

# Comments on Productivity Commission Draft Report on Alternative Default Models

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The Australian Government requested the Productivity Commission (PC) to conduct an inquiry to develop alternative default models in Australian superannuation. The idea of alternative default models was first raised in 2014 by a recommendation in the final report of the Financial System Inquiry (FSI).

## Financial System Inquiry

Recommendation 10 of the final report of the FSI (Murray et al, 2014, p. xxiii) states:

***Improving efficiency during accumulation***

*Introduce a formal competitive process to allocate new default fund members to MySuper products; **unless a review by 2020 concludes** that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.*

In this quote, emphasis has been added to show that the FSI saw *no hurry* in introducing new processes for allocating default fund members to *MySuper* products. The impact of *MySuper* products and the *Stronger Super* reforms would have to be assessed as being *ineffective* by 2020 before new reforms are to be considered.

The FSI (Murray et al, 2014, p.55) provided the following reason for making this recommendation:

*The superannuation system is not operationally efficient due to a lack of strong price-based competition. As a result, the benefits of scale are not being fully realised. Although it is **too early** to assess the effectiveness of the Stronger Super reforms, the Inquiry has **some reservations** about whether MySuper will be effective in driving greater competition in the default superannuation market.*

The FSI implicitly attributed the lack of strong price-based competition and the operational efficiency of the *whole* superannuation system to the default funds. Otherwise, why was this reason given for singling out default funds for attention? In fact, default funds are one of the best performing segment (see below), but their assets represent less one quarter of the whole superannuation system.

In neglecting to address competition and efficiency on the other three quarters of the superannuation system and focussing only on default funds, the FSI seems to be running out of useful reform ideas, thus “jumping the shark”. We suggest that

*This FSI recommendation should be rejected by the Australian Government based on false assumptions and inadequate evidence that default funds are mainly responsible for the inefficiency of the Australian superannuation system.*

Furthermore, in recommending improvements for default funds, FSI was assuming that the recently implemented *Stronger Super* and *MySuper* reforms will be ineffective, according to its own “reservations” or guess work, but based only on insufficient facts or supporting evidence. The FSI was wise enough to realize that further evidence needs to be collected by 2020 before consideration should be given to further reforms of default funds.

The judgement by FSI that the *Stronger Super* and *MySuper* reforms will be ineffective in improving competitiveness and efficiency of default funds is therefore premature and unconvincing. Indeed, it was not until 2014 that the first *MySuper* data were published by the Australian Prudential Regulation Authority (APRA), providing information on the new reforms. Even accepting that the system of default funds could be improved, more objective analysis based on empirical evidence is needed to decide what needs to be improved. We suggest that

*The necessity for further reforms to default funds needs to be considered only after 2020 when the impact of recent reforms of Stronger Super and MySuper has been properly assessed.*

## **Productivity Commission Inquiry**

In February 2016, the Treasurer, Scott Morrison, who hastily requested the current inquiry, suggesting in the Productivity Commission Draft Report (Harris et al, 2017, p. iv) that

*The Financial System Inquiry noted that fees have not fallen by as much as would be expected given the substantial increase in the scale of the superannuation system, a major reason for this being the absence of consumer-driven competition, particularly in the default fund market.*

This statement is factually wrong because

- The default fund market is only a small part (less than a quarter) of the Australian superannuation system and therefore cannot be *a major reason* for the inefficiency of the *whole* system.
- In any case, the default fund market is the most efficient part, compared to the other parts of the system. On average, data show many *MySuper* default funds have large scales and low fees, easily surpassing the performance of most non-default funds.

Official data published on 1 February 2017 by the Australian Prudential Regulation Authority (APRA, 2017a, 2017b) are used to compare asset weighted, Net investment returns (before super tax) and Net returns (after super tax) for 2015 and 2016, the only years for which *MySuper* product returns can be calculated accurately. The performances of the whole superannuation system, *MySuper* and non-default funds are compared in the table below,

where the performances of non-default funds have been deduced from the measured results of the *whole* system and *MySuper* performances.

Year	Quantity	System	<i>MySuper</i>	Non-default
2015	Net investment return (% pa)	9.1	10.1	8.8
	Net return (% pa after tax)	8.9	9.6	8.7
	Total assets (\$B)	1,972	425	1,547
2016	Net investment return (% pa)	2.4	3.3	2.1
	Net return (% pa after tax)	1.8	3.3	1.3
	Total assets (\$B)	2,046	471	1,575

- In 2016, the *MySuper* default fund market was only 23 percent by total assets of the whole superannuation system. It cannot be the *major reason* for the inefficiency of *whole* system.
- The *MySuper* default fund market has performed consistently and significantly better than the non-default fund market. Default funds generally have greater scale and lower fees than non-default funds.

