

21 August 2017

Superannuation
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne VIC 8003

Dear Commissioners

RE: Productivity Commission Issues Paper “Superannuation: Assessing Competitiveness and Efficiency” (July 2017)

BT Financial Group (BTFG) welcomes the opportunity to provide feedback on the Commission’s Issues Paper “*Superannuation: Assessing Competitiveness and Efficiency*” (Issues Paper) released on 7 July 2017, which contains material about which the Commission is seeking feedback to assist it in assessing the competitiveness and efficiency of the superannuation system.

Our comments and key recommendations on the topics discussed in the Issues Paper are detailed below.

1 Overall comment – absence of genuine choice stifles competition

BTFG supports the principle that all Australians should be able to select who manages their retirement savings. As stated in our 28 April 2017 submission to the Commission’s draft report “*Superannuation: Alternative Default Models*” (draft report), we believe extending superannuation choice to individuals subject to an enterprise agreement or workplace determination is a reform that is long overdue.

Whilst most employees have the opportunity to choose their superannuation fund, around one in five employees are prevented from doing so as a result of being subject to an enterprise agreement or workplace determination.

As such, we support the Commission’s assertion that freedom of choice is a “necessary condition to realise the benefits of competition in the superannuation market” and that “[i]t is therefore essential to extend genuine member choice to all employees”.¹

Legislation to give effect to extended employee choice was introduced to Parliament in March last year, but lapsed at prorogation shortly thereafter.

In our view, opening the system up to greater competition will promote better long-term outcomes for members, through lower average fees, improvements in service quality across the sector and encouraging greater product innovation.

Recommendation 1(a)

BTFG recommends that the Commission include a recommendation in its final report that the Government open the superannuation system up to greater competition by legislating to extend choice of fund to all employees, including those who are currently unable to choose their fund as a result of being subject to an enterprise agreement or workplace determination.

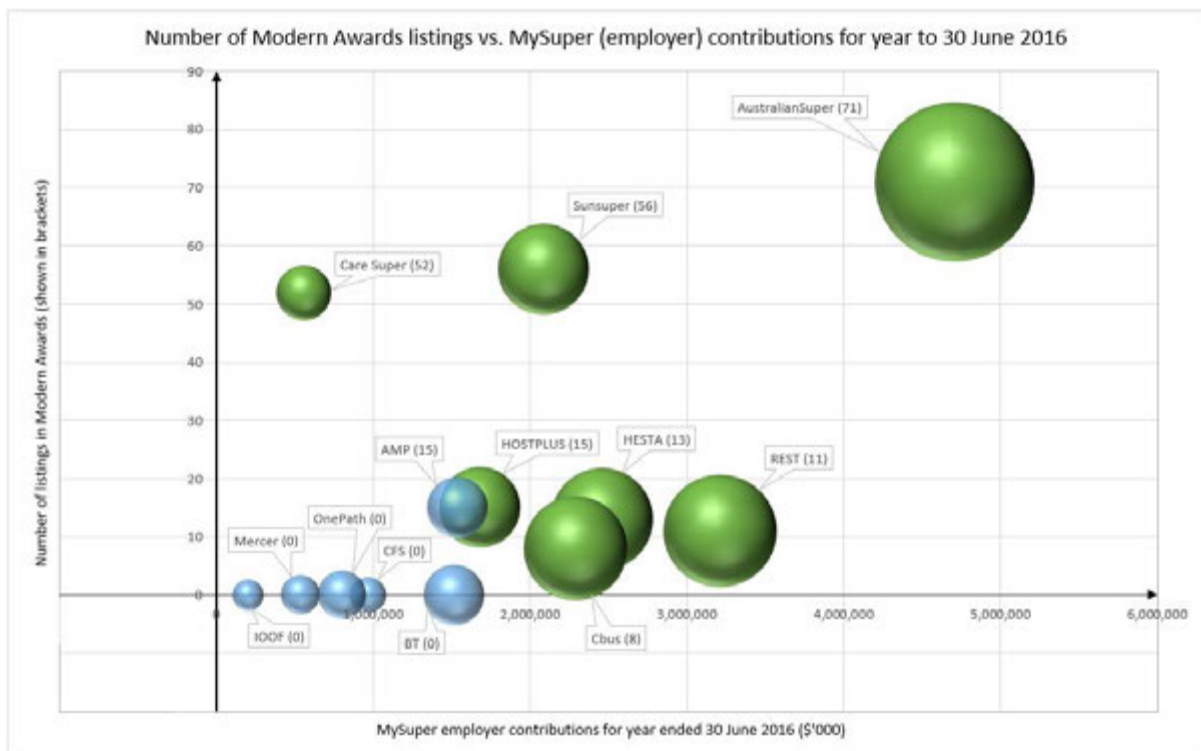
¹ Productivity Commission Draft Report, *Superannuation: Alternative Default Models*, Overview p.7.

