needs to be a considered choice by consumers.

So again we come back to how do we get early and ongoing engagement and informed decision-making by consumers. The thing that we do like is that default lives helps. So the process of ensuring that a single default and a default for life unless the consumer chooses to move, we think, is a good step in the right direction as is the move to a single active account.

MS MacRAE: It's Angela MacRae here. I just have one final question for you. In your opening comments, you talked a bit about some of your internal rationalisation and mergers. I'm just wondering if you had any comments around whether there were any policy impediments to external as well as internal merger activity, and how that process has worked for you and whether you think there's scope for that, either more scope for it within your own organisation and/or greater scope – and I mean you can't really speak for others – but the extent to which you could see there are opportunities for that more broadly across the industry?

MR ENGLUND: Yes. I think our situation is a little bit different to some of the tail of more industry funds that you call out. I think, we're bringing together three entities, but there are products of merger and acquisition that have happened in the past. But there certainly are impediments to smaller organisations merging together. There's certainly a very large big cost in that activity to bring the funds together. I think you'll find a lot of large funds are reducing their appetite to merge very small funds because of that big cost. I don't really have an easy answer for you on that one, unfortunately.

MS MacRAE: Look, we're probably just about out of time, so unless there was anything else you wanted to say that we haven't given you an opportunity for we'll thank you and we'll have to say farewell on the phone.

MS CHESTER: But we look forward to getting your post-draft report submission.

MS MacRAE: That's right.

MR McKAY: Thank you both very much.

MS MacRAE: Thank you.

MR ENGLUND: Thank you.

MS CHESTER: Thanks.

MR ENGLUND: Thanks for your time.

MS CHESTER: Good afternoon. We'll just make sure that that line's closed down with them before we continue the proceedings. They're off the call now? Well, hopefully, we'll be able to move to our next inquiry participant. Again, it's like listening to God from above, the gentlemen from COSBOA, Peter Strong, will be joining us by phone.

MR STRONG: I'm here.

MS CHESTER: Peter is that you?

MR STRONG: (Indistinct words). Peter Strong here.

MS CHESTER: Right.

MR STRONG: And Mark McKenzie, my Chairman.

MS CHESTER: Okay. Peter, we might just – are you on a mobile phone somewhere?

MR STRONG: (Indistinct words).

MS CHESTER: So this is a - - -

MR STRONG: Can you hear better now?

MS CHESTER: Yes, that's - - -

MS MacRAE: Yes.

MS CHESTER: That's much better. Terrific. Good afternoon, Peter. It's Karen Chester here and I'm joined by my colleague, Angela MacRae.

MR STRONG: Thank you.

MS CHESTER: So, Peter, thanks so much for being able to join us this afternoon and we do appreciate it's by phone, which makes life a little trickier. You are managing to avoid being filmed and YouTubed, which is probably a preference by some but not of others.

MR STRONG: Yes.

MS CHESTER: Just state for the purposes of the transcript, your name and the name of the organisation you represent, and then if you'd like to make some brief opening remarks and then we'll get into Q and A.

MR STRONG: Thank you. Peter Strong, CEO of Council of Small Business Organisations of Australia. I'd just like to make the obvious statement that we don't believe businesses should be involved in the collection process for superannuation with that complexity for businesses and creates situations where the programs themselves find it very difficult to manage the payment process and it adds confusion for employees and creates opportunity for people, bad employers, to keep employee's superannuation funds.

The tax office works out that 95 per cent of employers do the right thing, but that's still 5 per cent of an awful lot of money that isn't going to where it belongs. We're saying that if you remove employers from collection process that a lot of problems will disappear and be resolved and to us it seems a very obvious solution (indistinct words) by people who make money out of the collection process. That's my opening statement.

MS MacRAE: Peter, it's Angela here. So just for the purposes of the record here, I'm familiar with your preferred model of how collection would occur, but it might be worth, just for the record, you running through that just in a couple of sentences just so that we can then have a bit of a discussion about where you'd like to see things go, where we're at, and how things currently operate.

MR STRONG: Okay. Thank you. At the moment, the example we like to use is if I pay an employee at $100,000 a year. What I end up doing is paying them $70,000 over a number of pay periods and then I send $30,000 over that period to the tax office. Then I go and find another $10,000 and I ask my employee where to send that or I follow the award provision or I follow the provisions of an enterprise agreement or I use a superannuation clearing house or perhaps Superstream, and I send that $10,000 somewhere else over a period of it could be four payments, it could be 26 payments.

Now what we're proposing is that I pay that employee $110,000 and send $40,000 to the tax office and my job is done. It's up to the employee, who is now going to be called an investor, to consult the tax office where to send their retirement fund. Now the benefits of that is – can be found in many places but – well, obviously, with the employer because it removes the complexity. With the employee, it certainly removes any ambiguity of how much money they earn and who owns the money. A lot of employees, particularly younger people, they're very confused about superannuation because it's not presented to them as their wages. It's presented as superannuation. So having someone understand that they're earning $110,000, it's their money, I think sends a good message. It removes complexity, enormous complexity for the superannuation funds themselves.

So at the moment, the superannuation fund as an industry deals with, say, 800,000 employers, it could be less than that, but 800,000 employers on behalf of 14 million employees, probably more depending on who's got two or three jobs. That is an awful lot of transactions happening. That's an awful lot of complexity. The funds also have to keep a record of where employees – where their members work, when they change jobs. They have to contact the employer, they have to change employers and the employer has to pay them and they have to obviously transact - do all the transactions on all payments for people who've been paid.

