Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION: ASSESSING EFFICIENCY AND COMPETITIVENESS

MS K CHESTER, Deputy Chair
MS A MacRAE, Commissioner

TRANSCRIPT OF PROCEEDINGS

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MS CHESTER: Good morning folks, we might get under way. Welcome, and thanks for coming out bright and early on a Wednesday morning in Sydney. This is the first of our three public hearings as part of our consultation for our draft report on the competitiveness and efficiency of the Super system. I'm Karen Chester, deputy chair, and one of the commissioners on the inquiry. I'm joined by my commissioner colleague in crime, Angela MacCrae.

Before we get started I'd first like to begin by acknowledging the traditional custodians of the land on which we meet today, the Gadigal of the Eora Nation People, and I would like to pay my respects to elders past and present.

So today is our first cab off the rank for three hearings. We've got a full schedule today of about 15 or 16 participants so we will try to keep to time. We have hearings here today then a full day of hearings tomorrow in Melbourne and then a day of hearings in Brisbane on Friday. I've got to run through some common sense logistical matters before we can get under way with our first participants.

If fire alarms sound follow common sense, try to get yourself out of the building, and someone with a funny helmet will show you the way. In terms of the hearings themselves, hearings are really about our chance to get feedback on the draft report. What we got wrong, what we got right, what we missed altogether. Hopefully a little bit less of what we missed altogether given this is the third stage in two years' of work where we've done a lot of consultation already.

For the purposes of today's hearings a full transcript will be taken and we are live streaming this event, which means you can go home tonight and watch yourself on the laptop and see how you looked, but that also helps in terms of access to these hearings. It's very difficult for the folk interstate, people in the media that are covering us, to be able to be here in live time. So this helps us make sure that the hearings and the evidence that we gather today can be more broadly shared.

The participants today, we'd like you to make some opening remarks but if you can keep them to no more than five minutes that would be helpful. It just really allows us more time to have a conversation and for us to ask some questions of you. You're not required to take an oath, we're the not-so Royal Commission, but we just simply ask that people be truthful. And that sometimes be big ask. Media rules do apply, if there's any media folk here, I haven't spotted any yet but when they do the team will gently head high tackle them and show them the sheet of paper that tells them what they can and can't do.

So I don't need to invite our first participants to join us because they're already here, ready, willing and able to go, but if you could just state your names and organisation each of you individually for the purposes of the transcript, and then if you would like to make some opening remarks? Thank you.

MS TURNER: Of course. My name is Erin Turner, I'm the Director of Campaigns and Communications at Choice.

MR VEYRET: And I'm Patrick Veyret, Policy and Campaigns assistant at Choice.

MS TURNER: And thank you, I really appreciate the opportunity to appear here today. As mentioned, I'm appearing on behalf of Choice, the not for profit consumer advocacy organisation. I'm going to focus my remarks this morning on the areas where we think have the most potential to really benefit consumers and the few areas where we think the Productivity Commission could go further for the final report.

Broadly, we think this draft report puts forward recommendations that will be extremely beneficial for consumers. It puts consumers at the heart of the superannuation system by recommending changes to support people to make high quality decisions about their money in retirement. Reform to remove high fees and multiple accounts has to occur, from our perspective, in order to retain consumer trust in the superannuation system and to make sure people have more of their own money in retirement. From Choice's perspectives these reforms are relatively simple and common sense, they're not as radical as some in the industry have proposed.

We regularly hear from people who are frustrated, or worse, defeated, by the current superannuation system. This quote from our 2017 work is typical, a consumer told us:

> *I worked in a lot of part time jobs when I was younger and I ended up with a lot of different accounts. I went overseas for a few years and when I came back most of the money I deposited was gone.*

This is really too common. Young people, women that take career breaks, and people paid low wages, are the ones who are most harmed by the current high fee multiple account issues we see. As one person put it to us:

Because of high fees I have bugger-all to retire on.

No change or incremental change is good enough here. Failure to change is going to leave too many people with bugger-all in retirement. Choice strongly supports the best in show proposal in the draft report.

This allocation process is going to allow people to choose their own product but it controls the choices available so that any fund chosen should be high performing. The current account allocation process, it's tied to the industrial relations systems. And while we thought this made sense decades ago now we see it as failing to fully support people, particularly those that change jobs, industries, and increasingly hold multiple jobs.

Consumers can and should be able to choose their superannuation fund, but they do need that support to do so. Supportive consumer choice puts the right person in the driver's seat from day one, the person who is paying into the fund and whose quality of retirement rests on getting the right fund. We don't believe naysayers that, for example, say that 15 year olds shouldn't be trusted to make decisions about their superannuation. As a start these arguments do a great disservice to young people and their capacity.

A system that starts with consumer choice starts a process of engagement that should continue for life and will never have a large group of people that actively engage with superannuation unless we give them greater support and control. Choice's research confirms what has come through in the draft report, people can handle and they want more support and choice when it comes to superannuation. We found that when we equip people with the right information they can move from being confused and disengaged to informed and motivated.

In our 2016 research young people told us that they simply weren't engaged with the current system because it's not user friendly. One young adult told us:

> *I don't want to know what all my options are or what I could do, just tell me what I should do.*

For us this indicates that the best in show approach and supportive consumer decision making is the right move not just for all consumers but particularly for those who are poorly served by the current system.

Other allocation options, such as rolling over multiple accounts when people change jobs, fail to take account for people who hold multiple jobs

at one time. And broadly, we're cautious about these options, they seem to tweak at the edges of the system rather than deliver the real reform that people need. Such recommendations remove the simplicity of the best in show list. And the point that we're most disappointed with, the, don't put decision making in the hands of the most important party, the consumer.

There are three areas where we think the Productivity Commission could go further for the final report: First, on trailing commissions covered in recommendation 13 we support greater disclosure. At minimum people deserve to know what they're being charged for a service, however the better outcome would be to phase out trailing commissions altogether.

The second matter is about the Insurance and Superannuation Voluntary Code of Practice. Choice sat on the working group for this code. Our experience was that the industry stripped the code of its enforceability at the last moment. They removed many of the protections designed to end the erosion of accounts, particularly for young people. Our view is that at this point the industry is incapable of meaningful reform. Rather than allowing another two years we think this industry should be encouraged to act much, much sooner. We should be seeing standards lifted and requirements made enforceable as soon as possible.

Finally, we encourage the Productivity Commission to explore options to give consumers a greater voice in debates about the superannuation system. The superannuation system, as you know, covers 15 million Australians who collectively own 2.6 trillion in assets. We believe we need an independent and well-funded body that represents the interests of superannuation members. While Choice does our best to represent consumers in this industry, particularly in industry regulatory and legislative debates about superannuation, we're currently only able to devote half the time of one policy adviser to this sector.

Choice is the only consumer group in Australia that is permanently able to resource this work in superannuation. In comparison, industry groups have large budgets and staff to influence public policy decision making. We want an equivalent body to represent the interests of members. Based on figures given to the Senate Economics Committee in October last year we've calculated that industry groups like the Association of Superannuation Funds Australia, Industry Super Australia, Australian Institute of Superannuation Trustees, and the Financial Services Council, they collectively have over 100 staff, over 20 of which are solely devoted to superannuation policy and research.

It's a lot compared to the point 5 that the consumer movement can

devote to this issue. That's why we think Australia needs a consumer group that can focus on the highly technical area of superannuation. The concept of a Superannuation Consumer Centre, or SCC, was first raised by Choice as part of the Cooper Review. Work has been done since that time to develop a strong business case and a range of funding options for an organisation that would directly assist consumers, advocate for reform, and educate people about the system.

We believe that an organisation like the SCC could be a valuable steward in ensuring that long term the super system remains efficient, competitive, and truly works for members. Ideally, it's an organisation that would work alongside a regulator that champions member interests and it could be particularly useful in ensuring the work of this Commission is followed through and enacted. Given the vast size of the superannuation sector we think it's essential to have something like the SCC. And this is common practice in other consumer sectors that are less large and in a lot of ways important but less important than a superannuation system.

We have very focused consumer groups that do great work in health, energy, and telecommunications. Superannuation feels like the missing piece of the puzzle here. Unless we do have the strong organisation dedicated to representing people in debates about their retirement we believe we're going to continue to see industry groups dominate discussion and conflate their interests with the interests of members.

MS CHESTER: Thank you, very much. And I also should have said thank you to Choice because you've joined us along the journey of the three stages and been very actively involved in all three stages in roundtables and providing submissions to us, so we do appreciate the 0.5 people that have helped us out along the way. Maybe we might just kick off where you've ended first, Erin, and Patrick, if I may?

With respect to the members' interests missing in action, which was kind of one of the things of our report, we then highlighted what we thought was needed for the regulators, and in particular to both APRA and ASIC to become the members' champion, but more importantly for ASIC to play more of a forthright role there. And indeed when ASIC does get into areas of member harm and do research and analysis and data they can actually do some heavy lifting, so we're just trying to work out why you would need to have a dedicated independent body as opposed to if we elevated the role of ASIC who is meant to be looking after the interests of consumers in financial services?

MS TURNER: I think first of all we strongly support the idea of

encouraging regulators to become even greater champions of member interests, particularly the work that ASIC can do in researching and developing policy and commencing discussions about issues of concern, they're incredibly valuable. And they need to be increased. We would see a Superannuation Consumer Centre or similar body playing a supporting role in that.

Particularly, for example, when a regulator initiates a conversation about reform often they'll be running consultations and our experience is they'll be consulting as best they can with consumer groups who aren't able to provide very detailed comments, particularly on highly technical issues, but industry are very able to resource those discussions. It's very poorly weighted. If anything we'd hope that this would bolster the work that groups like ASIC and APRA are able to do, particularly when it gets to highly technical areas like discussions around dashboards and what factors consumers would most benefit from.

We particularly see the SCC as a body that could help regulators connect directly with consumers. Ideally it would be built on offering three different services; advocacy, which is very dear to my heart; but also education; and direct assistance to individuals. Much like community legal centres or other organisations that offer direct services they'll then be able to draw on casework to inform policy, so constantly connecting individuals with the super system.

MS MacRAE: Can I just ask you then about the dashboards, because it is something where we've made a specific recommendation, do you feel that the idea or the concept that we have of a one page dashboard for all products is achievable and what sort of timeframe do you think is realistic to allow for member testing and then to have this sort of information available for consumers?

MS TURNER: I always find debates about technical changes really interesting because anything is achievable. Unless it defies the laws of physics we can definitely do this. The question is really how much will it cost. Industry groups are better placed to give you a sense of that. From our perspective this is a really necessary reform if you're going to have consumers be more engaged in superannuation, or even just continue in the current system. We do need to equip people with better information about the products that they already own and enable that comparability, which I think it's really missing at the moment.

In terms of a timeframe, we would like to see it as soon as possible. I think a shorter timeframe can encourage more efficient action in a lot of cases. Our experience across a range of consumer sectors is that at times

industry groups who would not benefit from these kind of reforms because they may have poorly performing products will perhaps over inflate the time it will take to initiate these reforms. And for me there's a real question about if they don't have this information why not? The kind of information we'd expect to see on dashboards should be the kind of information we'd expect boards to be regularly looking at and those people governing superannuation funds regularly digging into and questioning. So I'd hope that it's quite achievable and achievable in a short timeframe.

MS CHESTER: I guess one of the common themes, and it comes across back to the points that you made about insurance, and perhaps you're wanting us to dare a little more greatly there, is when the regulators have these interactions it's with the funds and with their representative organisations and they end up sort of spinning wheels for two years and then still not agreeing on what's useful for members. Similarly on the insurance code we identified that, the problem that you talked about, I guess our solution to that was tell the regulators to just make it happen.

Like, tell them how to elevate the code, make it enforceable, consult with experts, consult with consumer groups, the 0.5, and just tell the industry this is what you have to do and this is the deadline. So I guess wanting to know if you think that's the right approach. And then secondly, is it just then a matter of timeline that you've got concerns about, that two years you think is still too long?

MS TURNER: I think the approach broadly makes a lot of sense. The other option is to encourage direct government intervention. And I think we should remain open to that possibility. Particularly if industry continue to demonstrate that they are unable to deliver here. They've already been given a generous amount of time to fix this issue. The fact that government has had to push them on this, in itself I think is quite damning. Our main concern is the two year timeframe. They've taken long enough, they know what needs to be done, it should be much, much shorter.

MS CHESTER: Turning, I guess, to the two architectural pieces in the report about how to make the system simpler and safer, we kind of struggled without a best in show how to make it simpler and - you can make it safer by elevating MySuper and getting rid of the tail, but how do we then make comparability a possibility if you don't have a best in show?

Based on some of the insights that you get from, you know, behavioural economics and consumer research and surveys, is there any

other mechanism, given the starting point we have of 40,000 options in the Choice segment and the amount of providers that we still have in the MySuper segment, to get there for the consumers, short of a best in show? And I'm not asking that as a Dorothy Dix, I'm really trying to - we're trying to get our head around is there any other way that we could have done this?

MS TURNER: So our take is that best in show is the best idea we've seen yet. It's got the greatest potential to help people make effective decisions about their superannuation. It does deal with that long tail issue, 40,000 different options in - they aren't options, that's too much choice, that leads to choice paralysis and a great deal of confusion for consumers, you just can't have comparability and engagement in that system.

We really like the simplicity of best in show and the fact that if done well and done with the right criteria no choice should be a bad choice. And it starts off that process of engagement that we really hope to encourage. I touched on it and it may - it puts people in the driver's seat, which is exactly what you want for superannuation, you want people to be engaged, always making good quality decisions even if they're not engaged, and able to understand the implications of what they're deciding over their lives.

MS CHESTER: One counter to that would be a lot of - some folk have suggested to us that even during the accumulation phase in default there's need for tailoring. And the clearest example I think we've had is probably high risk occupations, and then that's only for the insurance element of superannuation. We're still trying to work out how you might deal with that insurance component for high risk occupations if that should - but then that for instance becomes the tail wagging the dog. Based on the work that Choice has done and talking again about the default segment, so we're talking about, you know, the two thirds of people defaulting each year, and them all being sort of lower balances because they're a quarter of the assets but around half of members, what tailoring do you think is required in accumulation for that sort of cohort, is that something that Choice has got views on?

MS TURNER: Look, when it comes to just the accumulation phase, once you take insurance out of the equation our sense is that most consumers need the same thing; they need very, very low fees; they need solid performance over a long period of time; and they need a fund that communicates with them well. That piece in particular is really missing. There has been some improvement in recent years but that engagement with members has a lot of potential to develop. It's interesting that

tailoring is the issue that some industry members are struggling with because we find that in a lot of ways the current system doesn't cater very well for people who aren't middle aged full time workers who have a career with one institution for a long period of time.

The current system, and particularly that mechanism that means that new accounts are frequently created particularly at the early stage of someone's working career, it very poorly serves a lot of Australians, young people, people who work in sectors where they may hold multiple jobs. And women taking career breaks. If anything I think the proposals that have been put forward in the draft report much better serve a larger group of people.

MS CHESTER: And so the idea of - so one other way of getting rid of the problem of unintended multiple accounts, so ours was default only once and as long as it's a top performing fund or it's a good performing fund with an elevated MySuper you're safe and sound. Others have suggested the auto rollover model where the balances follow the member through their working lives to different jobs. And I guess going forward you might expect then that a member during their working life might have their balance move around with them maybe five or six times.

You touched on some concerns you had around folk with multiple jobs, which I think is about seven to eight per cent of the Australian workforce today, our initial estimates suggest that the auto rollover would apply to about 500, 000 - would occur 500,000 times per annum, from your perspective of if we're going to seek the grail of engagement how could that work in that scenario?

MS TURNER: Look, I will note that auto rollover, it seems to be an option that's better than the current system, but a lot of things would be. It doesn't have the simplicity of best in show, which we are really attracted to. We do have concerns about administration fees and costs that rollover process is likely - I think it's less likely to deal with the challenge of 40,000 different options for people in the sector and less likely to encourage healthy consolidation in the superannuation sector, particularly in the short term.

Our main concern is that it doesn't make that shift which comes through in this draft report that superannuation out of the industrial relations system where superannuation sits, choices sit more with employers and with other parties in the industrial relations and brings it into the realm of consumers. Our view is that superannuation should ultimately be for consumers. So having that decision rest with consumers makes a lot more sense going forward.

MS CHESTER: One other aspect of the best in show, a lot of people think that that might just benefit members in the default segment. We tried to sort of also connect the dots to how that might trickle through to the choice segment. In the world of financial advisers and faux pas ASIC had some comments around how that might work, it would be good to get your thoughts on that in terms of there's been a lot of questionable advice given to members in the choice segment, and indeed SMSFs, based on some recent ASIC work. Is that something Choice has looked at and has any views on?

MS TURNER: It's something that Choice is very, very concerned about. And we have been since I think the '80s when we've been reviewing the quality of financial advice that Australian consumers have received. I think, actually, Patrick, you might be able to talk about this, the first investigation that Choice did into financial advice covering super?

MR VEYRET: Yes. In 1987 we undertook a shadow shop into financial advisers and back then we discovered conflicted remuneration and similar problems that we see now. And, yes, the ASIC report in January this year really highlighted the problems that only somewhere between 25 per cent of advice was compliant with the law. So we do have concerns, especially with the choice segment.

MS TURNER: So since 1987 when we've been digging into this till now we've seen advisers continually put people into poor performing funds, whether that's an SMSF or just the fund that the institution they work for happens to have a financial connection too. And something that brings in the best in show requirement could certainly help reduce cases we see there. Ultimately I would love to see financial advisers act in the best interest of consumers, as they are required to do, those two elements should go hand in hand.

It's also worth flagging the one piece that may need to be fleshed out for the final report is a transition to a best in show system. We do know that lots of people out there are in poor performing funds, whether that's through a default or through the choice system, we do need a way to help people move from those very, very poor performing options, sometimes multiple poor performing options, into something that's going to give them a better retirement outcome. That particular piece, we're not as clear about how that process would work.

MS CHESTER: Yes, I think we've got some clarity from APRA as to how it would work with MySuper authorised products, i.e., once they lose authorisation then there's a process of the trustee board, and if not, the

regulator, shepherding them into another fund that has MySuper authorisation. I think where we probably don't have clarity is in the choice segment where the regulator doesn't have that automatic role, and I think that comes back to your point about how we deal with the poor performing legacy products in the choice segment and trailing commissions and things like that.

So that will be helpful in your post draft report submission if you could address that a little bit further. And indeed, we might ask the regulators to give us some guidance as to how they want to deal with it. The other thing to keep in mind is that ASIC now or shortly will have product intervention powers thus if there's a product in the choice segment - and that's probably the answer then, isn't it, if there's a product in the choice segment that's grossly inappropriate they can do something about it?

MS TURNER: Definitely. Although I will flag we're still concerned that product intervention powers, that the scope of that may not be sufficiently broad enough to cover all products in the financial services sector. The consultations are still ongoing but it does look like it will be quite a curtailed power to the one that sits in the UK and the one that consumer groups certainly envisaged. Product intervention powers will play a really useful role to deal with the very, very worst performers.

I think there will be a group that sits above that of poor performers that will lead to bad outcomes but they aren't as actively harmful as someone with $100,000 in an SMSF or a particularly toxic poor performing product. We'll be able to focus some comments on how we think we can help those people, but either through education mechanisms, although that may not necessarily be as effective, or through some sort of transition phase, to get them into something that will help them in retirement.

MS CHESTER: We are sort of thinking about we might have a roundtable, a technical roundtable but a roundtable, around regulated responsibilities and how they can best divide and conquer there. And I think this one of the areas where we probably need to get some more guidance from the regulator as to how they would see it working under the new product intervention powers and whether that's enough to deal with the exit of the legacy product. I guess then how do we make it safer and simpler for those members to then get themselves to a better product, which would then be elevated MySuper, I guess, and best in show.

Just one other issue that we didn't - we flagged as an issue but we didn't have a draft recommendation or a finding around it, was there was a

threshold around when contributions are actually paid from way back and I think it was $450 a month in wages, we sort of flagged that but it hasn't been indexed over time and thus a bunch of people that would not have otherwise been pulled into the superannuation system had been pulled into it. Is that something that Choice has looked at or has views about?

MS TURNER: We looked at it very briefly and we will be providing some detailed comments in our submission. Broadly it does make sense to re-examine it. We don't have a view on the firm number exactly what the threshold should be, it does seem quite odd that the number wasn't indexed because it is increasingly capturing more and more people. It does tell us though that if we're going to have a conversation about any threshold it actually needs to be under a system where unintended multiple accounts are dealt with because I'm sure a number of people are captured inappropriately where they do have multiple accounts, perhaps multiple jobs, multiple contracts, and they would sit above the threshold if it was accumulated into one fund. So there's a couple of elements to that. We would very much welcome a conversation about lifting the threshold, the exact number, I think, needs a bit of modelling.

MS CHESTER: Well, if that's something you could have a look at. And I guess we are looking at whether or not there'd be any unintended consequences, particularly with people in and out of the workforce more often than not compared to historically, and multiple jobs, and I guess multiple accounts, if they were removed that would sort of address part of that issue. I guess the only other quick question I had, and it's kind of interesting, Angela and I had a sort of a moment when we heard ex Reserve Bank Governor Bernie Fraser say that the problems that we identified have been here for yonks but there's been a hell of a lot of inertia, I guess that sort of begs the question why? I mean, why hasn't the industry done something about the twin problems?

MS TURNER: I think that is a great question. I'd love to hear the answer from industry groups about this. From our perspective this has gone on for far too long. And there's been a real cost to people as a result. As has been modelled in this report it's hundreds of thousands potentially in retirement, that's the impact for people. We regularly talk to people, close friends, consumers, people who contact Choice, who have gotten to a certain point in their working lives, in their 30s, 40s or 50s, and found that they may have $40,000 due to account erosion, or $80,000, which is nowhere near what they expected to retire on.

My sense is that - actually I couldn't speak to the motivations of industry groups about why they haven't dealt with it. I think it's a great shame. It's clearly impacted their members. And from our perspective no

change is not good enough, there has to be - something has to happen to leave more people better off in retirement.

MS CHESTER: One final quick question, because it's one area of issue that we also grapple with, is members having difficulties particularly as they get older and approach retirement in finding affordable and reliable advice.

MS TURNER: Yes.

MS CHESTER: Is that something that the SCC would have a role, not in terms of giving the advice but pointing members in the direction of where they could get it?

MS TURNER: I think very much so, particularly that focused advice on pre-retirement. The research we did in 2016 focused on three groups, young people, women taking career breaks, and that pre-retirement phase, and the big question was who do I need to talk to? I just need someone to hold my hand and guide me. I'd expect that a group like the SCC would provide simple general advice if possible, licencing pending, about the basic decisions to help people make sensible choices themselves. And direct them to advisers they can trust. Ideally non conflicted advisers that are pure fee for service. Under current arrangements we wouldn't trust any other advisers with consumers' retirements.

MS CHESTER: Okay. Have you got any questions?

MS MacRAE: No.

MS CHESTER: That's us. Is there anything else we haven't covered that you'd like to?

MS TURNER: I think that's it.

MS CHESTER: Well, we look forward to your post draft report submission from your 0.5 person.

MS TURNER: Will be working very hard on it.

MS CHESTER: And thank you for starting early and being our first cab off the rank this morning.

MS TURNER: Thank you.

MR VEYRET: Thank you.

MS CHESTER: I would like to invite our next participants to join us from Challenger. Good morning, and thanks for joining us. And also thanks, Jeremy, to you and your colleagues for having joined us along this journey, although the journey has been a lot longer for you given your historical role in reviewing the system, such a substantive review of the system in 2010, which we sort of benefited from when we began this journey. Just for the purposes of the transcript if you could just state your names and the organisation that you represent and then if you would like to make some brief opening remarks? Thank you.

MR COOPER: Certainly. My name is Jeremy Cooper from Challenger Limited. And I have a brief opening statement. I actually have copies that we can hand up to the commissioners just to make things easy.

MS CHESTER: You might just want to introduce yourself too before Jeremy starts.

MS HOORWEG: And Carla Hoorweg, also from Challenger.

MS CHESTER: Thank you.

MR COOPER: Just very briefly, thank you for the opportunity to be here and congratulations on such a significant contribution to this that's represented by the draft report and the other work that the Commission has been doing.

So I'll try to be very brief, there's nothing worse than getting lengthy opening statements when you're doing this sort of work. But I will make some observations. The first one is the view that one takes of this system, and I think the Commission from my perspective has viewed the system through the lens of super working as efficiently as possible to build up the highest retirement balances, which is largely what the system devotes its time to. This is absolutely the right approach for accumulation but for me the scrutiny can't stop there.

So for me super is not like a - retiring with superannuation is not like a university endowment, most retirees out there are going to need to actually consume those savings safely in retirement. They're not going to be able to live on the, whatever name you might give it, investment return, income, interest, from that pile of capital, they actually are going to have to spend it. So to put it another way, for most people a financially sound retirement doesn't automatically flow from having a satisfactory retirement balance by age 65, which is what the system attends to. The spending phase is actually possibly as critical or perhaps more critical to

success than building it up in the first place.

So retirement income means having a retirement pay cheque. Most people have the benefit of a regular pay cheque while they're working and this is what they're looking for in retirement, and this is probably the biggest thing that the system is actually not delivering. And having a retirement pay cheque is absolutely not the same as ad hoc spending out of an account. It doesn't matter whether you call that account a pension, it's still an account of capital that you're spending more or less as you see fit. Also we need to have regard to the weight of money that's already in the retirement phase, so by our calculations at June last year there was already $760 billion in the retirement phase.

And if we're looking at inefficiency what the industry currently does with this is highly inefficient because retirees through many studies and investigations around the industry are currently underspending those savings. And the consequences of that are twofold. One is that they're passing on concessional tax savings to the next generation. But that's swamped by the fact that actually they're enjoying a lower standard of living in retirement than they'd otherwise be entitled to. And in that respect the system is highly inefficient in the retirement phase.

While retirement is definitely less generic and more individualised than accumulation I don't think retirement is a completely bespoke exercise at the mass market level. So the Commission has made a few references that simple is wrong, that the MyRetirement default would perhaps not be the right way to go, I think the correct position is probably somewhere in the middle. That there is benefit in seeking - I wouldn't use the word default, but the current government policy of the comprehensive income product for retirement, the idea that you would have three, perhaps a flagship, and two other CIPRs, aimed at certain cohorts of retirees according to their account balances would be a substantial step forward for most retirees.

I think in saying that we need to also reflect on the fact that we actually currently have a very heavily defaulted retirement phase, we just don't call it that and we don't think about it in that term, but I would say that the current account based pension environment is actually effectively default. We don't call it that but everyone gets one. It's a little bit like the old story about Henry Ford and the choice of colours that customers could have as long as they got black, the fact that 95 per cent of the money in retirement is sitting in an account based pension, they might be given different names but they all are effectively the same thing. And so I think when we're talking about stepping forward I think we need to reflect on the fact that we very much have a default environment in the retirement

phase at the moment.

I want to talk also about advice, advice relating to retirement, so advice as you're leading into retirement and in retirement. And the point I want to make is that there's currently very limited training for advisers in the special needs of retirees and what retirement is actually about as opposed to the wealth accumulation, wealth management, tax strategies, estate planning. Where the advice industry was born is really in that world and the world of life expectancies, sustainability of savings for a very, very long time to a confident level.

The more sort of actuarial view, if you like, of retirement is simply not being taught to advisers out there. Even issues like cognitive decline, designing a retirement plan that actually still works when the retirees are sort of 80 plus and are increasingly finding it more difficult to make complicated decisions about their finances, you know, advisers need to be taught how to deal with those sort of issues. And I think the evidence is that that's not happening.

In relation to best in show, I think if that idea is to move forward I think it also has to embrace fairly robustly the retirement piece. And of course the difficulty here is that the measures of success for building the money up and then spending it down are very different. So it may be the case that those criteria are so different that you might have to have two lists, I'm not sure, but the sort of issues that you'd be looking for in the retirement phase.

While growing the savings efficiently is still going on in some respect in retirement there are many, many other issues including the liquidity of the savings, do they provide regular stable cash flows for spending. I think there are some psychological elements. In other words, you know, does the member feel comfortable, is there peace of mind that this is all working, does it protect them against inflation. For those retirees that want to leave some balance to next estate does it deal with that. You almost potentially get sort of health and aged care issues around the pot of savings, are they going to be able to ameliorate those expenses in the future. And again, I'll mention cognitive decline, does it get simpler, you know, is it more simple than the current arrangements.

Just very briefly, wrapping up, strong support for the idea in draft recommendation 11 that there's guidance for pre retirees, very strongly support that idea. And just lastly, some, I know you've looked at the thorny question of governance, but just the idea that there be some explicit representation of the retired people in the governance model. I think this industry is very good at focusing on gathering contributions from

employers and engaging 30 and 40 year olds in their superannuation but it doesn't spend a lot of time on paying that money back safely to retirees and it doesn't spend very much time at all thinking about how the 80 year olds are going. And after all it's really, again if you focus on the purpose of this system, it's really to provide income in retirement. And I think, you know, there's too little focus on that part of it. So that ends my opening statement.

MS CHESTER: Great, thanks, Jeremy. Let's begin with the key issue you raise and that is CIPR and what looks good in retirement. I think we had the advantage of being able to leverage off another substantive piece of work we did two years ago on post retirement super which helped inform I think close to a whole chapter in our current report around members' needs, including looking at it in a post-retirement phase. And I think we agree with you that at the moment we perversely have the reverse constellation that things are horribly complex in accumulation and a little bit simple in retirement when we think the reverse should be the case when you look at members' needs.

I think where we struggled with CIPR not being simple was even if it were to become a soft default, Jeremy, a lot of people would just find themselves going into it and making a decision to go into effectively an annuity or a longevity risk product which is a one-off decision. It's a big decision for a member to take and thus it comes back to your point about advice in making that decision about which retirement product to go into. So that's why we think it's not simple and why we emphasise the need as people approach retirement to be able to get good and affordable advice. If they are going to make a decision on which product to go into and those decisions are for many of them irreversible that they need to get it right based on their individual circumstances.

MR COOPER: The way that the CIPR is currently conceived is that it's a mix of things and as if often the case in these systems you try, rather than blasting away what's there, you try and work on what's already there. So we go back to the account based pension, that's what everybody gets, and the CIPR project accepts that, and then tries to put the missing components top of that. And missing components are really some form of longevity risk protection and a way of providing more constant, broadly constant and real, inflation adjusted retirement income. And when I say retirement income there I really mean spendable cash flow.

So you are, in the CIPR idea, you are going to be consuming your capital. Now in relation to the longevity risk component, it's thought at the moment that that is somewhere in the range of - the figures that have been mentioned are sort of 15 to 25 per cent of the overall component. So

let's just focus on the longevity risk piece. The modern annuity is not irreversible. Challenger currently has a very popular annuity product that is flexible. It gives a 100 per cent death benefit. Typically if you buy that product at age 65 until you're 74, if you die you get 100 per cent of your money back.

And then there is a tapering consistent with very recent legislation. And then there's a tapering capital access schedule that runs out to age 84. So the objection that you commonly hear about irreversible and, gee, you wouldn't have people going into these products without advice, that's in a world where the product is conceived as a 100 per cent investment, that it is irreversible and that you lose all of your money on death. We've moved way beyond that world. And therefore I think some of the objections about CIPRs are really they're not relevant to the current way things work.

But I think viewed through that lens and the way that the treasury is thinking about it, that it is a product that will work without advice, you can get advice if you want and if funds are in a position to provide advice then they will. But I think there are some funds out there that already have tens of thousands of members in retirement and not a particularly well-constructed advice system. And something has to be done for those members and this is the idea that I think will actually work for them because they get that mix of things, it's not - - -

MS CHESTER: Do you think the way that CIPR has been constructed by treasury is such that it precludes the need for a member having advice, which is what a soft default would kind of assume?

MR COOPER: Preclude, yes - - -

MS CHESTER: Because on the one hand you're saying you think there's an absence of good advice as people approach retirement and enter retirement but you're saying with the sort of the flexible super product that treasury is still working on as we speak advice would not be required?

MR COOPER: That's the thinking. Look, it's horses for courses, there are very, very many different people out there in different circumstances fronting this industry in different ways. There are people who have defaulted all their lives all the way out to people who are daily engaged with the system, and everybody in between. I think what CIPR is talking about is what I call the mass market and it is addressing, I suppose at its very centre it would be addressing a member of an industry fund that probably is a defaulter that maybe hasn't ever seen an adviser perhaps and maybe who is in a fund that is not particularly well-given the scale of all

of this, if you're one of tens of thousands of members already in retirement then the CIPR idea is - you're right in the centre of the CIPR idea, if you like. Now that doesn't mean it excludes others but that's really what it's aiming to do.

MS CHESTER: And for the component that is sort of the annuity component where you actually want to pull the risk across the biggest cohort possible you're saying that it is reversible, that reversibility is then priced into the cost of it?

MR COOPER: Yes, I suppose that is what happens. And that is not the only - there may be funds that choose not to have a flexible product and if you do that you get a higher return. And the trade-off is that, well, you're only putting a relatively modest proportion of your overall savings, you get all of the liquidity in the rest of the portfolio then why penalise yourself by insisting on liquidity across the entire portfolio? And as people think more fully about this they often come to that conclusion.

MS CHESTER: And we'll do some more work on this between now and final report. I think our key focus is going to be what form of advice might be required for somebody in a world if the government takes us to that world of what's really a soft default which in a world of no achievement becomes a hard default, and what advice might be required if at all. Coming to - sorry.

MS MacRAE: Sorry, I was just going to say in relation to the training for advisers, why do you think that is so limited? It's not like this train hasn't been coming along the track for a long time and the industry as you say has been very focused on the accumulation phase, why has it taken so long? And I guess what do you do about it, so how do you - - -

MR COOPER: It's very difficult when you're working very close up to - and if you're working day to day in an industry you don't often get the chance to step right back from it and ask, you know, is this heading in the right - I think in terms of problems in financial services if you threw that blanket over many of the problems you might see the answer. In other words, you know, there's a lot of activity and so on, maybe nobody stood back and said, well, are these advisers really being taught the right sort of things?

There is another aspect to it, and it does come down to the idea of giving members their money back, the system works at its best as everything is growing. So the way the lot of aspects of financial services are paid for are basically on a pro rata percentage of the assets, whether it's under advice, under management, or what have you, and a lot of

advisers are remunerated based on how many - you know, the value of the assets of the member. And so the incentive to actually help the member spend that money down the incentive is not obvious. That's only one small explanation for it.

If I could just go back to the advice please, I want to emphasise in the CIPR project the idea of the fund engaging with its member quite early on, so I'll pick a number, maybe it's post 50, the idea is that the fund would start reaching out to the member. And if you think about engagement, while it's true that many people are not engaged with their super, and in the compulsory system that's fine, the system actually ought to work for them, that's not necessarily the case as people get to 50 plus.

By that stage if they've been in super they've got a material balance and the evidence is that they are pretty engaged. And so the idea of the fund reaching out and saying, hey, look, we've got this thing called a CIPR, this is how it might work, and over a course of years on a relatively mass scale, you may - we don't know this, but you may be in a situation where members sort of quite well understand what they're being offered.

MS CHESTER: And during that phase how would you distinguish between that being information on the product provided by the fund versus what's really advice which members take to be personal advice, what it would mean for them and whether it's suitable for them?