The *MySuper* default funds appear likely to the best segment of the Australian superannuation system and reforming them are unnecessary and premature. Rather than reforming the default fund market, the Government should be reforming the non-default fund market, where the greatest inefficiencies are likely to be found.

In hastily calling the current PC inquiry so soon after a change of government in September 2015, the Australian Treasury has provided no additional evidence for why the FSI recommendation on default funds needs to be accelerated ahead of the 2020 assessment. Therefore the current inquiry into default funds by the Productivity Commission (PC) has “jumped the gun” on the 2020 assessment and also “jumped the shark” being based on an unconvincing idea on superannuation reform originating from the FSI (Murray et al, 2014).

## PC Draft Report

Starting from a false and wrong-headed premise about default funds, it is difficult therefore for the PC to come up with anything useful in the draft report (DR). The following is only a partial list, in many different respects, of the deficiencies of the DR.

- The report (DR) is remarkably free of hard facts and statistics which would have been inconvenient for the task. In particular, no factual evidence has been provided to show that default funds have high fees, or higher fees than non-default funds.
- The DR has admitted (p. iv) that

*MySuper has been a strong step in the right direction but more needs to be done to reduce fees and improve after-fee returns for fund members.*

Its “no defaults baseline” approach: “*Having no defaults is our preferred, objective baseline for this inquiry*”, contradicts its own assessment that “*MySuper has been a strong step in the right direction*”. Why start from scratch?

- The DR has ignored an enormous amount of research on default options cited in the Super System Review (Cooper et al, 2010) without adequate explanation. The PC did not come up with its own articulated view, based on its own analysis and research, about what is wrong with the current system of default funds.
- The PC does not seem to understand that choice of defaults is essentially an oxymoron. When superannuation members want choice, they do not use defaults. Defaults are bland and homogenous precisely for reasons of comparability and competition which the PC is supposed to encourage rather than to oppose.
- The PC has amassed, for the bulk of the report, a great volume of opinions from submissions; but without its own researched view of the superannuation system, the PC cannot assess whether the opinions it cited have any merit. The list of *findings* of the DR is merely a list of arbitrarily selected opinions.
- The PC has not analysed the strengths and weaknesses of *MySuper*, the current default system. Without this understanding, it is not really possible to compare it with alternative default systems. This may explain why “no defaults” is its baseline in the DR.
- No system is perfect. Every system has strengths and weaknesses. The right system has to be compatible with the particular regulations, values and culture of the country. Listing default systems of many countries is not adequate for deciding how the Australian default system should be reformed.

On the evidence of the DR, the PC has added little of substance to our understanding of the Australian superannuation system and the work on alternative default models is not based on a sound foundation.

## **Conclusion**

The current inquiry into alternative default models can be characterized as both “jumping the shark” and “jumping the gun” on superannuation reform. It is not as though Australia has been inactive in reforming superannuation. On the contrary, there have been far too many half-baked and ill-considered reforms, not based on careful, evidence-based research. With some justification, many in the industry and in the media have observed that “superannuation has become a political football”. We conclude that

*It is inarguably premature now to justify or to develop sound procedures for selecting alternative default models. The present inquiry should be abandoned as a waste of government resources.*

## References

APRA, (2017a), *Annual Superannuation Bulletin* (issued 1 February 2107), Table 4a; available at:

<http://www.apra.gov.au/Super/Publications/Documents/2017ASBEXCEL201606.xlsx>

APRA, (2017b), *Annual MySuper Statistics back series* (issued 1 February 2107), Table 1; available at: [http://www.apra.gov.au/Super/Publications/Documents/2017-AMS-BS-](http://www.apra.gov.au/Super/Publications/Documents/2017-AMS-BS-201606.xlsx)

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Cooper et al, (2010), *Super System Review Final Report*, Publications of the Commonwealth of Australia; available at:

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Harris et al, (2017), *Superannuation: Alternative Default Models*, Productivity Commission Draft Report, Publications of the Commonwealth of Australia; available at:

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Murray et al, (2014), *Financial System Inquiry Final Report*, Publications of the Commonwealth of Australia; available at: <http://fsi.gov.au/publications/final-report/>