Under our proposal, superannuation payments will be all in one place, not 800,000, and they wouldn't ever have to wonder where one of their members worked ever again. That would not be an issue. The money would be held by the tax office until it was told by the person who owns the money where to send it. Does that make sense? Have I described it properly?

MS MacRAE: Yes. No, absolutely. I think it's just - - -

MR STRONG: Or enough to have a think.

MS MacRAE: Yes. I think they're very helpful because it just gives us a bit of context then for the discussion. So what we've proposed in our model in terms of the way the default operations would work is that employees would be making the choice rather than employers, and if the employee didn't choose, then they would be put into one of the best in show on a sequential basis, between those top 10. So the first thing we would do is remove the employer from that position of having to make a choice for their employee where the employee doesn't choose.

I suppose, just as a starting point, you hadn't mentioned that point. You talked about the mechanism of payment. But do you have a view about the willingness and capability, I guess, of employers to make that choice where they need to under the current arrangements, and would you see the employees making the choice as a better option?

MR STRONG: The employee making the choice is a much better option because it's their money. Now my members are small business and very few of them, unless they're in the financial industry, are able to give advice to an employee on which funds to use and that's always been a problem (indistinct words) the employer (indistinct words). Now that's become complicated over the years, but it's certainly an issue that we'll be involved in the financial future of our employees and that would be a good decision to take us out of that process.

MS MacRAE: Yes. We had it put to us yesterday that there's a lot of things that employers do under awards that require them to make some choices for their employees, like how much they pay for them for their lunch breaks, I think it was. It was a small factor. Then they said, "Well if they're only choosing between 10 funds in an award, that's not such a big deal". Do you think that's how employers would see it?

MR STRONG: Well, employers, no, wouldn't see it that way. Look, my chairman Mark McKenzie is on the call and may make comments.

MS MacRAE: Right.

MR STRONG: But, again, where we come from is that it's nothing to do with us. It's their money. Our employee's money. We should be able to pay them. Now one of the proposals, is (indistinct words) well how about we pay them the money and they put it into the superannuation fund. Of course, we know that wouldn't happen. They would put the onus back on the employer to deal with someone else's money.

I want to point out that everybody in the system of superannuation is getting paid for what they do, except the small business employers. So if you work for big business, or a super fund, public service, whatever it is, you get paid as you should. If you're a director of a fund you get paid as you should unless you're a director (indistinct words), whether it's like (indistinct words) shop over there, they have volunteers running for that fund. But besides that, you (indistinct words) paid, we're the only people that can get fined for not doing that job and Victoria is looking at putting us in jail if we don't do our job as well. Now we want to do our job. We want to pay our employees and follow the tax rules.

If superannuation is a different (indistinct words). They've been there for a long time, but now we're saying it needs to be removed because there's a lot of ambiguity about it and it's not transparent for our employees. So if you put it in tax, then these conversations around us nominating funds, us being happy with funds, there wouldn't be complications. We wouldn't be involved. There'd probably be 20 Senate Inquiries into superannuation that wouldn't have happened and won't happen in the future. The Productivity Commission wouldn't have to investigate superannuation payments. It becomes a non-event and then the funds themselves would save (indistinct words). We shouldn't be involved in someone's financial future by making decisions around it.

Now those 10 funds, that's good that gives the person that owns the money the opportunity to select one of the funds, but even that's artificial. That's not a market place. If we put it in superannuation, they could pick any fund they wished.

MS MacRAE: Yes.

MR STRONG: And the funds would actually have to compete and they'd have to develop products that suit particular parts of the market, they would develop a product for young people, a product for people approaching retirement, a product for people (indistinct words) that's where the market could help select the funds. So that's 10 funds probably wouldn't need to exist. Now we would need a default fund where a person doesn't tell the tax office where to send their money. But we'd need – and it's been suggested to me that the future fund is a place to put that.

MS MacRAE: So, I think just - - -

MR McKENZIE: Commissioner?

MS MacRAE: Sorry, go ahead.

MR McKENZIE: Sorry, Mark's is offering a comment.

MS MacRAE: Sorry, could you just state your name again, just for the record, just for our transcript?

MR McKENZIE: Yes. My name's Mark McKenzie, M-c-K-e-n-z-i-e, I'm the board chair of COSBOA.

MS MacRAE: Thanks, go ahead.

MR McKENZIE: Look, I suppose, the question you asked about what's the difference between providing advice to a small number of funds versus talking about how you much actually pay for a lunch break, it fundamentally comes down to the fact that if I'm making a decision in relation to how I actually pay an employee in terms of entitlements or travelling allowance or compensation with a vehicle, that's part of the employment contract between me and the employee.

When we get into a situation where we're put into the position of almost a pseudo financial adviser, there's two concerns that arise from an employer's perspective. Small businesses don't have the governance practises that large businesses might have in terms of advising their manager's about attracting liability – litigated – litigation liability on the basis of providing advice that might come back to bite them later on. It's typically a decision they will make in a bit of a hot bed of trying to run the business at the same time.

So I suppose, the principle concern I have to the proposition that's been put in front of us is that if we ended up with the business owner being put in a position where it was providing de facto financial advice on a particular fund, then it always opens up a potential liability in the longer term than they might – should've taken reasonable steps to actually ensure that they furnish the employee with a disclosure statement, though they're providing financial advice. There's a whole series of things that would need to be put in place to protect that business in the longer term. And it might not be doing the right thing by the employee.