MR COOPER: I think in a reform project you're allowed to change the existing law and I think the treasury consultation very much engages with the fact that ultimately there might be something that sits in the middle of the current distinction between general and personal advice. And we can write a regime for that if that's necessary, it probably wouldn't be. But it is a bit of a fine line, the minute you start saying well, you're a member who looks like you're going to be getting the full age pension in your retirement you're already potentially stepping into the personal advice zone, that's well-recognised and I think the reform project will deal with that. There might be a special CIPR regime that deals with some of those technical issues.

MS CHESTER: We'll probably have some recommendations about what advice should look like, as well when we get to our final report. Coming then to best in show, and we were very careful not to be overly prescriptive about the criteria the expert panel would apply in deciding best in show, we've got a good page on what we think it should look like. We deal with the post retirement phase in a couple of ways there, Jeremy, we don't talk about investment strategies and long term net investment returns purely for accumulation, it's accumulation and post retirement.

We talk about track record on innovation and meeting member needs, including the design of super products both accumulation and in retirement. So we actually see the expert panel would have to play a role in deciding can they do the best by members by getting them the biggest balance upon retirement and can they do the best by members by making sure that balance turns into the best income stream or the best draw down vehicle for them during retirement. So that's how we kind of see it working. I know people have really just focused on it as they always do in this industry on the accumulation phase and existing leader boards?

MR COOPER: Yes.

MS CHESTER: But that's an area that it would be good to get some guidance from you in a post draft report submission on further guidance we might want to give to that expert panel in terms of making sure that the best in show is best in show for the members' life not just their working lives.

MR COOPER: If I could reflect on the difference between the accumulation phase and the retirement phase can be viewed as being a shift from effectively a wholesale world where although there's much talk about member engagement in actual fact many funds are far more busy engaging with the employers, they're the ones who give them the money, and largely the day to day interaction with the working member really oughtn't to be, in a mass market sense, really oughtn't to be that much. And certainly as the member reaches 50 and beyond they're more aware of perhaps their balance and the fact that they're going to be retiring at some stage but the machine is still whirring away in the background in a sense.

When retirement comes that very much switches to what I call a retailed experience. There suddenly is a customer who's stopped working, who actually is looking for their retirement pay cheque from the fund direct. It's the first time in a sense in many cases that the fund actually has a financial link with the actual member. Because in superannuation typically in the mass market the money doesn't come out of the member's pocket at all, it comes from the employer, and that's the first time when there is a customer out there who's looking for something each month from the fund. And now that's a very, very different environment. And I'm sure you've thought about this but it has to be measured and looked at in a very different way. And it's not - the whole idea of investment returns and asset allocation and so on become much, much, less important.

MS CHESTER: Well, I guess we're envisaging a world where member

engagement occurs before the age of 50 or 55 and making choice simpler and safer.

MR COOPER: It might. I mean - - -

MS CHESTER: Best in show and elevated MySuper.

MR COOPER: It's horses for courses. There will always be a distribution. And you want to make sure that you're serving those who want to be engaged or who can be woken up to be engaged, you want to be serving them but you also need to serve the people who simply won't be engaged.

MS CHESTER: So when you say distribution were you talking about performance of funds or were you talking about - - -

MR COOPER: No, human beings. You know, there's a very broad - - -

MS CHESTER: The needs of members.

MR COOPER: The needs of members, yes.

MS CHESTER: And we are looking at the needs of members in terms of the default segment and making it simpler and safer. We might turn to governance for a minute. You didn't touch on it in your opening comments but it's an area that we know that you've done a lot of work historically, back in 2010 and since. The whole area around making sure that the right trustee boards are in place, Jeremy, we focused on our report a little less on the number of independent directors and a little bit more on what kind of really matters.

And that is having the right trustee board members with the right skills to get the right investment outcomes for members but also mindful that we are living in a world of complex and affiliated and related parties and making sure that that's managed. Do you think we've gone far enough in terms of what we're proposing there with greater transparency and greater robustness around skills matrices and reviews and assessment of board and investment committee performances?

MR COOPER: Yes, and I think that there's been so much said on this topic, but I think also the batch of legislation giving APRA more power in relation to member outcomes including this topic, if you put all that together that's certainly progress.

MS CHESTER: On the issue of mergers, and this gets a bit conflated

with the issue of subscale and underperformers, in a world of trustee duties if a trustee board has persistently underperformed the market for an extended period of time or they're subscale and thus their cost bases are too high, even under the scale test and over the elevated outcomes test they should be sort of shepherding their members to a better fund. We don't see that happening at the moment. So I guess the question is why isn't that happening if trustee directors are doing their duties correctly? And secondly, what should the regulator be doing in this area that they're not doing currently to make sure that that happens? And in our report we sort of jumped to maybe this is a role for ASIC where mergers haven't gone ahead where they should have, but it's really difficult to prove that. So what's your take out on that area?

MR COOPER: Well, I suppose there are two views you could take of it and one is that APRA hasn't aggressively enough pursued its mandate into MySuper, and I'm not expressing that view, I'm just saying that's a view out there, and they would say, well, that's why we're asking for this new legislation that actually more expressly gives us those powers. So I'd be more than happy to give APRA the benefit of the doubt and say, well, once that new legislation is passed, the member outcome stuff, then it's unambiguously able to deal with the issue and should, you know, get on with it quick smart. Clearly there's a rump of - as you point, there's the rump of funds that need to be moved along.

Now, the interesting issue is where should those members go? Should the remaining funds be rewarded by suddenly being given new members or do you set up - the idea has been floated around that the future fund has some role to play, I don't know whether it's the future fund or not, but the idea of having a benchmark, another pressure point, if you like, a sort of a benchmark against which all of the private sector, if I can put it that way, funds would have to be concerned about. That's another idea that you could throw into that mix.

MS CHESTER: So the idea of competition through best in show and an elevated MySuper it's then kind of not rewarding those funds by them getting the members of the underperforming funds, because they've already sort of earned the rights to the keys to the kingdom?

MR COOPER: It makes it a very valuable kingdom to try and be in, doesn't it? I suppose in relation to best in show generally my reservations if I've got them it would be about the behavioural effects of creating this sort of gleaming list of 10 and just quite what that would do to both the behaviour of the people in the 10, the behaviour of the people who wanted to be in the 10, and then the behaviour of members who either are in a fund that was in the 10 or not in the 10, I wonder about all of those sorts

of things and whether you would find funds that were at number nine risking up a lot more than they otherwise would. We just don't know the answers to those things.

MS CHESTER: So if it's really the expert panel is deciding it on long term net investment performance and it's subject to review every four years, how do those risks come about?

MR COOPER: Well, you see, you say long term investment performance, I mean there are a lot of academics and other experts would say, well, you know, that's just past performance and you shouldn't actually look at that. But the trap you fall into is that the very funds you're anointing as great are just about to have a run of bad years. And we need to accept that in the system, there is a distribution of outcomes and that very, very good funds can have a sort of a flat period. So we'd need to be very careful about that.

MS CHESTER: So I guess a couple of things; firstly you do it every four years, net performance investment performance over a long period is just one of the factors that the expert panel would be looking at; governance I would have thought would be a pretty good indicator that you've got a trustee board that's a safe pair of hands for the members going forward; innovation; understanding the membership, so all those principles that we've outlined and we're looking for further feedback from participants on. I'm still struggling to see what are the risks for the best in show in that four year period if an expert panel has decided that across all of those criteria they - - -

MR COOPER: Well, let me go to the - and I think some of the risk is actually the expert panel itself. In an industry that is so driven, you know, it is in many ways a pretty divided and highly politicised industry, how do you get the right - it's a little bit like if you ever look into the legislation about how you become a - how you get on the board of the ABC, it would be an extremely vexed process to get the right balance of experts and the right sort of optics, if you like, of people that couldn't be politicised.

And then you run into all the potential conflicts of interest, you know, if you're on that panel would you - you know, what functions would you go to, how connected to the industry would you be, could you be working in the superannuation industry, would you have to be retired out of it, it's a little bit like being a sort of public official in your situation, you know, you really would have to watch out for the perception that you were being got at by funds that were at number 11 or at number nine, worried about being, you know, all those things.

So I think there are two quite nuanced and vexed issues. One is populating the expert panel and then it's the actual validity, and I suppose again, whether the system would grow to respect and abide by the decisions or whether it would just constantly be a brawl. Like, you know, some other aspects of this industry.

MS CHESTER: So absent having a process for competition for default and being able to identify some top performers, how in the system do we inject comparability, how do we make it simpler and safer for members?

MR COOPER: Well, I would say this, I suppose, but the original model was that APRA had to be very tough on getting a ticket to play. You know, if you look at the whole list of MySupers at the moment there are a lot of funds in that list that are there just for technical - if you actually go down and you look at how many of these funds have got scale, are public offer, are really out there, you know, doing the best by their members, it's certainly a much smaller group than the great long list that you get from the APRA website.

So I think, again giving APRA the benefit of the doubt, if it gets the powers that it's asking for then my personal, you know, Challenger doesn't have a view on this particular topic, but my personal view would be that if APRA aggressively, not stupidly but very purposefully said, you know, these are the rules, if you don't abide by them you will be moved out of the MySuper field. And on top of that the benchmark doesn't just stay static, you guys are all getting better at what you're doing, technology is helping you, scale is helping you, so that the standards keep going up. And I think in that world if you ended up with a population of, you know, who knows, what the magic number is, 21, 27, 33, whatever it is, then that in itself would be enough.

And that maybe then you would almost have a lottery type situation where you'd just randomly get four funds. You know, a little bit like TattsLotto, you pick four funds out and a new member you just show them, well, they're just four of this, you know, excellent field of funds. And that's where we get to, and then that way you've got an independent statutory regulator making those decisions. You're not going through the grief of having to empanel yet another body of experts, many of whom may have links to the private sector and all those sorts of things, and then all the drama of selecting the top 10. So that would be an alternate view.

MS CHESTER: So I guess we agree that if we did elevate MySuper to realise the vision that you originally had and we're trying to put teeth into it to make sure we get there, that gets rid of the entrenched under performers but you're still then living in a world where there's no

comparability of choice, it's still complex in the choice segment. And you're saying that members in the default segment really shouldn't be exercising choice, we shouldn't make it simpler for them?

MR COOPER: They certainly always, the idea was that if they wanted to choose then they're free to move into any product that they like. And I suppose it's just incremental improvement. It took a long time, there was a lot of struggle with the industry to get the dashboard done. Could that be improved? Yes. So it's just a matter of incrementally improving some of those things.

MS CHESTER: Did you have a better answer to the Bernie Fraser quote?

MR COOPER: The Bernie Fraser quote?

MS CHESTER: Where Bernie said the problems have been there for yonks but there's been a hell of a lot of inertia. I guess our question is why hasn't the industry done something about it?

MR COOPER: Well, it does tend to be a bit of a divided industry. I remember when I took on the role of, you know, nearly 10 years ago now, of reviewing the system in 2009 the state of the back office was a great surprise to me. And I sort of asked well, how come the back office hasn't - the back office of super, all the paperwork and all the - you're still working on it, the multiple accounts, the lost super and so on, you know, how come this hasn't been dealt with.

And it's really one of the fundamental issues for us, that the industry couldn't agree on a standard data field, if you like. When a member joins a fund what data would be need to have about this person to make it work better? You know, that simply couldn't be agreed upon. One part of the industry wanted more detail, the other part of the industry wanted less detail. And unfortunately that just plays itself out over and over again.

MS CHESTER: Okay, well, we saw data as a problem but we didn't see data as the problem driving entrenched under performance and unintended multiple accounts. But anyway we'll keep our journey happening. And we do look forward to getting a post draft report submission from you, Jeremy, that would be really helpful. Particularly on if we do dare greatly and have a best in show and an expert panel, making sure that we cover post retirement in that decision making process, that - - -

MR COOPER: Certainly.

MS CHESTER: Thanks, very much.

MS MacRAE: Thank you.

MR COOPER: Pleasure.

MS CHESTER: I don't need to call our next participant because he's biting at the champ to get up to the table. Welcome, Adam, thanks for joining us. Just for the purposes of the transcript recording if you could state your name and the organisation your represent. And if you'd like to make some brief opening remarks?

MR GEE: Thanks, Karen. Adam Gee from KPMG. I will make some brief opening comments, and look, to be honest, somewhat supportive I think of some of the comments that Jeremy has made. So overall we are very supportive of the work that has been done. This is possibly one of the better reviews that we have seen of the superannuation industry in the last number of years so congratulations to the Commission on that. I think there are a number of operational considerations that will emanate from the review, particularly if some of those recommendations do come in to legislation, and also potentially some unintended consequences, which I'm happy to discuss today.

Overall we agree that there are a number of funds, there's too many funds in the industry, a raft of under performers, which are of real concern to members that sit within those funds. In saying that though we do also recognise that there are a number of very strong performers in the industry, and potentially limiting defaults will have some interesting operational, as I said, considerations for the industry as a whole. But we do believe that engagement is critical for members going forward and that that is probably one of the key focus areas that needs to be considered though in the course of the next few years, to lift the education and literacy levels of members within superannuation.

Interestingly, similar to Jeremy's comments, we believe that there are avenues that exist to shut some of smaller under performing funds. The challenge I think is that a number of those just have not been used over the course of the last few years and so we do think that there is opportunity to continue to drive consolidation within the market for some of those under performers and that the regulators have a larger role to play within that.

On an overarching comment, we are concerned with some of the media press that has been seen in the industry over the last three to four weeks subsequent to the report and more broadly, which has painted the industry in a particularly poor light. We're very concerned the outcomes

of this is to increase the level of distrust that members have within the industry. And we recognise that globally the Australian system is seen as a positive and one of the best performing industries or systems around the world.

So we would continue to want members to feel that they can trust the underlying system. Overarching obviously is that they continue, the funds continue, to deliver good outcomes for their members. And as I said before, member engagement we think is critical in driving those sorts of outcomes to members and the more we can do to engage members to make active choice we think is the right outcome for them. So then I'll stop there and I'm happy to take questions.

MS CHESTER: Great, thanks very much, Adam. Let's begin where you ended, driving member engagement. So how do we do that absent a simpler, safer system where there's a chance of members being able to compare products, which is kind of missing in action at the moment, so assuming we have a role of an elevated MySuper, so you've chopped off the tail eventually, how do you then make it, in the absence of a best in show, how do you make it simpler for members to be engaged during the accumulation phase in both default and in choice?

MR GEE: It's the multimillion dollar question, unfortunately. Our view is that funds are doing a lot more over the course of the last two to three years around member engagement. Their use of underlying data analytics and tailoring of communications to members is absolutely critical. Our view is that the data within the superannuation industry, as you've identified within the report, has been particularly challenging. I think there is a better way to collect data. Obviously in my old role within SuperRatings we took a view that we could provide reasonable comparisons of member data and we were very confident that the work that we had done to try and compare funds was enabling members to be able to do that.

But the challenge continues to be drawing members into those comparisons and actually getting them to take action in relation to what they're doing with their superannuation funds. And I think the ability for now funds to use some of those analytics to try and tailor different messaging has gone some way but our view is that the government needs to do more around financial literacy and member education to enable members to make a choice. But we absolutely agree that the level of data within the industry is particularly challenging and doesn't provide for a strong comparability.

The product Dashboard has not worked, we believe there is a better

way to compare funds around some of those net benefit concepts that we talked about, considering fees and performance overarching as well as a level of service that is provided and also taking in to account some risk outcomes for funds. So we do believe that the data collection piece needs a lot of work across the industry.

MS MacRAE: Just in relation to how much you'd need to lift that financial literacy, I guess we looked at some of this in our - even going right back to stage 1, where we find that there's hundreds of programs for people trying to increase financial literacy and despite all of that effort we're not really making much headway. And I think it's fair to say that even when we talked to professionals in the industry, and you would know this even in your time at SuperRatings, that you have to be a pretty smart cookie to try and make these comparisons and work out, you know, what is a better fund, how does it work.

So in many respects that's why we're attracted to an expert panel making that. What we hear from consumers is, and we heard it from Choice today, we don't want you to give us more information and more choice, we want you to tell us what to do. And one of the reasons for the expert panel and the choosing of the 10 and then having an elevated MySuper so that there's choice still available for people of course but making that choice safer, is that these decisions are really difficult.

I think we think that trying to say that we're going to put that burden back on the individual to make those choices and make those comparisons is probably a bridge too far. We've been trying to do it forever and it's just so complicated that if we can give much clearer, easier markers for consumers that's how we'll get that engagement. And I guess even in response to our draft report people are - the reason there was a flurry is, oh, we've got some information here that we think we can comprehend and make sense of and we've never seen this before, because most people won't go to a SuperRatings, whatever, at least not till they're much older.

So that's really, I guess, the attraction of the expert panel, is that you have got experts looking at all the data, taking everything into account, potentially hopefully not being hoodwinked by a bit of marketing or whatever that might get people off on the wrong track. And so getting consumer engagement is about making it safer and simpler, and this idea of the top 10 is really the best way we could come to getting that engagement in a way that we felt was the best sort of bullet proof mechanism to ensure the consumers might actually be engaged on the right metrics in the right way. So I just wonder if you've got any response to that.

MR GEE: I've got concerns as to whether it will drive engagement, to be honest with you, because I think you will end up still with members defaulting into the top 10 best in show list potentially. So whether the actual use of an expert panel to effectively select the top 10 funds will drive engagement I have some questions over, but I would agree that simple information and comparable information is the best way to at least constitute a best in show type list. Whether or not though that does drive engagement I think is questionable. So I don't think unfortunately there's a silver bullet to some of these questions, I think it needs to be a broader assessment.

MS CHESTER: So we agree there's a range of things that need to change in the industry and in government policy to make that happen. We did do a Choice survey with about 2500 members where we actually sort of did a best in show arrangement for them and even for the 15 year olds the only five per cent didn't make a meaningful choice and then defaulted. And indeed the number was even lower for the 15 to 19 year old cohort. So when we provided them with a best in show with simple metrics some people then say well, they're just defaulting into those 10 whereas the Choice survey actually showed that they didn't just go with number one, they actually looked through it and made a decision. So if you're looking for engagement, absent of best in show, how do you get it in the default segment?

MR GEE: I think it's the ability to provide simple clear data, as you've talked about there. And I think the ability to make that available, I think the discussion was around the ATO being able to provide almost a product dashboard. Whether that's 10 times as Jeremy said, or whether that's 30 times, whether that's the right answer I'm not sure, but I think the ability to provide simple comparable data will absolutely assist in driving engagement. The ability then also to tailor communications to members by super funds to engage in an early date I think is absolutely critical. You're right in your comments earlier, we don't want members starting to engage at age 40, they need to do it early when they commence contributions with a fund.

MS CHESTER: On the dashboard, we did have some detailed recommendations about that. It's very frustrating when there was a vision earlier on of a simple one page dashboard that would be meaningful to members as opposed to meaningful to disclosure purposes of funds, with what we're proposing around the MySuper Dashboard across all products and the regulator being proactive and basically saying this is how it will be done based on us consulting technical experts, behavioural requirements and consumer experts, industry go forth and do it, do you

think that's the right approach or is there another way to take it forward so we can - I think we're all agreed that we do want a single one page MySuper Dashboard for members.

MR GEE: Yes, absolutely. We agree completely. I think our view is the current dashboards that exist on a lot of funds' websites do not provide sufficient information. The information also is not consistent with the disclosure document of superannuation funds. So if we look at, you know, things like standard risk measures, et cetera, et cetera, jargonistic type terms that most members don't understand we have some concerns. I think the recommendations in the report are exactly what we should be looking for.

The only comment I'll make is that net benefit concept whereby we're looking at actual performance of funds over a 10 year period I think is a fantastic way to compare funds. So that looking at the actual return that a member has received over the 10 years, the actual fees that they have paid, and effectively putting that into a dollar amount over a 10 year period is a wonderful way to enable members to assess the success of the fund over that period. So inclusion of that sort of information I think will be very helpful as well.

MS CHESTER: Yes. The other issue that people throw up when we talk about trying to make it simpler and safer in accumulation and the reverse constellation issue that we touched on before is people suggest there's a lot of tailoring that's needed in accumulation. If you're just looking at sort of the default member, that cohort today, what tailoring is needed if at all in the accumulation phase?

MR GEE: The majority of members want good investment performance and low fees at the end of the day. The challenges I think come around insurance, and that's where we start to see the need to tailor. So if we look at some of the larger and not for profit funds that utilise or offer members in particular sectors relevant benefits that's where the level of tailoring generally required. So a HESTA for example, a Cbus, and have a particular cohort of members that may require specific insurance that they may not be able to get from a standardised type insurance arrangement is where we think that tailoring comes through. In terms of the underlying accumulation product though, a focus on long term net performance is really what members are looking for.

MS CHESTER: Yes. So the only example that we've been given is around high risk occupations and then getting insurance so is there any others beyond that cohort that you're aware of from your work?

MR GEE: That's the main cohort, I think to be honest with you. So, yes, similarly the Cbus example is one where you have a number of members in high risk occupations, police, ambulance, in some of the other funds I think they're also critical, obviously a number of funds will want to tailor products to a broader demographic of members so they might want higher risk investment options, those sorts of things, but at the end of the day too many options, as we know, creates paralysis in terms of choice a lot of the time. So I don't see other than insurance realistically significant need to tailor accumulation products very differently.

MS CHESTER: You touched on before, a lot of people suggest that we have the world best pension and super system globally and we're aware of sort of the Mercer studies and that that focus more on sort of inputs and sustainability but I guess we're looking at performance from the perspective of competitiveness and efficiency which is investment performance over the longer term, that hasn't been done internationally before.

MR GEE: The Grattan Institute tried to do it. I don't think they did a great job of it, unfortunately. But I think it's very hard to compare systems globally given the tailoring and the intricacies of the system. I think if we look at the longer term investment performance of the Australian system, and we obviously have to take into account the difference between the growth and defensive asset allocations over the different systems, the Australian system has provided stronger long term net outcomes than for example the UK or some of those other systems, given they have a more conservative investment strategy across the board.

So we haven't done a lot of work, I'll be honest with you. When comparing globally we've seen some of the research that's been done it does show that the overarching net benefits that are provided within the Australian system are good. Obviously the compulsory nature of the system also assists in that.

MS CHESTER: Which is why we're hoping to get better investment returns by asset class so we can actually do that, and we're looking forward to doing that in the coming weeks when we get those data from the funds. But I just wanted to check what you were suggesting before, because everybody keeps saying we've got the world best system and then we get into trouble for suggesting that maybe it's not world best which is what members are getting today, there are some problems, but that's not to say that all members are doing well. So hopefully we will get to doing that piece of work so that we can all form a view on how we're doing internationally.

The barriers to mergers, if we're going to mop up the tail of underperformers effectively we're moving the members to somewhere, you can call that shepherding or you can call it a merger, are there any other impediments that need to be removed for that to happen more efficiently and effectively going forward, apart from the inclination or non-inclination of trustees to do it?

MR GEE: Our view is the MySuper was a somewhat of a lost outcome within the Australian system. Our view is that rather than granting licences to every superannuation fund that have requested one that there should have been a selection process in place that would have reduced potentially the number of funds that received MySuper licences. In terms of mergers, we do take the view that APRA has a greater role to play and we recognise that there are some legislative proposals in place that may allow them to move funds along in a more efficient manner.

The challenge I think associated with merging funds, and we've all talked about the conflicts of interest associated with those processes to occur, is if funds are to merge there still needs to be a best interest test for the fund that is receiving the members from the merging fund. And I think that is a real challenge across the industry as a whole. There are some funds that, small funds, that have significant under performance, that have very large inactive member bases, that once the fund that does take on the smaller fund is unlikely to be able to achieve any significant benefits for their underlying members.

There's also a significant cost obviously for merging as well so the ability for a fund to bear that cost and bring on a number of members that they may not then see a significant benefit for their existing membership base presents some challenges. So I think that is an issue that we need to work out a proper solution for because I think there are some real concerns around some of those larger funds and whether it is in the members' best interests to take on smaller under performing funds.

MS CHESTER: Okay. Someone had suggested to us that it nearly got up historically the best over the boot test which - - -

MS MacRAE: Better off overall.

MS CHESTER: Better off overall, thanks, Angela, with respect to the mergers. Because there's two ways of looking at it, it's what's required for the new fund taking the other members, i.e., making sure that it's an improvement for them, but as you've said making sure that it's not a drag. Although the denominator for such of those larger funds is such that if they're taking a small cohort you can't spread across that entire

membership it wouldn't be materially problematic. So is the problem more about what a trustee board has to satisfy themselves when they shepherd their members to another fund in terms of it's much more of a legalistic interpretation of you might have a slightly different insurance product, or a slightly different product information?

MR GEE: A lot of it is done by what's called an equivalent rights analysis. Say you have a successive fund transfer where effectively the only way that you can transfer members without their consent is to satisfy - the trustees need to satisfy themselves that effectively no member will be worse off. Now that is generally done on a broad membership test. The challenge is there's a significant cost associated with undertaking that analysis.

So costs can be from $1 million to up to five to $10 million depending on the complexity of the fund, the underlying investment strategy of the fund, there may be a requirement to wind up or remove existing assets, direct property, et cetera, that may cause a loss if they're exited early. So there are some complications associated with it but it is the cost more than anything else of undertaking that merger process that provides the challenge.

MS CHESTER: But I guess the cost really should be seen from the perspective of applying a boot concept to the member going forward. If we live in the world of inertia where you're not going to undertake that analysis because it might cost one to five million dollars and you've got a couple of hundred thousand members that are in our tale of woe, it's kind of like a no brainer.

MR GEE: Absolutely. And it's not so much the cost, that it's not doing it because of the cost, it's what benefit does the member get of the existing fund of taking on a larger cohort of underperforming fund of members, or potentially won't provide any - maybe if there was a number of funds out there that potentially have active member ratios of 30-odd per cent, so if you merge those members into your fund all of a sudden 70 per cent of those members walk out the door or aren't merged, is there any benefit in providing or undertaking that merger on the basis that you're going to get a very small cohort of members that really won't provide any benefits or overall economies of scale to your existing membership base? And obviously the cost of unwinding a number of the investments associated with it could be a larger issue than the number of funds that are willing to take on, so there are a number of challenges around that.

MS CHESTER: So we've covered off the tail, we've covered off best in show and engagement, unintended multiple accounts was the other big

problem we identified in the system. We said let's make the system safe and thus you can then default once unless you choose to move beyond. Another option that's been put on the table, and I don't know if you've thought about this, is instead of the member's account being stapled to the member and going with them, the default once, which is what we've proposed, the other option that's been suggested is the balance rolls over each time the member moves into a new job.

Thus the balance is stapled to the member not the account and thus they would be changing funds every five, six years, or who often people change jobs these days. Have you had a think about - they both try to address the same problem, they do it in different ways and there's different pros and cons, have you had a chance to have a think about the relative pros and cons of those two models?

MR GEE: Look, we have. I think what we see is that second model reflects very similar to the KiwiSaver model in New Zealand whereby the IRD, the ATO equivalent over there, effectively acts as a central clearing house and as soon as a member opens up a new KiwiSaver account there is an auto consolidation of accounts between funds. There's a cost associated with that, and again I don't think, or our view is, that that doesn't drive strong member engagement. The preference would very much be for a member to carry their existing account with them until such time as they chose another account.

We certainly are also of the view that, we agree completely, that multiple accounts is a real problem across the industry and continues to be a challenging one to resolve. But the ability to carry a single account will provide greater opportunity for member engagement. So we're absolutely supportive of the recommendations that have come through there. Whether or not it is an ATO obligation to ensure that a member continues to contribute to that I think will create potentially some administrative complexities that were meant to be thought through but overall our preference would be for a single account to continue with the member going forward.

MS CHESTER: Yes. And how would that second model work in a world where we now know that eight per cent of the population actually has multiple jobs, how does it work then?

MR GEE: It's very challenging. So effectively what is in the New Zealand system is the member will generally select - there's no compulsory nature of superannuation, of KiwiSaver contributions, so the member will actively select a KiwiSaver account at some stage, if they're not then they do default into one of the eight providers over there and then

they maintain that account until such time as they choose another account. If they have multiple jobs one would assume because it's not tied necessarily to an employer arrangement that the single account would continue. A little more complex but it seems to work reasonably well over there.

MS CHESTER: Yes. And this is something that we're only just starting to think about now because it's only just been put - well not put to us directly but raised in the media by some active inquiry participants, how would it then work if there was like a major market risk event if you're moving the balance every time somebody moves a job? Now if you're in the same sort of investment strategy it wouldn't matter because you're only out of the market for four or five days, but say if you were moving and you ended up defaulting into another - something that's a different investment strategy, are we introducing a level, a modest level, of sequencing risk for members every time they switch jobs then?

MR GEE: Look, potentially. I think it's fair to say that the majority of funds other than those that offer a lifecycle investment option have a reasonably standard default investment option which sits around a 70, 30 per cent growth defensive asset allocation. So I think the risk of that is reasonably low. If we are looking at MySuper lifecycle investment options then there is a challenge of moving from potentially a balanced option at a time when the market does crash or there's a significant event and moving if you're an older member into a more conservative investment option. So there's absolutely a risk associated with that. I don't think that's a significant risk though, to be honest.

MS CHESTER: Okay. You raise lifecycle, we raise lifecycle in the report too, we did some funky stochastic modelling work around it that suggests that it probably takes too much growth of the table for the insurance policy that most members may not need, there's a cohort that would benefit from an insurance policy around sequencing risk, but then the default segment where you don't know what the member is, what they look like, you know their age and that's about it, and their balance, have you done work around the extent of net benefits of having lifecycle products, should it be in default, should it be in choice, should it be subject to financial advice?

MR GEE: Yes. I will draw on some research that we did at SuperRatings about a year and a half ago, so before my current role. We took a view that and we did some analysis whereby we looked at all of the lifecycle products. We assessed if they met their investment objective every year over the course of a 40 or 50 year investment timeframe and compared those to a standard balanced option and assumed that they met

their CPI costs, three, three and a half investment objective every year. The outcome was effectively that the balanced options out performed mainly due to the level of risk that was taken off the table and the growth assets that were taken off the table over a 40 year period.

So it does prove that potentially if you sit in those investment options provided there isn't a market crash very close to retirement that you could potentially be better off. I think our view is there are two views as to around where lifecycle works. So where you have a member that is highly disengaged and that takes no interest in their superannuation but just continues to receive contributions, the de-risking of a portfolio as they get older could be in the best interests of members where the ideal outcome obviously is for members to be engaged, make an active choice when they do get older, and then the balanced option of 70, 30 stops the end of default, works reasonably well for those members. It's for those disengaged members that we think a lifecycle is appropriate.

MS CHESTER: Yes. Did you have a look at the stochastic modelling that we did that actually showed the small cohort that we actually looked at that what the sequencing risk is around retirement versus what is taken off the table?

MR GEE: Yes. So we agree with the modelling that was presented there, that's consistent with some of the work that we've done.

MS CHESTER: Okay, yes.

MR GEE: But I think it's that behavioural psychology aspect in terms of if members could actively make a choice that is the ideal outcome of where they don't and they're disengaged. As a somewhat paternalistic industry we feel the need to protect them on the downside potentially as they age.

MS CHESTER: Okay.

MS MacRAE: We touched a little bit on insurance earlier and just talked about, you know, the need for tailoring in some respects but in relation to the other draft recommendations we have on insurance have you got some views about that?

MR GEE: I do.

MS MacRAE: Yes?

MR GEE: We're broadly supportive of the recommendations that are in

the report. We have taken the view that the ISWG report is probably a very strong step in the right direction for insurance within the superannuation industry. We believe that the mandatory nature of that would provide a better outcome for the industry as a whole. So again how that is implemented presents some challenges. I guess the one recommendation that we were somewhat concerned about was consistent with the budget recommendations around removing insurance for under age 25s. We've done a lot of modelling and we're about to release a paper in the next week or so on the outcomes of that.

But our concern is removing a significant cohort of members under age 25 will have an impact on the group pooling arrangement of insurance. So the numbers that we've run suggest an effective 26-odd per cent increase in insurance premiums for the rest of the pool if we remove younger members. So our view has been there is a benefit in having insurance across the entire lifecycle for members. I think AIA was in the papers a week or two ago saying that they continue to pay somewhere around the $80 million mark of insurance to under age 25s.

Our view is, and the industry is starting to move to this already, is almost a bell shaped needs based design for insurance as appropriate. So small levels of cover for younger members to protect against potential illness or injury is appropriate, so maybe a $50,000 level of death and total and permanent disablement which can be bought for 30 or 40 dollars a year is more appropriate than having no cover at all for members under the age of 25.

MS CHESTER: And more appropriate for those members in terms of it keeps the overall cost of the pool down so when they're over 25 they get that benefit, or of benefit to those members in the ages between 15 and 25?

MR GEE: Both. Yes, is in our view.

MS CHESTER: Okay.

MR GEE: So given that members continue to get married younger and have children younger there is benefit in small amounts of cover to provide some protection for those members. Additionally, as members age they do get the benefit of that group pooling arrangement. So we ran some numbers around benefit erosion. If the member is under the age of 25 then certainly inactive accounts were removed. The ISWG work that we did showed erosion of about 6.2 per cent of an account balance on average over the lifetime of the member. If there was a removal of that cover and the premium was increased that erosion would increase to about

7.3 per cent on average. If there was no increase in premiums, which to be honest with you is highly unlikely, the erosion amount will go down to about 5.8 per cent. So almost an immaterial difference if we remove the cover and there's no increase in premiums.

MS CHESTER: And when you mentioned that if we took out the under 25s the premium of the broader pool would go up by 26 per cent, if we were to go down your route of going for - or the route that's been considered of having a very sort of low cost vanilla product for the under 25s of 30, 40 bucks a year, what then would be the premium increase?

MR GEE: We're still in the process of modelling that. The view is that the impact is minimal. The challenge you have is moving younger lives out of the pool effectively increases the risk of the pool in its entirety. So there is some issues around that it's more the shape of the group insurance pool.

MS CHESTER: Okay. And you're going to give us all this wonderful information in a post draft report submission, Adam, in a couple of weeks?

MR GEE: Yes.

MS CHESTER: That would be fantastic. The other little culprit that we found in insurance that bedevilled us was income protection. Are you going to provide us with some guidance on what we should be doing around income protection given that it seemed to be the chief culprit of zombie policies and all the rest of it?

MR GEE: Look, yes, we have done some modelling around income protection. There are some challenges and our view is that income protection is a great benefit for members when they use it. It also provides the ability for members to be rehabilitated over the course of a certain period rather than paying a lump sum just have a benefit where members could potentially return to work at a later date. The challenge with income protection is it's expensive and it does erode accounts, but it provides a strong benefit for those members that do need it, albeit we recognise there are some zombie polices in existence. So we're more than happy to provide some information on that.

MS CHESTER: Thank you. And are you also going to tell us about TPD in an NDIS world and how that might - - -

MR GEE: Yes. Yes, we can put some - we've done some modelling on that one as well.

MS CHESTER: Excellent.

MR GEE: So we will do some - the challenge obviously again is removing insurance from the system as a whole will put a greater burden on the taxpayer and the government. So there are some challenges associated with that as well.