In addition to supporting greater member choice, BTFG also supports the central recommendation in the Productivity Commission’s draft report regarding the need to dismantle the current industrial awards-based system of allocating employees to default funds.

Most employees (as many as two-thirds of Australian workers) stick with the default fund chosen by their employer, or specified in an industrial award or agreement under the auspices of the Fair Work Commission (FWC).

This system creates a virtual monopoly on default fund provision under the current FWC model, since the vast majority of superannuation funds specified in awards and industrial agreements as the default fund providers are union funds.

The chart below highlights the fact that union funds dominate the default superannuation fund market through guaranteed inflows resulting from the current awards-based system.



Note: The data used in this chart is based on the APRA MySuper Statistics report issued on 1 February 2017 (30 June 2016 edition). Not all funds will have completed the transfer of all default monies into their MySuper products at the date of release of the APRA report.

AMP is the only professional fund in the top 10 default funds by the number of listings. AMP ranks in 7th place, with 15 listings in the 122 modern awards; AustralianSuper is the most named fund in awards, with 71 listings, followed by Sunsuper (56) and Care Super (52).

Further evidence of the union funds’ dominance of the default market is the fact that, based on figures previously released by the Financial Services Council (FSC), professional super funds make up just 5% of those included in modern awards and, even more disturbingly, that 83% of professional funds with MySuper products approved by APRA are excluded from the modern award system.

As a result of the guaranteed compulsory superannuation contribution flows from being listed on modern awards, union funds have been able to allocate a greater proportion of their portfolios to infrastructure and other illiquid assets than their professional fund counterparts. This not only provides union funds with diversification benefits, but also gives them an advantage over professional funds in terms of their ability to access illiquidity risk premiums, which results in union funds having an increased opportunity of outperforming professional funds, who are unable to invest in illiquid assets to the same degree by virtue of being effectively 'locked out' of the modern award system.

In our view, allowing such a monopoly, in a system with a \$9 billion-a-year default superannuation market, and whose overall size is projected to grow from its current size of \$2.2 trillion (or 130% of Australia's annual nominal GDP) to around \$9.5 trillion by 2035, is unacceptable.

BTFG supports the conclusions reached in Financial System Inquiry (FSI) final report that amendments should be made to the current competitive regulatory settings in order to strengthen competition in the future.

In particular, we support the FSI's assertion that "[t]he superannuation system is not operationally efficient due to a lack of strong price-based competition and, as a result, the benefits of its scale are not being fully realised".

In our view, this lack of price-based competition is to a large extent driven by the fact that union funds are guaranteed substantial inflows of default monies as a result of current awards-based system, which effectively closes the default system to competition. Such outdated industrial barriers stifle competition between superannuation providers and should be removed.

BTFG therefore supports the Government's commitment to move towards an open and competitive default market where any APRA-authorized MySuper product is free to compete. If competition reforms are introduced, competitive tension between an increased number of large scale funds for default flows will result in fees in superannuation falling dramatically.

In a recent report, Deloitte Access Economics predicts that the total fees paid by Australia's 14 million MySuper accounts will fall by at least \$292 million (or 13%) a year.

We believe that a highly competitive MySuper market has the capacity to drive better outcomes across the whole superannuation sector, as advisors and individuals will increasingly make competitive comparisons between all superannuation products.

Recommendation 1(b)

BTFG recommends that the Commission include a recommendation in its final report supporting the Government's decision to move towards an open and competitive default market by removing superannuation from modern awards and allowing employers to select any of MySuper products approved by APRA as the default fund for their workplace.

Alternatively, if superannuation is not removed as an allowable award matter, we believe the legislation should be amended to enable employers effectively disregard the funds listed in the relevant award and instead to choose any of the APRA-approved MySuper products (if they wish to do so) without legal ramifications.

2 Current MySuper system vs alternative default arrangements

BTFG recognises the rationale behind the Government's request for the Commission to develop a workable model, or models, that could be implemented by Government if a new system for allocating default fund members to products to replace the current MySuper system is deemed to be desirable.

Establishing a formal process to allocate new default fund members to default products could potentially improve operational efficiency in the accumulation phase of the superannuation system, which could lead to improved retirement outcomes for members.