There's also a risk that – and I don't want to give you the suggestion that small businesses always look for other opportunistic revenue streams, but there's also a case where you could be opened up to potential kickback arrangements and so on that that business might have with a select number of super funds, and that becomes particularly important if it just becomes a small number of funds. So I suppose our central proposition here is to say the employer, and particularly in small business levels, should not be in a position of actually directing or advising the employee around their chosen fund for the reasons that we talked about.

MS MacRAE: Thank you. That's very helpful and it helps us with some greater evidence, I think, to support the case that we have made for the employee choice model that was chosen – that we've chosen in our draft report. We've looked at the role of employers there, but that's just given us a bit more firmer evidence from the horse's mouth, if you like on the sorts of issues that we sort are part of the issues that the bedevil the current default system and in fact some of the other default models that we considered in our earlier work. So coming back then to the payment issue which I think was the one – sorry, did you want to say something else there?

MR STRONG: No, that's fine, thank you.

MS MacRAE: Just on the payment arrangements, and I guess this has been a bit of an issue really since the SG began about how to streamline payments, and I can see some – from a small business perspective, Peter, the model that you've outlined there, has quite some attractions.

One of the opportunities, I guess, that we might want to think about in responding to our report, where were you now proposing the centralised online service? The way that it would work is that there would be a requirement for employers and employees to report electronically at the point of entering the workforce and nominated a fund. The employee would nominate a fund at that point and if they didn't, they would be defaulted into one under the arrangements we spoke about previously. So at the point of employment, the ATO would now be advised of the employee and the fund through that form that would come via the employer. But beyond that point then, the ATO would have that information.

So I just wonder if we could think a little bit, and we haven't gone here in the draft, but thinking creatively about how, particularly for those employers that might already be using a small business clearing house, would it be possible for the ATO to take on the sort of responsibility in the model in the way that you've described it, Peter? So it wouldn't cover everybody, but maybe there's a way, a mechanism to move towards the sort of model you're looking at there.

Now we'd need to think about the consequences then for the private sector small business – private sector clearing houses and whether they could be brought into that kind of model. But, I guess, in terms of we're thinking about a slightly new way of – a new architecture of getting new employees into the system that would give more direct electronic information to the ATO and perhaps we could then be more creative about the way we could potentially reduce the role of employers in that whole mechanism.

So it's not something we thought about in any great detail for the purposes of the draft, just given the scope of the work we had to do. But I'd be interested if you could, perhaps, have a look at that architecture and see if you can think about, and we will too, about the ways we might be able to build on that, even if it's not an immediate thing, but does it work out a design for the future that might reduce the role of employers in that space going forward. But in that context, I'd be quite interested if you had views about the current role of the small business, the ATO small business clearing house and the private sector clearing houses and how they're the same or different or more innovative or more helpful for employees in the current environment. But you might want to say something about the more general point in the first place?

MR STRONG: Yes. Look what I hear about the clearing house, the ATO clearing house, is its very good, it's been positive feedback. But the criticism, if there is any, is you've still got to get in there, still got to enter information, still got to sit down in their own time, probably on a Sunday morning, and enter information in there and connect up. I know that some people say it's easy. Well, whenever people say it's easy, it means they haven't run a business. So we need to just understand that every extra activity you undertake, takes our eye off the business (indistinct words). So even getting into the clearing house is an issue.

The second thing with that clearing house is that hasn't stopped the superannuation funds from still harassing employers at all. We've got very recent cases where employers or an employer representative, their chief execs, are receiving threatening letters from the funds or from the funds' debt collection agency telling them to pay up when they're paid up. So there is another issue here, which is really important. We have an efficient tax office (indistinct words).

We have superannuation funds that are private sector, unregulated when it comes to the collection process that scam or threaten small business people all the time through letters because they don't know what they're doing. So, you can have a good collection process, but we have a bigger problem in the behaviour of the funds themselves in their inability to be good administrators of the payment process .

MS MacRAE: If you were able to give us some evidence of that in a submission, Peter, that would be helpful.

MR STRONG: Yes, I will organise that.

MS MacRAE: Great, thank you.

MS MacRAE: I guess, the final thing and it's – from my point of view and I'm happy for you to raise other things if you've got them, but we did – we have raised in the report that the $450 threshold for contributions hasn't been indexed or changed in fact, since the SG was introduced, so for 25 years. And that if that threshold had been indexed, we worked out that it would be more likely $1000 rather than a $450 threshold today. I just wondered if you had any views on that.

I know one of the reasons it had been an issue in the past was that the compliance burden, particularly for employers with very many employees or particularly casuals who might be undertaking actions like fruit picking and that sort of thing on a short term basis, on low incomes, that they would have very small SG amounts that would be collected, potentially never paid out because the people then move overseas, go back to their home countries or just forget that the money's there, once they move onto their first proper job, if I can call it that. Would you have a view on whether that threshold should be moved, and to what extent that might help employers with some of the compliance costs if we weren't able to move to a more streamline system for employers?

MR STRONG: Yes, look Mark McKenzie will answer that. Before I put on to Mark, I'll say I'll state the obvious here, if you don't have to collect super there'll be no thresholds, it won't be a discussion point. But Mark will respond to the question.