MS CHESTER: And I think this is a theme we're going to continue with our next inquiry participants in a moment.

Are they all the questions that you have?

MS MacRAE: Yes.

MS CHESTER: Is there anything else, Adam, that we haven't covered that you'd like to cover?

MR GEE: Well, the only - the best in show was the only area that we probably haven't covered as much. As I said, there's some unintended consequences. We were somewhat consistent, I think, with Jeremy's comments earlier, is that it may drive some challenging behaviours across the industry. If you're at number 11 will you take a higher risk investment approach to make sure that you're in the top 10 number of funds in terms of your net investment performance? And then we're very pleased to see that net investment performance was a key driver of the outcomes in the best in show concept. The other area is risk needs to be considered as well. There are a number of very strongly performing funds on a risk return basis that may not appear in a top 10 best in show list. So there needs to be some recognition of risk associated with some of these metrics.

MS CHESTER: Yes, and we get to that around investment strategy because unless you've got a longer, a really longer, term investment performance track record which means you kind of know what the risk play out has been you can't get there. So what would be helpful in the post draft report submission on best in show is give some further guidance to us on that one page we've got in the report where we talk about what things we think the expert panel should be taking into account to make sure that we've covered off those basis, that would be really helpful.

MR GEE: Sure.

MS CHESTER: Terrific. I love setting homework at the end. Thanks a lot, Adam.

MR GEE: Thank you.

MS CHESTER: I'm going to rather outrageously (because we're running ahead of schedule) propose that we just take a five minute bathroom break. Purely for my own benefit if not for anybody else's. So we'll resume in five minutes and then we'll welcome our next inquiry participants to join us.

ADJOURNED **[9.42 am]**

RESUMED **[9.49 am]**

MS CHESTER: Okay, folks, we'll get started. We've hit our initial KPI, we seem to be on time. So I'd like to welcome our next participants from Rice Warner, if you could just both state your name and organisation for the purposes of voice recognition for the transcript and then if you'd like to make some brief opening remarks?

MR RICE: Thank you. Michael Rice.

MR JENKINS: And Tim Jenkins from Rice Warner.

MR RICE: So thank you for agreeing to see us today. We are very interested in the process and we made a number of submissions along the way. What we'll do now is I'll hand over to Tim who's going to make a brief statement about some of our observations on your draft report and then briefly to answer any of your questions.

MS CHESTER: Right, thank you.

MR JENKINS: Thank you, very much. So I've prepared a statement which I provided to you and I would like to read that statement if I may to you, thank you, for the record. So regardless of whether all your recommendations are legislated the reports provided a thorough assessment of the super system and it's really going to help everybody refine and improve the system. So thank you for that.

We agree with your analysis of the many deficiencies in our complex super system, particularly the issue of multiple accounts and under performing funds. However we're optimistic that many of these issues can be remedied with some key changes. For example, we note the

changes made in the recent budget which addressed the issues of unnecessary life insurance and multiple accounts. What we'd like to do is briefly comment on four aspects of your report.

The first one is setting the bar for MySuper. Your report makes some suggestions which we fully support. The key one is that the original MySuper hurdle was set too low and the requirements to maintain a MySuper licence should be elevated. In setting this standard though we caution against using past performance as a key mechanism for eliminating all non performing products. Your 12 year analysis of annual net returns was for the pre FOFA and Stronger Super environment and isn't representative of the MySuper world.

To illustrate, many retail funds allowed employers to select default investment strategies pre MySuper. The fund I was with before had 51 different default options pre MySuper. And these could vary significantly. Further, MySuper has led to the removal of commission and reduction of other fees since its introduction. We believe that the MySuper system needs to be measured over a longer period to prove its worth in delivering value for money outcomes for default members. Of course none of this should delay APRA in removing licences from those who are under performing and those who show no signs of improvement.

While we accept your view that member circumstances are too different to set up a homogenous MyRetirement product we do though consider MySuper should also be extended into whole of life and retirement. We also believe that the standards for choice products need tightening. Many of these products provide relatively poor value and consumers will not always understand this due to the known problems of knowledge asymmetry and lack of financial literacy. It would be worthwhile considering the range of choice options to see if any further recommendations could be made. For example, like you we question whether eligible rollover funds do have an ongoing role given the consolidation of lost accounts.

Secondly, the role of employers in the system based on wages, we agree that the Fair Work Commission process to allocate default funds imposes constraints on the ability of funds to compete for employers and members. If the bar is set high for MySuper products we believe this process of the FWC should be removed. Many larger employers are well equipped to choose a default fund for their employees. However the fact is they can only secure discounts in tailored insurance if the employer plan remains the default. If your recommendations were fully put in place we could see the demise of employer plans to the detriment of many employees.

Thirdly, and very briefly on the role of life insurance. Really the question is what is the role of life insurance? It isn't part of the objectives of a superannuation put forward by the government yet group insurance is the largest life insurance segment and provides the best value of all insurances when you measure via claims as a percentage of premiums. We support a formal review of whether insurance should be funded through super funds and what structure the benefits should take. And we also support the fact that you put forward that the insurance and super voluntary code should be turned into a binding and forceful rules, noting that the government's budget measures were chief aspects of this. We further note that the budget changes will remove some of the inequities in the system and address some of the Productivity Commission's concerns.

Lastly, our views on best in show. If introduced immediately the best in show short list of 10 MySuper products could stifle innovation as a differentiated strategy and may not be rewarded. See, the 10 initially selected funds have a significant liquidity and scale advantage over other MySuper funds and make it difficult for any other MySuper fund to be chosen in future for the list. Potentially encourage funds to chase returns with potential risk if they believe they need a good short term return to make the list of 10. And finally, prevent new entrants from establishing products that can obtain default status. We note that the number of MySuper products was initially much few than anticipated when the Stronger Super legislation was passed and that the number of MySuper products continues to decline through continued fund mergers.

Indeed, the number of MySuper products that can be selected by public offer and which aren't employer specific is already only around 65 and trending lower. The Rice Warner Superannuation Market Projections Report last December suggested that the number of funds is likely to halve in the next five years, so by extension that could be MySuper potentially of 30 or so. We consider that it's worthwhile based on this strengthening the MySuper standards and letting the market settle for a period of five years before considering the merits of best in show. This will be less disruptive and will allow the industry to address the many issues raised in your report. Thank you.

MS CHESTER: Great, thanks very much, Tim. We might start with where you left off and then we'll work our way backwards through your batting order. On the best in show it's kind of interesting, the feedback we seem to be getting is very much about what the implication is for funds and not for members. We've got two objectives with the best in show. The best in show with elevated MySuper is just meant to make the choice simpler and safer but the best in show is really what's meant to make

choice simpler for members whether they be in default or in the choice segment to have some form of comparable benchmark against which they can compare their product if they're a vanilla accumulation member.

So I guess getting to that issue first. With the elevated MySuper, you're right, it does a lot of the heavy lifting around the tail but how in the absence of a best in show do we make choice simpler for members so we can get a modicum of engagement into the system before people turn 55 and start thinking about retirement, i.e., how do we get engagement and competition for default?

MR RICE: Look, I think firstly if all funds are by definition giving good value or properly regulated and the bar is high enough then does it really matter how a member chooses a fund? Wouldn't the market just work itself through in normal conditions? Admittedly young people are unengaged and, you know, I think my personal view is will always be so. I don't think financial literacy is ever going to raise the standard of knowledge of the lay person adequately amongst the masses. So the real goal of government is to make sure that any choice made is a satisfactory one.

MS CHESTER: So we might set aside the whole Choice segment for the moment because with 40,000 options and given the tale of woe in the choice segment, we know that it's not simple and it's certainly not safe for about half the members - or we actually don't know how many members are in the tail, we know it's one in two products. So how then in a world of if we've just got an elevated MySuper do we get member engagement if it's still not simple? Or you don't think member engagement matters in the default segment until people get closer to retirement?

MR JENKINS: Actually, can I - - -

MR RICE: Yes.

MR JENKINS: The default market there is for people who do not make a choice. If we move to a model where we're looking to engage more people and they take a fund with them potentially as they move from job to job then the thought process behind what you're saying is that there will be less people who are disengaged. So the number of people who would default would be a lot less than it is today. So if you have that there could be an argument that a list of 30 automatically allocated sequentially, if it only is the 30, perhaps is an efficient model to start them on their journey.

MS CHESTER: Okay. So two thoughts, so the default segment is absent choice by members, you're right, today, but it's not absent choice by

employers or the FWC. You've taken FWC out of the equation in your model and you're going to leave the employers in there making the decision on behalf of members. So then how do we mitigate the current risks that some employers don't feel capable of making those choices on behalf of members, how do we deal with the conflicts that an employer would naturally have and are unavoidable between their interests to shareholders or their equity versus their interests to their wage earners?

MR JENKINS: Perhaps a way to answer that is the example from New Zealand again, from my New Zealand experience, where when KiwiSaver was initially established, and I don't know if that's the case still, employers were able to override the default choice. So an employer could pick their own default for their people if they thought that was the right thing to do. And maybe a small percentage of larger employers chose to do that. So they didn't pick from the list of six.

MS CHESTER: So you see a world preferable where the employer is making the choice on behalf of members as opposed to the member making the choice on behalf of members, in default?

MR JENKINS: On entering the workforce.

MS CHESTER: On entering the workforce, okay. You mentioned risks with how best in show might be selected, we set out in a page not prescriptively but high level factors we thought that the expert panel should take into account in choosing best in show. If they were the principles that were followed we're not sure how the risks that you've identified would be manifest. If it's long term net investment performance, if it's investment strategy, if it's products, accumulation and retirement, if it's knowing your member cohort, if it's having good governance, so - - -

MR JENKINS: Well, I'll answer one and maybe Michael the others - if you were outside Australia introducing a new fund here how would you get your performance to get onto the list? How would you ever crack the chestnut?

MS CHESTER: So we address that completely by saying you can look at comparable net investment performance anywhere, if you're an institutional investor from North America or Europe or whatever.

MR JENKINS: But if I'm an Amazon or someone coming in afresh, a complete disruptor, looking at this, I wouldn't necessarily have that investment performance to come from.

MS CHESTER: No, that's right. So you'd probably head off into the choice segment where there's more money and you'd be looking at establishing a track record fairly quickly. But remember this is the default segment, these are those people with lower balances and thus we want them to be the exemplar. You would want some semblance of a comparable track record before you'd allow anybody to - so that's the only risk that you see that - - -

MR JENKINS: It's not the only risk and - - -

MR RICE: No, I think one of the risks is that people might be a good fund at the time they're picked but might not stay a good fund. But if you end up with a small number, I mean, there are examples, Chile is probably the best example, where over a period of time the list shortened till I think there's only one left because everybody competed on fees. And eventually the terms were uncommercial. So there are dangers - - -

MS CHESTER: Yes, and that's not what we're proposing, and indeed, we used the Chile model to reject another model, but if we're looking just at the contribution flows it's just new job entrants and even if you assume with the best in show at least a lot of people start switching to the best in show, if you look at contributions, so net flows into the system at the moment, new entrants are a billion each year, switching is 2.2 billion, re-entrants and turnover is 16.5, so only about 13 per cent of the 150 billion in contributions going into the system each year are kind of like the up for grabs, assuming that everybody who is changing a job or switching then switches to best in show.

MR RICE: That's what would happen with the mandatory new entrants but then if you're best in show you'd have a marketing advantage so you would attract people from the established funds as well.

MS CHESTER: Yes, so we've picked up switching and re-entrants and turnover in that 13 per cent of the contributions, so what switching rates are you assuming that there's a flood of? I mean, we would want some people to move particularly from the choice segment to best in show, or even to an elevated MySuper product, but what are you assuming when you say that they'll have this huge economies of scale advantage during that four year period when - we specifically chose new job entrants and looked at the switching numbers within the system to try to think about we wanted to create a competitive dynamic each four years that would see competition remain within the system as opposed to it, as some people have suggested, creating a cosy oligopoly, albeit it's not a cosy - - -

MR JENKINS: Well, you know, who knows? Again, KiwiSaver is

perhaps one of the closest ones to look at. The advantage provided to the six funds who were the default funds was pretty significant and those have had a competitive advantage because of net funds flow and everything that's come from there they have been able to perform better because of - - -

MS CHESTER: Yes, and we spent a week in New Zealand understanding that system, Tim, and I think some of the differences were it's not compulsory in New Zealand, it is here.

MR JENKINS: True.

MS CHESTER: Much smaller market, fewer players. We've got a very different market structure here. Anyway, I think that's been helpful in terms of understanding your thoughts around the best in show. MySuper, coming back to your batting order now, the MySuper default for retirement, we had a lengthy discussion with Jeremy about this this morning, you're obviously familiar with the work that treasury is doing, I guess the key question for us around CIPR in retirement is what form of advice you would see as accompanying those decisions?

MR RICE: Well, we gave a submission to treasury recently, and we're happy to send you a copy of that. Our personal view, our house view, is that a CIPR should be mandatory because otherwise the level of take up would be very low. And for a number of reasons; firstly, people don't naturally buy longevity products; secondly, they need financial advice and if they have to pay for it it will be a much easier option to just pick an option that doesn't need advice like the equivalent MySuper asset allocation. So it's interesting that there are - - -

MS CHESTER: So when you say mandatory, is this mandatory for a fund to offer it, Michael, or is this mandatory for a member - - -

MR RICE: No, it's part of - - -

MR JENKINS: If it's going to work it's mandatory for a percentage of your account balance at retirement to be placed in a CIPR. Else we don't think it - - -

MS CHESTER: What about a member with a low balance where it doesn't make sense for them?

MR RICE: Well, it may or may not make sense but the fact is it's probably easier to have a system where you've set some rules around CIPR, it's part of our default structure and if you don't want it you can opt

out. If you want a CIPR to work you need to get the numbers to make - - -

MS CHESTER: So you're talking about a soft default then on an opt-out basis?

MR RICE: Yes. I mean there's a real problem with retirement, everybody who retires has to fill out a new form to join a new fund, even if it's a continuation of the vehicle they're in. So it would be a lot easier if we could move more of the defaulting structure into retirement as well. And that might simply be a continuation of the MySuper investment strategy with some intra-fund advice about what you should do to ensure that it's appropriate for yourself. I take your point that retirement is not homogenous, everybody's individual circumstances vary. But if you don't have something as a structure people won't have a benchmark to work against so you'll just end up with a choice smorgasbord again.

MS MacRAE: And do you nominate what level of longevity and what percentage of any balance should be part of - or mandated to go into longevity if you did default?

MR JENKINS: That's the thought, yes, we had a figure in mind of about 15 per cent, something like that, of your account balance. With exemptions for those with smaller account balances.

MS CHESTER: Sticking with MySuper for a moment and then looking at it for MySuper authorisation, we've gone from scale tests to elevated outcomes tests with the government proposing legislation, and we welcome that, we think it's a step in the right direction, we've just added - we bolstered it further with some of our recommendations around MySuper authorisation. One aspect which isn't meant to be the binary driving force is going forward for a MySuper authorised product if you haven't - if you've underperformed materially your own portfolio benchmark, so adjust it for your own asset allocation, have you been able to meet or not meet the market over a five year period going forward and you've missed it by 25 BIPS consistently across those five years? I just want to try to understand your concern given it's just one component part of the outcomes test, we saw that as an insurance policy of making sure that going forward the tail didn't re-emerge.

MR JENKINS: You said for five years, and five years would be better than 10 or 12 because it's the period pre 2013 where we have most issues with looking at the comparisons going back in time - - -

MS CHESTER: But if it's your own portfolio benchmark it's just whether or not you outperform the market so if it's your asset allocation

and there's a market event the benchmark moves with the market.

MR JENKINS: But the funds haven't moved that way, the actual products that are there, some industry funds obviously rebadged, but for many other funds, the retail funds, they're actually a new portfolios with new style investments and new benchmarks, and it would be very difficult indeed to actually go back and reconstruct what that benchmark outperformance would have been.

MS CHESTER: So we're saying that APRA do it going forward, you've got an investment strategy with an asset allocation, here's your portfolio benchmark, you have your own individual portfolio benchmark for that product, if you persistently underperform it over five years why should you continue with MySuper authorisation?

MR JENKINS: I'm not saying that you should, we say - - -

MS MacRAE: Yes, I don't think they're disagreeing with us on that point, Karen.

MR JENKINS: We're not disagreeing. We're disagreeing with the past, pre 2013.

MS MacRAE: Yes.

MS CHESTER: So the misunderstanding - no, no, no, so we're saying this - so it's all prospective, we're proposing it from - - -

MS MacRAE: No, no, and they - - -

MR JENKINS: But, yes, so we were looking at the figures in your report when you were looking at underperformance which went 12 years.

MS CHESTER: Yes. Sorry, I should have been - you should have shushed me up earlier, Angela.

MS MacRAE: No, it's all right, I thought maybe there was something I got wrong and I'm thinking - - -

MS CHESTER: No, no, you were right, I wasn't, so that's good.

MR RICE: And hence the idea that if you leave the best in show for five years you'll then have a 10 year MySuper track record to review.

MS CHESTER: I think we're at counter purposes of best in show versus

MySuper authorisation.

MS MacRAE: Yes.

MR RICE: Yes.

MS CHESTER: So let's move on to another question.

MS MacRAE: Let's go to insurance.

MS CHESTER: You mentioned that the budget measures went a lot of the way that you thought that was needed around insurance. A couple of other areas that we looked at in our report, firstly the role of the income protection and the role of TPD in an NDIS world, which the budget doesn't address - - -

MR RICE: Firstly NDIS is provision of services rather than income, so it is slightly different. It goes back to the issue about what is the objective with insurance. You know, that there's a lot of complexity. Our view is that default insurance is good because people get it more efficiently, they don't need to be underwritten, which brings people in that would otherwise be loaded or not get it. And we know that if you look at the retail insurance market before mandatory superannuation the majority of people didn't buy insurance. So the old adage is they'll insure their house and their car but not themselves is true. So this is beneficial provided it's delivered cost effectively. And largely it is. But there are obviously some areas which need to tweaking and I think the budget has gone a long way towards looking at that.

MR JENKINS: Just while we're on the income protection there, if the objective of super includes something like that you think super is a fantastic place for income protection. It's a very valuable benefit. But it is expensive, unless you redesign waiting periods at older ages it can be very, very expensive, so the question would be inside or outside a super rather than is income protection a valuable benefit.

MS CHESTER: And we do improve income protection to some extent by getting rid of unintended multiple accounts because that's where they can - one of the sources of them being the bad zombies, but how then does the trustee board make sure that it is, income protection is value for money, what sort of data and what understanding of their cohort would they need to be really able to satisfy that test?

MR RICE: As it happens at the moment, I mean, income protection is a better design than a lump sum benefit. But a lump sum benefit is much

easier to offer but it's all or nothing, you're either TPD or you're not. One of the difficulties with income protection is that it can cover multiple benefits over your career because you can come back to work. It's actually quite difficult to manage and we question whether funds have the capacity through their administration to do it properly. They've obviously beefed up. But many of the industry fund benefits are only for two year benefit periods.

You can argue that income protection to be realistic should cover right up to the retirement but once you do that the cost goes up significantly. And the issue - so one of our thoughts is perhaps there should be an objective of superannuation and it's specially earmarked, you know, one per cent of salary to pay for it and then it's a secondary issue as to where it's administered.

MS CHESTER: And so going the cap route, from the perspective of the member?

MR RICE: From a default point of view, yes, if it - you know, if you feel the SG is not enough and obviously the Labor Party and others want it to rise, then earmarking a significant part of that to insurance is going to take away from retirement. But it doesn't mean that it's not valuable, it's a question of what's affordable and where's the trade-off?

MS CHESTER: And that's really all we're trying to do in this inquiry, we think there are bigger questions about insurance in super that were sort of outside of our Terms of Reference such that we suggested a more holistic review in a couple of years' time. Thus the industry has got a little bit - with the regulators to get their house in order and see what value for money members are getting now. The other, we touched on this before with a previous inquiry participant, and I'm not sure if you were here around how we deal with the under 25s.

Those that may not be getting value for money from any of the insurance policies but they're certainly providing value for money for those above the age of 25 by them being in the risk pool. And I should have said earlier on, sorry, you know, thank you again for all the help that Rice Warner has given us throughout all the three stages, Michael and Tim, and particularly on insurance where you've done a lot of good work that we drew and leveraged upon. There seems to be a model now suggesting that if we take out the under 25s the cost for the rest of the members' insurance will grow by about 26 per cent in terms of higher premiums.

MR RICE: Yes.

MS CHESTER: And what's now being suggested to us is why don't we just keep the under 25s in there but have a much more smaller vanilla product for them that's cheaper, 30 or 40 dollars a year, and thus you wouldn't get this 26 per cent premium increase?

MR RICE: Yes, well, firstly, we've surveyed the big group insurers, primarily AIA and TAL, and they've told us that they're expecting a 15 per cent increase, which I would put at the upper range. So our view is it will be five to 10. We note that Australian Super came out with no coverage for under 25s and their premiums went down for 98 per cent of their members. So not everybody has cross subsidies. They do exist, and we're not quite sure of the extent, but the reality is if there are cross subsidies then it's irrelevant to say that rates are going to go up because effectively that's going to happen anyway when you fix the system.

The issue for under 25s most of the people that die under 25, about 90 per cent of them, don't leave a dependent so you could argue that the benefit is not necessary. We believe in rural and regional areas that can grow as much as 20 per cent. People marry earlier in some places. So really for life insurance we think it's a good trade-off to cut it out under 25. Disability is more difficult because obviously that's not age based and it's not based on the number of dependents you have either. So that is a challenge.

But it's interesting that some companies - or, sorry, some of the super funds have already started looking at their past claims experience and picking an age, so I think Cbus picked age 20, Hostplus picked 19, so they're all looking at, you know, where would there be little damage if we changed and perhaps where we could deliver better value. I think the issue of income protection for young people is not resolved by cutting it out but I'm not quite sure how you fix it short of just having disability cover and no death cover.

MS CHESTER: The other wrinkle we've got in a world where we're trying to make the system simpler and safer is less products geared to a particular workforce because we know from the metrics today that when folk turn over jobs now they're above 50 per cent likely to move to a different industry sector. So they're moving around industry sectors and not staying in for long periods of time. But the only argument that we've come across for tailored insurance still being needed by an industry sector is the high risk areas like construction. Have you given any thought to what - if we're trying to make insurance better value for money, more affordable, more vanilla, members can move across different industry sectors over time and move between insurance products, how do we deal

with that, that small cohort of the high risk construction workers?

MR JENKINS: Well, it's actually quite a large cohort, the vulnerable members. Many insurers will provide a lower level of cover for casual employees, non-permanents, as well as those in the higher risk industries, or low premiums even depending on the industry that you're in. I guess the concern is if you are in one of those industries where your super fund caters especially for the abattoir worker, say, wherever it might be, they won't be able to get insurance elsewhere. It will really prohibit their ability to be insured for the - of available benefit available for them. So the different benefit provided for them through the group insurance is something they could not get on an individual basis and therefore to take it away based on that would be quite tricky.

MS CHESTER: But is that only when they're approaching it as an individually underwritten proposition, if it's a MySuper product and it's default segment, you're defaulting into the insurance product.

MR JENKINS: But you can default into no insurance, it's unaffordable.

MS CHESTER: But if the high risk member is part of a larger pool that's a mixed pool with white collar workers and the rest of them and they've just defaulted into it, it's not an individual underwrite, wouldn't they stand to benefit from that?

MR JENKINS: They might be, it might be the expense of the other workers that are choosing to opt out of those funds and take their own assets and therefore go a different route. You might actually drive out the good lives by that behaviour.

MS CHESTER: In the default segment where people aren't exercising choice?

MR JENKINS: Yes.

MS CHESTER: Okay. All right, then - - -

MR RICE: Particularly if premiums vary by funds then the good lives will be the ones that can opt out.

MS CHESTER: Yes.

MS MacRAE: We're already in time.

MS CHESTER: Are we?

MS MacRAE: Yes.

MS CHESTER: Okay, one quick last question, if I may - - -

MS MacRAE: I wouldn't mind one as well, but anyway - - -

MS CHESTER: You go first.

MS MacRAE: I'm just a bit concerned about the role you see for employers going forward, because I can see from your point of view talking about larger employers being well-equipped, and I think we would agree with that, that there's quite a number of large employers, but we also hear that there's a lot of - a vast majority, of small employers who are absolutely not well-equipped and do not want to make this choice and one of the reasons for members - us trying to get members more engaged and put the onus on the member making the choice is that we feel that most employers are - it's not their job, financial advice is not their job, they don't want the job and they don't see that they're expert in it and they don't feel that they should have to become expert in it so they won't, and so we've just got a concern around the ongoing role of employers in this space. And I see that your model sees them having an ongoing and probably even a heightened role if you got rid of the FWC, so I'm just wondering what your response - - -

MR JENKINS: Well, not necessarily, what we're saying is that's a role for employers who choose to take that route and not those who don't want to. So we're actually supporting your process of the allocation of members when they join the workforce without - - -

MS MacRAE: Okay, so the employee would still choose?

MR JENKINS: Correct.

MS MacRAE: But you would still give a role for employers where they wanted one.

MR JENKINS: But the employer is able to override if it sees it can bring economy of scale and some special benefits to its employees whilst they're with them - - -

MS CHESTER: And, Tim, when you say override, because we did have some very carefully crafted language in our report and chapter about what role employers and unions where they do feel they're able to get a better deal for their members, when you say override what do you mean by that,

how would the employer - so say in our world a member has gone into a best in show or they've chosen and elevated MySuper, they've gone to employer A, employer A said we've actually got a better deal going, another super fund for our workforce, we'd like you to join it and here's what you can get and here's what this - is it offering choice, the member, or is it an override?

MR RICE: Well, perhaps I can - the issue is if it's a large employer and they may subsidise the plan, they may have staff that deal with employee benefits and they may pay for the fees or insurance or some part of them, then they clearly could give a good outcome provided the fund itself is properly authorised and APRA is comfortable that it meets the bar. But if you took that away that fund would quickly become diluted and, you know, if all new members joined a different - one of the best in show funds, over time that employer fund would lose its scale. And the employer might then decide that it's not worth continuing. So it's a philosophical issue, should there be an employer fund or not, I guess is the issue.

MS CHESTER: I guess based on the evidence that we could grapple there, Michael, we were detecting that that was an area that employers were exiting playing a role.

MR RICE: Yes.

MS CHESTER: And what was elevating was the problem scenario that Angela has identified. But if you've got evidence to suggest that there's a whole bunch of big employers out there who want to go gangbusters about providing support and getting better deals for their members we'd love to get it because we haven't got that information. We really struggled to get sort of the corporate discount story, it's not out there openly and transparently for us to - - -

MR RICE: No, there's a significant number of fairly small funds as sub-plans of master trusts or industry funds that offer extra benefits.

MS CHESTER: And I guess we then need to distinguish offering extra benefits on top of their in a top performing fund as opposed to offering extra benefits on an underperforming or an average performing fund - - -

MR RICE: Yes, I'm sure we can get you something on that.

MS CHESTER: Yes.

MR JENKINS: And of course the MySuper legislation does permit the

employer scaled discount, and it was put there for a reason, of that coming through.

MS CHESTER: So in a world of an elevated MySuper where they're good products, which they aren't today, all said, how you could make that happen without it being some form of compulsion for the employee.

MR JENKINS: Yes.

MS CHESTER: Which we've kind of tried to get to in the report, and maybe you could give us a bit more guidance as to how we could do that in a way that's readily implemented?

MR JENKINS: Sure, yes.

MS CHESTER: Because we don't want to stop employers from doing the right things where they want to.

MR JENKINS: Yes.

MS CHESTER: Okay. Is there anything else that we haven't asked you that we should have asked you or is there anything that you wanted to say that we haven't allowed you to say?

MR RICE: No, I think it's very comprehensive and we're looking forward to your final copy which presumably will come out before the end of the year sometime.

MS CHESTER: Perfect. And we look forward to getting your post draft report submission to us.

MR RICE: Okay.

MR JENKINS: Thank you.

MS CHESTER: That will be great, thanks so much.

MS MacRAE: Thank you.

MS CHESTER: And sorry for my misinterpretation earlier today.

MR JENKINS: No problems at all.

MR RICE: That's all right.

MS CHESTER: Okay, folks, we're going to take a luxurious 15 minute break to have the best instant coffee that Sydney has to offer outside and we'll resume at 10.45. Thanks.

ADJOURNED **[10.25 am]**

RESUMED **[10.43 am]**

MS CHESTER: Folks, we'll resume the hearings, thanks. I'd like to welcome our next participant, John Berrill, who, fortunately, made his flight from Melbourne this morning. Thanks, John. If you wouldn't mind just stating your name and organisation for the purposes of the transcript recording. Then if you wanted to make some brief opening remarks, it'd be most welcome.

MR BERRILL: Thank you. My name is John Berrill, I'm a principal at Berrill and Watson Lawyers. I've given you a one-page dot point of issues that I thought might be of interest. I don't propose to give an introductory statement other than to say where I'm from.

I've been an insurance and superannuation lawyer for 25 years representing consumers. I'm currently on the board of Consumer Action Law Centre who you're from tomorrow. I'm on the Superannuation Complaints Tribunal Advisory Council. I was on the FOS AFCA transition board and previously I was the Stronger Super and the SuperStream implementation council. So I think I've got a bit of experience in the area and I've got some insight into some of the issues that are raised in what I think is a terrific draft report and deals with very, very important issues and it's got lots of – raises lots of issues that are really important for consumers and provides a good way forward, I think.

I'm happy to perhaps – if you want to ask me any questions. I will be putting in a written submission and there's just a couple of points perhaps at the end before we wrap up that – there's a couple of issues that I think or potential unintended consequences in the draft report that I wanted to raise with you briefly to have a look at.

MS CHESTER: That's great. Thanks, John. Look, maybe given the lens that you bring to superannuation where you've seen maybe, the bad, bad and the ugly along your journey, and hopefully some good as well, our report kind of identified what we thought were the two largest problems; unintended multiple accounts and persistent underperformance,

and then how that trickles through to member harm.

But I guess behind the persistent underperformance is difficulties for members to engage comparability products. Are there other material problems in the system, from your experience, John, that go beyond those issues?

MR BERRILL: There are many. And this is one of the good things, I think, about the draft report and the design piece around best in show is that it incorporates a number of other areas that are relevant. I think if the design piece is substantial it can connect the dots and solve a lot of the problems. For example, unpaid superannuation, that's a huge problem for clients I see. It's a huge problem particularly in the casualised workforce, et cetera. It's not dealt with at great detail in the draft report but I think it's a key part of consumer rights here and making sure consumers are adequately looked after in retirement. Insurance issues around comparing products. You raised the issue of zombie products. I couldn't agree with you more; that's a significant issue and needs dealing with.

There's also issues around the type of insurance products that are on the market, and you raised the issue of income protection, whether it should be opt in rather than opt out. I've have long held views about the role of income protection in superannuation. There are issues around claims and consumers' access to information, both in claims, both in the products they've got. That's dealt with, at least in part, by the code of practice. But you've identified some flaws in the code of practice being designed; and I couldn't agree with you more, certainly in some of them.

I think it all sort of dovetails into each other and it sort of hangs off the best in show proposal, which I think is a novel proposal and I think it's very worthwhile. There's a couple of issues in it that concern me. I suppose it'll depend how it all plays out. What I worry about is once the 10 are selected, what then happens to the next 10, 20 who are good performing funds but don't hit the mark and aren't in the best in show group. For the next four years after that they are going to be at a disadvantage in that they won't be getting new members under the default regime. They'll still be getting new members but they won't be getting it under the default regime.

What I fear might happen is they'll lose members so that their economies of scale in relation to admin fees and in relation to risk profiles in relation to insurance, they may result in increased admin fees and increased insurance premiums. That's what I fear for those who are not underperforming funds, they're well-performing funds. The draft report identifies that there are significant co-hoarder funds that are well-

performing, are good performing, but they won't hit the top 10. So I do have concerns around them.

One of the areas I work in, my sort of meat and potatoes over the years has been insurance issues, advocating for consumers in relation to insurance. Unpaid super is a big issue around that. So if the default funds are removed from awards, one of the mechanisms by which consumers can seek to have unpaid super paid is through the award system. It is actually relatively cost effective to do it through the Fair Work Commission. It's not perfect, but it is a mechanism that consumers have and we have used it on many occasions. But if the best in show funds are removed from that arrangement, superannuation is removed from that arrangement, you lose that collection mechanism. The primary collection mechanism is through the ATO under the Guarantee Act. But, as has been highlighted many times over the years, that has had its flaws.

The primary problem has been resourcing for collection, also issues around what constitutes an employee as opposed to an independent contractor. There's all sorts of issues around that that has meant that many consumers who are employees and who are in the employed workforce, particularly the casualised workforce, have missed out on superannuation. It has a huge long-term impact. Particularly it affects younger people and it has a huge long-term impact. But one of the unintended consequences of that is that the ATO is charged with the obligation of collecting unpaid super. They do that, but there are resourcing problems with that.

But they don't collect any insurance that's lost. So if someone is in a job, should be in a super fund, they're not, because the employer doesn't pay, then they don't have the insurance. So I've acted for many people who in that situation have become disabled or died and all that the ATO can collect is the unpaid super, plus a bit of interest. There's no collection mechanism or no recourse to collect from that employer, bring action against that employer for their lost opportunity for the insurance component. That does exist under the award system and it does exist through the Fair Work Commission. But that would be lost if they were removed from that.

MS CHESTER: That's a lot to cover, so let's start with the best in show list. I think one of the things – the way the media sort of played out the best in show list, some participants have suggested that there's going to be this huge benefit to those 10, albeit it comes up for review every four years, they'll become a cosy oligopoly, although I'm still struggling to see how 10 funds that are subject to competition every four years can meet any definition of oligopoly.

But we were very careful when we structured it, John, to make sure that it was – it's only the new entrants. So that's about $1 billion annually for new job entrants. Then you might expect people that were switching or re-entrants and turnover might also be attracted, moths to the flame of the best in show. When you actually look at the metrics of annual contributions, all of those three, taken collectively, are only 13 per cent annual contribution. So they're only about 20 billion. There's still, all up, $150 billion.

So all those members that are already with a good fund, so under an elevated MySuper if they're with a good fund, unless switching rates were to go from anywhere between 2 and 8 per cent to a high level, I can see there's still very significant commercial advantages for the best in show list of having that status and we want them to want that status because that's how we inject the competitive dynamic to make sure that we don't continue with a lacklustre distribution of performance.

But when you structure it that way and it comes up every four years and, indeed, the size of the system, being 2.6 trillion today and being forecast to be about 4.3 trillion by 2032, that can support a very large number of very large funds. So I think we're not overly concerned and we're hoping that those industry participants that think that that's not how it will play out, we need to get some evidence from them about what increase in switching rates would be required such that those 10 funds would become the 10 only in show.

We've structured them in such a way – and the reason we chose the 10, John, was two things. One it was really when you look at the distribution that actually allows for a good competitive dynamic because there is a group just below them that you think would be nipping at their heels every four years. But more importantly, behavioural economics told us that if we wanted to make it simple choice for members, particularly new job entrant, up to 10 was about right for the member.