However, in our view, it is too early to assess the effectiveness of the MySuper reforms. Having only been in operation for a few years (and with 'accrued default amounts' in some instances having only been transferred to MySuper products shortly before the 1 July 2017 deadline), we believe more time is needed to appropriately judge the effectiveness of the MySuper regime in driving greater competition in the default fund market.

That said, if the Government decides sometime in the future that an alternative model for allocating default members to products is needed to replace the current MySuper system, we believe the 'assisted employee choice' or 'assisted employer choice (with employee protections)' models developed by the Commission could be workable alternatives, with some modifications (as discussed in our submission to the Commission dated 28 April 2017).

Alternatively, a hybrid of these two models that was proposed by the FSC in its submission to the Commission could also be viable alternative worth considering. In this hybrid model, every consumer would be able to choose their own fund, with an enhanced APRA approval process for MySuper accreditation, and where a consumer does not make a choice their employer can choose a default fund for their workplace.

We do not, however, support the 'multi-criteria tender' model or the 'fee-based auction' model for the reasons discussed in our 28 April 2017 submission.

Recommendation 2

BTFG recommends that at least 5 years is needed (from 1 July 2017) before any decision is made on whether an alternative model to allocate default fund members to products is required to replace the current MySuper system, to enable a full and proper assessment of the effectiveness of the MySuper regime in driving greater competition in the default fund market.

If, at some point in the future, a decision is made to replace the current MySuper system, we believe the 'assisted employee choice' or 'assisted employer choice (with employee protections)' models developed by the Commission could be workable alternatives, with some modifications. Otherwise, a hybrid of these two models as outlined above could be a viable alternative.

The Commission should not recommend the 'multi-criteria tender' model or the 'fee-based auction' model for allocating default members to superannuation funds in its final report to Government.

3 First timer default mechanism

BTFG supports the Commission's key recommendation that new employees should only be allocated to default funds once – when they first join the workforce, and where they do not already have an existing superannuation account (the 'first-timer pool'), with individuals retaining that account as they move jobs, unless they choose a different fund at any point.

Since the advent of compulsory super 25 years ago, the structure of employment in Australia has undertaken a significant change. Jobs for life are no longer the norm and individuals increasingly work across multiple employers and even multiple industries over their working life. The allocation of default superannuation contributions also needs to modernise and adapt to the changing nature of employment.

We believe this proposal will go a long way towards stemming the unnecessary proliferation of multiple funds, which is especially problematic among younger members and can ultimately reduce a person's retirement balance by around \$25,000 on average.²

BTFG is also supportive of the Commission's recommendation that, if an alternative model is selected by the Government, the allocation of employees to default funds will be applied prospectively (i.e. limited solely to the 'first-timer pool'), which will remove the need to unnecessarily transfer existing default members to the new default product(s).

Recommendation 3

BTFG recommends that the Commission proceed with its proposed recommendation that new employees should only be allocated to default funds once – when they first join the workforce, and where they do not already have an existing superannuation account (the 'first-timer pool').

In addition, we support the prospective application of any new default model, such that individuals already in an existing default fund will not need to be transferred to a new default product.

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In addition to the comments and recommendations outlined above, the attached Appendix contains our feedback in relation to various topics discussed in the Issues Paper.

We would be pleased to discuss any element of our submission with the Committee.

Yours sincerely



Melinda Howes
General Manager, Superannuation
BT Financial Group

² Productivity Commission Draft Report, *Superannuation: Alternative Default Models*, Overview p.9.

Appendix – BTFG feedback on various topics discussed in the Issues Paper

A.1 Constituting a body to select default products

BTFG strongly opposes the creation of a new Government body responsible for selecting default products. In addition to the costs associated with undertaking this endeavour (which are likely to be substantial), in our view it would be extremely difficult, if not altogether impossible, to establish an ‘expert panel’ whose members have sufficient expertise to undertake the role of shortlisting the most appropriate funds, and also be completely independent and devoid of any conflict of interest or of duty (and remain detached from the politics inherent in the industry).

The difficulty of finding non-conflicted qualified experts was demonstrated when the Full Federal Court had to review the makeup of the FWC expert panel in 2014. In his decision Justice Perram J stated “It struck me that the qualification provisions are likely to generate problems of the very kind which have arisen. Most of the people who are qualified will also be disqualified”³.

In our view, a model that relies on a Government body to approve a short-list of preferred superannuation funds is susceptible to political interference given the often highly partisan nature of the superannuation industry.