MR McKENZIE: Commissioner, I suppose, the point – our understanding is originally the $450 a month limit was actually determined on the basis of a tax free threshold, which was about $5800, I think, from memory. I suppose we have a – when asked in terms of where do we think it should actually be pointed out here, would be to actually look at the current tax free exemption threshold because I think it's at $18,000 and actually turn that to a monthly payment.

I suppose, the point for us here is it's at that point, particularly if we start seeing - to look at it, it's just that we're actually paying tax for employees that's being collected through the tax agent. We're actually proposing that it doesn't make a lot of sense if you actually got an employee that has not been identified to have any PAYG contributions but you're actually making a super contribution. So we would see some rationale in aligning it with the current tax free threshold and then turning that into a monetised monthly payment.

MS MacRAE: Right.

MR McKENZIE: So I think that would work out to be about $1500.

MS CHESTER: Yes. So I think the only other thing I just mention – it's Karen Chester here, Mark and Peter. I think the only other thing I'd mention is the other thing that's also changed over the 25 years is the incidence of people now with multiple jobs. So we know that 8 per cent of employees in the work force today do have multiple jobs and thus, for an employer looking at the monthly salary of an individual, they may not know what their total salary would be across more than one job.

So you could end up with the perverse situation of someone on a low income who is still paying tax and thus, perhaps, should be paying an SG contribution towards their retirement balance, would miss out in that context. I don't want to overstate the order of magnitude of that, but that's one other little wrinkle in how we might want to look at adjusting that threshold going forward if the Commission were minded to do so in its final report. So it'd be good to get your thoughts around that interaction as well.

MR STRONG: Okay. Just building on what you said, the workforce has changed. We've got the so-called gig economy. So there are some people out there who work for maybe two or three different people. Then they contract as well or they run their own business and it becomes very complicated. Quite often they're young people doing that, so superannuation isn't high on the agenda. That's an issue that's never been considered in getting in the way of the proper collection. We have the issue with people who work for a month here and a month there and an employer may only employ someone for a month and never employ someone again. So the system doesn't – it's not flexible enough or transparent enough to deal with what's happening out there in the current workforce.

So people are missing out on super we should be getting and some people are not contributing to super and particularly the self-employed who should be contributing. And again, that would be another benefit of putting it into tax, it forces the self-employed (indistinct words) and it means you're not looking for superannuation and trying to work out what that even means for you if you only employ someone for one month or two months. It removes that little problem in the area of employment. And for young people, in particular, it's not an issue that they're going to think about until they've filled out a tax return. Well, they fill out a tax return once a year and they'll certainly understand it then.

But the complexity of employment at the moment and complexities of industrial law and the complexity of a whole range of things, means it's a problem for our members. And we had a meeting yesterday where we talked about the real problem and the complexity and more complexities being developed out there. So we're actually talking about the (indistinct words) complexity which everybody will win on. People out – if I can (indistinct words) people outside the tax system are going to have to come back into the tax system if they want the superannuation. The black economy is going to struggle with that – Mark's got a comment.

MR McKENZIE: I suppose, that the question has been asked and so it's one of the reasons why we believe that the tax office should – who should actually collect it. So if I've got multiple jobs, I'm typically filling in a tax file notification for each of those positions. I can only claim the exemption for the tax free threshold for one of those positions. So I suppose the argument we actually have here is that if the employee has actually claimed from an employer the tax free threshold, then that employer is making contributions below whatever that threshold is, would not be collecting PAYG, but the other employers would actually being paying that.

I mean, this is a simple – this for our reason and this is our principle reason why we believe it needs to be the tax office because it's so closely linked to the structure of employment. So if I had multiple jobs, the only one who really knows how those jobs are actually accumulating from an income perspective is actually the tax office. So the simple way of actually administering this in terms of either a change of employer and therefore a redirection of funds, is one of the things you'll frequently get as a small business if you lose a staff member you're being chased for either the last month or last quarter of super as the fund catches up with the fact that the staff member's actually moved. Similarly, if they've got multiple jobs, the way to deal with the issue that's actually been raised, is to do it on the basis of approaching it the same way they do PAYG.

So these are very strong reasons. It's not just an issue around straight simplicity, but the administrative task in terms of movement of staff, employment in multiple jobs and administration of that threshold of multiple jobs, because I'd argue the same issue applies now that for each of the employees who are sitting below the current $450 level, I could still have three or four jobs and that same person is missing out. When you go down a process of actually saying, "I'll exempt you from the first job if you're below that threshold. Beyond that, I'm actually capturing it all".

MS MacRAE: Okay. Well, look, that's been very helpful. So I think we are pretty much out of time, so unless there's something that you – else you wanted to raise before we finish, we'll thank you for that and look forward to your submission when you can get to it, hopefully before – on or before 13 July.

MR STRONG: (Indistinct words). Thank you for the opportunity.

MS MacRAE: Thank you.

MS CHESTER: Thank you.

MR McKENZIE: Thank you very much.

MS CHESTER: Okay. So we'll now move on to our lucky last inquiry participant for Brisbane, but also for our public hearings. So we're as relieved as you are, Michael. So welcome and thank you for being so patient through our earlier inquiry participants this afternoon and welcome.

MR DREW: Welcome.

MS CHESTER: So if you could just state your name and organisation that you work with or represent

MR DREW: Michael Drew, Professor of Finance, Griffith University.

MS CHESTER: Great. Michael, if you'd like to make some brief opening remarks, that would be appreciated.

MR DREW: Sure.

MS CHESTER: And then we can get into some discussion.