MR BERRILL: I completely agree with that. I've seen over the years and I get asked this so many times by clients, "What fund should I join? What fund should I join?" The proliferation of superannuation funds means that there's effectively no choice and there's effectively limited competition because people are not geared to this, they're not paying attention to their superannuation, particularly new entrants; and this is the target group. I mean, we've had default funds dealt through awards. We had them through the CHOICE regime. We had them through MySuper. But they've never properly dealt with the issue.

There are too many funds out there. We do need, I think, a small cohort of default funds and I agree entirely with the notion that it should be a confined number, whether 10 is the right figure or not, but it sounds like a reasonable number to me. I agree with you that the effects on those outside the best in show is ameliorated by the fact that the target audience is only new entrants. But then when you deal with it over the – I think probably closer to the end of the four-year period is when you start to see the potential effects on those that are CIPR, particularly if their funds whose dynamic is more younger people. I think that could have an effect on them.

I don't really care for the funds themselves, I care for the members of the funds and how it would affect them and would it mean, particularly closer to the four-year period, that their admin fees, their insurance premiums would be on the rise and would that be an adverse consequence. That does concern me somewhat.

MS CHESTER: We did transition modelling. For those funds that are what we call net negative cash flow positions where they've got more outflows than inflows, they're the ones that you need to start to be worried about if they start to lose cash flows. Where we're focusing on is those that are underperforming that are in that territory should lose MySuper status and their members quickly get shepherded, otherwise it's this case of slow death on the vine at the expense of members as they sort of go through that process.

MR BERRILL: The enhanced role of the regulator in relation to MySuper and oversight of performance I think is an important factor and that is in the draft report and I support that, for sure.

MS CHESTER: Before we get to insurance, unpaid super – and I'll probably let Angela talk to you about that because that's about the ATO and what we're envisaging there, which I think might address some of your - - -

MS MacRAE: I will admit – and I don't know if any of our team is – I wasn't aware about the award mechanism that allows for you to get compensation for your insurance through the award system. If we were to remove the arrangements from the FWC, as we're proposing, even if it required a legislative change, is there another mechanism – I mean, it sounds like it might even be worth making some kind of change to allow the ATO to also take insurance within its powers under payment and losses. Would you see that as a good outcome and something that might effectively replace then what's - - -

MR BERRILL: I'm not sure how well they'd do it though, frankly, because what you're doing is putting the ATO in the position of making a decision about what someone's loss was. So they would have to make a decision about whether someone was totally TPD, for example, or unfit to do their usual job for income protection purposes, make that decision and then make a decision about whether they should bring action against an employer who didn't pay. So I'm not sure that would play out very well.

MS CHESTER: It might actually be the new FOS going forward would play that role because they're meant to be doing more in the super space. That's the sort of role that they would play.

MR BERRILL: Who, sorry?

MS CHESTER: The new Financial Ombudsman Service.

MR BERRILL: No, they wouldn't be doing that.

MS CHESTER: I haven't worked on this directly, but my understanding is that new enhanced role, that is meant to cover super. So if people haven't gotten what they're expecting to get through super, they actually have the role of assessing the case and making sure that compensation or - - -

MR BERRILL: But that's against the superannuation fund. So there must be an FSP, a superannuation fund that you're complaining about who's complaining against the employer.

MS CHESTER: I guess that's the issue; is it within their remit? I guess we're trying to work out – we agree with you if that's the problem, for a small cohort that super is not being paid and a risk event has occurred and they haven't been able to claim on insurance policy they would have either defaulted into, what's the best mechanism to deal with it?

MR BERRILL: AFCA won't be able to deal with that because the common situation is somebody starts work with an employer, they're not paid superannuation or there's a delay in that superannuation contribution being paid or they're not paid super at all, then there's no superannuation fund to lodge a complaint against that drives you into action.

MS CHESTER: No, because it's the employer who hasn't paid. We understand that.

MR BERRILL: So there's no right of complaint to AFCA against an employer. Your complaint is against the trustee of the super fund. From

there they can potentially – others can hang off such as insurers. But you can't bring a complaint to AFCA against an employer for non-payment of super under the proposals. I've been involved in those and yes, it's not good.

MS MacRAE: I'm guessing if you could see a way of finding a mechanism that would work, that would be helpful to us if you had some ideas about how we could.

MR BERRILL: The primary other mechanism is for breach of contract, employment contract. The problem with that is that the case law says that super guarantee, SG contributions are not automatically imported into your employment agreement. It's only if the employment agreement says so. Now, most awards specific superannuation in accordance with the Guarantee Act as an award obligation. But a lot of employment contracts, if someone has one, do not. So that doesn't give you a contractual right of action against the employer. Therefore, you've either got the ATO, which has no power to collect this secondary benefit, or if you got through the award system, which does allow for it.

MS CHESTER: If the ATO currently have the powers to get the unpaid super contributions - - -

MR BERRILL: Back four years.

MS CHESTER: If that were extended to insurance?

MR BERRILL: Yes, but as I identified before, Karen, the problem with that I see is that the ATO in order to bring such an action would have to make a decision about whether someone was or was not totally and permanently disabled or unfit to do their usual job to bring such an action because your loss is the lost benefit. You've got to have an entitlement to that benefit first. You've got to make a decision about whether someone is TPD or not.

MS CHESTER: We're going to car park this one and we'll try to work out how we can come up with an effective solution.

MS MacRAE: I was just going to say in your remarks you said that you'd had some long-held views about IP and insurance and how it all works.

MR BERRILL: I do.

MS MacRAE: I'm wondering if you could elaborate a bit on what they

are.

MR BERRILL: I will. If you look at the history of superannuation and insurance within superannuation, in Australia there was originally defined benefit funds, usually government funds, and they provided defined benefit formulas which included benefits for – defined benefit formulas for death and permanent invalidity, which were usually pension – well, the permanent invalidity benefits were usually pension benefits as opposed to lump sums. And they were lifetime pension benefits for totally permanent incapacity, for example, or death benefits, with perhaps reversionary pensions for surviving spouse and children.

With the introduction of occupational-based superannuation and compulsory superannuation, a lot of superannuation industry funds and retail funds and also corporate funds developed policy settings around insurance to compete potentially with what were these old DB funds. The design model was usually death, a death benefit lump sum, a TPD lump sum and an income protection payment for a maximum of two years, a temporary disability benefit payment for two years. The policy setting being that the TPD benefit, at least, was designed to – so if your working life was cut short because of a disability and you can't go back to work, you'll have an inadequate retirement income. So the TPD insurance benefit was designed to top it up so you did have adequate retirement income.

The policy setting around the income protection was a two-year benefit because the TPD benefit involves an assessment about long-term incapacity to return to the workforce. So the benefit design was for a short to medium period of time you'll be provided with some income support with a view to getting you back into the workforce so you become productive, your superannuation would start again, you build up on your adequate retirement income. That's the sort of policy setting behind it as I've seen over the years.

That product design has evolved significantly over the period with product designs have been put in place. But the significant change occurred in about – I think it was about 2004 when the regulator allowed for superannuation funds to provide income protection bonus or temporary incapacity benefits not capped at two years. What followed from that was in the last 10 years or so some super funds have moved towards providing long-term income protection benefits. Rest and Hesta, for example, have got income protection benefits to retirement age, some with a matching super guarantee contribution as part of the insurance benefit but some not.

Now, in my view, income protection, if you're looking at what the

design purpose of the insurance within superannuation is, it's designed as a retirement – it's got to be a retirement benefit. It's got to be consistent with a retirement benefit. Income protection is not a good fit for that because that is a working life income benefit. It's not designed as a retirement benefit, it's designed as a benefit to tide you over for a period of time that you're out of the workforce. As I say, that was sort of spread out a bit with the change that was made in the mid-2000s.

If you look at the stats – and I've seen the data in the draft report – the income protection insurance premiums constitute a significant proportion of the total insurance premiums paid by members. What I see is that I think income protection for the long term is not a good fit because it doesn't provide you with a retirement benefit. It provides you with a working life benefit. I see the sense of having a benefit for two years with a view to promoting people back into the workforce.

There is also a debate going on in the industry at the moment about whether insurance companies should be allowed to provide limited medical expenses, rehab expenses to promote people getting back into the workforce. A very good measure I think. There's another committee dealing with that at the moment in Canberra. So in my view, there's been issues around the affordability of insurance, the cost of insurance premiums in this market, in the group market, over the years.

It's certainly been the case that it's a wholesale product. There's AALs which mean that people get coverage without having to go through individual underwriting and it's very cost-effective so that the compliance obligations are a lot less in the group market. So it's a much more affordable product. It's a very good vehicle for delivery of insurance to the Australian market. But the cost of it increased significantly in the last five years and in no small part due to lawyers, so people keep telling us.

MS MacRAE: Can I just ask, do you know why the change was made in 2004?

MR BERRILL: I don't know actually. It was just announced. It allowed insurance to be provided for longer periods. It did take a bit of time for that to kick in. But quite a few funds have now got it for benefit periods beyond two years. In my view, that is not a good fit for a retirement income benefit. I think, at least in the default setting, if you're doing – if part of the piece here is sort of a comprehensive design piece, including insurance, then I think this would be an opportunity to look at that issue of the cost of income protection, its relevance as a retirement income and I think to revisit this issue about whether it should be paired back to the two years.

But what it should definitely come with is it must come with an SG component because – for example, Rest does have an SG component. Its default insurance income protection offering is a maximum of $2750 a month, 77 per cent of your income, plus a 10 per cent SG component that's paid into a super fund. Without that SG component, then it has no relationship really at all to a retirement benefit. I think if it is that you see your role in this in providing the report to look at a substantial design – I'm not suggesting you sit there and work out all the terms and conditions of every policy. But if you're looking as part of the best in show – and it's not dealt with in the draft report, but I think looking at what arrangements or what minimum default arrangements for insurance should be in the best in show fund, this is I think something that could be worth looking at.

MS CHESTER: I think the other vehicle that we can use, John, that we identified in the draft report is the insurance code was a bit underwhelming for us, particularly when we looked at what it appeared to be at the beginning and where it got to in the end. So we say that we want ASIC and APRA as confident pro-member regulators to sort it out, elevate it, bolster it, make it enforceable. In that context, I think in our draft report, we'll probably have some things to say about areas where we want it to be enhanced, the code, and talking about of comparability of entitlements or the policies. I think that would be the avenue as opposed to best in show for us to pursue better design of insurance within super.

MR BERRILL: I suppose there's design and design, isn't there? If you're looking at sort of minimum standards you could look at the issue around income protection, whether it be a two-year benefit or not. But if you're looking at the sort of more detailed analysis such as standard definitions which you raise in the draft report, yes, that's better dealt with in – and that is dealt with – sorry, it's not actually dealt with in the code of practice.

MS CHESTER: Not now, yes.

MR BERRILL: They deal with it as headings. They don't deal with it. But they say – and what's been said to them many times – and this fed into why the external administration dropped off from the draft report to the final code of practice was they said, "Section 58 of the SIS Act says that the trustee cannot be directed – dictated to by a third party". There are exceptions built into that such as an SET determination or APRA determination. What we will need I think as part of that is legislative intervention to extend that to a code compliance committee.

I couldn't agree with you more and more power to your arm in suggesting that a code of practice should be compulsory, should be external oversight. It's a minimum standard from the consumer movement I've worked in – I've been involved in developing codes of practice in the general insurance industry, bank industry for years. Codes of practice are good if they operate well. A crucial part of it is having external oversight. There is an issue in relation to the SIS Act and how it operates which needs legislative intervention. But even without that, an external administrator has the power of investigation, audit, reporting, name and shaming. There's a role that can be played right now by an external administrator.

I was actually involved in some of the consumer discussions around the development of the draft code and the final code. We certainly expressed our view in no uncertain terms that we're disappointed with the final product, particularly in relation to the external administration to the extent to which that this gives it – they kicked along and it happened sooner rather than later, terrific.

MS CHESTER: Some have suggested – we said two years and that was too long. What's your view on timeframes? If we do get a competent regulator going in there and making it happen, what do you think is reasonable given - - -

MR BERRILL: Look, I suppose aspirationally one year would be great. Don't get me wrong, I think the code of practice has got some really good features. Before we had a code of practice – I operate in the area of claims, I operate in the area of complaints and I operate in the area of information distribution to members or the lack of it and complaints around those areas. So for years we've dealt with a system that had no time limits, poor information provision and complaint systems that took too long.

The code is very prescriptive in relation to those things and it's really good in relation to those things. But there was some watering down in relation to, for example, the inactive accounts et cetera and particularly in relation to external oversight. But I think the code, generally speaking, is a significant step forward. But it does need bolstering. It needs it now. We need it yesterday, not in two years' time. But I think aspirationally one year would be okay.

MS MacRAE: All of that in a submission would be terrific, all of the things you've just said, particularly I think in relation to this – at least as I read the main issues around getting to the end was we just can't make it binding and enforceable because of this role, there's this conflict with

what the trustee can and can't – you can't encroach on that. The trustee having to do what's in the best interest of members and you just can't override that - - -

MR BERRILL: But the code defaults to the best interests of members and defaults to the law.

MS MacRAE: Anyway, anything you could give us on that would be especially welcome because we've had the counterview but we haven't heard much on the other side.

MR BERRILL: Yes.

MS CHESTER: The other two things it would be good to get your thoughts back on, John – and these are areas that we went further than the government did in the budget and insurance – was around what – so the government had under 25s as well. We see the trustee being required to play a bit more of a proactive role. From our member survey we identified that one in four members didn't even know that they had insurance in super. So having a basic calculator on a fund's website so a member can jump on and actually understand "I've got these policies and this is the trade-off that's been made in terms of my retirement balance. Am I happy paying that to have life insurance if I've got a family and a mortgage? Maybe yes. Do I want income protection?" This is – so we've seen some new entrants with apps where members can dial up or dial down their insurance cover, according to what implications it has for their retirement balance.

The only perverse risk then is if they do that, does that then flip them out of a group policy into an individual underwrite and being somebody who benefits from a group policy you may not want to be flipped into an individual underwrite situation. So there's all these sorts of things that we're trying to grapple through. It would be good to get your feedback in the post-draft report.

MR BERRILL: Yes, I will.

MS CHESTER: But if you've got some thoughts to share with us now, we'd love to hear the rest of them.

MR BERRILL: The answer is yes to all of that. There's no doubt that there's a lack of consumer awareness, there's a lack of consumer engagement in superannuation. Superannuation is a compulsory product. It's only compulsory because of a lack of consumer engagement in retirement incomes. Insurance is a subset of that. There's a lack of

consumer engagement in insurance within superannuation. Yes, I think making those sorts of changes to information provision will help, but it's at the margin and it's incremental change. It's a slow change.

I've seen over the years I think people's awareness of superannuation and insurance within superannuation has increased, but it's a slow burn. I think it's directly related to the size of the account balances. People are now paying a little bit more attention to their superannuation as their account balances increase. I think the best in show arrangement provides a mechanism for young people in particular to be more involved because they actually have to make a decision about which of the 10 they pick. So I think you're going to get a little bit of a spike in member interest or engagement from younger people. And that's an important thing.

I mean, it's only boffins like me that look at this stuff. You get product disclosure statements. They're impenetrable so many of them. Back in the day insurance would only be a couple of pages out of the 30-page PDS. It's now about six or eight out of a 20-page PDS. So it's a significant component to it. I'm asked all the time by people who have got potential claims on what their entitlements are in particular situations. It takes a while to go through a PDS to work out – sometimes you need a compass and a cut lunch to get your way through this stuff.

MS CHESTER: I think sometimes great treatment for the insomniacs of Australia. But I guess the other mechanism we've identified – and it's not so much about the member then making a decision about whether or not they want to have insurance in super, but having the trustee be accountable in a public sense each year to what's the trade-off that they've decided for their members and on what basis did they decide that was right? That's something that we think they should report annually on their website and their annual report.

MR BERRILL: Yes.

MS CHESTER: Not so the members will go and read it but so informed journalists, informed academics, informed people like yourself that are looking out for members' best interests can have a look at those founds where the numbers don't actually look like they could be in members' best interests.

MR BERRILL: That has an impact now that it never did have before. I mean, back in the day superannuation was part of the business section of papers which is a couple of pages in the middle of it in one day a week. Financial services is now a big story, it's big news and journos are interested in it and good journos are interested in it. You're looking at this

stuff and funds are responding because they're worried about appearing on the front page of the – so it's risk aversion stuff. So I couldn't agree with you more that that stuff can have an impact. It will have a limited – as you acknowledge, Karen, it will have a limited impact on consumers because they don't look at this stuff as a general rule. But yes, it can have an impact in the marketplace and in the media, and that's a powerful tool.

MS CHESTER: John, I think we've covered a lot of bases here. Is there anything else you wanted to cover?

MR BERRILL: There's just two things. One thing is this is a potential unintended consequence. I'm not sure it's been addressed before. That is, the duplicate account issue and the impact on, for example, a TPD payment. If you have duplicate accounts and you roll them over – if you've got an account – if you've got a current fund with a TPD benefit in it and the TPD claim is accepted, the benefit is calculated and, in particular, the tax is calculated based on your eligible service period, which is the date of the commencement of your membership of your fund.

If you have rolled into that fund moneys from inactive accounts you will inherit the eligible service period start date from those funds. So what it can mean is that the eligible service period is spread out and the tax-free component of that is a lesser period. So it can have significant consequences for the tax payable on a TPD benefit if you have duplicate account rollovers.

MS CHESTER: We're trying to get rid of unintended multiple accounts by having members, new job entrants default once and then going forward people auto-consolidate as they go. The other option on the table by some industry participants in the media – and I'm sure we're going to hear about it tomorrow in Melbourne – is instead of the member having one account that follows them through their life, the member takes their balance with them and rolls over with every next job. So that's going to trigger the problem that you're talking about.

MR BERRILL: It will.

MS CHESTER: That is good to know before tomorrow, John; thank you.

MR BERRILL: Just one thing with that is that there's a recommendation at the end of that mopping up of old duplicate accounts, legacy stuff. One thing I think that could perhaps be relooked at is I was involved in the Stronger Super arrangements after the Cooper Review. One of the Cooper Review recommendations was a three-step auto-consolidation process.

The last step of that was never implemented. I'm not sure why it never happened. I think it was because the Tax Office turned their attention to lost super accounts and consolidating those. But the last auto-consolidation process which was the latest employer – if you joined an employer, then that employer could then search the ATO's website and auto-consolidate any money into that fund on an opt-out basis. It's just something to help with the mopping up process.

Just one other thing. I'm a board member of the Consumer Action Law Centre, which is a not-for-profit organisation that is actively involved for consumers' rights in this area and other areas, the financial services. I strongly endorse the notion of a dedicated consumer organisational voice to deal with issues around this stuff. I mean, superannuation is an issue now and it's something that is in the public mind now that never was. There's a need for a consumer voice in this area. CALC I think is a terrific organisation. I'm on the board of it. But I think we need a voice in superannuation. I think the CALC model is a very good model, but it's something that needs looking at.

MS CHESTER: During the course of our inquiry we've struggled to get the consumer voice. We've managed to find people like yourself and CHOICE and CALC, academics. Indeed, we want the regulator to be a bit more of a member's champion. But we had some good evidence from CHOICE this morning and we'll be hearing from Gerard Brody from CALC tomorrow.

MR BERRILL: You will.

MS CHESTER: But, again, it's good in your post-draft report submissions just to differentiate what role you see that organisation playing versus the regulator doing their role for members. What's the gap that still needs to be filled, if there is one.

MR BERRILL: Superannuation, it's a bit of a funny creature in this sense in that superannuation fund trustees see themselves as we're acting in the members' interests. We have their interests at heart, so we will promote their interests. This plays out in dispute resolution as well. It's not your typical commercial relationship. There is a voice for consumers that are provided through the superannuation organisations. But there's, nevertheless, a competitive – there becomes a tension point at which consumers' interests can deviate from those of the trustee. In that sense, I think there is a need for an active consumer voice in this dynamic environment.

MS CHESTER: Indeed. I think we did a word search in our stage 2 of

all the submissions that we got from the representatives of the industry and the word "member" rarely came up. Anyway, on that note, thank you very much, John.

MS MacRAE: Yes, thank you.

MS CHESTER: We look forward to your post-draft report submission.

MR BERRILL: Thank you.

MS CHESTER: We've got some auto-consolidation happening here. We have our next two participants merging together without any prompting from the regulator. We welcome them; Prof Susan Thorp and Prof Hazel Bateman who have been with us on this journey even before we started the three-stage process when we did post-retirement super and housing decisions of older Australians. Firstly, on behalf of the Commission, thank you so much, both of you, for all your help and constructive engagement and involvement in all of our work to date. Now we're nearing the end, at least of our work. So just for the purposes of the record, if you both state your names and who you represent, although I understand it's individuals, but which universities you're affiliated with and then if you'd like to make some opening remarks.

PROF THORP: My name is Susan Thorp, I'm Professor of Finance at the University of Sydney Business School.

PROF BATEMAN: My name is Hazel Bateman. I'm Professor of Economics in the School of Risk and Actuarial Studies at the University of New South Wales.

PROF THORP: In terms of opening remarks, we'd like to echo some things that have already been said by contributors this morning. That we congratulate the Productivity Commission on all this lengthy, extensive and thorough review process and work that's been done. As Hazel said earlier today in discussions, this is a report that's really well put together and easy to read and very, very informative. I think that the emphasis on understanding how members are affected by default settings is absolutely the critical point to be concerned with and the focus on that in this report is unusual and very welcome.

In general, the questions relating to the way that these structures impact on people over the long term, how it promotes or discourages engagement and the focus on trying to encourage the industry to turn towards members, as you just noted, is extremely helpful.

PROF BATEMAN: I'd just like to add I've been working on and thinking about superannuation issues for half my life, which is a long time. When I first started looking at this we had a lot of corporate funds, we had a lot of employer involvement in superannuation through defined benefit corporate funds. But the world has changed and the labour market has changed and I don't think it's unreasonable now to break the nexus between the employer role in superannuation and superannuation accounts. In fact, I think it's a good time because the world is changing and we know that people move employers, we know people move in and out of self-employment, unemployment, employment. It's important that people can take their accounts with them. So a big tick there.

One of the things as I read through the report I saw that there's an increased emphasis on financial product disclosure, so disclosure information for people to enable them to make sensible decisions. I'm hoping you're going to ask us some questions on that because we've actually been thinking about financial product disclosure since about 2010 and we've looked at – we've consumer tested different types of disclosure that's now regulated such as the standard risk measure for risk, the shortfall in financial product disclosure statement and the dashboard. So hopefully you're going to be asking us some questions about that.

I also applaud your highlighting the insurance aspects of superannuation. Even when we look at financial product disclosure we see that there's been a lot of attention to disclosing risk, fees and returns, far less attention to disclosing insurance information to people. Finally, I'd like to highlight the comments you make about data. As people who've been working in superannuation research for quite a long time, we've always had a problem with data. We understand on the industry side there's lots of inconsistencies between data and sometimes measuring performance. There's a lot of concerns that they're not measuring like with like. But trying to get good data on members – as you report and as we know from our research, funds just don't collect the data that helps you to make good decisions for members. Overall, a big tick. It's a great report and a great starting point.

MS CHESTER: Thank you very much. Before we get into some of the architectural changes, let's talk about information that matters to members if they're to have any sense of engagement or able to do a little modicum of comparability across products. You could probably sense in our report a sense of frustration with what's happened around disclosure and product dashboards. We've identified a way forward with a strident member champion regulator making it happen. A one-page my product dashboard across all products, not just MySuper, that's about information that would help members make a safe choice. I guess are we being too aspirational?

Is that achievable? If it is, who should the regulator be consulting with? What sort of information do you think would be on it and what's a reasonable timeframe to make that happen?

PROF THORP: I think in the setting that we're in where people – as many have said this morning, where people are being compelled to contribute or their employers are being compelled to contribute on their behalf into a mandatory system, adequate information provision and comparison is absolutely essential and ought to be required. So I don't think it's aspirational, I think it's minimal. In terms of the consolidation of this information into a central area, that's an area that's clearly lacking and it can be quite difficult for any individual to find even the prescribed and simplified formats of disclosure now for the fund of which they are a member.

So actually finding the dashboards in different funds' websites can be challenging. I know from setting assignments for students that navigate – even third-year finance majors have trouble navigating the websites of different superannuation funds and finding the information. So ordinary people who don't really know what they're looking for will find it quite difficult. So consolidation and comparability are really important. I'm sure that Hazel will reinforce this too. Our experience with testing, even the simplified forms of these disclosures, indicates that the format in which information is provided for people has an enormous impact on the way that they use the information and whether they use it in unexpected and unintended ways or whether they use it in the ways that are expected.

The work that we've done over the past few years, for example, on the MySuper dashboard indicates, for example, that people are able to perceive the differential impact of fees. But the way that, for example, returns are presented in that format is very, very uninformative and, in general, people do not understand the risk information that they're given pretty much at all. So part of the problem is that the way that these disclosures are developed goes to some degree to understand the comprehension of people in limited ways. But so far the development and testing of the disclosures that has been done generally doesn't go as far as understanding how they're going to be used.

I know from the work that you did in an earlier report you tested certain formats of information, but they weren't actually the same as the formats of information that people are given under the current legislation. So if it is to be the case that this comparison becomes increasingly important, particularly for people on entering the workforce and making a choice about a fund from a short list, comparing 10 MySuper dashboards is not a task that I would like to undertake. Understanding how this could

be done and testing to see whether it's working effectively is absolutely critical to the implementation of the system.

PROF BATEMAN: I'd like to add to that. I think we have to be very careful when we design this information. Our experience, as I said, we've got papers that we can submit in a submission, but we have papers looking at the standard risk measure, which is so many years in 20 of negative returns. We have papers looking at consumer understanding and use of the eight-page short-form disclosure and also the dashboard. In all of those cases if you look at the history of that disclosure, those information formats were decided by regulators, policymakers and industry effectively sitting around tables deciding what they think people might understand.

Then the way that regulators have tested those – and, in fact, I don't think the regulator tested the standard risk measure – but the way that the eight-page financial product disclosure and the dashboard were tested were to use companies that tested a very small number of people on what they thought of the format. "Do you like the font? Do you think it's a good size? Can you find the information? Do you think it will be useful?" The way that we test this is we run CHOICE experiments and we get people to actually use this information to make hypothetical decisions. But we motivate people to make those decisions and incentivise their behaviour.

We find that people not only find, particularly in the dashboard, find the information very, very hard to understand, but use it in surprising ways. For example, when we tested the right-page financial product disclosure statement – and we dig deep in the research here – looking at the regulatory impact statement, a lot of that was designed to help people understand risk and return. Yet we found what people focused on in using that information was the assets allocation information. Using that, they ended up using risk and return in the wrong direction.

You have to be very careful here with financial product disclosure. You need to understand how people are going to use the information and don't just use rules of thumb. I saw in your report several times that less is more. Our work shows that less is not always more because people can misinterpret this information. If you look at the MySuper dashboard there's a graph in the middle and, of course, some of the academic literature tells us, behaviour literature, people prefer graphs. They can understand graphs. Have you ever tried to understand the graph in the middle of the MySuper dashboard? I mean, the people in our experiment had no idea.

I think we have to be very careful with disclosure. It's not always – it

does help people but we have to be very careful that we pre-test it properly and we don't just use norms that less is more, that people like diagrams, that people like graphs. We have to be very careful that we're not leading people to use this information in ways that we don't think they will.

MS CHESTER: I think what will be helpful for us going forward is – we've got what I would call a high level recommendation about how to take the dashboards forward. And you're right, Susan, in linking it back to – you imagine a triage world of a new job entrant tomorrow going to the ATO website, doing tax file number, then flipping to, "Hey, you need to now choose a super fund. Here's 10," with some basic information on the 10, see if they want to make a choice. But if you want more on them, maybe flick through to a dashboard. For us to get some more guidance from both of yourselves in a joint or separate post-draft report submission so we can put a little bit more flesh around that in the final report.

We did actually say in the draft recommendation that when these one-page dashboards are prescribed by the regulator as to how they will be done and then they'll all be available on the ATO centre website, that they have to be subject to extensive consumer testing. But if you think we need to put some more discipline in there about what that extensive consumer testing should be, not in the recommendation, but perhaps in a chapter, that would also be helpful.

PROF BATEMAN: It's interesting to know that the world is moving on too. Something that we would say in our submission is look at what the SEC is doing in the US. There's now a number of academic papers on the lines of beyond disclosure. Even well-tested disclosure only partially helps people and perhaps you need other things to help people make decisions as well.

PROF THORP: I'd just like to make a comment about that in relation to the discussion about – both in relation to the discussion that we're having about how people might choose a default and the discussion that we've just had about employer compliance with pay and superannuation guarantees and things like that. One of the aspects – we often focus on how people might use information about fund characteristics to make a choice of a fund. But a lot of the confusion in financial decisions relates to the process as well as their information content.

As you would know, in many cases a new entrant to a the labour market or to a new job is confronted with superannuation information in a bundle that comes along with a contract provided to them by probably an HR clerical assistant who is not very knowledgeable themselves and probably has little interest in the understanding of the employee as to

what's in this bundle and what it means for them. One of the things that seems to be lacking is an understanding of the whole system and how it works.

If I join a super fund, what should I expect to see? How often should I be reported to? In what form will those reports come? What should my balance look like in six months' time so that I can tell whether my employer is actually contributing as I expect or not? for example. This sort of information is not readily available to people and it's not yet in the social capital that we carry around with us. So process as well as content seems to be an important part of the disclosure, in my view.

For example, the taxi driver is always really helpful. This morning on the way to the hearing the taxi driver said to me, "Can I ask you one question? How do I opt out of your life insurance in my superannuation fund?" This was not a 22-year-old. This was a man well into middle age who would have been in the system for quite a long time but still did not understand the process by which these sorts of steps can be undertaken. Then immediately I hear that question I had that slightly sinking feeling of actually, this is quite a complex process. Even though on the surface it feels simple, these things are difficult to do. I think disclosure runs to practice and process as well as information content.

MS CHESTER: I guess that then goes to if trustees are acting in the best interests of members life would be a little simpler for members in terms that it would be one or two clicks to get to a product dashboard or one or two clicks to get to how do I change my insurance in super? In the interim, who should be doing that role? Is this the role of the regulator telling funds what they should be doing? Is it the role of – I mean, we've heard earlier today that even a pro-member champion regulator still isn't enough. We need a superannuation consumer centre similar to what we see in energy markets to help the member know that basic semantic that I think you're getting at, Susan. Maybe not answered between now and - - -

PROF BATEMAN: It's sort of something that should be on a government – well, these days people interact a lot online. So it's sort of something which should be on a government website. The government is mandating us to be part of this.

MS CHESTER: Where we take a member to MyGov today to do their auto-consolidation, to get their tax file number, to do all of this, the basic how-tos of our super system need to be there as well is what you're saying.

PROF THORP: Yes, the basic how-tos and information about what I

can expect. What should I expect to find out? What's going to happen next? How will I know when something is wrong?

PROF BATEMAN: A lot of this information is already in different forms on the MoneySmart website. ASIC has thought, I think, quite well about how to explain some of these things to ordinary people.

MS MacRAE: Quite a lot of people wouldn't even know who ASIC is though, would they?

PROF BATEMAN: No, that's right. In fact, the MoneySmart website is not that easy to find unless you're looking for it on the ASIC website either.

PROF THORP: That's not to say that the consumer advocacy organisation would necessarily be any easier to find. Then it also raises questions, at least in the initial stages, as to credibility. So independent advocacy organisations have an advantage if they are both independent and advocacy organisations. But I tend to agree with Hazel, that since this is basically a tax structure and it's enforced by government regulation, that the public sector has a responsibility to see that it operates efficiently in the first place. Now, maybe that's a responsibility that under certain circumstances is well-delegated to an independent authority. But in the first place I think it lies with the authors of the regulation.

PROF BATEMAN: The work that we've done in many different contexts shows that people make better decisions and all sorts of financial decisions if they understand the context of their decision-making. So people who have better knowledge of the superannuation system are likely to be able to make better decisions. That's often even more important than having financial literacy skills, actually having system knowledge skills.

MS CHESTER: From the member perspective then, we're now hearing from industry participants that what we're proposing is high risk, experimental and unproven and, indeed, it's dangerous to allow a 15-year-old to make a choice. I guess our partial counter to that is we did do what we thought was a thoughtful and robust experimental CHOICE survey of like a best in show arrangement. You guys are the gurus in this area. Is there any other work that we should have done as part of our evidence base to make sure that the best in show process is as robust as it should be so it is safe and simple engagement for young members?

PROF THORP: What people do when they're faced with a complex problem that they're not sure of how to answer – actually, when we go

back to talk about engagement at some point we should talk about the fact that most people don't position themselves as uninterested in superannuation; they position themselves as unskilled. In fact, work that Geoff Warren and co-authors and I have done in this area would suggest that the idea that people are uninterested is somewhat true for a low stakes member, but generally the obstacle is feeling unskilled.

So what can we do in that instance in – whether a 15-year-old knows how to answer this question or is capable of doing it will vary a lot between different 15-year-olds. But a good majority of them wouldn't really necessarily have the right set of skills. So if they go to a problem and they're confronted with I need to choose a superannuation fund from a list of 10 and they don't quite know how to do it, they're likely to use a rule of thumb. So whatever system it is that we offer to them needs to be robust to those rules of thumb.

For example, if it is the case that they may choose randomly from the list, then it should be not to their great detriment if they choose randomly from the list. Or if they choose the first fund on the list, it should not be to their great detriment. Or the one with the appealing name, the one that sounds familiar. Who knows how this might be done. It will be done in many different ways. But if it is the case that the offering at that level is reasonably homogenously of good quality, it may not matter.

MS CHESTER: But then what does it mean for I guess initiating the engagement at that first decision point for a new job entrant, having them default once into either a best in show or an elevated MySuper good product? Does that auger better in a world of greater semantic around super, hopefully, but then them actually sort of making informed decisions when events occur in their life then as they go forward in super as opposed to it becomes very binary with what we hear from industry participants. It's, "Well, they should only really get interested in super as they approach retirement," and that's when financial advice might be appropriate or – I don't know if you were here earlier this morning when – it's starting to sound like it's a very binary system. All of a sudden the light switch happens and then they can become engaged.

PROF BATEMAN: It depends here what we talk about engagement. We have a paper which is actually cited in your report, "Just Interested" – I've forgotten what we called it now. But there's a difference between active engagement and people being interested. A far greater proportion of people are interested in superannuation but don't make active decisions such as changing investment options or changing funds. We found that there was a close relationship between interest and people searching for information, getting onto the website and looking for things. So you don't

actually have to be actively doing things to be interested. We have to be careful what we're talking about here with engagement and people being interested.

PROF THORP: The reality with all sorts of consumer decision-making is that there's a huge variety of responses to any given situation. So it's impossible to generalise how any individual 15-year-old would respond to being confronted with a choice. There'll be a small minority of people to whom the decision makes no sense whatsoever and there'll be a small group of people who are highly engaged already and thinking about what this means for them. Then there'll be a big variety of behaviours in the middle. So the question of will giving people an active choice at this point lead them to more engagement with superannuation later is very difficult to answer and I don't think any of us know the answer to that question.