BTFG considers that it would not be possible to design a process for constituting a Government body to select default products in such a way that would mitigate the likelihood and risks of politicisation and bias discussed above.

Recommendation 4

BTFG does not support the establishment of Government body to assess the quality of default funds and select a shortlist of funds that employers or employees can choose from.

In our view, the Commission should include a recommendation in its final report to Government that any MySuper product that meets the APRA authorisation process should qualify to be selected as a default fund.

A.2 Centralised clearing house administered by the ATO

We note that the Commission is exploring the option of a centralised clearing house (akin to that which operates in New Zealand), whereby employers would remit all superannuation contributions directly to the clearing house, with the clearing house then transferring those contributions to the relevant superannuation funds.

Although on face value this proposal might have some appeal, BTFG does not support a centralised clearing house for the Australian superannuation market, on the basis that:

- it would not leverage the considerable benefits that already exists as a result of SuperStream,
- it would be anti-competitive,
- it would increase systemic risk, and
- it would not deliver any additional efficiency compared with existing market solutions.

³ Financial Services Council Limited v Industry Super Funds Australia PTY LTD (2014) 447 NSD 36

The superannuation industry and employers have made a very significant investment in developing, implementing and maintaining existing SuperStream services. A significant amount of this investment has ultimately been borne by members, through increased fees or reduced returns. Members have a right to expect a return on this investment through prompt and efficient receipt of contributions in their account. To this end, SuperStream has replaced manual transactions with electronic processes, considerably improving the quality of superannuation contributions data and increasing the overall efficiency of the system. The vast majority of contributions are currently allocated to member accounts within three business days.

A centralised clearing house solution would require substantial additional investment by the ATO, employers, the superannuation industry (and members), thereby reducing the return on the investment in SuperStream, without delivering any material benefits for super fund members in the form of improved efficiencies or reduced costs.

A centralised technology solution would also create a single point of failure risk, whereby if the system fails, the entire system stops working. System failure under a centralised superannuation clearing house model would result in contributions not being allocated to member accounts and potential financial loss to members as a result of contributions not being invested in the market.

Additionally, a single provider model creates a monopoly which is anti-competitive and generally undesirable for any market. This is particularly undesirable in the superannuation context considering that the existing market solutions, in conjunction with legislation, already provide the right level of market competition and deliver high quality service and efficiency for employers and members.

Recommendation 5

BTFG recommends that the Commission does not proceed with a recommendation to Government in relation to a centralised clearing house for superannuation contributions to be administered by the ATO.

A.3 Merger transparency framework

The Commission identified several potential ‘foundation’ reforms in the stage 2 Inquiry, including a proposed merger transparency framework.

BTFG supports the proposal to require trustees to disclose all merger attempts involving their fund, as well as the reasons for any decisions.

There have been a number of instances in the past few years of trustee board directors (and their sponsoring bodies) having an incentive to avoid mergers that would force them to relinquish their position on the merged fund’s board, which may have resulted in the merger not proceeding, regardless of whether or not the merger would be in the best interests of the members.

We therefore believe there is a case for the Government to develop a clear, transparent and accountable framework to guide trustees when proposing or considering mergers, including:

- clear guidelines for funds on how to approach another fund with a merger proposal;

- an obligation for trustees to give genuine consideration to merger proposals in the context of member interests; and
- disclosure by trustees to their members and APRA of all genuine merger approaches and the reasons for any decisions.

In relation to the third bullet point, the requirement to disclose merger negotiations to APRA could be established so that it only takes effect once a certain point is reached, such as when a Memorandum of Understanding (MOU) is agreed between the parties.

The requirement to disclose preliminary merger discussions to members should be retrospective (i.e. allowed to be disclosed in the fund's annual report, for example) in the following circumstances:

- the negotiations are at an early stage and have not proceeded past the point of a decision being reached by the parties; or
- the parties have genuinely considered the merger proposal and have reached a decision not to proceed with a merger.

However, where a decision has been reached by the parties to proceed with a merger (subject to due diligence being undertaken), the trustees of both funds should be required to disclose this to members by way of a Significant Event Notice.

We believe that the disclosure mechanism outlined above would strike the right balance between transparency and incentives for trustees to enter into preliminary discussions on potential mergers.

Recommendation 6

BTFG recommends that the Commission proceed with a recommendation to Government to establish a merger transparency framework requiring trustees to disclose to their members and to APRA all merger approaches/discussions involving their fund, as well as the reasons for any decision.