MR DREW: Look, as an economist, I understand the incentives I'm working under in terms of you and three days of hearings. So I understand completely. I think, for the record, it's important to state I'm a Director of Drew, Walk and Co. I am a member, specialist member of the Investment Committee QSuper Limited and I am a member of the Investment Advisory Board of the Petroleum Fund Timor-Leste which is the sovereign wealth fund for East Timor. Thanks again to the Commission and thanks for the opportunity to speak with you at this public – important public hearing this afternoon.

I started my journey in super in 1997 as a newly minted doctoral student reading my degree in this new area of investment performance around superannuation. So it was a new field and, I suppose, I was at the right place at the right time. Our research findings, over the past two decades, have highlighted the challenges of benchmarking and evaluating performance of single and multi-asset investment vehicles, particularly those we deal with in superannuation.

Good governance demands the best practice evaluation in undertaking a timely robust - in a defensible way, to ensure the interests of fund members is paramount. We would also stress in our submission, with Professor Robert Bianchi and Dr Adam Walk from the Griffith Business School, that good performance evaluation is something more than just the inputs, something more than just financial returns and asset class returns. It really is about, has this strategy been accretive to the outcome. This is something we've been on the public record here and in the United States debating, and in parts of Europe, around the world, the importance of framing regarding money or dollar weighted returns, outcomes, versus returns, time weighted returns, which are an input to the outcome.

We think this framing is so vital, in fact, that much energy actually goes into a debate that at times, whilst important, is a second order debate. I played a lot of cricket at school. I was a fantastic opening batsman. My average was 23 and we didn't win a game. The reason I tell that story a lot, both in our research and the work we do with industry, is that sometimes there's a flaw in averages and we need to be very clear that we're setting up success in this business, that we're thinking about outcomes, particularly money or dollar weighted outcomes that actually affect things like a member's adequacy risk, longevity risk, and all the other risks that we're going to talk about today.

So we commend and support the key findings of the Productivity Commission's review. It's been multi-staged. It's been a long process for you and we commend you and your colleagues for the journey that you've been on. We absolutely support a greater emphasis on an individual superannuation outcomes, that is the money weighted, the actual dollar weighted return, rather than the disproportionate energy that's allocated to inputs time weighted returns. In my life, I have my university, my school, my hospital. There is a range of these things in life and this is one that we have to get right for the sake of our members.

We also support your initiatives around fundedness and thinking about, perhaps, the dashboard incorporating things like retirement wealth ratios, annuity equivalent values, how these deal with inflation risk. Risk, in its fullest form not simply volatility or standard deviation, but what's the probability of this strategy falling short of the objective. If it does fall short, by how much? What's the drawdown risk? So having a holistic conception of what risk is through the life stage. Being clear on language, target date funds versus the next generation of life cycle funds, static approaches to defaults settings rather than dynamic outcome oriented approaches to default settings, and acknowledging that what's safe and what's risky changes through your life. That, to me, is a really important part of the conversation to be had in the setting of the system. Thank you again for allowing me to make some opening remarks.

MS MacRAE: Thank you.

MS CHESTER: Michael, thank you. I do appreciate that you hit the KPI we set this afternoon and with a one minute efficiency dividend for all.

MR DREW: Thank you. Thank you.

MS CHESTER: So for that we are grateful. But also thank you from the Commissioner, because you have been on this journey with us. We have met with you several times. We have benefited from your submissions.

MR DREW: Thank you.

MS CHESTER: Particularly as we grappled with getting the methodology right for our own portfolio benchmark work for the way we've constructed investment performance series over times, but also as we grapple with the murky world of life cycle products.

MR DREW: Sure, sure.

MS CHESTER: So probably three things that would be helpful for us to run through with you this afternoon. Firstly, our best in show criteria, what should the expert panel take into account? I don't know if you've had a chance to look at that part of our report where we set out a page which is like high level principles of what areas would we want the best in show expert panel to go to.

MR DREW: I think this is an industry, as you know, that's gone from troubled teenager to young adult. We're now 20, 25 years into this journey. I think what's important in terms of setting up success now is bringing together something that really was a shoebox of cash, collection. We have a world class accumulation system. Now we're demanding a maturity from this system that actually morphs into a world class retirement income system. I think, to me, that's the nub of the idea. The things that need to be on, I think, for consideration are how do we best set up a set of criteria that are meaningful to folks, that are aligned to the objectives of superannuation? Our research has shown that there is a real risk in doing anything in a deterministic way in this business.

I know at the moment, some of the excitement is about target date funds and the static glide path and the way you draw the line and the line of descent. As you saw in the US, and you know I was in the US giving testimony to the SEC and Department of Labour Hearings on this very matter, part of the challenge with that design principles it's when you think about landing a plane safely, you line it up with a runway at an angle of three degrees. But the pilot knows there's wind sheers and atmospheric conditions that require you to make those adjustments. We put a lot of faith and trust in the pilots and their training and the instrumentation to do that. We don't just simply blindly land the plane at an angle of three degrees.

To me, this is the next generation of life cycle. The idea of life cycle is robust. There are Nobel Prize winners who absolutely support this idea. Going back to this idea of what's safe and what's risky changes through your life, I think we've got to be very careful about enshrining deterministic approaches. So that would be the first thing. Once you buy that as an approach, everything is, dare I say it, solvable from there. Things like probability of falling short of the target, evaluating success criteria that have a meaningfulness to households, to mums and dads.