But what we do know is that engagement comes with super in many indirect ways. It's a work in progress at the moment and the results are very preliminary. But work that we're doing indicates that, for example, other major financial decisions lead to engagement with superannuation. So people that are thinking about purchasing a home demonstrate increased interest in their superannuation account at the time they're making that decision. Work that we did last year with one of my students indicates that insurance, while as your report points out and as our study also shows, is actually very poorly understood and many people don't know that they have it, for those who do start paying attention to insurance, that becomes a point of engagement with superannuation as well.

The roads into super are not necessarily super driven. They're driven by general financial decision-making. That point of engagement with your finances at some point in your life will be different for different people.

MS CHESTER: I like the way that you described it before about making sure that it's set up very carefully so there's no disadvantage when they do exercise choice. That's kind of what we're trying to do with the architecture. But, you're right, a lot of it is then going to be in the implementation of what they see when they go online. The other main problem that we were dealing with was unintended multiple accounts, which we kind of identify as more than problematic in terms of their impact in terms of member harm but also very highly progressive.

Another way of dealing with unintended multiple accounts, it's been put to us – well, not put to us directly but through the media recently – is

to have the balance roll over with the member. So every time a member changes job, unless it's the same fund or MySuper produce, they would take their balance and move it to another fund. I guess that's another way of getting rid of unintended multiple accounts. Our way is actually stapling the account to the member and the member takes it with them unless they choose to move or unless that account is no longer MySuper authorised.

It'd be good from the lens that you bring to this problem what you think of the relative merits of the two ways of getting rid of unintended multiples. That was a very long way of asking a short question.

PROF BATEMAN: That's interesting. I would like a world where when you first start working and you make contributions you have a super fund but you have a bank account. I mean, you don't change your bank account every time you change employer. And this is unproven, but I suspect that we would have greater engagement if we had a default system with active choice at the beginning, so there was awareness at the very beginning. Young people are very different to people like us. Young people live in an electronic world with apps. This is ad hoc sort of evidence that I observe younger people doing their banking on apps which I don't do yet.

You join. You have a super fund. You engage at the very beginning because you've made this decision out of a shortlist. I would see people would wonder why on earth – I would imagine young people would say, "Why on earth do I have to move to a different fund now that I've changed my employer?" There's nice evidence in the report about the increasing flexibility of the labour market. People are moving jobs a lot more. People are moving in and out. People are working as Uber drivers and all sorts of things. It would be a bit silly to keep changing your account, in my view. Once you got used to a super fund, the way it communicated with you, the way it engaged with you, why change funds?

PROF THORP: The only reason you can see for changing funds at that point would be if you were moving out of an underperforming fund to a better performing fund. That would make you potentially better off. And the reverse could also be the case. So there's that aspect of it. But as well as the member relating to the fund itself, the fund gains an understanding of the member. So one of the problems that we have is that many funds don't have a labour market history of their members. They don't trace them through – they don't have very good or long panels of data.

If it were the case that a person, at least by default, stayed with the same super for most of their working lifecycle or perhaps moved at some

point, the funds themselves, I would imagine, would incur few administrative costs with churning and, as well as that, would gain a better understanding of who their individual members are and what's happening to them over time. So there could be a deepening of knowledge which at the moment is really seriously lacking in the system. As we pointed out and as you point out, the funds themselves have a very thin understanding of what their members are experiencing and what their financial situations are.

I think that is a really critical misperception between the members of funds and the funds themselves. I think most members, if we asked them –and I haven't asked this question directly – actually think that their funds know a lot more about them than they do. I think a lot of people perceive that their funds know everything that HR their employer knows, which is evidently not true. So we could improve the data collection that way too.

MS CHESTER: The other area that we're – a lot of people sensed that our report was very much just focused on the accumulation phase. It wasn't. We still tried to do quite a bit around transitioning at retirement and then post-retirement products, and we talked about a world of reverse constellations where things are very complex and muddied in accumulation and very simple in retirement. We're now hearing from folk around the CIPR proposal in post-retirement super and making that a soft default. I note that's still sort of an evolving policy that the government is still working through with treasury.

We kind of focused on the approaching retirement and post-retirement phase as making sure that funds do have tailored products to meet their members' needs. For many members that might be the point in which financial advice, particularly if they're going into CIPR product, might be appropriate. We had some evidence this morning suggesting that that might not well be needed. It's just if you get the My CIPR product right, then it's steady sailing. It'd be good to get your thoughts around that because that's also going to feed back into what guidance an expert panel might need to look at when deciding on a best in show.

PROF BATEMAN: I had trouble with the CIPR proposal from the very beginning that there would be one product which was appropriate for a fund membership because we know that people are so much different at retirement than when they start work. There's a lot of difference in background, financial assets, in home ownership, in household makeup. A whole range of things are different when people reach retirement. There's no reason these days when we've had choice of fund that people in a particular fund are going to be homogenous. So I had a lot of trouble with that from the very beginning.

We also know from work that we've done and many other people have done that people stick with defaults. If you set a default, the odds are that 80 per cent of people are going to stick to it, whether it's appropriate for them or not. There's a whole range of reasons for that. I mean, a lot of them stick to it because they just procrastinate. But people stick to it because they think it's a recommendation that that's what they should be doing. So I had problems with the single CIPR.

I think what needs to happen at retirement is people need a lot more guidance than they're getting now. Disclosure is one thing. I think funds need to offer people a greater portfolio of products. At the moment it's an account-based pension or leave the fund and partially annuitize or take a lump sum or whichever. There needs to be a greater menu of products. But I think people actually need guidance and guidance can be disclosure, but that's only part of the story and that's where disclosure gets more complicated because we have to disclose expected lengthy of life to people as well as costs and returns.

I've been toying with the idea of whether we need mandatory sort of advice around the time that people are thinking of retiring to be able to convert accumulation to accumulation. I think people need help. I think we need more than just a dashboard which explains the key features. I'm not sure that people need a full $10,000 financial plan, but they do need some sort of help that they're currently not getting. That's I guess my starting point on that.

PROF THORP: I'd reinforce the non-scalability of advice at retirement. Apart from the heterogeneity of people as they reach that point, the means testing of the aged pension means that general settings are not scalable. That's not about to go anywhere quickly, it's not about to change, neither necessarily should it. Then in addition to the complications of making these decisions at retirement, many people eventually will also find their financial situation impacted by the need to My Aged Care, either in home or institutional, which, again, is complex and non-scalable. So the sorts of – the points of time at which people need a lot of guidance certainly retirement and then probably through retirement at different stages as well. Yes, the work that we've done in this area, first of all, shows that people are very limited in their understanding of the way that retirement income products work even when they're explained to them in simple disclosures, and that, again, given that complexity, they'll revert to using rules of thumb in this instanced as well, which can be costly at this point.

MS CHESTER: Susan and Hazel, have you had an opportunity to look at where the CIPR product is going in the treasury consultation at the

moment?

PROF BATEMAN: We haven't specifically spoken with treasury since the budget actually, since the report came out just after the budget.

MS MacRAE: I guess one of the key problems is – I think that there's no disagreement that people do need that advice at retirement. But we heard from Jeremey Cooper this morning that there's very little training for people. So while in theory people getting advice and more advice is better than CIPR, there's a lack of that advice available. People are still having trouble working out even if they can get advice whether they can trust it or not. Some of what we've seen from the ASIC report says that's a problem as well.

In some senses I think the resort to a CIPR arrangement is because the alternative is advice that we also don't trust. So we're in a world of second best and is second best CIPR over can't get advice or get poor quality advice?

PROF BATEMAN: I think we need to be careful about what we mean by "advice" here. Sometimes people don't need a full financial plan. What they need is someone to explain to them what an annuity is or to explain to them the implications of an account-based pension that it's not giving you longevity insurance, which studies that we did many years ago showed that people got those products mixed up, for example. Because you call something a pension, so they assume it lasts for their life. I think people need explanations of products, understanding products. They don't need a full financial plan.

MS MacRAE: Would you see a role of the government in doing that or do you think there's another – is it some kind of other advisor type role and would those people have to be accredited in some way to make sure that even when they're just providing that information - - -

PROF BATEMAN: I mean, it's possibly something that if people are going to buy some sort of hybrid product that's got an account-based pension and an annuity, some sort of CIPR, that they understand the broad description and implications of that product at the time that they buy it. So they don't need a full financial plan for that, but they need to be sort of – some sort of tick box that they actually understand what they're doing.

MS CHESTER: Some discussion that they means they understand it in terms that would be relevant to them at a high level, like do you own your family home, are you married, are you going to be getting the full age pension, those sort of basic - - -

PROF THORP: In some cases it's unsuitability that people need to understand necessarily rather than suitability. So indicating who this does not suit would at least be the start of a conversation. That's probably a shorter list and an easier task than trying to explain the workings of longevity insurance to anybody at that point. It also goes to process. In discussions with treasury I've often emphasised the fact that people need to be talking about framing their accumulation phase in ways that help them understand that this is a retirement provision, which is changing at the moment, but until recently was not the way that accumulation was framed. And then talking to people about what retirement incomes might look like.

As a person in my 50s, I don't love the conversation about retirement. Everybody feels slightly the same about this I think – differently about this perhaps. But making a translation from accumulation to decumulation by explaining to people how their accumulation is going to turn into a retirement income is something that is not happening. So people are coming to this decision very cold in terms of their potential understanding of what's going to happen next. What is going to happen next? What might this look like?

Then at the same time – then if it's the case that these things are complex, heterogeneous and hard to understand, they need to be easily reversed, which is not necessarily the case with longevity insurance products, for example, and people need time to understand how these things are going to work and how they might change it. So rather than seeing this as a point in time decision, we really need to see this as a phase, as a process where there's information in advance, there's a process of decision-making and there's the opportunity for revision as you move through this period of time.

There's no need for it to be made in a hurry. Things can be held in – and they are now for many people held in sort of states of transition and allowed to move slowly through this process.

MS CHESTER: I think this is an area of the report that we want to advance between now the final. The baby steps that we've taken I think they're good baby steps in the draft report are around the government has trusted the ATO nudging people as they approach retirement to here's a website with some information about what you need to know about super and retirement, that sort of thing. So it would be good to get your feedback on how we can put more flesh onto that and for our final report - - -

PROF BATEMAN: Actually, it all comes down to what's the goal with superannuation? To provide income in retirement is my take on it. And just pushing other work that we've just finished is looking at putting benefit projections in statements. As the moment as a standard people will see a lump sum. What does that really mean? But if you start putting income – if you convert that using standard sets of assumptions, which everyone can argue about, but convert that to an income you get people, hopefully at an earlier age, thinking about my income in retirement and that will get them to understand income products more than they currently do. But it would also, hopefully, get them interested and be thinking about have I got enough, should I contribute more, should I work longer, can I afford to work part-time in my 60s? There's a whole range of things if you convert that lump sum to an income stream.

PROF THORP: One of the interesting things we found in that study, which we weren't expecting to see, was that this reframing of benefits into income, the actual reframing had the largest impact on the youngest age group. So that the 25 to 35 year olds that we included in this experimental work were the most affected by the income stream reframing and the projections. The older group were the most willing to add to their savings but the younger group were the most susceptible to the reframing of the information.

MS CHESTER: We did a little experimental choice survey with our cameos to that effect and we've got a comments site on our website and media call back station suggested that's exactly why it's there. But we did actually draw on your work in approaching that way. I'm conscious of time. Are there other issues that you wanted to raise with us that we haven't covered? I think this has been pretty comprehensive.

PROF THORP: I just want to go back to reinforce this issue of distinguishing between activity and interest when it comes to engagement. I think it's very important that we don't confuse those two things. While I understand the Commission's emphasis on the need for activity in terms of applying competitive pressure in the market, which I fully support and I think that the divergences that we see are, to some extent, an indication of a lack of competitive pressure through inertia, at the same time it's very important not to assume that people aren't interested just because they're not doing something.

PROF BATEMAN: I'd like to add to that. We have another study where we actually have survey data of people's actions and people's interest, but we also asked the question on trust in their super fund. We found that there was a group of people who don't do anything and they don't do anything because they trust their super fund. So they appear in

the data as being disengaged but they are actually interested but they have trust.

MS CHESTER: So they have made a decision. On that positive note, thank you very much. We're keeping the academics (indistinct) and invite our next participant to join us. Thanks for joining us, Geoff, and also our sincere thanks. You've been with us on this journey but you also were very much the coalface of our technical roundtable work which helped us to compare apples and zebras in a world where we haven't been able to do that. So we're very thankful for your help behind the scenes. With no further ado, if you'd just like to state your name and organisation for the transcript and then some opening remarks and then we'll go into - - -

ASSOC PROF WARREN: Geoff Warren, I'm Associate Professor at ANU. Opening statement. I'd like to make four points in my opening statement. The first one is I'd also like to congratulate the PC on their draft report which I think was of high quality. It showed really good depth of understanding of the industry and I think, most importantly for me, if there was somewhere where you were unsure about the analysis, you were very clear about that. So you know where the warts are. That's a good thing.

The other thing is I have to say most of the recommendations, it was very sensible. So anything I say here has to be countenanced as overall pretty supportive of the direction you're taking. I'd like to make some – the first thing I'd like to do is make some observations on the investment performance benchmarking. First thing is I think it did the trick, basically. It did highlight sort of the distribution across the industry. Particularly notable it highlighted there was a lower tail there that needed to be dealt with.

Perhaps the only other thing I'd sort of say about that this – and I've suggested this to you already – is that you maybe need to do some statistical analysis around to make sure – to ask the question, does this deviate from what we'd expect if it was random or just the usual fluctuations you get within funds? Because you're going to get a statistical distribution, what you need to ask is, is there something strange happening within it? I bet you that tail will pop out when that's done. But that I think is just a step I'd add in.

The second point I'd like to make in opening is comments on the process of allocating members to default funds, best in class. Now, I have to say I think the idea of a panel selecting the best hand has a lot of merit. And most of those arguments have been set out by yourself. But for me, I think there's three that are important. One is it is going to stir

competition; big tick there, that's valuable. Secondly, I think it's a very good mechanism for dealing with multiple accounts; so that's a big tick there.

The other thing I think is important – and this will connect in with what I'm saying a bit later – is that you've brought in an informed party to make a fund selection. One of the things that's missing from the industry has been an informed party often making the selection. This was highlighted before when there was some discussion over the informed employers versus those who don't want to – they're just left – basically members are left to the wood. So I think bringing in an informed party to make that selection is very useful.

But one of the big questions here I think is – and it relates to my previous point is that do you need to change the industry or do you need to clean up a tail? I think that's really one of the big questions. I know in some of the earlier discussions you raised that yourself, so you're very aware of that issue. So I think a lot of what I'm going to say before about – I would like to discuss later about the unintended consequence and some of the consequences of if you do go the route of going for the top 10 funds around that sort of issue is what cost could there be in trying to change the industry in that way to secure the benefits that you've identified?

One of the main things I'd sort of suggest is that a much more thorough and diligent being done to try and tease out what could be the unintended consequences of going down that route so that you can either do a proper cost benefit analysis – you get all the costs, potential costs on the table – or you can identify what needs to be dealt with if we do go down that route.

The final thing I'd like to say is just more a conceptual one. But can I say one of the ways you can look at – you can look at super as a product or you can look at super as a fiduciary exercise. I think this is particularly important in the default. That is, that – we've heard this earlier. You've got members who are interested but don't understand, as Susan and Hazel were saying. We got that from CHOICE earlier. They basically want to trust somebody. They want somebody to tell them what to do. What they're crying out – that says I'm crying out for a fiduciary relationship, somebody who'll look after me.

When you actually go down the route of trying to get members to spur the competition (indistinct) you establish it more like a product provider and you end up with different dynamics. I think one of the things that might happen when you go down the top 10 route where you're pushing on competition is one of the costs is you could disrupt the fiduciary side of

things. One of the things I noticed in the discussions today the trustees are the ones in the fiduciary relationship, but they aren't getting a lot of discussion here as well. We're getting members – we're getting discussions about the proceeds of funds. But one of the players here with a fiduciary responsibility is the trustees. I know that you've got the governance part and the rest of it trying to deal with that. Again, it's a prism you look at it through.

Is it a product or is it a fiduciary relationship, a trust relationship? If you see it through trust relationship, the governance and the board things really become critical. Anyway, I'll stop there and maybe you might want to explore some of those issues.

MS CHESTER: That's great opening remarks, a great start. Thanks so much, Geoff. I guess the first question is, why best in show, we were trying to inject a modicum of healthy competition in one segment where there's no competition, being default, and mindful that we see elements of unhealthy or non-workable competition in the choice segment. If we assume a world of an elevated MySuper, so we lop off as much of the tail as possible and we make sure that APRA does that, do we still think there's a benefit of having competition for default? I guess what made us think there was still benefit of doing that is when we looked at the distribution of performance you could see that the around 10 would actually inject that every four years because there's a bunch right under that. But the twin advantage was it made it interest, to quote academics, interest of the member easier.

So they could actually see who were the top 10, decided by an independent, informed group without any conflicted interests. I could then compare my choice product to it, I could then decide whether that was right for me or whether I wanted the elevated MySuper list. So maybe we're trying to achieve two things here. We're trying to inject competition for default but at the same time make it easier for the members to - - -

ASSOC PROF WARREN: Can I just say I have no argument with that. I think they're both very solid arguments and worth aiming for. So that's not really my - - -

MS CHESTER: They're focusing on the unintended. I guess one thing is – and there's maybe two streams to this, Geoff. The first one is making sure that we don't create perverse incentives around fund behaviour with the best in show. The main way we've tried to address that is it's every four years. So that means others get a chance to compete. But we identified in one page what would be the kind of the high level principles

that we'd expect the expert panel to apply. We haven't been overly prescriptive. But I think that's one avenue that we need to make sure that we've got those principles right, such that when they exercise the choice they're not creating any perverse incentives around investment strategies and the like.

It would be good to get your feedback on those as to whether we need to go further or have a modicum of greater prescription. The other side of unintended consequences is the value to those funds of being best in show, what does that mean for flows to them? We actually got the team just to revisit recently the metrics around all of that. So when you look at overall contributions every year they're about 150 billion. Of that 150 billion, 1 billion are the new job entrants. So they get those guys. Then there's switching, which is about 2.2 billion. So you might expect that might increase with the best in show list. You've got re-entrants and turnover, that's another 16 and a half billion. So in all that's about 20 billion of your 150; so it's only 13 per cent.

In terms of unintended consequences for the other good funds, that seemed to us to not be too much of a jolt to the system. So you'd need to assume an incredibly high level of new switching from choice and even within default to the best in show to have an impact on the other good funds in a fundamental sense. So it'd be good to sort of get your thoughts around that.

ASSOC PROF WARREN: The first question you asked was around how does the panel choose? I've done some research not on this specific problem but how do managers, super fund managers and whatever, choose (indistinct) managers. What we have is an equivalent problem here. When you get an informed person making this choice often investment performance doesn't become the pre-eminent thing, and so it should because past performance is revealing but it's not indicative of necessarily what's the best. So they try to understand it.

But the most important thing – the way to frame your question is, do I trust this manager with my funds? Will I give it to them? It gets down to things like people, confidence in them, governance, all this sort of – the organisation they're giving it to and the rest of it. So that's all healthy. But what happens then is that you end up with also there's a lot of subjectivity in it, which opens up – it no longer becomes objective, so it becomes subjective, so there's both good and bad.

It also means that it doesn't actually stay the same all the time. So the change in the organisation can often drive what happens as a change in selections. The other thing that can drive a change in selections, of

course, is a change in the panel because it is very subjective; so you're getting it every four years. Now, why I'm sort of dwelling on this, I wanted to make two points about it. One is that it's not a straightforward process and getting the best fund going forward is not guaranteed. Just because you end up in the top 10 list doesn't mean you will be best, maybe you're not even best, but at least it's an informed decision, so it's likely to be right.

The second thing is it can become quite politicised and one thing I do worry about this is it will become politicised but at the selection change. If the government is choosing they might want the right type of people being in there. So I'm sort of worried about those things. The third thing is that you would expect some churn. I might just lead onto the second question here. When I thought about this idea that we're funnelling into a specific number of funds I started to think about okay, right now that looks sensible. What happens in 10 or 20 years' time? That's the way I looked at it.

Then I said okay, we're going to have – what you really want is a situation where you have a small number of funds – I think somebody mentioned 20 or 30 – who are all competing to be on that list and they stay competitive. But the problem is what happens if you don't have that consolidation and you have 50 or 60 funds, 30 of which think they're never ever going to get there or they might have been there before and they've fallen off and they've given up.

I think if you get into that circumstance what you end up with is your tail again right down the bottom but they're there for a different reason. So you could end up with funds in run-off, you could end up either wanting to milk – they're just saying, "Okay, well, I'm not playing this game anymore. I'll just milk the members I've got." They don't invest in innovation, they don't have any incentive, they end up to be down in that tail, as I said, for different reasons.

I think it works fine, as I said, if you keep competitive tension against a number of funds that are very high in their game. It then will be good. But there is a risk that one of the unintended consequences that you could leave (indistinct) that is actually hurting those members and giving members that disengage they don't switch out of it or a lot of them don't.

MS CHESTER: Just two thoughts there. One is we're not suggesting the way this is done is a set and forget. Given the size that the system is going to move to in the next 15 years, the government might want to revisit the parameters of the best in show. But we're still mindful that it's making choice simpler and safer for members that's still the driving

factor. On those who might over time – and it would take a long time when we've looked at the transition log and we looked at following the money, the cash flows – except for those that are already in negative cash outflow position at the moment – and a lot of them are already in the tail, we know that from APRA – if they fall off that much that it's starting to harm members, that's when the elevated MySuper kicks up. That's kind of like our little insurance policy along the way. I guess - - -

ASSOC PROF WARREN: By the way, I acknowledge that and, in fact, that's consistent with the notion that cleaning up the tail might do the job as well in elevating MySuper.

MS CHESTER: While we're on cleaning up the tail, one of the areas that we identified about elevating MySuper authorisation further – so there's scale at the moment. There's an elevated outcomes test that's subject to potential legislation and then we've said let's go a bit further. So we've actually even bolstered up what's been proposed to legislation. One part of that is actually saying going forward if you're on MySuper authorised product and you don't meet your own portfolio benchmark, like you miss it over five years by 25 basis points, that you lose your MySuper authorisation.

Now, we're trying to work out should there be a modicum of get out of jail free card for the regulator in terms of applying that. Given it's against the market and their own asset allocation, we really struggle to think of it. And I don't want to put you on the spot if you haven't thought about it. But we would like you to think about it because this is right down your alley in terms of would there be a scenario where they've still got a good fund but it doesn't meet its own benchmark portfolio for that MySuper product over five years going forward.

ASSOC PROF WARREN: Well, I mentioned statistical significance, so 25 basis points underperformed versus your own benchmark over five years, it could be just luck. You place bets when you're in the investment market. Sometimes they don't come off. It doesn't mean they were a stupid bet. It also gets back to what I was saying about manager selection. It's not just about historic performance, it's about the rationale for why he put that investment in place in the first place.

The first thing you'd do is you would inform – an informed chooser is not going in and say they've underperformed by a hundred basis points, they're off the list You go why have they been underperformed by a hundred basis points? Did they actually make a sensible decision in the circumstances or were they just doing something crazy that indicated there was a problem in their investment process?

The people who do manage (indistinct) they do that by going visiting the funds, going through their processes, speaking to all the people and the rest of that. If we're dealing with a panel what information are they going to get?

MS CHESTER: No, this would now be APRA. This is MySuper organisation.

ASSOC PROF WARREN: No, that's too harsh. You've got to allow for just random – you've just got to let the bad luck. What you want to tease out is bad skill from bad luck. Just having a hard limit of 25 basis points against your own benchmark, it's - - -

MS CHESTER: That's across the whole portfolio. They have to have bad luck in equities and unlisted infrastructure and property.

ASSOC PROF WARREN: It could be one hedging decision bet that would cause that.

MS CHESTER: Over five years, less than 25 points.

ASSOC PROF WARREN: Your decision on hedging is – if you got 50 per cent equities and you decide to take a hedging decision, say 25 per cent Australian equities, 25 per cent world equities and you made a hedging decision, that – 25 basis points like that. It doesn't mean they've got bad processes. They just made one bad bet. Same with any other asset – (indistinct) asset allocation level there's a lot of fluctuations there.

MS CHESTER: We might throw that one into the technical roundtable because the other thing we want to do before we come to a landing on that one is we want to do – better understand the drivers of performance. And we can't do that until we've got better investment returns and fees and costs by asset class and then we could do some more analysis.

ASSOC PROF WARREN: I just wanted to get back to the unintended consequences because really I was talking – I was saying before about what happens to – there could be (indistinct) that underperforms. But really what I'm trying to sort of say here is you need – a request or a suggestion you do a better job of that. I have a number of other things that I've listed here, but they're only really preliminary stuff that I've thought of in the last few days. I think there'll be a lot of smart people out there with views on what could go wrong and my suggestion is maybe try and tease a bit of that out and see what you can discover.

But the other ones I had on the list is what would be the basis of competition? I as a fund and I wanted to be on that – want to be on the list, my customer is the panel members. So I think about how I'd go to them. Then once I'm on the list I would have to get somebody to tick the box in my favour. I'm just thinking brand marketing. Brand marketing goes through the roof because (indistinct) both of those. That would cost members as well.

MS CHESTER: But if they make best in show they won't need to do brand marketing.

ASSOC PROF WARREN: Yes, they will because you're one of 10, you'll want to be ticked. If you're a member and you - - -

MS CHESTER: Tipping the behaviour of media in the last three weeks I would have thought that the best in show would be known.

ASSOC PROF WARREN: I think if you showed a new member a list of 10 funds and you wanted to be ticked the first thing I would invest in would be – I don't know – putting my name on the back of a footy Guernsey or something like that so that they do tick you on that list. There's two other things that I mention like – and these both came up by Jeremy Cooper earlier on. Behavioural effects within the funds themselves. Another one is how does it gel with the retirement phase? I think Jeremy was making a suggestion that maybe it's two different skills here we may have to tick the list.

I think these are some of the things where it needs – I guess employer to be better specified and work out what the consequences are so that they can all be identified as much as possible.

MS CHESTER: And you'll cover off those in your post-draft report submission?

ASSOC PROF WARREN: I'll put them in yes, absolutely.

MS CHESTER: Great. Thanks, Geoff.

ASSOC PROF WARREN: I have to now.

MS CHESTER: The only other thing – I know we're running a little bit late now which is probably my fault. Lifecycle products, that was an area we didn't expect to get into but when we did get in there and started doing some stochastic modelling we thought we need to actually do some real work in this area. Have you had a chance to have a look at what we did

around life cycling in the report, Geoff?

ASSOC PROF WARREN: I read what you said and I agreed with it and I did look at the stochastic modelling. I probably wish I did because I knew I was going to be asked about it. But I just – from what – can I just frame how I see the lifecycle issue?

MS CHESTER: Yes.

ASSOC PROF WARREN: There is some logic to lifecycle. But the way you look at it is to say that your superannuation balance is just one of many assets you have. When you're in your accumulation stage the other asset you have is your earning capital, your earning power, which runs down. So by the end you get to retirement – by the time you get to retirement your big asset is the superannuation fund. Then when you go post-retirement there's another big asset there. It's called the age pension. And there could be other things.

So what happens is if you wanted to hold relatively stable risk through time, what would happen is you would probably end up with a de-risking in your super fund at balance, basically because your human capital is running off and – but then you're approaching – so you can get that. But what happens is that I think the industry over-de-risks because what it's doing is protecting a balance at retirement. Essentially you have to solve this problem as a lifetime problem and you have to include all the other assets in there. What you've described about the industry I think is right.

It had a large cost in going into the lifecycle because they over-de-risked and took – in fact, when you take yourself out of your highest returning asset, when you balance this highest you're going to incur the cost in sort of – at the other end and more risk your money runs out.

MS CHESTER: Sorry to put you on the spot then, we should have given you a heads-up. But if you could have a look at our Stochastic modelling. We haven't made a recommendation. We've got a finding I think on lifecycle. We'd like to take that further in our final report. So can I add that to the - - -

ASSOC PROF WARREN: Okay, yes.

MS CHESTER: That'd be great.

ASSOC PROF WARREN: I would probably say something along the lines if you're going to model lifecycle products, do it properly.

MS CHESTER: And we've got some other experts we're going to hear from later on on that, both here today and up in Brisbane on Friday. Geoff, is there anything that we didn't let you say that you wanted to say?

ASSOC PROF WARREN: No, I'm all good.

MS CHESTER: Thanks again for coming today.

MS MacRAE: Thank you.

MS CHESTER: Everyone has earned some calories. We're going to take a lovely break until 1.20. So we'll resume in about 50 minutes. Thank you.

LUNCHEON ADJOURNMENT **[12.30 pm]**

RESUMED **[1.25 pm]**

MS CHESTER: Well, we might resume our hearings today in Sydney, post-lunchbreak, and I'd like to welcome Scott Donald, our next participant, to join us, and he has already. Scott, just for the purposes of the transcript, if you could just state name, organisation that you work with at the moment, and then if you'd like to make some brief opening remarks, and keep them to up to five minutes. Thank you.

DR DONALD: So I'm Scott Donald, I am University of New South Wales, Faculty of Law where I am the Deputy Director of the Centre for Law Markets and Regulation. I also, by way of disclosure, consult to Herbert Smith Freehills on a part-time basis and have consulted to a variety of funds over the last decade. The views that I will express are mine, they are not the views of any of those organisations that I've just mentioned.

I had three issues I thought I might mention as being things that I thought might be of interest to the Commission. The first is one that the Commission has obviously thought very long and hard about, which is around governance and independence of these institutions that we call superannuation funds.

In the interests of being within five minutes, I would just simply like to challenge the assertion that independence of directors is somehow

global best practice. My research and the research of my colleagues can find no empirical evidence to support that assertion. That's not to say that independence isn't a good thing, it may well be, but the idea that somehow you can point to research out there that says it's essentially is, on the basis of my research, not valid.

The research that Professor Le Mire and I did in independence in superannuation tended to indicate that cognitive independence, that is independence of mind, the ability to actually form an independent judgment and to be free from the distractions and pressures of external parties may deliver value at what we might think of as existential moments. So the things like fund mergers, the appointment of a major contractual counter party, such as an administrator or a fund manager and so on.

But was unlikely to demonstrate itself in respect of ongoing investment performance, we just didn't see much evidence that that was likely. What we did find though was that independence by itself would not even deliver that. That in order to be effective you would need buttressing measures around things like how directors were appointed, what sorts of rules there might be around how tenure is to be managed, and one that hasn't been as widely discussed, in this context anyway, remuneration of those directors, who is to receive it and so on.

I'd like now to move to the second of the issues that I might input into the process, and that is the role of the two main regulators, APRA and ASIC. I concur with the draft conclusion or tentative conclusion that the Commission has drawn that to some extent the jurisdictions of those two organisations, in respect of superannuation, has become blurred; it's unclear who is necessarily responsible for what; there are places where there appear to be gaps and there are places where there appear to be overlaps. So I would agree with that.

I think also, and perhaps more fundamental, APRA who have done a great many good things over the past decade for the superannuation system, have started to lose sight of what prudential regulation means in the context of an investment offering that doesn't have a contractual nature, so what does prudential mean when you're talking about a defined contribution plan. I think you can see evidence of that through some of the things that they're trying to – some of the rules and procedures and so on that they're trying to bring in and they don't fit very well, in my opinion.

I would also point to the issues around enforcement of the rules that do exist by APRA and ASIC, over which they have some influence but

not total, and in particular it seems to me there's a lack of political support, at least prior to the Royal Commission into pursuing wrongdoing that's detected. You can see that in the lapsed MySuper authorisation and the infrequency with which fit and proper requirements are ever really enforced in the sector.

When you look at the statement of expectations that the current Government has articulated for both of these organisations, it gives very little emphasis on enforcement, a lot of emphasis on light touch and efficiency and so on, which is fine, but it seems to me that it's very unfair to stand back and criticise them for not enforcing the rules if you haven't actually really emphasised that as being a priority.

Finally, I'd like to reiterate something that I know is a theme in your report, which is the importance of transparency to the system. Transparency is important for a variety of reasons, and I often hear the industry say, "Well, members aren't going to read that", or, "They're not going to understand that". And apart from the inherent obnoxiousness of that sort of a claim, that's not quite the point. This system is disciplined by a whole range of regulatory and market forces, and to the extent that they can be informed by better information, more frequent, clearer, less ambiguous information, I think we can expect the discipline processes to work more effectively.

Actually it's much more effective if they do work that way than if we have to call major inquiries and commissions and so on to actually go and do the hard work in digging it out. So those are the three things that I'd like to suggest. I'm happy to take questions about any number of things, but that was what I was going do.

MS CHESTER: That sounds like a pretty good three things to start with, Scott, so thank you for that. Let's take your batting order and we'll work our way through that as a bit of a discussion. First going to the issue of fund governance, we'll come to system governance with the regulators in a moment.

There's been a little bit of misreporting in the media about our position around independent directors, indeed, we have no recommendation about what would be an appropriate number of independent directors in terms of being mandatory. You're right, we did have a finding that talked about we thought best practice would be a critical mass of independent directors, but that being a means to an end. And that means to an end resonates with some of things that you touched on, that is that it would assist independence of thought at the trustee board level.

I guess the other angle from our perspective is super is fraught with the world of potential conflicts and affiliated interests, and a critical mass of independent directors does afford a control or a check on that at the trustee board level. I like your term "cognitive independence", because at the end of the day, it shouldn't matter who appoints you, if a shareholder appoints you to a board, you still have to act in the best interests of the company, not the shareholder under your duties. It should be the same with super funds, but we know that there are anecdotes and instances of where that hasn't always occurred.

So our focus has really largely been then on making sure that you've got the right trustee board from a skills and appointment perspective. And from what you're saying though, Scott, I think you're saying that we – (1) it would be good to get your sense of have we gone far enough around what we're suggesting boards should be doing and APRA should be reviewing or watching in terms of skills matrices, triennial independent reviews of the performance of the board, the skills of the board and what's required going forward, and then having transparency around who the current trustee board directors are, what skills do they actually bring to the board, and how does that match up with what the board needs today in going forward.

DR DONALD: Those are all very important processes in terms of achieving good decisions or encouraging an environment, creating an environment in which good decisions can get made, and I think that's useful. I'd like to go back to, you mentioned the appointment process, that was something that we were very concerned about, Professor Le Mire and myself, when we were looking at this.

If we have a nomination process which is equal representation and we simply allow the board to nominate their own directors, they're independent directors; they will replicate the existing equal representation structure, almost certainly. We heard that time and time again, that was what they were going to do, or they would redesignate some of their – or they would satisfy the requirements of the statute by just identifying that some of the members who were actually nominated by particular entities were in fact independent, because they could satisfy the statutory definition.

So that process of getting the independence onto the board is, I think, easy to underestimate. One of the suggestions that we made was that perhaps you have member elections, and that was partly to do with bringing members more into the governance of the – and also to inspire the legitimacy of the people who were active on their behalf because there

is a perception in some funds it seems that the board doesn't really represent the members at say the granular level.

I think we really need to look carefully at that appointment process, because simply replicating an existing structure and pretending that the people who have now been appointed as independent are actually independent is, I think, potentially naïve.

MS CHESTER: Yes. So we are in a slightly different world to the corporate world where there is a clear fiduciary duty established between the trustee board and the member, and we're also dealing in the world of compulsion where many members might be interested but not actively engaged. I'm just thinking how would that actually work, Scott?

DR DONALD: Well, that's an interesting question. I'm not sure that corporate shareholders are that much more engaged, necessarily. There are some who are, clearly, but there are a great many who aren't, but yet we seem to have that model thrown up all the time. There are a number of funds which have member relations and they report varying degrees of success and frustration at various times, and that's true of any process. It's like this – it's democratic. But there are also stories of nominations that have gone awry or – so I think we need to be careful with it.

MS CHESTER: So if we get the two things that we want to see at the end of the day at the board, you want to have some clearly independent trustee board members there, and there might be the definition issue, we'll come back to that in a moment, and then the regulator making sure that those people that are appointed do fully meet the right definition. Then the second thing is, if you've got the right calibre trustee directors with the right skill sets, at the end of the day does it matter who ends up getting them on the board, as long as they're the right people in terms of that skill set that's needed?

DR DONALD: The skill set one is an interesting one, because if you don't have that well thought through, and one of the things we encountered regularly as we were interviewing fund directors was that people would say, "Oh, but whenever a conflict arises I excuse myself". Well, that plays havoc with your skills matrix, because now the people who might be most expert on the thing you want to talk about have just left the room.

One of the issues that you have in this area is that the skills matrix has to be robust to that kind of thing, that people may be – you don't want the three people who know something about infrastructure investment to go, "Well, actually I sit on a sub-board related to infrastructure so I have to

step aside here". And now what you're left with is a board that initially looked skilled but now looks quite weak.

So I think it's actually much more difficult than people realise to in practice make this work.

MS CHESTER: No, no, and I guess we were taking as a given that a related party or direct conflicts have been dealt with prior to getting to the point of having another person there with the right skill set, but agree with what you're suggesting.

So if there's anything else we can do on the skills matrix side in terms of getting the right folk on the board, that will be good to know. But also then on the point of independent directors, we hear conflicting views about the definition that's currently being proposed as to whether on that that really deals with all related and affiliated parties, you know, has it got the spirit level right.

DR DONALD: I think, categorically, no. As a lawyer, reading those – the definition that is currently in the bill, Professor Le Mire and I went around and we couldn't actually find any of the boards that we talked to that didn't already satisfy the definition.

MS CHESTER: So give us a tangible example of under the current definition what sort of trustee board member would be appointed that shouldn't be appointed?

DR DONALD: Well, not they shouldn't be appointed, but they would – so for instance - - -

MS CHESTER: Sorry, they wouldn't satisfy the criteria of being independent in your mind, but they would under the current definition.

DR DONALD: I could be a lifelong member – and I don't particularly want to make this political, but I could be a lifelong member of a trade union, but not a director of any of its entities, and I would not be regarded as being anything other than independent under the current definition, because I'm not a director or an employee of the entity that nominated me.

You can go through each of the definitions and find that people who you might expect ought to be regarded as being independent, so for instance there are senior executives within some of the vertically integrated financial institutions who act as independent directors on a couple of boards, they wouldn't be regarded as independent because they happen to serve on another board.

You can argue whether that's a good thing or a bad thing, but the current definition is not well crafted. It's well-intentioned, and I know where it came from in terms of trying to look very carefully at exactly what is the relationship between the individual and nominating parties and other interested parties, but as a matter of legal drafting it's very poor and I think it would need to be revisited to be effective in delivering what it wants to.

MS CHESTER: So from what you're saying it's dealing with the vertically integrated potential conflicts in how it views independence, but it's not dealing with it in terms of other affiliations with appointing parties?

DR DONALD: I can give you the detail, I don't have it in front of me, I don't have the definition in front of me, but as I say, we went through 20 funds and I don't think any of them would fail, without restructuring, would fail currently to satisfy a one-third independent count, notwithstanding that they're equal representation. That was because at least a third of the members on their boards would fit into an exclusion, wouldn't satisfy one of the definitions.

MS MacRAE: So is there a holy grail that you just can't get to? I mean, this might sound like a really ridiculous question, but because of this problem with independence, we've tried to focus more on the skills and attributes you want on board, and I guess there's this – and if you get that right, I guess you've still got to make decisions about when someone is going to have to excuse themselves as a result of a conflict. So you've still got this issue I suppose of what do you regard as a conflict, and ultimately then that takes you to the definition of independence and perhaps it can't be avoided.

But it seems like we've got so hung up on this definition of independence that we've almost forgotten what the aim of the game was.

DR DONALD: But if we go back to the comment I made some time ago, the value of governance judgment is likely to be fairly limited on an ongoing basis. The difference between okay and great is probably not going to be very – not really going to be able to see it in terms of performance very clearly. Where you will see it is where there is a fund merger or some other existential moment where you really have to have clear, unemotional, objective assessment of things, and that's why I tend – although skills are important, I think there's a minimum level skill you must have because you can then outsource other types of expertise.

But that basic integrity of the decision process, it's insular. It's insulation from outside influence and distraction is absolutely crucial. That's why I keep coming back to cognitive independence as being really important. I'm not saying you don't want to have skills on the board, you do, but I actually think that the major risks in governance in the sector don't run from deciding to be 45 per cent of Australian equities or 50 per cent of Australian equities this year, they actually run from who do you appoint as your administrator or who do you appoint as your asset manager of whatever.

I know one of my colleagues is speaking in a couple of speakers time and I know he's looked very carefully at that appointment process and the potential conflicts to really cause bad member outcomes if the process isn't fully - - -

MS CHESTER: Well, we'll park that one with you now and we'll resume in a little while. On the issue of the role of regulators, which is an area that you've helped the Commission on previously as part of our consultation, I guess a couple of thoughts; we've tried to grapple with understanding who's meant to be doing what when, and we look at it through a non-legal lens in terms of if there's this form of misconduct, who's meant to go after it and how should they be doing it, and we tried to do that with the regulators and we got horribly confused. So anyway, they're going to give us some clearer guidance on who's meant to be doing what when.

From your view of what the regulators are meant to be doing, what are the areas of conduct that you're concerned about where there are either overlaps or gaps across the regulators, ASIC and APRA? I say overlaps and gaps, so gaps where somebody should be doing and nobody is, and overlaps where they're both sort of half accountable and, thus, there could be a level of inaction.

DR DONALD: Well, one of the overlaps is obviously the licensing process, which requires the regulators to assess whether individuals and organisations are fit and proper to conduct business either as a financial services licensee or as an RSE licensee, and the types of misconduct that the Royal Commission and, frankly, others have been very aware of for a long time simply haven't been addressed.

Now, is that because the two regulators are each assuming that the other one will take account of it, or is it some other thing to do with the amounts of backing that they have from the Government to actually prosecute?

MS CHESTER: So what would be a tangible example of something that would be considered, in your view, to be a breach of your obligations under the licensing?

DR DONALD: Look, there are examples that we hear at the Royal Commission of people charging fees and so on, when there's no service being provided. We will see, and presumably in a couple of weeks' time, some more concrete examples of misconduct that has gone on that very often does not get fully resolved, and the individuals who were involved in it seem not to be held fully accountable for it.

I can't go into personal details obviously with examples in this forum, but I don't think there is sufficient anecdotal evidence around to sustain that basic problem.

MS CHESTER: So with the forms of misconduct that you're talking about, and maybe in a post-draft report submission you could at a higher level give us a bit more a steerer as to what forms of misconduct they are, which regulator should be acting?

DR DONALD: I don't think there's an easy answer to that particular question. It is a feature of the regulatory landscape that it's divided between ASIC and APRA in terms of market conduct versus prudential regulation. The problem that we have is that when that distinction was made many pension systems around the world were delighted to find benefit, of which there is a promise that you can look at. Prudential regulation is all about ensuring that the promise that's made is actually delivered on.

That's not as clear in a defined contribution system, so you have something that looks much more like sort of a mutual fund type arrangement. It's not exactly the same, but in other countries that would be under a market conduct regulator. I'm not suggesting that's the correct outcome, but it seems to me that we have a bespoke arrangement here that's somewhere in between. It doesn't fit as nicely as insurance and banking does into APRA's remit.

MS CHESTER: Yes.

DR DONALD: And it may be that we – we talked about this in the Cooper Review eight years ago. We may need a bespoke regulator to look at this type of entity, there's enough different about it that makes that worthwhile.

MS CHESTER: So we can understand – and you're right in pointing out the prudential is not the traditional prudential here, and we kind of – and maybe it's a bit awkward and clumsy in our economist terminology – view it as APRA's really about the health and hygiene of the super system, and that's about as prudential as it can be, because as you said, it's an accumulation, it's DC, the member's wearing all the risk, and the way that they do that isn't like in a strategic conduct regulation enforcement way.

Whereas if there is misconduct and misdeeds, that's kind of like ASIC as the market conduct regulator, are there egregiously bad products, is there a clear breach of trustee duties of the directors. But it seems at the moment that APRA's got a foot in both camps, ASIC's kind of missing in action, and they're the first to say that they want to do more in this area. What would be the principal base clearer delineation in your mind between what APRA should be doing in superannuation and what ASIC should be doing?

DR DONALD: Well, I don't know that there is a clear line that I can articulate that in the time we have and the way that you're suggesting. I think one of the things that does challenge APRA and is different from APRA and ASIC that people don't appreciate is APRA's role in – and they're looking into this at the moment in terms of prudential standards – means they actually do create the law. So they table instruments which then go to Parliament and become the law.

But they do so not primarily as lawyers but as financial regulators, and often that's finance economists or actuaries and so on. What you end up having then is you end up having rules that don't fit well and are not terribly easily enforced, because they're drafted by people who aren't lawyers, who aren't experienced in seeing how all these things fit together and what you need to do in order to be able to mount a case in Court.

There are plenty of examples of that. As I said, APRA has a consultation out on that at the moment and that will be some of the feedback I think the legal community will give to them is if you're writing these instruments and you want to enforce them, then they need to be in a form that is capable of enforcement, and at the moment the principles are described in ways that are inconsistent with prior law or don't – or are ambiguous or whatever.

That's actually going to impede enforcement, because you go to Court to say you haven't complied with the standard and the Court will look at it and go, "Well, we're not sure what the standard is expected of the entity".

MS CHESTER: Okay. So there's a couple of things then you've identified at play here in terms of where we're not seeing conduct regulation where we'd like to see it, so there's the issue of other regulators doing what they should be doing. Secondly, have they put in place the enforceable instruments within which to enforce. Then thirdly, you mentioned much earlier on, the statement of expectations, which would kind of look like ancient history now, a long time ago, I think it was 2014, previous prime minister, and very much an emphasis on light touch enforcement and more about getting regulation down.

DR DONALD: Well, it seems to be that would be one very obvious thing that the Government could do if it felt that, off the back of your analysis, that there were systemic shortcomings or things that could be changed, is that by providing a statement of expectation that was more clearly targeted at addressing these things, it would give political cover to the regulators to actually go and do those things.

So it strikes me that it might sound like those are just words, but actually I think it may provide more backbone to the - - -

MS CHESTER: So here's a counter factual, assuming you get a statement of expectations from the Government for both and APRA and ASIC making it really clear that given the findings of our report and given potential findings in the Royal Commission, go forth and enforce and trustee directors that have strayed, you lose your members – you're struck off of you lose your members and we get them into a better fund.

If that statement of expectation was in place, are there any other changes that would be needed to make sure that we get the model regulator outcome here?

DR DONALD: I think you're right to point to the ambiguity and the need for APRA and ASIC to work more closely together to work out exactly who's going to prosecute or what information they need and so on in this area where they do overlap. I'm not sure that you'll ever get a really clean demarcation between what should be in either category, because very often conduct is a consequence of some kind of structure that sits within the organisation, and so you have to deal with both.

You have to deal with the conduct of the miscreant, but also you have to go to the organisation and say, "Well, the reason they've done this is because your remuneration structure is encouraging this and would you please change it".

So I think the idea that it should be just one or the other regulator, or there's just one that's going to be relevant, is probably – I'm not sure that's viable. I think in many cases you will actually need coordinated action to say, "Right, we don't like this conduct but we can also see that it's a product of something that maybe APRA's dealing with, and ASIC can deal with it as well".

MS CHESTER: So the two regulators, working hand in hand, using all the tools that they've got, deciding that they're going to go after enforcement action, whose powers and who's got the best chance of - - -

DR DONALD: I think that does, I think one of the things that APRA doesn't do very well, ASIC has tried to do a bit better, is that you don't want to scapegoat people for bad behaviour necessarily, but you can't do everything behind closed doors. Working behind closed doors to find a solution can give you the space to find something that works for members, there's no doubt about that.

But if you do everything behind closed doors, then you lose the opportunity to signal to others what's expected. You also have a bit of a rule of law problem that you actually want people to know that the law will be enforced, that's actually part of it. So you want that flexibility, to be able to come up with bespoke solutions that will address the issue, but you also want to be able to talk about it and show people so it's not just – you don't have to keep going and doing it in different places.

MS CHESTER: Sounds like Malcolm Sparrow, strategic conduct regulation principles, which are - - -

DR DONALD: Mr Sparrow had some, yes, good things to say.

MS CHESTER: Yes. I think we've covered a lot of ground here. I'm conscious of time. Scott, we look forward to getting a post draft report submission from you with some tangible examples, that will be very helpful. But also, seriously, ASIC and APRA both are going to be very helpful as well, they've been very (indistinct) and they're going to be helping us to better understand the lie of the land.

DR DONALD: Thank you very much for you time.

MS CHESTER: Terrific, thanks, Scott.

MS MacRAE: Thank you.

MS CHESTER: I'd like to ask our next participant to join us, Professor Pamela Hanrahan. Thanks very much for joining us this afternoon, and I know you haven't been extensively involved in our work to date, but we know that you've got a lot of interesting relevant experience around the regulators, which is an area that we're grappling with and, indeed, you were very helpful for me when I was doing the ASIC Capability Review in a previous life.

But for the purposes of the transcript, if you wouldn't mind just stating your name and where you work, and then some brief opening remarks.

PROF HANRAHAN: Certainly. Professor Pamela Hanrahan, School of Taxation and Business Law, University of New South Wales. I should mention that my research interests are predominantly in financial services regulation and the law of collective investments, so more on the mutual funds side rather than superannuation side. I'm also a former regional commissioner of ASIC from some time ago. I was on the ASIC Enforcement Review last year, so we can talk about some of the proposed changes coming from that, and I'm currently an expert advisor to the Royal Commission being run by Commissioner Hayne.

I think I'll follow my colleague Scott's lead and point to maybe three things that we might want to explore. The first one is about the extent to which the current financial services laws support appropriate member decision making in the superannuation context.

So at the moment, Chapter 7 of the Corporations Act is directed at giving certain information to members either at the time they select the fund or during the course of their membership of the fund. So mandatory disclosure both at the PDS stage, the initial investment stage, and then during the life of their investment, including product dashboard, which is within ASIC's regulatory remit at the moment.

They also regulate the provision of advice to members, and that at the moment includes things that are defined both as general advice and personal advice. ASIC's responsibilities in relation to disclosure and advice are limited to people who are defined within the legislation as retail clients, and that often doesn't include for example the trustees of self-managed superannuation funds, who are routinely wholesale investors and so therefore not covered by that regime.

I thought we might want to explore a little bit the limitations of that framework. My view, and I've been on the record saying this before, is that Chapter 7 may well be coming to the end of its life. It may well have

proved to be a failed experiment in some respects, and despite the fact that there has been significant tinkering, both with the mandatory disclosure regime and the advice regime, I don't think we're yet at the point where we've got to a situation where at the very limited points in the life cycle of their fund membership members do actually need to make choices about what they're doing. I think they're encouraged at the moment to make too many choices, but that's a different issue.

But at the point where an individual member is required to make a choice, I don't think they're well supported either by mandatory disclosure or the advice laws at the moment. So that's the first thing we might want to talk about.

The second thing I'd like to talk about, again as a lawyer, is the way in which regulators and legislation thinks about the management of conflicts of interest. Conflicts of interest and, in particular, conflicts of duty, which are also an issue in the system, are not always in financial services law dealt with with the precision or rigour that they're dealt with in the general law of trusts and fiduciary obligations.

I think at the moment there's a bit of – a lack of clarity about what the law requires of people in terms of situations of conflict of interest and duty and conflicts of duty. The legislation was amended following the Cooper Review to deal with conflicts of interest and APRA has strayed into that space as well with a prudential standard. But again, as my colleague points out, not always with a clear understanding of what the background principles are.

That's a significant issue, not just really in the superannuation space but in the mutual fund space as well, because they're also fiduciary relationships. That's my second point.

My third thing that I thought we might like to explore is about the current regulatory architecture, in particular the relationship between what ASIC is responsible for and what APRA is responsible for. But also within that there are issues about the nature of ASIC's own portfolio of responsibilities that mean that even though we think of it as a single regulator, it's in fact doing two quite distinct jobs.

It's a financial markets regulator, or a markets conduct regulator, but it's also a consumer regulator. And I think sometimes internally within ASIC there's a bit of tension between those roles, and I think that has spilled over since the enactment of Chapter 7 and that regime. It was a model that defaulted towards treating investors in – sorry, treating superannuation fund members as if they were investors, rather than as if

they were consumers, and I think that's an issue in the regulatory architecture more broadly.

I'm not surprised that there – well, I understand that the Productivity Commission has kind of taken the current regulatory architecture as a given, I think that it wouldn't be surprising if out of the excellent draft report there was a broader discussion about whether we now are at the stage that we need either a dedicated pensions fund regulator, and that can be accommodated in some different ways, or whether more broadly we need a specialist consumer regulator for the financial sector, either as a separate operating division of ASIC or as a separate agency.

So they're my three issues, the disclosure and advice for member choice, the management of conflicts of interest in the system, and the regulatory architecture.

MS CHESTER: Three substantive issues, let's start with number 1. So we'll go through your batting order. With respect to – I guess one of the common things that came through your opening statement, Pamela, was this is what ASIC can do, but APRA's also come in and done things under the SIS Act with their prudential standards. So I'm just wondering if there is a common thematic here that there are areas where you would have expected ASIC to have been a conduct regulator in the super space, but because APRA's working in that space as well and come in, is there an element of crowding out occurring? Before I get into some of the more detailed issues.

PROF HANRAHAN: Well, the performance of regulatory agencies and why they make choices about the different types of regulatory tools that they use is such a fertile area for discussion, so I shouldn't be flippant and say nature hates a vacuum, but I think 10 years ago after the Cooper Review there was a sense in terms of that conduct space, if ASIC had available to it the legislation and the enforcement tools, then it wasn't using them.

I think APRA came into that space for that reason, and that's really where – I mean, there are areas of overlap in relation to disclosure and things like that, but it's really about that, well, to what extent are trustee company directors, particularly in the public funds, to what extent are they actually discharging their obligations as expressed in the statutory covenants now, and also, to what extent are the trustees themselves performing against those benchmarks.

I think it's – I should add, I worked on Trio, and that was an interesting exercise in inter-agency cooperation, because there were

mutual funds, or managed investment schemes they're called in Australia, in that portfolio, and superannuation funds as well. But there is kind of a sense that people are often surprised how lenient the performance standards in the legislation actually are.

So if you are sitting there and saying, well, what's expected of me as a superannuation trustee director. If you ask a law firm that question they'll say, "Well, it's a very high threshold and there's a duty of care and there's a duty to act in the best interests of the members" and so on. But the conduct has to be pretty egregious before there's talk of enforcement again or, indeed, a successful enforcement action can be run.

Even though there seems to be a lot of regulator interest in that space, when you actually drill down and say, well, what if you've got a board of trustees that's just woefully underperformed for a decade, it couldn't possibly be in their members' best interests to keep this dead dog zombie thing lurching along, but then you say, well, what kind of levers do we have to control that.

But it's not necessarily going to be the conduct, the performance standards that we think about in terms of well, the duty of care or the best interest duty or so on. They're very blunt instruments to control that kind of decision, or why did this merger fail or why didn't you pursue this merger, it's very - - -

MS CHESTER: Is that a function of Corps Law and SIS Act current legislation, or is it how that legislation has been implemented and interpreted and applied by the regulators?

PROF HANRAHAN: Well, duty of care is a great example, right. So company directors have been subject to a duty to exercise care and diligence in the discharge of their functions for 150 years in corporate law. But that's a standard that moves not with community expectations but with community standards. So the level of diligence, professionalism and so on that we require of directors, say, in a listed company is obviously at a higher threshold than it was 50 or 100 years ago.

Sometimes when particularly I speak to audiences of trustee directors and so on, there can be a little bit of a sense of, well, you know, it's good of us to do this job, and don't set the thresholds too high, don't have the expectations too high. And I think that's a pity.

I think there is a space, I'm not a great fan of projection by regulatory agencies, but there is a place for regulatory agencies to be clear about the level of professionalism and diligence and so on that ought to be the

standard, and then once in a while taking action against somebody who falls short of that standard reinforces that message for the whole of the community.

So there is a little bit of prevarication around where those standards are set, and whether that's just because the system has not yet fully matured and we're not perhaps as stern, if that's the right word, as we ought to be about where that line ought to be drawn.

There have been various attempts to do that and for example, after the Cooper Review they redefined the standard of what reasonable care was. So they lifted that by saying, well, it's the standard you would reasonably expect of somebody who was a professional trustee managing someone else's money. So we try and move those things, but I think that there are parts of the trustee community where there hasn't been a full acceptance of the kind of minimum standard and that that needs to be reinforced.

MS CHESTER: So if the legislation now has the right standard of care, and that's translated into whether it's guidance notes or whatever from ASIC and APRA, it shouldn't matter what the industry thinks they should be doing, it's the regulator then enforcing that standard.

PROF HANRAHAN: Well, it's the regulator enforcing that standard, that's quite right.

MS CHESTER: So from what you're saying then, it's not a legislative issue, it's a regulator appetite for action.

PROF HANRAHAN: Yes.

MS CHESTER: That was number 1, and I have to keep an eye on time, otherwise I'm going to get into trouble. Regulators and conflicts, that was your second nugget.

PROF HANRAHAN: Yes, so the management of conflicts of interest is just not particularly well understood in the financial services sector. Part of the reason for that is that some relationships in the financial services sector are fiduciary in character and some aren't. The ones that are include the obligations owed by the trustee to the members.

Now, it may be, because of the statutory covenants that apply to trustee directors, they may have some kind of proto fiduciary duties to the members as well – that's an interesting question as a matter of law. But because you're – the way it works, if we had no legislation at all and we just said, all right, this is a trustee and the members are beneficiaries, then

the underlying legal principle is that a trustee can't put itself in a position where it faces a real and sensible possibility either that its personal interest or that its duty to another person might even subconsciously sway its decision making, right.

So it's not a question of saying this is okay as long as you disclose it, or this is okay as long as you don't act in a manner that's contrary to the interests of the beneficiaries. The general law rule is don't put yourself in that position at all. And the Courts say that's not a kind of ethical or moral judgment, it's just hygienic, right.

It's just a matter of saying because of the vulnerability of the beneficiaries, whose financial interest can be affected by the trustee's action, we say the trustee out of everyone in the whole world is just not allowed to be in that position because it might be swayed or seen to be swayed by the conflicting interest.

What tends to happen in the financial sector, and you really see this in advice for example, is that people think, well, it's okay as long as I disclose it, right. So as long as I disclose that I've got a conflict of interest then it's fine either for me to pursue that interest, right, to say, "Oh, I've got a conflict, but as long as I've told you about it, then it's fine for me to act with that interest", and if you think about advice, that's what happened.

The other kind of confusing thing about using disclosure to manage conflicts of interest is that the evidence, the behavioural evidence is that once a person discloses to another person that they have a conflict of interest; the intention is that it makes the recipient of that disclosure more sceptical. So the recipient of the disclosure is supposed to say, "Well, given that you're going to make money if I act on your recommendation, I should be a little bit sceptical about the fact that you're recommending that to me".

But in fact the behavioural response is the opposite. So the recipient of the information thinks that the person is more trustworthy because they've disclosed that, and they also think, because people are funny and complicated, that they owe something in return for that candour. They are, in fact, more what the behaviouralists call compliant with the advice than they would be in the absence of the disclosure of that conflict at all.

A lot of what happens in relation to the management of conflicts is that there's an assumption that so long as you disclose it, that's fine. But that doesn't really address what the original principle was, which is that the existence of the conflict in and of itself is dangerous.

MS CHESTER: How does that manifest today in super land with respect to you mentioned – quoting you, not me, for the record – APRA stray with the regulation here.

PROF HANRAHAN: Well, there's an interesting piece of legislation that was passed about a decade ago after the Cooper Review that says if you're a superannuation trustee and you have duties to beneficiaries, then you must prefer those duties to your beneficiaries over any other duties that you have, which is fine, except what do you do if you're the trustee of two funds? The legislation just leaves a giant vacuum around conflicts of duty because if I'm under a statutory obligation to act in the interests of A, that prevails over my obligation to B, but I'm in the same position with B, then that's not resolved.

I think it comes back to this issue about the fact that we create relationships which have this fiduciary character and then we embed in a financial system which is rife with conflicts and we don't think that through in terms of, "Well, what's the outcome that we want?" not what's the rule that we want to apply. Law-making is like buying a drill. I don't actually want to buy a drill, I want a hole. So what's the outcome that I want to get?

If the answer is it's fine to disclose the existence of the conflict, so long as you remember that is not permission to act on that conflict, then in theory the law resolves itself. But the guidance is not always consistent with that and the enforcement message is not always consistent with that.

MS CHESTER: What needs to change?

PROF HANRAHAN: What needs to change? It's difficult - - -

MS CHESTER: Is it a combination of all three? Is it a change to legislation, a change to the guidance and how it's been interpreted and then corresponding change to it being enforced?

PROF HANRAHAN: Yes. I think that the – I mean, there is a need to reform the statutory covenant just because it's not – doesn't work in its current form. Then I think there's the place for more effective guidance from regulatory agencies but guidance that doesn't start from the position that well, the industry is set up this way, so we need to come up with guidance that makes that concord of the legislation, which is kind of where we start from now.

What we need to say is, "This is the harm we're trying to prevent. What

do we expect of trustees working back from there to make sure that we avoid that harm?" That's the guidance. At the moment in significant parts of the financial services sector we've kind of gone about it in the reverse direction. So we've tried to make the standard match the industry structure instead of saying, "No, this is the standard and the industry structure is going to have to adjust to that." It's the same problem about fee disclosure. "We can't disclose those fees because they can't be quantified in that way," rather than thinking, "Well, if I can only charge a fee that can be quantified in that way I better change my fee structure."

We tend to – and it's a problem that they had in the UK as well when they changed the law there, that they found that a lot of the political speech about that reform was, "Well, good trustees would have been doing this anyway." The answer to that is, "Well, then why is there a need for legislation?" Clearly they're not doing it. But the firms internalised that message. So they say, "Well, if I've got an obligation to act in the bests interests of somebody," or, "I'm required to put out to open tender all of my service contracts, not just do them within the financial institution," that actually involves changing my behaviour and it's not just a matter of adapting my existing practice to fit around changes to rules that people have said, "People are doing this anyway." It's that kind of problem.

MS CHESTER: So where the UK has gone in this respect for financial services you think is a good model?

PROF HANRAHAN: No, I think they're struggling with it as many people. I think a little bit because of the problem I pointed to before, which is we've tended to assume – we've tended to focus so much on the accumulation phase, which is really just a tax advantage mutual fund, that's all it is. Like at that stage in the system it's just a mutual fund, except if you keep the money in there in return you get concessional tax treatment and you get a different treatment of your assets in terms of its interaction with the social security system. So we've tended to focus on that and we've tended to think about these members as if they were investors, but they're not; they're consumers. They're actually purchasing financial security when they can't work. So it's a consumption type - - -

MS CHESTER: With your third point about how the regulatory architecture has been implemented that you see ASIC – how does it manifest itself when you say that ASIC has viewed a member as an investor and not a consumer in terms of - - -

PROF HANRAHAN: Well, there's a traditional – there's a very large level of deference in our superannuation system to market forces. There's a reluctance on the part of government to limit people's choices or to limit

product offerings. That's really interesting because – even in the draft report there's a lot of talk about members' money, but there's a very large amount of public money in the system as well. So when somebody makes a poor choice or spends too much money on a product using money in their superannuation account, some of that they've put in but some of that I've put in too in the form of the tax concessions that sit inside that system.

So it's interesting that if you give regulation of those matters to a markets regulator, then it's not surprising that they're going to assume that it if fits the information asymmetries in that system that the market will be kind of self-correcting. But it's not a market like that necessarily.

MS CHESTER: You have to argue they haven't fixed the information asymmetries either.

PROF HANRAHAN: Well, yes, that's certainly true. The current disclosure requirements, it's full of information which is not meaningful to members and it's provided at the wrong time.

MS CHESTER: Apart from information symmetries and getting meaningful disclosure for members as opposed to meaningful disclose for funds – or full disclosure for funds – what would you see change if ASIC were to view the member as a consumer and not an investor today? We're not talking about legislative change. We're just talking about how they practice the art of being the regulator in this market.

PROF HANRAHAN: We do have legislative change that's been foreshadowed around product intervention. Whether a consumer regulator might be more of a product safety type regulator and just say things like bars on babies' cots have to be 4 inches apart and so on rather than just saying well, it's a very open architecture, which we have at the moment. So they might do that. They might also see their role as championing the interests of the members rather than building relationships with the regulated entity. The idea that you – and this is an issue in relation to competition policy more generally in the financial sector.

Where is the person who sees its core constituency as the members and not the providers? ASIC, because of its approach to regulation, the types of regulatory tools that it uses and so on, does spend a lot of time with its regulated population and sees that as its constituency. So consumer regulators tend to think about things differently. It's really only – I mean, the rest of the economy, the consumer regulators are not ASIC; they're the ACCC and the State Fair Trading agencies. A lot of work at the individual consumer level is actually done by the state agencies which are

very close to consumer sentiment.

For example, the state consumer regulator in New South Wales will go on commercial radio and people will ring up and say, "Someone came and knocked on my door," and you say, "We'll fix that." They're very close to the kind of consumers on the ground, whereas ASIC doesn't have that attribute in its DNA.

MS CHESTER: We've covered a lot of ground and we've run over time because it's been a very helpful discussion for us, Pamela; thank you. It would be really very helpful for us if you could put some of that down also in a post-draft report submission to us. It doesn't need to be a lengthy one. But take us to the how to fix it.

PROF HANRAHAN: All right.

MS CHESTER: From what you've run through today we think we know where you're heading. When you talk about how to fix it it's good to know examples of how it's manifesting today in the way that it's occurring as opposed to the way that you'd want to promote sort of members - - -

PROF HANRAHAN: Indeed. I'll just flag this: one of the things that I might point to in my submission is that we have for a long time trusted providers – so superannuation trustees – to manage disclosure to investors and that that might not be the best model, that it might be – particularly with technical advancement in terms of data and those sorts of things, we might be coming to a stage where the government needs to be more in control of the information flow to members, maybe harvesting information from funds and then processing that and delivering it in a meaningful way for members because the conflict that providers face in their marketing with fair disclosure may not be something that we can resolve under the current arrangements.

MS CHESTER: I don't think that's, in principle, inconsistent with some of the direction we're going in with the regulators playing a much more strident role on what should a product dashboard look like and then getting that implemented and onto a central ATO MyGov website.

PROF HANRAHAN: Indeed.

MS CHESTER: Thank you very much for joining us this afternoon.

PROF HANRAHAN: Thank you.

MS CHESTER: I think we're going to continue on this thematic with our next participant who I'd like to invite to come and join us. Kevin, thank you very much. If you wouldn't mind just stating your name, where you herald from for the purposes of the transcript recording and then if you'd like to make some brief opening remarks.

DR LIU: Dr Kevin Liu from University of New South Wales, School of Risk and Actuary Studies. I also follow the lead of my two colleagues who have extreme points.

MS CHESTER: This is collusive conduct.

DR LIU: Yes. I think my first comment is related to the fund governance. I'm going to make a comment on the independent director requirements or the fundees, 9.2. I think my research suggests that it's consistent with my colleague, Scott Donald's finding as well. There's no consensus in the economic literature regarding the value of independent director theoretically and there's no consensus empirically on the performance implication of having more independent directors. Basically, if you're looking at the academic literature you will find that it doesn't matter it's in the public listing companies, mutual fund or pension fund, probably equal number of people argue for and against having more independent directors.

On the theoretical side some people argue having more independent directors will add value because the independent directors are more likely to be effective monitors, monitor the company management because of their independent status. However, the equal number of papers of authors argue the other way around. They say their interests are more aligned not with the shareholders or fund members but aligned with interest of the director of the fund management, people who appoint them on the board in the first place.

Theoretically there's no consensus on the value and empirically if you're looking at the value-add, whether having more independent directors will help a firm to improve the performance or have a fund to improve their returns there's mixed results. Actually in the literature at the moment if we're looking at mutual funds and super funds, what we find what matters is not the lack of independent directors but the presence of affiliated directors. So when we say affiliated directors we mean the directors of affiliated that fund service providers.

In the research in the US mutual (indistinct) for example when we have a mutual fund board is captured by (indistinct) use of affiliated directors, then the fund performs significantly worse. That's the same result we find

in our submission (indistinct) Dr Edith Ooi from University of Western Australia in the submission 92. We also find that when affiliated trustee director is used (indistinct) and when the funds have majority of directors affiliated with the (indistinct) service providers they tend to have significant negative impact on the performance of the fund. It doesn't matter how you match that performance, at total fund level, at super level, no return, net return or (indistinct) return (indistinct).

I think that's number 1 I'd like to point out. The second thing is related to the expertise which is the next point in the fund governance section. The academic literature in the pension space actually recognised the two expertise models, if you like. One is what we call the expertise model that basically require all the directors on the fund board to become (indistinct). On the other hand, you also have what we call the competency model. You require the directors not become the expertise themselves and not (indistinct) of expertise but they're consumers of expertise.

If they have competent skills and to ask the right questions and to utilise expertise they can access from external – that's also another dimension we should measure when we're looking at the expertise of the board. So that's related to funding 9.3. If we want to measure or evaluate expertise of the board the expertise of directors is one dimension of that. Another dimension is if they have competencies to actually utilise other expertise that's another thing we should take into account. There's no universal model.

Also, in the (indistinct) literature it suggests that we should treat DB funds and DC funds slightly differently. In a DB fund because you have a clear financial promise the key problem is you need to have a panel of experts to help you achieve that objective. So in that case the literature suggests that what is more important is to have expertise so that expertise model you should probably use that in DB scenario.

In a DC fund because there's no financial promise what is more important is representation. The directors actually represent the interest of members. So we should also value not just only expertise in the DC world as well as representation. Some director may come in they become a director of the trustee board, they don't necessarily have investment expertise but their value-add is they actually represent the best interest of members.

That's what the literature argue, that in the DC world because it has (indistinct) numbers, because (indistinct) engage, because there's no clear financial promise, the better model is probably – the more pronounced issue is probably the conflict of interest issue and you're probably better off to have a board that represents the best interests of members and then

if you're competent enough through training requirements, et cetera they can access expertise externally. They do not necessarily have to have people with voting power on board with investment expertise. They can be a member of the investment committee reporting to a trustee director who actually have voting power.