Now, isn't it amazing, my mother's a hairdresser. My stepfather was a Woollies manager. When I talk to them about standard deviations and glide paths, their eyes just glaze over. But when you talk to them about replacing income levels or weekly spend – and we have mathematical terms for those – engagement is a lot easier. Sorry, that's a very long answer, nudging, if you will, not just the behavioural finance – using behavioural finance to nudge the criteria to a more outcome oriented frame of success.

MS CHESTER: Yes. So I guess there's two decisions we're looking for folk to make, firstly the best in show expert panel deciding who are the best in show funds with good defaults products.

MR DREW: Sure. Yes.

MS CHESTER: We haven't been prescriptive or deterministic there.

MR DREW: Sure.

MS CHESTER: That is, if we want to make sure that we've got the thematic buckets right, we might provide a bit more guidance under that. So it's things like long term investment track record, governance.

MR DREW: Yes.

MS CHESTER: And governance would get into, do you have the right board, trustee board, and the right investment committee with the right skills matrices; investment strategy; product innovation in accumulation, transition and retirement; knowing the member base, the cohort; what data do you have on them that informs that product innovation; and then how you go about member engagement and how you got value for money insurance. So they're our bucket headings. Are there any other bucket headings we should have for the expert panel on the best in show?

MR DREW: You've danced around this, but actually it goes back to my remarks about the system becoming more mature, actually bringing together the asset problem with the liability problem and bringing those two domains together.

MS CHESTER: So that would be under two things, your investment strategy and then also your product innovation?

MR DREW: Sure, sure. Then the beauty of that, of course, is that engagement becomes a lot simpler. Because the thing I would challenge about some of the conversation you've had over the last three days is that these things are solvable. Now they're mathematically complex. You need to have the stochastics and, dare I say it, a few propeller heads who like this sort of stuff, but we can bring them out of dark rooms occasionally to help us.

MS CHESTER: We've got ours in well-lit rooms.

MR DREW: Well, the Productivity Commission, of course, is a dynamic, leading organisation. I understand that. At University – no, no. My substantive point is this, is that we can actually have a debate now where beliefs, if you will, or strong opinions can be tested in a cogent framework. The technology now exists that if the expert panel is guided and a debate is had on what those priorities are, now us, others, we've shared these citations with you, there's now technology where you can actually put that through, if you will, a sausage machine, all the strategies through a sausage machine and come up with these sorts of criteria. But they're not deterministic. Unfortunately, they're not straight lines and 81.27 per cent. They are more about putting the balance of probabilities in favour of the member.

MS CHESTER: Yes. I guess that's what best in show's really about at the end of the day.

MR DREW: Sure.

MS CHESTER: It'll be judgment by the expert panel, but at least its transparent judgment and it's subject to scrutiny and revisited every four years.

MR DREW: Yes, yes.

MS CHESTER: That's one part of the decision-making that matters.

MR DREW: Yes.

MS CHESTER: The other one is about the member themselves with a modicum of interest and potentially engagement. The role of the dashboard, we did have some commentary around that in terms of, it seems to have been, a not so dashing dashboard has eventuated thus that it does – indeed we've heard from some of the behavioural finance, behavioural economics at some of the other academic institutions that have tested these dashboards on real life members and they got a fail mark. So we, again not been deterministic, but say that the regulator now needs to be proactive, consult with technical experts and do behavioural economics informed consumer testing on a one page dashboard that means that a member could make a meaningful choice. So your hairdresser or - - -

MS MacRAE: The Woollies manager.

MS CHESTER: The Woollies manager of the world could actually look at a dashboard and understand something on it and think, "Well, I like what this fund's doing a bit more than this one".

MR DREW: I have the great pleasure of having a link with Defined Contribution Institutional Investors Association in the US. I'm on their research centre board. I'm happy to share with you and maybe make some contacts, but their work is showing similar to what you've been hearing in the last few days, simpler is better. Things like a stack of coins and where you are against a stack of coins is immediately engaging. Studies in the US that show that during the global financial crisis if we presented an asset framed outcome where the asset portfolio fell, the people receiving went, "My balance has fallen" and they switched to cash at the wrong time versus the trial group that had an income projection very simply done and saw that when their future self - their future income was falling, they actually had a nudge to put more in.

So I actually think there are some really nice things that are happening around the world that don't require huge complexity, but are extremely powerful with the nudge. So maybe I'm a slightly more economist on a Friday afternoon being slightly more optimistic, but I am. I'm slightly more optimistic on how – and there's great work that industry folks are doing that can share with you that wearing some other hats, that I get to see which use wonderful things like little speedometers and things like that that are incredibly engaging and cut through all of that complexity into things that people can have an engagement with and immediately cause to act.

MS CHESTER: We are anything but public policy optimists at the Commission, otherwise we wouldn't be doing the day job.

MR DREW: Sure, sure.

MS CHESTER: Indeed, we wouldn't have had the draft recommendations we did. But I guess, again, we're not going to be too prescriptive and deterministic.

MR DREW: No.

MS CHESTER: It's just saying that the regulator should do this, consulting with the right people and so as a process for our recommendation that sounds about right from your perspective.

MR DREW: Yes, yes. The wonderful thing about what you're proposing is that the behaviour finance links naturally to a liability based conversation. It links naturally to an outcome – so this isn't something over there. You are actually, perhaps for the first time, aligning why are we doing this superannuation thing in this country? How are we marshalling in – and we're leading to an outcome. That sounds like good work, if I could put it that way.