The third point I'd like to make is on the governance of the proposed independent expert panel that select all the best in show fund. I think one thing I'd like to point out is in the best governance practice I think in the proposal is suggest that this panel will meet every four years and then they can decide the selection criteria as well as make the selection. My suggestion is it's probably the best practice to separate those two tasks. That the people who actually make the selection following a particular criteria should be a separate group than the people who actually develop the selection criteria.

The people that actually make the selection we can (indistinct) every four years. But for the people who actually design the selection criteria, that institution can be there on ongoing basis to ensure continuity and consistency of policy because we don't want to have different criteria every four years. I think it's a good idea to separate the two functions so the development of the selection criteria can be assigned to one group of people and then the actual selection can be assigned to a different group of people. I'm happy to answer questions.

MS CHESTER: I like this law of three. It's amusing to track. Let's follow your batting order again. Independent directors first. You frame it, Kevin, in terms of the affiliated trustee director where there's a competent (indistinct) because they're affiliated with the service provider. So why wouldn't an affiliated trustee director be picked up by the definition of "independent directors"?

DR LIU: I think the issue here is if we have – basically the independent directors and affiliated directors, they are not mutually exclusive. We can have directors, they are not independent directors, they are also not affiliated directors. I'll give you an example. For example, under the current definition if we have a direct that represents employees or represents employers or represents the government, they are not independent director, but they are also not affiliated with the service providers. So we can have a category of directors that is not - - -

MS CHESTER: I understand that. But my question is you said that the problem child was the affiliated trustee director because the literature says that's where you get poor outcomes. But wouldn't the definition of an independent director preclude an affiliated trustee director?

DR LIU: This is the empirical question. The empirical evidence suggests that, for example, in my research in the last 10 years looking at governance issues when we analyse, for example, whether the percentage of independent directors on the board - - -

MS CHESTER: Sorry, no, my question wasn't an empirical one. It was if we have the definition of independent directors that's proposed at the moment, would that definition rule out the affiliated trustee director?

DR LIU: No. What we find, for example, if we have independent directors one third or two third – these independent directors would not preclude directors that are affiliated. At the moment the result we (indistinct) our submission, for example, shows that on average 78 per cent of directors own the (indistinct) retail fund they are affiliated. So even if we implement that one third independent director rule it still does not address that issue because in theory you could still have up to two-third directors affiliated, which is pretty much the status quo.

MS CHESTER: The affiliated trustee director would have a relationship with the service provider and thus there's an actual conflict.

DR LIU: The affiliated trustee director is defined if the director is also a director or executive or employee of a service provider or a related party of the service provider.

MS CHESTER: You're saying that the current definition of "independent director" doesn't pick them up.

DR LIU: The current definition doesn't pick it up.

MS CHESTER: Isn't that then a matter of fixing up the current definition?

DR LIU: Well, I think if we fix the current definition, then the question becomes what's the requirement? Do we use one third or two thirds?

MS CHESTER: Let's not go to numbers. Internationally, because you talk about – sorry, you talk about the empirical evidence. If we're looking at the empirical evidence saying that independent directors don't make any difference, the definition of "independent directors" internationally in the large markets where you've got the empirical evidence from, do they pick up the affiliated trustee director that's got a clear conflict?

DR LIU: Yes. For example, in the US mutual fund area there's clear

evidence shown that when the affiliated director is used this has significant negative impact on performance.

MS CHESTER: Sorry, that wasn't my question. You said that the empirical evidence shows that independent directors make no difference. So my question is well, what definition of "independent directors" is being used internationally in that empirical evidence? You're saying that all the definitions of "independent directors" and all the empirical studies that you've looked at do not pick up an affiliated trustee director.

DR LIU: I think I can see – understand your - - -

MS CHESTER: Otherwise we're comparing apples to zebras.

DR LIU: I think what we tried to focus on here is a particular type of affiliation. When we use independent director definition here we say the director is independent if he's not affiliated with employer (indistinct). If we add a new definition not affiliated (indistinct) you can have this independent definition. However, what we find here a particular type of affiliation that matters is not the affiliation of these employers/employees, it's the affiliation of the service providers or funds. So we're finding - - -

MS CHESTER: I know that. We've read your paper. What I'm trying to understand is you keep pointing to the empirical evidence and I'm trying to understand in the definition of "independent directors", in all of that empirical evidence, you're saying that definition doesn't get you to an affiliated trustee director where the damage is being done.

DR LIU: I think if we're looking at the definition of "independent directors" there's no consensus on the way that how we define "independent". So that definition (indistinct).

MS CHESTER: I think we have to put some caveats against the use of your empirical evidence. Anyway, let's get to bucket number 2 because I think this is an area that we've got some similar views about getting the expertise right. It's interesting the divide that you draw between having all skills versus competency skills. You've got the competency skills, then you just draw on the external experts. I was just trying to understand why you would differentiate between DB and accumulation. Under a DB scheme there is a promise to deliver an outcome and the member is not underwriting that promise; another party is. That party is appointing people to the board. That's the one you want to have the expertise to get the right outcome.

In the world of accumulation or DC that we're in, there is still a

promise – it's called a fiduciary duty – and there's an investment strategy, but the punter, the member, is underwriting that investment risk. So you're saying in that world you can actually dilute the all expertise model to a competency model and rely on external experts. I actually kind of thought intuitively the other way around if you're going to make a different change. I would have thought if I was a member underwriting the risk I would want on that board someone who can deliver your investment strategy promise, not somebody who's got some competencies who can draw on other externals.

DR LIU: I think in an ideal world we'd prefer to have a board that have both. They're competent, they have expertise but also act in the members' best interests. In practice, as the literature recognised, especially in the pension space, sometimes you do have this bit of trade-off. If you want to have people who represent members those people don't necessarily have the investment expertise. That has something to do why we distinguish DB and DC funds. The literature suggests that in the DB world because you have the employer sponsors bears the ultimate risk and they're the people who actually have strong incentives and to actually appoint people on the board to try to achieve that target.

In the DC world because the decision-making is all the members is dispersed, so it's very difficult for members to collectively get together and select a group of people that act in the best interest. So what they've been suggesting here is in the DC world because of dispersed membership issues because of lack of financial promise issues, the more pronounced governance problem here is do you actually have the board of directors that actually can represent your best interests?

MS CHESTER: But isn't the best interests of the members to get the best investment outcome, which means you want the expertise? I wouldn't want the expertise diluted with a competency model if I was a member.

DR LIU: Well, we can have a board of directors that have the best expertise; they're all investment managers. But if they use their expertise they don't act in the members' best interests, it means the member may not necessarily get the best investment performance, that investment performance may be charged (indistinct) and other things. So we have to balance these two things.

MS CHESTER: You're saying you don't think we can find people with the expertise to be on our trustee boards that aren't conflicted?

DR LIU: It's not what I'm suggesting. I'm suggesting that - - -

MS CHESTER: I'm just trying to work out why we have to depart from investment expertise.

DR LIU: What I'm suggesting is - - -

MS CHESTER: On the boards of super funds in Australia.

DR LIU: - - - when we're looking at investment expertise we should look at the broad aspect, not just the particular expertise of the directors sitting on that board because we live in a world that is a fast-changing financial market. It's difficult to say we have the complete expertise on the board. People need to actually ask the right questions and access external expertise. I think my point is we should take into account and assess the expertise of the board, not just the directors' own expertise, but also do they actually have the right group of people to ask the right questions and access other expertise outside the board as well.

MS CHESTER: You're saying that they need to have everything. So investment expertise, plus the competencies to challenge, be robust, draw on external expertise when needed.

DR LIU: In an ideal world, yes.

MS CHESTER: Expert panel. So you've raised an interesting issue here around who sets the selection criteria that the expert panel should apply and the expert panel then applying it. I can see why you've gone to that. We've in our report identified some high-level principles which we think are some of the factors that the expert panel should take into account. We weren't too prescriptive and we probably want to do some further work on that between now and final. But we also realised that there's a level of interpretation and a point in time that the expert panel would need to have around the application of those principles. In your world, would there still be a modicum of interpretation allowed, given it will be a world of judgment for the expert panel, but you just want somebody else setting the prescriptive criteria for them before they get going.

DR LIU: Yes, I think that would be a good governance practice for people actually (indistinct) themselves, not people involved directly in making the selection.

MS CHESTER: Who do you see making those rules?

DR LIU: I think we want to make sure that people who are making the rules reflect – the overall objective is that they should act in the members'

best interests. So we want to make sure they're independent from political interference as well as they should not be heavily influenced by the participants in the market that may have a conflict of interest as well.

MS CHESTER: That's what we want the expert panel to being those sorts of people.

DR LIU: That's why I'm suggesting the people actually on the correct (indistinct) panel they should include people that have not necessarily the people who may have a conflict of interest.

MS CHESTER: You want two expert panels. You want one expert panel to set the criteria and then another expert panel to come in and implement the criteria.

DR LIU: Yes, they make decisions based on the criteria. I think the criteria development function can be an ongoing thing rather than we have it every four years. That can ensure consistency of the policy making.

MS CHESTER: Kevin, that was great. Is there anything else that you wanted to cover that we haven't gotten through?

DR LIU: No.

MS CHESTER: Thank you. The three buckets are really helpful to work through.

DR LIU: Thank you for your time.

MS MacRAE: Thanks, Kevin.

MS CHESTER: I'd like to invite our next inquiry participant for the hearings. It'd be great if you could join us.

MR GROZIER: Thank you very much. I'm Dick Grozier, Associate Director of Workplace Relations for the Australian Chamber of Commerce and Industry. Thank you very much for giving me the opportunity to consult with you today. I'd like to make a brief opening statement, if I could. Partly I thought it was important to deal with why we're here and what our interest in the superannuation system is because we're not a regular player and we're probably a bit of a discontinuity from at least the last two witnesses.

Our interest is on the employer experience of the superannuation system. In our view, employers play a fairly key role in the system,

although that's not always recognised. They're certainly not always recognised as part of it. They obviously have an immediate interest in the administrative and expenditure burden which is imposed on them by the superannuation system and in their interactions with funds, regulators and transaction system service providers. But they also have a clear interest in the system's overall efficiency, an interest we believe is shared with employees or fund members.

Whilst a number of the Commission's draft report findings and recommendations attract the Chamber's attention, perhaps the most significant from the employers' point of view are those directed towards default allocation. Under the current system employer default allocation is the way to give the employer somewhere to make contributions for default fund employees. Employees do need a fund to make contributions into. The current system requiring employer default fund allocation for each non-choosing new entrant employee supports unintended account proliferation and does nothing to support member engagement.

The current regulation of the range of possible defaults does not support beneficial competition for the market. Once-only default allocation and carry the fund, subject to employee choice, is now a technical possibility but it also calls the current regulated fund specification system into question. Carry the fund, subject to choice, also raises the prospect of contracting and lifting from employers the administration required by the current choice regiment over time.

There's no systemic reason why an employer should choose a new employee's default fund but there are good systemic reasons why employers should not be doing this. Employer allocation risks conflicting principal age and interest. It creates an incentive for funds to market to employers rather than to members and it does nothing to support member engagement. Improving member engagement at its simplest, that is, being aware that you have a fund, like a TFN, and having a contact point for it, having it independently from the employer seems likely to at least support improved member engagement. It may also support improved timely contributions and assist with the early rectification of contribution errors.

MS MacRAE: Thanks very much, that's very helpful. We actually haven't heard much at all today from – haven't really talked at all about the role of employers. So if I might just confirm if I take from your opening statement that you see that employers would rather not be involved in the super system in the way that they currently are and that the Chamber would be supportive of the default option that the Commission has proposed in the draft report whereby the choice is made by the employee rather than the employer?

MR GROZIER: That's correct, Commissioner. There's not much recent evidence of which I'm aware, but certainly the studies around that 2009, 2010 – and I'm thinking mainly of the ones commissioned from Colmar Brunton – certainly indicated that – not all employers are the same obviously – but certainly indicated that the vast majority of employers were not well suited to allocation of employees into funds and were quite happy not to have the task. I think the research also fairly clearly indicated that where they made decisions they were not necessarily based on the employee's best interest even if the employer was in a sensible position to ascertain that.

MS MacRAE: Are you able to elaborate at all on the role of clearing houses in how the current administration arrangements work? Has that been helpful? Certainly from the take-up for the small business clearing house the ATO runs is well below the range that it could cover. I wondered if you could elaborate on that at all.

MR GROZIER: I think, Commissioner, in that question there's a bit of a point of time issue as well. I think with respect to the small business superannuation clearing house there was a profound initial reluctance and numbers of courses are attributed to that. The advent of SuperStream and its implications for small employers clearly significantly affected the numbers. Not so much the transfer from the Department of Human Services to the Australian Taxation Office but the change in security arrangements probably have had a detrimental effect on the carry through and I think is a reasonable part of the explanation for the relative decline in numbers.

My initial comment about point in time extends beyond the small business superannuation clearing house. I think particularly at the moment there is quite a lot of turmoil in the market and in decision. That's primarily coming from the implementation of Single Touch Payroll because although Single Touch Payroll on the face of it looks like the answer to many questions and up and running it will address a number of system errors, it also entails more change than was envisaged, for at least some employers, and certainly more costs than were envisaged. It is also leading to a redistribution of services across various service providers. So that if you were to look at the contribution of clearing houses at the moment it would probably be something of a different answer than it might have been two years ago.

MS MacRAE: Just in relation to the sort of centralised online service and the way that we've proposed that it might run, we have suggested that all employers and employees should be using electronic forms when

employees are first engaged. Do you see that as presenting any problems for particularly very small businesses?

MR GROZIER: If we look at SuperStream as some sort of analogy for the implementation, first of all, of Single Touch Payroll, because perhaps employees are slightly different – we have may to come back to that – it is clear that the residual part of SuperStream that isn't working is where there are businesses which don't have electronic payrolls or don't have access to the internet and things like that. So there is a small group of employers for whom special arrangements are still being done with respect to SuperStream.

In the introduction of Single Touch Payroll, that has been recognised and the designers of Single Touch Payroll are looking at solutions to try to address the issue of people who do not have digital payroll systems and therefore don't have a system at the moment which is all that amenable to the hopefully light touch of Single Touch Payroll over the top of it.t amenable to the hopefully light touch of Single Touch Payroll over the top of it. With respect to employees, there will be a great diversity. Clearly there's a generational component to that as well. But there's no doubt that phone apps have taken on something of a life of their own. Whilst a government-run system like MyGov may not be the universal solution to an online databank of employee information or citizen information which can be released by that citizen whenever is appropriate, it would seem that we are moving to an era wherefore a vast majority of people that seems to be an option.

MS MacRAE: By and large, having all of the superannuation – the work being done through an electronic sort of system would, you think, by and large, suit most employers, be a preference to doing paper forms?

MR GROZIER: "Most" is a bit of a tricky word. There clearly are people – and there may be a small business on the side for whom the shoebox is still the filing system of choice. But I think it is fairly clear that is reducing in scale and it's fairly clear that few younger people think in those sorts of ways. Can you get a hundred per cent? No. Are the percentages of people for whom an electronic solution is unviable? Is it static? No, I think it is declining.

MS MacRAE: Just one other issue which we raised only sort of tangentially in the report but it's come up a little bit in some of our discussions today. In relation to one of the issues that I know have been of concern to employers for quite some years is how many people are in the system and the small contributions that might be made in respect of employees who might be casual and only very short term. So the

threshold that applies that brings people into the system currently $450 a month – and it's been there since the introduction of the SG, so it hasn't been indexed for 25 years. We do mention in the report that had that been indexed that threshold would be more like $1000 today. If that was to change, do you think that would make much of a difference to the compliance burden from employers and would it be a welcome measure?

MR GROZIER: By change you mean the index back to roughly - - -

MS MacRAE: If it was put up to say a thousand to catch up with the indexation that hasn't happened since introduction.

MR GROZIER: Clearly there would be some employers for whom that would be welcome. There certainly are parts of the labour market where short one-off engagements are the norm and don't incur very much in the way of salary or wages. Yes, there's no particular reason why those types of engagements shouldn't continue. For the vast majority of employers I suppose it's a technical issue.

MS MacRAE: Thank you very much for coming today. I think we're now breaking for afternoon tea. Have I got that right?

MS CHESTER: We are. Let's make it a short one, if that's okay, folks, so we can all – thanks very much, Dick. I'm conscious some people have flown to join us today. I'm not looking at that clock anymore because it's not right. Let's resume at 5 past 3. How does that sound? Great. Thank you.

ADJOURNED **[2.52 pm]**

RESUMED **[3.07 pm]**

MS CHESTER: Folks, we'll get underway. We're in the final stretch. Three more groups to hear from this afternoon. I'd like to welcome the folk that have joined us from AustralianSuper. Thank you for coming and being here today. If you'd just like to each respectively state your name and organisation for the purpose of the transcript recording. Then if you'd like to have a few minutes of some opening remarks and then we'll get into a bit of a chat.

MR WEATHERHEAD: Thank you very much. My name is Richard Weatherhead, head of insurance at AustralianSuper.

MR BARKER: My name is Alistair Barker, head of portfolio construction at AustralianSuper.

MR WEATHERHEAD: I'll just say a few words, if I may, about insurance and just focusing on the areas of the report where we had some particular input to make to your deliberations. First of all, we are passionate believers in group insurance because we think it's good for our members. And I'll talk a little bit about why that is. As we know, the payout ratios for insurance and super are around 80 per cent of premiums. That compares with about 50 per cent of premiums for retail business. That's out of a KPMG report for group insurance in super.

AustralianSuper works really hard to maintain appropriate and value-for-money insurance for all its members. Importantly it aligns with our needs and insuring that their retirement outcomes are not compromised. I think that's quite rightly brought out in the retirement that the core purpose of super is retirement. We are very conscious of not wanting the insurance provision to eat unduly into the retirement balance. So I'll say a few more words about that as I progress through.

We use a lot of data on members to determine our default levels of insurance. We draw on data from the ATO which actually does provide splits of the overall population by salary level, part-time, fulltime, marital status, dependent children, et cetera. That's one key input. There is also independent research around housing costs, costs of raising children, et cetera. We look at that and we look at that for younger members, older members, low income earners in particular. We look also at social security benefits that are available through Centrelink because they're essentially providing some of the insurance needs of our members in the event that the worst happened for them.

That all goes into the melting pot to determine what underlying needs are. Having looked at needs, we then look at member preferences. We do a lot of member research into their attitudes towards insurance. In particular, I'll just highlight that part of that research has asked members about their preference for insurance, both before and after them understanding the costs involved and how it impacts on their retirement balance. And you do see slightly different results coming out and such good gauge on the impact on knowing cost on member preferences. So we take that into account.

I can say that broadly for our current default scale the influence of member research has been very much less for younger members and actually less for older members. The closer members are to retirement –

I'm talking here about 50 onwards – the preference towards "gee, I'm worried about my retirement balance" tends to dominate over the needs for insurance. So our default levels of cover are actually less at older ages than they would be purely by looking at needs.

Finally, affordability – and this is the really important one – we have an insurance principal which is now actually aligned with the code of practice which is that the cost of insurance shouldn't absorb more than 1 per cent of salary over the member's lifetime in super. Our current default scale at current prices actually absorbs 0.66 per cent of salary. That gets to the heart of the purpose of super being retirement and insurance not unduly eroding those balances. That's the equation that we sort of go through, the three considerations; needs, preferences and affordability.

A few innovations. As you know, AustralianSuper has put into the market Super Only. That's very much addressing low income earners and, again, that rightly comes out as a theme in your draft report. Super Only is there now for eligible employers and there is an assessment as to whether those employers are funding employees who are genuinely low income earners and therefore no insurance is really the best for them. Having gone through that assessment, the employer is going to have Super Only, which means no insurance at all, no erosion of account balance at all for insurance. That's now in the market.

We have a rehabilitation service. In the last 12 months – this is linked with the income protection product – in the last 12 months we've rehabilitated 374 members back to the workforce through the rehab service which is linked to our insurance program. Finally, in May we actually implemented a streamlined opt-out process for members to simply click online and their insurance is gone. That's for those members for whom they say, "Despite AustralianSuper's best efforts to set the default program up for us, we don't want it, so we'll just click a button."

I will, before I hand over to Alistair, wanted to focus on one area which we had some concerns about. That is the possibility of not having default opt-out income protection. We're passionate believers in default income protection. There are some statements that members are not getting a benefit when they've got multiple insurances. For AustralianSuper 0.4 per cent of our insurance benefits are not paid because the member has multiple insurances. What that's saying is that our members generally don't have income protection elsewhere.

VNow, that's AustralianSuper's sort of population, if you want to put it that way. That's not to say it's not the same in the broader market. But it is something we look at closely to make sure that we're not providing

insurance that has little or no value. Insurance for casual workers, again, we pay income protection to casual workers as well. There's been some accusations that doesn't happen. Members who are unemployed, we'll pay benefits for up to 12 months after they first become unemployed.

I guess the reason for going through these points is that we believe the right thing to do is do detailed analysis of membership and needs and really look at individual groups and design products around it. We do, as I said, believe passionately in opt-out income protection. Indeed, income protection is more important than TPD. TPD will pay a lump sum benefit for those with an extreme disability. In other words, they can never work again. In fact, for those members there is now the NDIS which will take care of the provision of some support services for those with permanent disabilities, but not those who are temporarily disabled and can't work for a period of time. For them, they need income replacement, plus the payment of superannuation guarantee contributions that are not being paid because they're not employed.

So those are broadly my opening remarks. I wanted to just pause there and perhaps let Alistair say something about investment.

MS CHESTER: Thank you.

MR BARKER: My remarks are framed from the context of an investment practitioner's perspective. I'm responsible, along with Mark Delaney, our CIO, for advising our board and our investment committee on our default investment strategy which has just almost $100 billion in member assets invested. I think what we're really interested in is what's the impact on members from how we design our investment program, but also how might investors like ourselves and other funds react to the potential reforms that have been put forward in your draft report.

I'll cover three specific things and then we'll run through some questions. First is around how we think about performance and cost assessment. Second is about how we think about benchmarks, which features quite strongly in your paper. Third is around lifecycle and retirement products. With respect to cost and performance assessment, we have two principles which we've taken all the way through to our board and investment committee. The first is the fund should be a strong performing fund in relative terms because otherwise members should go potentially into another fund. So if we're not providing competitive returns, it's an important issue for us.

The problem is that's not something we can invest in or look at because we cannot know the actions of other people in the marketplace.

So it's not useful for performance benchmarking purposes. What is more useful – and this is, I guess, at the heart of our profit for member focus – is that we have to ensure over time that we put more money into members' accounts than what we take out in investment costs. A key principle when we're thinking about benchmarking is if we're spending members' capital on investing in an infrastructure project or backing an external fund manager to do active stock selection or bringing internal a team to run say active asset allocation, all those decisions are framed with respect to what the potential return to members is and the potential value-add to members is, compared to what the cost is. So we link cost and performance benchmarking.

One key implication for that is that when we think about the draft report it seems to us that linking those two things net benefit is really at the heart of what we think is in members' best interest. Secondly, when we think about performance in that context using a benchmark then provides a fairly unbiased measure of whether or not your investment program has been successful. That can be judged without reference to necessarily a peer group. But what we do know is that there is a bit of persistence in the bottom part of performance across superannuation funds. That does exist. And it would exist more if some funds hadn't either dropped out of the survey or merged.

In some senses that persistence is a little understated. But what we do see is that persistence in the top half of the distribution tends to move around a bit. So trying to identify a top 10 is a little bit harder in the sense that funds can move around the top half of the distribution, depending on whether exactly what they're doing at the time works in the economic cycle. If you're in a period where, as we have been in the last nine or 10 years, of fairly strong investment markets in a very elongated economic cycle, funds that are positioned for that environment and falling interest rates would have done quite well.

It's very sensitive to both the time period that you're in but also the timeframe over which you measure performance. With respect to constructing benchmarks, we're a big believe in using benchmarks. It's important to be able to attribute performance. One thing we do make sure though is that we try and set a benchmark portfolio that is fairly stable over time. The key point about that is that we're trying to set a benchmark which gives us the best chance of meeting the long-term return objective for our members.

Our members are generally low to middle income and, as a result, growing their account balance and having a fairly strong bias towards growth – 70:30 portfolio in your draft paper is a good example of that – is

an important aspect of making sure that we deliver those long-term returns. But we then have a risk envelope that we try and operate within that's set by the board. So it's a risk appetite where ideally we are taking more risk when we are being well-rewarded and less risk when we think that markets are difficult and we're being maybe not as well-rewarded.

We think it's really important to have a benchmark but we can't be bound to it and we can't end up from an investment practitioner's perspective being too stuck on a particular asset allocation or a particular strategy because markets do move around and it's important to have a dynamic view. So when we think about benchmarking and when we reflect on the Commission's draft report we don't have too many issues with the broad concept of a benchmark portfolio. But we would try and keep it fairly simple and fairly constant over time.

The main concern I think we have is that not so much the benchmark itself but how that marries with the potential best in show model. Really, I think the interest for us is that the draft report refers to behavioural economics in respect of member preference, member choice, which is a really important aspect of an appropriate model. What interests me and what concerns us is how will the industry from a behavioural perspective react to a model where a potential top 10 is what everyone is clamouring to try and get in to?

When we look at examples in the funds management industry, say for example, a benchmark relative portfolio, say S&P 500 or the ASX 200, there's clear types of behaviour like herding or crowding or even alternatively a contra strategy where someone does something very different to a peer group to try and get into the sort of upper echelons of fund managers. Our concern is probably that the design of the system has to support really good investment decision-making.

As part of my job, I allocate out benchmarks and allocate out what each of our different portfolio managers are responsible for and how those are framed is absolutely critical to getting great investment outcomes. So we have to be very careful about setting appropriate timeframes, about giving people appropriate risk budgets and ensuring that there is actually some freedom to make investment decisions. Yes, there's accountability at the end of the day. But innovation comes from giving people both the licence to be able to make an investment decision but also the accountability that if it doesn't work out and it's measured over a reasonable timeframe.

Finally, just a couple of brief remarks on lifecycle and retirement product design. We've done a number of reviews. The first one was

immediately post-2009 of our default. We think the principles for lifecycle are fine, but their application in the industry has been very mixed and I think your draft report points out the fact that there has been a very, very mixed outcome. For us, wealth is really critical factor. Most of our members, over 99 per cent, get at least some form of government age pension and the majority of our members either retire with a full age pension or actually retire and actually take their savings from the fund as it stands.

Building their savings is important and, as a result, the bulk of their retirement income is coming from the government age pension. So our lifecycle approach leads to us de-risking very late in the piece. What we tend to find is that it doesn't compare to international experience because most people who are doing lifecycle strategies that de-risk very early are doing it because they're converging towards purchasing an annuity. In Australia the popularity of annuities is not phenomenal. People value flexibility. People value a number of the features of the existing account-based pension. So we have to be mindful that we're actually working towards a slightly different trajectory. It's even more the case for us given our membership.

But I don't think that necessarily results in us saying that lifecycle is a particularly flawed concept. There are a few funds in the country who have membership basis with very high account balances and those funds are responsible for delivering the bulk of someone's retirement income. They probably should think about their design in a slightly different way to what we have. That differentiation is something which the MySuper reforms helped. The problem is it's actually made it very difficult to compare, very difficult to understand. I think, going back to my original remarks around benchmarking, the need for benchmarking is about attribution and comparability, which is undeniable, and lifecycle can't be used as a way to hide that.

MS CHESTER: Thank you very much, Richard and Alistair, for what were very good opening remarks. I didn't intervene because a lot of things you were saying were areas we wanted to go get to with you. So I'm sort of working out what we need to talk about. But we do have quite a bit. So let's start maybe with investments first, then we might get to insurance, if that's okay. Alistair, the point you make about benchmarking is right. It's just about performance attribution analysis and we wanted to be able to do that across a system, agnostic of asset allocation, which is how people kick dust up in the air and say, "Well, our performance is less but we've got more risk off the table," and all the rest of it. That was the purpose of doing the portfolio benchmark.

Going forward, it's not something that we would see as a tool for the best in show. The best in show is really about the long-term investment track record when you're looking at it from an investment perspective. That's at one level. Then it's about innovation. Then it's about understanding your members. Then it's about product design and accumulation in retirement. So we've got a whole page about what best in show would really be about which tries to address any of the perverse incentives that you've raised, which are real perverse incentives that could occur and we want to make sure that we address them.

One thing that would be really helpful for us if you were to have a look at the principles that we've suggested would guide the expert panel in doing best in show, if there's areas where we need to be more prescriptive to avoid any of those perverse incentives being created, that'd be great to get that feedback from you. Where we do see the portfolio benchmarks having a role to play going forward is under an elevated MySuper arrangement. So this is MySuper authorisation. Again, this is an area we'd love to get your feedback on.

We've got a scale test that really didn't work. We've got an elevated outcomes test that's now subject to new legislation and we're actually trying to put some more belts and braces around the elevated outcomes test. One addition – so it's not the key driver – would be in a going forward world for a fund that persistently underperformed their own portfolio benchmark over a five-year period by a modicum of 25 basis points, should they still get MySuper authorisation?

Our thinking there is elevated outcomes test should knock off a large part of the tale of woe. But then going forward you don't want it to reappear again. But we want to make sure that that's implemented in a way that you wouldn't knock out a good fund. So we're trying to think of circumstances where a good fund could persistently underperform for five years by 25 BIPS their portfolio benchmark that product. We'd love you to help us in a post-draft report submission identify any scenarios that you could think where a good fund might do that because we're not looking at pipping off a good fund. We're trying to do that as an insurance to stop a tail of underperformance regrowing.

MR BARKER: I think the comment you raise about timeframes is very critical. Your funds take a particular position based on where asset allocation is against what they might have as an average asset allocation at the time, then there has to be some flexibility for trustees to make that decision if they believe it's in members' best interests. If I can give you an example. If we're entering a period where we're almost 10 years since our last major fall in markets and certain trustees are already making

decisions about saying, "Well, I'd prefer to actually take some risk off the table," in the interest of trying to protect members' balances, then we need to be able to make sure they have the safe harbour of an appropriate timeframe. I think we would - - -

MS CHESTER: But if they take that risk off the table, they've adjusted their strategic asset allocation and thus the benchmark adjusts with it, thus – for me, it merely takes SAA decision-making out of the equation. It's like you've made your SAA, if you still get it wrong you still can't at least get the market index with your SAA. There's got to be something wrong with you as an investor.

MR BARKER: Potentially. What you'll tend to find is that because persistence is fairly strong you might review performance every five years but whether the return timeframe you're looking at is 10 years I think is the question. I think you could almost delink the timeframe over which you're measuring performance and the frequency with which you need to actually look at those funds and challenge them. If you're taking asset allocation off the table as far as that timeframe is concerned, sure, that's one aspect.

MS CHESTER: I'll let you have a think about it because I've thrown it out today without any warning. You can see what we're trying to do. We don't want the tail regrowing over time. We know that regulators perhaps aren't as confident as we would like them to be in implementing scales and outcomes tests. So we thought that would lend a little bit of discipline.

MR BARKER: As I've sort of highlighted in my remarks, the challenge that regulators have is often the challenge that we have with our fund managers, which is where whichever benchmarks or measurement or incentives you set, the mind wanders to exactly what type of behaviour that will incentivise. We see it across the industry, across the fund management community, putting aside the superannuation community. I think we're keen to make sure that some of the mistakes that we've seen over time and that academics refer to aren't repeated in this process.

MS CHESTER: I think we can all agree to agree, particularly (indistinct) economists, that this is a system that's incentives on steroids. Coming then to lifecycle – and I appreciate you have done a nuanced reading of what we've said about lifecycle in the report. We were very careful with what we said about lifecycle because there's a range of ways that funds are implementing it. So it is a good, bad and ugly story. But you mentioned an international analogy, Alistair, when you said – and I want to make sure I've got this right.

Where sequencing risk is its greatest at retirement, when someone's effectively doing a complete drawdown to buy an annuity and that's where you sort of want a de-risking to have occurred so they don't potentially crystallise large capital loss of (indistinct) market movements at that point in time. Is that right?

MR BARKER: In effect, yes. An annuity is primarily backed by – has a lot of backing with long-dated fixed interest investment. So if you're trying to purchase an annuity at the time the most sensitive factor is interest rates. If you are looking to buy an annuity you would be converging towards something where you're hedging that risk that interest rates move - - -

MS CHESTER: You're basically flipping your investment strategies so extraordinarily at one point in time you want to de-risk it as you do it.

MR BARKER: Yes, you do, but - - -

MS CHESTER: So you don't have markets working against you.

MR BARKER: Yes, correct. But the challenge with lifecycle is that, depending on how it's structured, what it does is just move the de-risking earlier in someone's lifetime frame, in which case you may well create a sequencing risk by doing that process anyway. That's sort of often what you have to grapple with is that whatever you're doing, you are crystallising an investment in the equity market and transferring it to something else.

MS CHESTER: Yes, you're paying the price of insurance policies - - -

MR BARKER: Yes.

MS CHESTER: And you don't know what that price is going to be. It depends on where the market is at. That's why smarter people than Angela and I at the Commission who could do the funky stochastic modelling approached it that way. In that world then where the sequencing risk is the greatest and for your membership a lot of them with the lower balances are doing large drawdowns at retirement – and that might change a bit as the system continues to mature and their balances get up a bit – but I guess where we're struggling a bit is lifecycle being in the default segment, unless it's done in a very, very smart way.

At the moment any lifecycle could be in MySuper authorised product. So that's what we're kind of grappling with. Again, don't want to put you

on the spot now, but how can we – if lifecycle remains in MySuper authorisation world, how can we ensure that it's a smart version of it where you don't need to know a lot about the member and what risks they're prepared to take off the table, given how they're going to deal with their balance on retirement?

MR BARKER: It's a challenging issue and I think one of the challenges we have is we have a sort of multi-polarity with our various reviews going on at the moment. Having just finalised our submission on the CIPR policy, that's a particularly live issue. How the default system dovetails with choice in retirement but also how it dovetails with what an appropriate safety net or default is really critical. It sort of feels like there's a number of different reviews under way where we're all trying to seek some form of convergence and consensus about what's appropriate.

The challenge is – and I'll call out my wife in this particular example. She's a doctor and all of her friends are doctors. They're on very high incomes but they have no idea about what a default setting is. And they probably should have a slightly different default to what the average Australian super member is. So for a few occupational schemes – and this will be a challenge if we move to a best in show where occupational schemes mean less – the difficulty will be around how do those occupational schemes that have cohorts of people that they can identify – and that would be the test for me – specific cohorts of people where we say we can do better than just an average.

There are a couple of funds out there who've shown that that can be done. I think our position for AustralianSuper is it's not as relevant for us and our members, but we don't have a fundamental problem with it. The challenge is trying to create comparability and investment discipline and not have asset allocation, as you say, cloud an understanding of who's actually good and who's struggling.

MS CHESTER: If we were to look at your submission to treasury on CIPRs, would that give us some guidance on the questions that we've raised about CIPRs in our report?

MR BARKER: No, not exactly in the sense that we believe CIPRs are a choice product. I think Treasury have been reasonably clear in our discussions with them that it is providing an alternative choice to a simple traditional account-based pension. What we have certainly raised concerns with is that any product that requires a particular choice for our membership who aren't used to making choices in a number of cases is a challenge. Our biggest challenge as a fund is getting people to choose a retirement income, not to choose a particular retirement income product.