MS CHESTER: Yes. We can leverage a little bit early on some of the early inquiry participant feedback we had, given that you do work with QSuper and we've heard from the CIO of QSuper. But in terms of what you see across the industry, will most funds that are in the MySuper default space have the data and the internal capability to be able to come up with a life cycle product that's going to be a smart life cycle that will be in members' best interests versus some of the simpler life cycle products that we’ve seen and we’ve done stochastic modelling about that don’t look like they’re in the best interests of members.

MR DREW: And we are, obviously, on the public record, finding similar results. I’d say this, the wonderful thing about this conversation is not actually about smart life cycle or smart balance or smart target date funds. It’s actually, maybe for the first time, moving to the responsible adult, if I could use that – overwork that metaphor a little bit, where outcomes are central to success, where the acknowledgement - and you have seen ours and the work of others on sequencing risk and part dependency, where those sorts of issues really are material to members.

So I suppose, for me, things like flags around balance, so where you are in your life stage and thinking about sequencing risks becoming more important when the largest amount of money’s at risk. Actually, when you move into the retirement phase, the importance of sequencing risk actually declines, because money weighted returns are no longer as important as they were when the money’s at its zenith.

So I think you might be pleasantly surprised to know that even that, as a first step - and our research, the research of others, some of the folks who’ve have been – you’ve had testimony from, Molevski, a whole range of authors around the world, would support that. The fact that you’ve actually added something as simple as a money weighted outcome, improves outcomes dramatically. It’s almost like the first step.

Then, I think as others have said over the last three days, “gender”, we’ve written on that. I think “gender” in a way now is so important that it’s joining a larger issue around the under-employment of Australians, the casualisation of the labour market, all of those worrying statistics that say how few people under the age of 25 are in full time employment. So I can see, this - there has to be a system now that can handle different cash flow profiles at different parts of the life stage, that’s clear on the North Star, if you will to use that metaphor, is clear on the objective.

MS CHESTER: So we can talk about a best in show and an expert panel making a judgment call about who is best in show in an aspiration sense about getting product design right for the member.

MR DREW: Yes, yes.

MS CHESTER: We’re also dealing with the reality that, based on our analysis and evidence, there is a whole bunch of life cycle products that are inappropriate for members at play today.

MR DREW: Yes, yes.

MS CHESTER: How do we deal with those, because we've got member harm occurring now and while aspirations through a best in show led innovation leadership sounds pretty good to us as well, that takes time for that to trickle through.

MR DREW: Sure.

MS CHESTER: And there's a large number of members, 30 per cent of MySuper products are life cycle products.

MR DREW: I don't want to compound the problem for you, but if we were having this meeting in Washington this afternoon, you know the vast majority of defaults in the US now are life cycle funds and they have the qualified default investment alternative safe harbour for fiduciary. So certainly, I would answer the question this way, I think in a way we're getting excited about a debate on life cycle.

I have lived through investment markets where if the volatility and your near retirement is very high, you would like obviously less growth based – particularly if you need to draw on it in a short period of time, life cycle actually comes up okay. But that's the point in time risk that you mentioned versus that 70/30 or an 80/20 or a 100, whatever it might be, that's again another version of a straight line. So I actually, would be – I could probably frame your question, if you don't mind, Commissioner, which is always a risk in reframing the Commissioner's question, slightly different and again have a set of a value to criteria through which an evidence base can be presented. We can do that.

MS CHESTER: We could do that for best in show. What I'm struggling with is if we make a call that there's a large number of life cycle products at the moment that are inappropriate and, given the basis of the stochastic analysis that was presented in our report, that seems to be the case, we can't allow that to continue in a default segment.

MR DREW: Sure, sure. But can you allow a 70/30 to continue if you don't think that's – I suppose my question here is - - -

MS CHESTER: So maybe the easiest way then is an envelope solution and that is if we have a tail of underperforming funds where over a period of time their net investment returns have been systemically lower. We lop off that tail through our elevated MySuper authorisation. Perhaps the good funds that are left are those that will quickly work out how to get themselves to better life cycle products?

MR DREW: Can I give you some confidence? I've been in this game a little while and everyone I meet in this industry is literal. If the Commission and the regulations are very clear on what success looks like, people are pretty literal. They will literally engineer to meet that hurdle. I think in a way I'm slightly more optimistic in that we are on this journey. We remember the 70/30 funds. We saw the linking of the first time of target date funds and the life cycle with life cycle theory, which is absolutely appropriate for what we are talking about this afternoon.

The problem is though is that target date funds are just so elegant in terms of their simplicity. But they're actually dangerously complex. You're drawing a line today where you think you know what will happen to the asset allocation in the next 25 years. But that's a big call. So I suppose, I would perhaps put it more constructively, that life cycle target date, dynamic life cycle and innovations we haven't talked about yet, really need to be considered through the lens of the life stage. I believe they need to be the default. I think this is now so important and so challenging that they need the best minds and the best thinking and the best innovation in the country focussed on this.

MS CHESTER: While we're in the world of default, default retirement products.

MR DREW: Right. I think we have sometimes in this industry, the Swedish driver problem, everyone wants to be above average or thinks they are above average. I know, as a professor, I have yet to have a graduate student come up to me and say, "Professor Drew, I'm a below average student. Why did I get this mark on my" – everyone's above average.

So I think the debate has actually moved on from that. I think there is the green shoots of a very important debate here and offshore about incorporating dynamism into the design of the default, that in my lifetime '87 crash, Asian financial crisis, Russian default, 911 and all the tragedy that went with that, tech rec, we go through the list. We seem to have things that happen in markets that should not happen, every three or four years. So the more I'm in this game, the more I am less believing of normal probabilities and normal distributions.

The reason I'm sharing this with you is I think at times we are trying too hard to solve too many problems with one asset allocation. We can get into some really silly debates. Take the default. Don't de-risk it too much for our 25 year olds, but hang on you need to let it safety for our 60 year olds. We want to be top quartile, bottom quartile. We set these things up and the more layers and the more we add, the impossibility of achieving it is – it is impossible.

So I think, to me, there are some nubs of insight that life cycle bring to the debate, cohort, gender that's been mentioned, account balance is really important. There are some people who's account balances are such that success can be managed today and they have, pick a number 15 times their final salary and they've replaced 80 per cent of their pre-retirement – who don't need to take any risk and just live off the earnings.

But there's a very important rub that we need to, I think as fiduciaries, focus on that are in this zone of they're going to need some age pension, but we're going to have to have designs which aren't just investment based defaults but defaults on insurance, as you've mentioned, to take away some kinds of risks; dare I say it, we don't talk about inflation any more, but I remember as a kid there was this thing called "inflation", I wonder if we need to start talking about that at some stage again; the public pension and the interplay between those levers.

So I think a best practice to fault design as being holistic. It thinks about adequacy as distinct from longevity. It thinks about sequencing as distinct from ruin. I think that's where this committee and the way you're framing this debate – and as others have said today, importantly, it's step one in a journey. Life cycle is an important first step. The cohort idea, there's a simple brilliance about that, but it's more complex than that. The individual features need to come to bear.

MS CHESTER: So, Michael, are you involved or providing any submissions or feedback to Treasury and their consultation on the CIPR product?

MR DREW: We have. Yes, we have.

MS CHESTER: What's your thinking there in terms of the direction that Treasury's taking that in? Our understanding, and we're still looking at it, is that it's meant to be dynamic within in terms of the buckets that are within this product and what members would have, what dial up or dial down in those buckets.

MR DREW: Sure. The biggest issue we face is to retirement versus through retirement. I'm sorry, I know your job is very complex as it is now. But I think the Productivity Commission and colleagues at Treasury need to get as one voice on this sort of stuff, because you can set up a fantastic system that engineers to the retirement date. But, as we all know, people are living longer. Women are living much, much longer. There's a "through" debate that has to be had as well. So if you're designing defaults, you actually can – the sequencing risk goes up because you've got this hard date that you're trying to manage to. Whereas, if you had the opportunity to have clarity around the "through" debate, you make some very, very different decisions. So, I suppose that's the first one.

The second one, which Brad and others have alluded to, is we are still a bit silver bullet in our thinking on CIPRs as they stand today, from my perspective. We seem to be searching, in the navy term, for the golden rivet, the thing that's going to hold it altogether. There must be one of these things right that does that. I wonder whether or not it's a lot harder than that because as we – I'm in the dynamic camp, so I think about mortality updating as you age, so mortality updating of life expectancy is important; quality of life; active EPOC in retirement versus more passive EPOC in retirement; age care; accommodation bonds; health shops. We've written on these things.

Some of these things fit very neatly to a market based solution and some of these problems actually fit very neatly to a balance sheet based solution. So, unfortunately, I'm very much in the both end camp on this stuff, that these things can be very important. If we grab the top five risks in retirement, I would suggest three of them are probably market – can be handled in a market based way, but a couple of them, maybe like annuities, deferred – some of that sort of stuff or mortalities credits and things like that, dare I say it at a Productivity Commission, tontine. Sorry, there's nicer dinner party words for a "tontine". But some of these things are going to require good governance, good fiduciary practice and a unified framework at a regulatory level that can help folks in retirement manage very different risks with very different horizons.

MS MacRAE: Time. Sorry, I've got to get a plane.

MS CHESTER: We do. We've got to get a plane.

MS MacRAE: It's all right.

MS CHESTER: So take out is CIPR ain't simple and it's not going to be one size fits all and there's a whole bunch of other – okay.

MR DREW: But please, celebrate both and, not either or, but a both and solution. That's all of research points to that and we're happy to share that with you if it's of interest.

MS CHESTER: I did find the golden rivet analogy a good one, so I thank you very much for that.

MR DREW: Okay.

MS CHESTER: We'll probably quote that in the report, I think.

MS MacRAE: Karen loves analogies.

MR DREW: Thank you, Commissioners.

MS CHESTER: Especially when they're not mine, because mine don't make sense. All right. Michael, thank you so much. I'm sure we could've spoken for a lot longer, but I have a - - -

MS MacRAE: One who (indistinct words) flight.

MS CHESTER: - - - Commissioner sitting next me who's going to kill me if she misses her flight as will her husband and two children.

MR DREW: No, no.

MS CHESTER: So thank you very much.

MS MacRAE: Thank you.

MS CHESTER: Folks, that's it. We have completed our "oh so super" super hearings and we look forward to doing some further consultation and post-draft reports and I think we've now added probably one or two more technical round tables to what we offered to do in our draft report. Thank you, linesmen. Thank you ball boys. We are finished for the day. Have a good weekend all.

MR DREW: Thanks.

ADJOURNED **[4.03 pm]**