So we are at a fundamentally different – we have a fundamentally different challenge ahead of us, which will evolve because our demographics are maturing.

The average balance of members will increase as they have a lifetime of SG contributions. But we have a slightly different challenge on our hands. CIPRs are most likely a very viable alternative to some people but more of a choice product.

MS CHESTER: I think that's kind of where we're heading as well and some financial advice might be required before you sign up.

MR BARKER: We're very keen to make sure that if whatever retirement income products are developed, that there's demand for them. The challenge is to make sure that people can actually exercise those choices easily.

MS CHESTER: Especially in a world where if something becomes a soft default or a nudge by government, all of a sudden, demand is created and it's not informed demand.

MR BARKER: Yes.

MS CHESTER: We will have a look at (indistinct) to that, so we'll save some time now but we might come back to you later, if we're allowed to do that. Let's move it then on to insurance. We had already benefited from some earlier discussions with AustralianSuper as part of our consultation to get an understanding about what funky stuff you were doing with your members in terms of understanding the data around the cohort, using ABS data in a smart way. I guess a couple of key things that would be helpful for us, Richard, was firstly, the decision for your under-25s with insurance. We understand the decision and we understand the analysis that informed it.

Two questions. Knowing other funds out there, do they have the sort of information or data around their membership to make that decision about under-25s in the vein that AustralianSuper did? Secondly, we've heard about a world of Armageddon if our draft recommendation is followed and under-25s are taken out and insurance premiums for the rest of the pool will go up by 26 per cent. So it'd be good to see what your counterfactual is given you've just done this.

MR WEATHERHEAD: Yes, thank you very much. In terms of other funds, the short answer is yes, they should be able to do it. The key factors for us were, first of all and primarily, examining where all the

benefits were going. For the people, for example, dying below the age of 15, between 10 and 20 per cent of that money was going to dependents; and that might be a spouse, partner or direct to dependent children. The rest was primarily going off to the parents of the members because there was nowhere else for it go. That's probably loose language, but you can understand my point.

For us that's the case of saying why have a default arrangement where really only 10 to 20 per cent of your members really have a need for it. So any fund can go through their claim file and work out where they pay the money. That's the short answer to that. The other reason for us was – and this is a fact behind affordability in a sense. We did feel that there was a real desire for people joining from below age 25 to see a material retirement pot developing early. So the premiums, whilst very small, do actually erode the account balance, albeit only by a small amount. We just felt that – and this came back from – I talked about member preferences in the research – came out from that research and also came out from our own sort of understanding of the membership that we felt psychologically it would be good for members to actually build that early pot and not have too much distract them from that until age 25.

Then we talked about ATO data and family status. We know that the demographics around that many people who are – have status partners or dependents. So all that data is available. Any fund can see and use that data, either their own data or broader market data. Having said that, it doesn't necessarily have to be a one size fits all. But there are funds – I'm here relaying to you messages that I have had from other funds. But there are funds, for example, that have a lot of members in rural Australia where people do tend to have partners and get married and have children younger. There are certain industries where that tends to happen as well.

So yes, it could be that it's not appropriate for some. But certainly in our (indistinct) it was absolutely right for our membership. Perhaps just remind me of the second question.

MS CHESTER: I've got to remind myself.

MS MacRAE: The impact, so a 26 per cent, what we were suggested there'd be a 26 per cent increase in fees for the rest of the pool. I guess what taking the 25-year-olds out of your pool would do for your - - -

MR WEATHERHEAD: Sure. For AustralianSuper it will happen gradually but it will take out about 100,000 members out of our 2.2 million members who have insurance. That's the number of members below age 25, assuming that none of them actually opt in for cover. So

that's the impact. The broader impacts I think you were talking about, the budget changes and so forth – AustralianSuper already has that 13-month cessation of cover provision, except for death and TPD, it does continue if you've got at least $10,000 in your account. Following the budget and the recommendation of the Productivity Commission report, if we remove that $10,000 piece – so that's everyone that gets the 13 months of inactivity – that will take 8 per cent of our members will not have insurance because it's been – so they're essentially the members who've been more than 13 months inactive and have more than $10,000 in their account.

And I talked about the 100,000 members and I talk about the 8 per cent. If you look at the provision to cease insurance for anyone with an account balance less than $6000, that one will take out – you can use a number of 22 per cent. So the combined effect of that, plus the 13-month cessation, is 30 per cent of our members. Now, in terms of premiums, the number is about 18 per cent of premiums. That's the numbers which - - -

MS CHESTER: So that 18 per cent is cumulative across all those policy changes?

MR WEATHERHEAD: Yes. It's 30 per cent of members, 18 per cent of premiums across all those changes.

MS CHESTER: Sorry, I might have missed it. You just unilaterally taking out the under-25s, what impact did that have on the premium pool for existing members?

MR WEATHERHEAD: About $5 million a year of premium. But, of course, that – $5 million per annum out of $580 million of premiums overall, which I haven't done the maths, is about 1 per cent, isn't it?

MS MacRAE: Well done.

MR WEATHERHEAD: That's because obviously prices are much lower (indistinct). AustralianSuper has a policy of not cross-subsidising members at different ages. For example, our younger members do not cross-subsidise all the members, which means insurance is a lot cheaper at younger ages, which is why when - - -

MS CHESTER: Is that common practice in the industry?

MR WEATHERHEAD: No. I mean, I know there's one other major fund I know does the same. Apart from that, I'm not aware of too many that do that. And I know that's one of the recommendations of the draft

report and it's something we would absolutely support. I haven't said it to you before, but for example, we've done analysis of cost by gender. That can be very emotive. I know the EU has gone down the road of no discrimination which is essentially where AustralianSuper is at the moment because we don't. We've done some work – we don't believe for our default package that the cross-subsidisation between genders is material. By material I mean it's less than 10 per cent. But we do monitor that. Again, it's one of the things we monitor and our executive are very interested in that obviously on an ongoing basis to make sure that there is no perceived discrimination in that area.

MS CHESTER: You also mentioned income protection. We found it a little bit of a problem child in our report. It explained a lot of the incidents of the ugly zombies. You found that was low incidence in your membership.

MR WEATHERHEAD: Yes.

MS CHESTER: You cited the 0.4 per cent not paid because of a double policy. How does that track back up to across your membership how many people would have unintended multiple accounts that might have income protection? Because that's only across the claims which is I'm assuming a much smaller – so what percentage of your membership would make a claim against income protection? I'm just trying to work out what order of magnitude 0.4 per cent represents.

MR WEATHERHEAD: It's about sort of 1.3 per cent of members a year. So we've got 2.2 million members and we have about 2700 new IP claims a year. That's the total IP claims.

MS MacRAE: Of that 2700, 0.4 per cent of that number - - -

MS CHESTER: Had doubles.

MR WEATHERHEAD: The 0.4 per cent is by amount rather than by number. One of the things I didn't say in my opening remarks was that the fundamental difference between income protection and total and permanent disability – because income protection we found is actually better understood by members because they'll essentially start paying you a benefit if you're unable to carry out the duties of your job. It's pretty much we have a definition of what important duties of your job are. But essentially it's really well understood. And it's a broader coverage, whereas TPD by its name is covering those with very severe disabilities. The reason we get more complaints for TPD than we do for IP is because people have a disability, and there's no doubt about that, but it's just not

quite severe enough to be called permanent. That's where the issues of TPD come in because I think as a product it's actually more problematic than income protection is.

MS CHESTER: With your income protection policy you've obviously managed to do it in a cost-effective way to get your budget envelope down as low as you have.

MR WEATHERHEAD: Yes.

MS CHESTER: How many years does it run for?

MR WEATHERHEAD: It runs for two years. That's one of the reasons – yes.

MS CHESTER: Which isn't common in the industry.

MR WEATHERHEAD: It probably is the majority actually. But you're right, there is a lot of income protection to age 65 and that is very expensive. You'll find those funds that have IP to age 65 are generally breaching the 1 per cent cap. That's the way it would work. But it is interesting for us that, as I say, complaint rates for TPD are double complaint rates for IP. In fact, complaints about denied claims for TPD are five times those for IP. We think about that and we think why is that? It's because IP is simpler and, we'd say, perhaps more aligned with the purpose of super in the sense that it's paying you temporarily to get you back to work and it dovetails with that rehab program to assist people back to work. Apologies, I'm doing a bit of a marketing job, but you can tell we feel passionately about the valid subject.

MS MacRAE: I mean, it's a bit more catastrophic too. If you think you're on the borderline of TPD and you're refused you'd probably find it harder than you would if you thought I'm going to lose benefits for a few weeks or even a few months and I'll get back to work.

MR WEATHERHEAD: That's right, I agree entirely.

MS CHESTER: We've covered a lot of ground this afternoon, gentlemen, thank you so much. We'd really look forward to getting a post-draft report submission from you on the issues that we've raised with you this afternoon but any others that you'd like to give us feedback on. In particular, it's good to see we're not the only people that are obsessed with the value of portfolio benchmarks when used appropriately over the right timeframe. So thank you very much for joining us this afternoon.

MR WEATHERHEAD: Thanks for the opportunity.

MS CHESTER: I'd like to call our next participant to join us, Douglas Bucknell. Douglas, I'm just mindful of time because we've got two more participants to go through and we need to finish up about 4.30. Would you mind if we read this into the transcripts as in evidence and would you just be able to give us a high level couple of minutes snapshot of it?

MR BUCKNELL: Look, I will give you a high level snapshot.

MS CHESTER: That'd be much appreciated.

[Inserted into transcript as per Commission's instructions**]**

1. Our interest, unlike most others, is principally in the efficiency of the system in allocating default members to products – **that is the Default Investment Option within a fund, not which fund.**

2. Allocating members to tailored investment options lifts retirement outcomes by $5+ billion yearly, being four times the $1.3 billion estimated by the draft recommended '10 best in show approach', without the radical disruption.

3. We appreciate the positive references in the draft report to our prior submissions, and Smart MySuper Defaults, however Page 196 of draft report **as written is false and may mislead.** It should read that:

a. Sufficient data is held by all MySuper funds (age, balance, contributions, to produce the FSI recommended projected retirement balances per member) in order to implement an initial version of a Smart Default.

b. Explaining a Smart Default to members is only a little more complex than the current explanation of the associated funds Choice investment options and Age Based life cycling.

c. Tailoring existing investment options (Australian Shares, Aggressive, Balanced, Conservative etc.) is a classic case of 'a small change that can have a real impact in retirement' as highlighted by the Treasurer in the ToR.

d. Smart Defaults are the only major 'default product allocation' innovation provided to the Commission that is on the horizon and implementation ready.

4. Regarding the comment that "the Commission is cautious about recommending the replacement of simple life-cycle products with 'smart' alternatives at this stage"; we seek guidance on how the Commissions caution might be removed? Our submission provided a methods for the Commission to run the test. We hold auditable reports on funds, consistent with the Outcomes Test on over 100,000 members and $30 billion in assets, proving the 100+ bps p.a. average uplift. We have tried to engage with the executive without avail, although they reported soundings by entrenched interests. Further starting in the Choice segment is a fallacious proposition, inconsistent with the ToR.

5. This draft expression of caution is in stark contrast to the lack of caution being shown in the Draft Report in effectively culling up to 90% of the MySuper industry by the Best in Show recommendation.

6. The Draft Report approach has dropped the ball on Dynamic Efficiency, instead treating member's financial retirement outcomes as equaling annual net investment return of a MySuper Funds single balanced default option. Consistent with the SIS Act, system purpose and ToR, we reject that approach as a secondary indictor only.

7. Trustees should focus on member's retirement, not funds return and not be so simplistic. The bar is set too low.

8. We fundamentally **reject propositions that placing members in the same investment option for life is efficient**, regardless of their investment horizon (time to retirement or age) and regardless of if they will retire on a million dollars or the full Age Pension. MySuper members are not all the same and hence one-size-fits-all is wrong.

9. Financial planners acting in a one-size-fits-all manner would be banned. Trustee obligations are different and higher.

10. Age Only life-cycling does lower average retirement balances, however the Draft Reports approach of appearing to ignore higher growth options earlier in life by comparing the same $129,000 starting balance of a 'one-size-fits-all balanced option' appears flawed. It again shows disregard for dynamically changing investment options over time.

11. Despite the poor data quality, the Draft Report uses restricted growth option performance above the default option, but the reverse for conservative options, inconsistent with equity premium axiom and many other studies.

12. Smart Defaults are complementary to the draft recommendations of account consolidation and (retirement) Outcomes Tests however the Draft Report has started chilling innovation and investment decisions already.

13. Elimination of innovation in MySuper in respect of big data, contraction to internally indexed single investment options by an oligopolistic few and proliferation of current inefficient practices is the likely 'best in show' result.

14. Draft report arguments in support of this best 10 approach, are not equally used in respect of the Smart Default alternative of allocating MySuper members to products (investment options), although of equal relevance.

15. The crux of the difference is that the draft recommendation would move members to better performing funds, where the alternative, Smart Defaults would move members to better tailored investment options within their existing fund. Leaving consolidation to the new APRA Members Outcomes Test, a market rather than a bureaucratic process.

MR BUCKNELL: For the record, Douglas Bucknell, CEO Trustee Tailored Superannuation Solutions as it's known. Thank you for having me today. Our major point here is that we believe that allocating default members to products, that is, default investment options within a fund, is far more important than allocating members to which fund. Our analysis, which is analysis on over 100,000 members and $30 billion in assets, shows that the uplift across those funds is 100 basis points on average. That is a $5 billion per year benefit compared to the 1.3 billion benefit that you have in best in show.

So we think this is a very, very important aspect that the Commission should be looking at. We have made submissions in relation to the first round. We didn't in relation to the second round, which is about default allocation to funds as we read it, but we have in the third. I guess the other factor that we'd really like to point out without reading the whole statement is that we really see outcomes as what happens to a member's projected retirement balance or income. This idea that you can measure outcome as net returns of a fund's default balanced investment option is anachronistic to us. We think that changing investment options over time, that is, a dynamic efficiency over time, is a very, very important aspect that the Commission should be looking at.

There are other points that we'd like to make, in particular page 196, which says that there is currently insufficient data held to run a smart default. We want that clarified and we want that corrected, if we can. We know that every fund that we have touched has sufficient data. That data they require to run a smart default is age, balance and last year's

contributions and those figures are put together combined in our methodology to a projected retirement outcome. That projected retirement outcome is what was recommended in the financial system inquiry 2014 report. A lot of super funds are actually putting that on statements already.

We're just asking funds to use those projected retirement balances and allocate members to their existing investment options based on that projected retirement outcome. That produces the 35 per cent improvement in retirement outcomes. As I said, that compares very well to your 1.3. It's 5 billion. And we think it's worth testing. Look, I guess the other part that we would point out a little bit is that the treasurer highlighted the very small changes in the system can have very significant impacts on outcomes. This is a very small moderate change that we're asking for, particularly compared to, for example, the best in show, which we see as quite a radical change to the size and structure of the industry. All we really are asking is for funds to use their existing choice options – aggressive, balanced, conservative – for their default members, not the 40,000, just maybe five.

That's essentially what we're about. We see this is something the Commission really should study. We asked for that in our last submission and we're yet to see that in the report.

MS CHESTER: Thank you very much. Just so we can understand, your company, Tailored Superannuation Solutions, advises superannuation funds on how to take members through tailored investment options over time. It's effective a lifecycle glide path.

MR BUCKNELL: It's not a lifecycle glide path. It's multiple lifecycle glide paths. I think the example that we had in the last submission that we provided to you – and some of the speakers earlier today have highlighted how different outcomes for different members can product different glide paths. So what we would say is you will have glide path for members who are going to end up on the full age pension, one that might end up on a part age pension and one for members that are going to retire on 1.6 million.

Fundamentally, if you're a financial planner and you put everybody into the same investment option for life regardless if they were 18 years old or 64, regardless if they were going to retire on the age pension or 1.6 million, you'd actually be banned. The Royal Commission has come up with some fairly strong comments on that. What we would say is that you should tailor those options based on the projected outcome of the member.

MS CHESTER: We did some analysis around lifecycle products in our draft reports, Stochastic analysis that we've had some feedback from other technical experts on. What you're proposing, would it be fair to describe it as more of a smart lifecycle dynamic product over time and thus our Stochastic modelling didn't really capture what you're proposing?

MR BUCKNELL: Look, that's correct. We do have a question for – well, actually two questions for you on that. I think it comes back to supplement 4 on page 35. It says that you used $129,000 starting balance for two members and compared them. But, of course, if you're in lifecycle you're in higher growth options earlier. So that 129,000 starting balance wouldn't be the same.

Now, whether that's how you've looked at it or not I'm not sure. But what we would be saying is that single age-based life cycling does reduce average retirement balances; we're consistent on that. If you use multiple glide paths and tailor that to the member's outcome – that's not net returns but projected retirement outcomes or income – then you can actually increase that outcome by 35 per cent.

MS CHESTER: Is that putting them into higher growth as they approach retirement? As their balance gets greater you've got them in a higher growth before they retire.

MR BUCKNELL: Yes. So you'll have 25-year-olds, one who's going to retire – projected to retire on 1.6 million in high growth options up until age 50 and then they might slowly come down to aggressive. You'll have another 25-year-old who'll be - - -

MS CHESTER: Sorry, when you say slowly come down to aggressive - - -

MR BUCKNELL: Sorry, from aggressive to the conservative option, for example.

MS CHESTER: But why would you be taking risk off the table at age 50?

MR BUCKNELL: That's just one glide path. You might have another glide path for a member who was going to – had projected to retire on the full age pension at age 25 and their glide path will be a slightly different shape. So that the tailoring is tailored to the outcome of the member and it's a more efficient use of that member's investment horizon. It's not going to be able to be explained here in the 20 minutes that I have in front of you, but we - - -

MS CHESTER: I understand it doesn't make sense.

MR BUCKNELL: - - - have provided quite a lot of detail on that.

MS CHESTER: I've read the submission. It still doesn't make sense. The advice that you're providing to super funds today, are there any products that follow this smart, dynamic multiple glide path model that you've got in mind?

MR BUCKNELL: We have run the model on around about 100,000 members, as I said, and about $30 billion worth of assets. We're aware that - - -

MS CHESTER: Sorry, those members are in those products and these are the outcomes they're going to get or you've just used their data?

MR BUCKNELL: We used the member demographic for that fund and we used the investment option return and loss ratios that are published for that fund and put it into a report that looks very like the APRA outcomes framework test that they've got. Then we can peer test that against a one size fits all default. That's the methodology that we've asked the Commission to use and for federal treasury to use on the full 15 million MySuper account data that you've got.

MS CHESTER: When you're dealing with the trade-off between keeping growth on the table as the balance grows so you have the highest retirement balance versus potential sequencing risk at the point of retirement, the order of magnitude of the sequencing risk depends on how much you expect the member to draw down at the time of retirement and then the member's preferences. How would it default well do you know that?

MR BUCKNELL: What we do know is we know all members' projected retirement balances in the fund and we rank members into life stage retirement bands based on their projected retirement balance. That is regardless of whether they're aged 18 or whether they're aged 64. The trustee will then have a different glide path, if you put it in your terms, the amount of trade-off between sequencing risk and growth, as that member ages. Those that are facing a full age pension retirement might have more sequencing risk taken off the table. Those that are about to face a $1.6 million projected retirement outcome will keep their growth on for longer; in fact, may stay in a balanced or a 70:30 type option through the retirement phase.

MS CHESTER: Why does a member with a low balance that's going to be eligible for full age pension have low sequencing risk when they're going to be at greatest risk of a large drawdown and that's where the sequencing risk occurs at retirement?

MR BUCKNELL: If you were facing a full age pension retirement your glide path will be more conservative when you get there. Perhaps I could show you that in a diagram, but we're talking multiple glide paths here. Importantly, it's the trustee that would set those glide paths. It's not set by us.

MS CHESTER: But the trustee doesn't know what the member wants to draw down at retirement and the trustee doesn't know the member's risk preferences. Thus, we're heading in the direction of saying that we think there are smart lifecycle products like the ones that you're looking at that can work well for some members in superannuation. But you need to know that about the member. The trustees don't know that about the member and thus it should be in a world of choice and advice.

MR BUCKNELL: What we would say and the data that we provide in an auditable way member by member puts those members into retirement cohorts. We know what the return ratio is, for example, lifestyle retirement band 2, which are the members that might retire on full age pension, versus those that might be in band 3 or 4 that are self-funded retirees.

MS CHESTER: But the issue is we still don't know how much the member wants to draw down at retirement, which defines what sequencing risk is, plus what are their risk preferences.

MS MacRAE: I mean, I guess just coming to the core of it, you said the only data you'd need is age, balance and the amount of their last year's contribution.

MR BUCKNELL: Correct.

MS MacRAE: But there's an awful lot of other stuff in there like their marital status. So is there one or two of them at retirement? If they're partnered, what's happening with the other person? That will impact on whether they get the age pension or not and that'll be based - - -

MS CHESTER: Do they have a mortgage left to pay?

MS MacRAE: Will they still have dependent children?

MR BUCKNELL: Perhaps if I can answer that. We quantified that benefit for each of those cohorts. On average, it is 35 per cent higher projected retirement balance outcome. If you have a 35 per cent higher average retirement balance you can do an awful lot of different things in retirement no matter what those factors are. What we would also say, as highlighted elsewhere in your report, let's not think that the best outcome is defeated by a better outcome.

Over time – and this is what we found with big data elsewhere – we would include things like insurance. This methodology does take into account career breaks, not making contributions for a year, bonuses, increases. There is an element in it that lags by one year. So it takes a lot of those factors that you're talking about into account but notes that we've only got certain amounts of data at the moment. In five years' time we would expect that there'll be a further version of this that creates further tailoring. The moment the regulations only allow for these factors and those are the factors that we use.

MS CHESTER: I've just got one final little question. And we will go back and have another careful look at your submission and discuss it with our stochastic model as to make sure we've understood it all. But if you're taking growth off the table as someone is about to retire, how do they end up with a 35 per cent higher retirement balance?

MR BUCKNELL: I think this is why it's very important to go through the numbers and get them audited. And that's what we've asked for on a member-by-member basis. So if members – and it depends on the demographic of the MySuper population. But typically MySuper members are younger and their balance obviously grows in size as they get older. So you've got a number of different factors that are competing as to what the outcome is and you really need to break that down into each of those cohorts and add up what that impact is over a lifetime.

If you simply take what the net return of the fund is this year you're not measuring what the member outcome is; you're just measuring what the outcome for that fund is. We really think this should be a member - - -

MS CHESTER: That's not our counterfactual. Our counterfactual is what the member would have got if they stayed in a high growth or a balanced growth portfolio throughout their whole working life versus a glide path that de-risks them approaching retirement. That's where, I guess, I was struggling with how do you get a higher retirement balance when you're taking growth off the table.

MR BUCKNELL: Well, you're taking greater risk when the members

are younger for longer.

MS CHESTER: So you're dialling up the aggressive upfront.

MR BUCKNELL: Yes.

MS CHESTER: Which you could do anyway and not take any risk.

MR BUCKNELL: And members are preserved.

MS CHESTER: That's great. Douglas, thank you so much, that's been really helpful.

MR BUCKNELL: Thank you.

MS CHESTER: I'd like to invite our lucky last participant for our first day of super hearings to join us. Good afternoon, thank you for joining us. If you'd just like to state your name and the organisation that you represent for the purposes of the transcript and then if you'd like to make some extraordinarily brief opening remarks that would be much appreciated.

[Inserted into transcript as per Commission's instructions]

First of all, I would like to thank the Productivity Commission for the opportunity to appear today at this hearing and for previously engaging with the SMSF Association as part of the Commission's work.
The SMSF Association is the peak body representing the SMSF sector which is comprised of over 1.1 million SMSF members who have $712 billion of funds under management and a diverse range of financial professionals servicing SMSFs.

Today, I will focus my comments on SMSF issues that the Commission addressed in the draft report but before I do that I will make some high-level comments on the Commission's report.

Without making specific comments on the individual recommendations, we broadly support:

- Preventing account duplication and savings erosion by ensuring that people are only ever allocated one default account.

- Enhancing choice in the superannuation system by empowering individuals to choose their own superannuation product. This includes maintaining the role of SMSFs as a choice superannuation vehicle and

preserving the ability, and in some instances opening up the choice, to have an SMSF as a retirement savings vehicle.

 Ensuring insurance premiums do not erode low account balances or those of younger fund members.

 Improving superannuation data for improved policy analysis.

We are also pleased that the Commission recognised the role that SMSFs play in providing a competitive force within the superannuation sector and the effect this has had on fees across the sector.

I will now address the specific areas concerning SMSFs that the Commission focussed on in the draft report, starting with draft finding 2.2 regarding SMSF returns.

SMSF returns

We are pleased that the Commission's assessment of SMSF investment returns showed that returns in the sector are broadly equivalent to that of large funds. This is an important draft finding and supports the rationale for many people establishing SMSFs.
However, we are concerned by the draft finding that SMSFs with balances below $1 million deliver lower returns than large superannuation funds. We believe it is important all SMSF trustees consider the cost-effectiveness of their SMSF and the long-term viability of having an SMSF compared to other superannuation options.

While this point is important, caution must be taken regarding the Commission's analysis of SMSF returns. I note that the Commission caveated the difference between APRA-fund and SMSF data and the issues this creates in comparing the sectors. This is especially relevant to how return on assets (ROA) is calculated, with the Commission's Technical Supplement 4 illustrating that the difference between APRA's and the ATO's methodology for calculating ROA can create a 0.6% difference.

In addition, the ATO's ROA methodology which uses a crude average assets basis can distort net returns for funds when they are established. This is because new funds may be established earlier in a financial year but contributions/roll-overs are made towards the end of the year. This larger end of year balance can increase the average assets figure, reducing the overall ROA calculation, while the true amount of assets exposed to risk/return has been far lower for much of the year.

Accordingly, further work and analysis is needed to make better judgement of the returns of SMSFs under $1 million.

Finally, on this issue, we would be concerned that a $1 million balance was seen as a required balance to establish an SMSF. A $1 million balance is a good aspirational goal for SMSF trustees to achieve to ensure their fund has appropriate scale and is efficient. Considering that this would represent $500,000 per member in a two-member SMSF, we do not believe that this is an unattainable or unrealistic figure.

SMSF costs

Again, in regards to SMSF costs the Commission pointed out the difficulties in comparable data across the sector yet made the draft finding that costs for low balance SMSFs are particularly high. SMSF trustees should be aware of how costs affect their retirement savings, particularly when deciding on whether they should establish an SMSF.

Similar to our views on returns, we are concerned by the implications that poor data and different reporting methods across sectors may have on the Commission's draft findings.

In regards to costs, establishment costs of a capital nature can grossly distort net returns and cost ratios for SMSFs with small balances when established. These costs distort comparisons with large funds, especially for lower balance SMSFs which may have been recently setup. Similarly, advice costs for SMSFs are of a different nature to those incurred by APRA-fund members, further distorting comparisons on cost.

How costs are accounted for also affects comparison between SMSFs and large funds. For instance, costs of maintaining a direct property investment are recorded as investment costs to the SMSF but where a large fund invests in a property trust, costs of that trust are more likely to be accounted through reduced returns.

In regards to costs, the Commission noted that, "It is unclear to what extent the presence of small SMSFs in the system is necessarily a problem." We believe that these smaller funds do not represent a problem and cite the research undertaken by Class Ltd, an SMSF software provider in 2016. Analysing the funds that use their software Class found:

- For the 2015 financial year around 50% of funds with less than $50,000 were either newly established in the year or entered this bracket due to drawdowns or rollovers during the year.

- Class' findings point to the dynamics of funds with balances of less than $50,000 being similar to "that of an airport transit lounge, with

constant arrivals and departures". On average these funds stay in this bracket for around 2 years.

We also note ATO data which showed that in 2012, of SMSFs that lodged for the first time, 51% reported total assets of $1 to $200,000. Comparatively, this asset range made up only 20% of funds still active in 2016.

SMSF advice

Finally, I will address the Commission's draft finding on financial advice. Part of the SMSF Association's mission is raise the standards and professionalism of financial advice provided to SMSF trustees. Given the draft finding of the Commission, revelations at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and recent comments from ASIC, it is clear that more is needed to raise the standards of financial advice.

In regards to SMSF advice we believe it is critical that those providing advice to SMSF trustees have undertaken specific SMSF education or qualifications. SMSF advice should not be seen as part of superannuation or retirement advice but a specialist advice area. This is necessary given the unique aspects of being an SMSF trustee and the complexities of superannuation and related laws. While general standards of financial advice are being raised to a minimum bachelor degree level, at the moment there is no additional requirement for specialist education in SMSF advice. We strongly recommend that completing specialised SMSF education or accreditation be a requirement to provide this type of advice.

MR GEORGE: Jordan George, SMSF Association, I'm head of policy for the association. I will cut down the thousand word opening statement and give you the brief gist of it. Very much I think the association definitely supports the measures and recommendations in the report about making the system more efficient in general and making sure that over the long term that people's accounts aren't eroded. I think the benefit for SMSF is obviously that when people do choose SMSF that there is a higher balance (indistinct) going forward. So I'm not going to make too much more around those broad proposals because that's not our association's remit.

What I will focus on more in this short statement is three key areas that I think we would like to interact with the Commission on going forward from the report. That was SMSF returns, cost and financial advice. I think they were the salient areas for us to comment on. In

regards to returns, we were pleased with the draft finding that SMSFs generally have a similar profile to large funds. But there are some concerns about funds that have less scale. I think the figure that the Commission (indistinct) less than $1 million in assets.

What we are concerned there is pretty much – and I think the Commission flagged a lot of this and had a lot of caveats around quality of data and comparability of data – is that it is really hard to actually make comparisons between APRA-regulated funds and SMSFs and because of that some of the return figures for lower funds can be distorted. I think one of the key things that we have focused on is the difference between the ARPA methodology for return on assets and the ATO methodology.

I think in the technical supplement number 4 it showed that if you apply the APRA method to SMSF, SMSFs could have a 60 basis point uplift in return on an aggregate figure. So it does show it's quite hard there to make comparisons and we do wonder how does that actually impact on analysis of funds with low balances. One of the things we are concerned about – and we know that the Commission has not made a draft recommendation about this – is that if people do take this million dollar figure to be the minimum amount needed to establish an SMSF, we don't think that is an appropriate figure for that.

The reality is that many people may start off with smaller SMSFs and achieve scale over time and that million dollar figure is probably a good aspirational figure, especially when you think of a two-member fund, which 70 per cent of SMSFs are, that'd be about $500,000 per person, which would be what we would regard as a good amount for people to aim to to save for super in their SMSF.

Summarising that, we think more work needs to be done and potentially better data sources as well on calculating returns for SMSFs because we know that the reality is that the ATO collect SMSF data through the SMSF annual return which its primary job is to collect revenue, not statistics. So (indistinct) best it can with what's given to them and we think that more work could be done definitely around data which we know the PC has said in general about a industry-wide working group on data.

In regards to cost, I guess we have, again, similar concerns around the analysis is driven by the quality of data available on SMSF costs and comparing those to APRA-regulated funds. We are aware that the idea that smaller funds who have particularly high cost ratios compared to APRA fund members is a concern to many people throughout the super sector and has been highlighted again by the Productivity Commission.

One of the issues we do look at there is though that often this is driven by establishment costs which are capital in nature and – I know the draft report focused on this. Once again, it would be great if we were looking at to get data that would strip out the nature of some of these costs and have more (indistinct) analysis rather than the aggregated figures we get through the ATO and through the SMSF annual return that the ATO get.

Also, just in general, the nature of costs in an SMSF are different to those in APRA-regulated funds. Often we're talking about advice and investment costs, which are quite different to what an APRA-regulated fund provides to their members. Advice is obviously a direct cost. It's very transparent in SMSF and reported through the annual return, while for many APRA funds it's kind of – the way that cost is spread throughout the fund is quite different and it's meant to be reflected in an administration cost or an investment cost as it would be in an SMSF.

Also, costs of investing in different assets. One example would be SMSFs investing in direct property. The cost of holding that property would be reflected in the SMSF as an investment cost while APRA-regulated fund may invest through a property trust and those costs are probably reflected as lower returns on that investment rather than direct cost. So there's things like that which need some consideration when we're already breaking down what are the cost differences between SMSFs and large funds.

The final point I'll make about cost is that the Commission made the statement it is unclear to what extent the presence of small SMSFs in the system is a problem. We don't think it is a problem because they generally do achieve scale over time or they are exiting the sector. So we think that those funds that the very small funds with funds under $100,000 in assets are either going one way or the other. They're either going out or they're going up in scale.

There's some interesting research done by Class Ltd who are a SMSF software provider. So one of the companies in our sector who does have access to more great newer data per SMSF and per member and they showed that in the 2015 financial year that 50 per cent of funds with less than $50,000 were either newly established or were entering this bracket due to drawdowns and rollovers. So they very much were in the process of probably winding their fund up.

I think this Class report actually is a really good description. They say this bracket between zero and $50,000 is a bit like an airport transit lounge. There's lots of people coming and going in and out of the bracket. The found that on average SMSFs were only in that bracket for

about two years. So they're either drawing down and rolling out or they were on the way up and waiting for more contributions to get scale.

The final point I will touch on is around SMSF advice. I think this is a common theme coming through in numerous inquiries we've had over the years. There are some positive changes happening. The increase of education standards for financial advisers is something that's going to be kicking in from 1 January 2019 and there's a five-year transition there to bring the industry up to at bachelor's level requirement to provide financial advice.

But one thing we are concerned about is there's no requirement to have specific SMSF education to provide SMSF advice. We think that is definitely seen as important given the complexity of self-managed super funds and that they are quite different to the rest of the super system. So the idea that you may have covered off superannuation in retirement in your studies to be a financial adviser but not necessarily SMSF – and if you take a 12-week course, probably SMSF is two weeks of that – you're not getting the expertise that we believe you actually need to advise people on their retirement savings through an SMSF. We would definitely encourage consideration that those who are advising SMSF trustees should have specialist SMSF education or accreditation to do so. That's our summary of where we are and report.

MS CHESTER: Terrific. Thanks so much, Jordan. I guess first before we get into some questions around the data and the investment performance story, just to understand, so your association – what's the membership profile?

MR GEORGE: Our association is the vast majority of our members are advisers, so either financial advisers, accountants, lawyers, auditors. But we also do offer a category of membership to SMSF trustees. So we have about 700 now SMSF trustees who engage with us mainly on an education basis. So we have a website which we call our trustee knowledge centre where they can go and get independent information on the super laws, tax laws, how to run their SMSF. The idea of that is that they can get better quality conversations with their advisers, which touches on the idea that you had in the report about providing independent sources of information to allow people to evaluate how well – what kind of advice they're actually getting. So that's one of the roles we perform in the sector.

MS CHESTER: How many members does the association have to date?

MR GEORGE: About three and a half thousand professional members and around 700 trustee members and (indistinct) trustee database about

7000 who are actually - - -

MS CHESTER: Are the trustee members paying for the educative database or are they part of your advocacy membership?

MR GEORGE: Some of those members do pay subscription fees, some of them have been brought in through corporate offers and things like that. But a subscription fee has been $99 for the year to access that trustee knowledge centre.

MS CHESTER: What do the other members pay?

MR GEORGE: Our professional members pay anywhere between 500 and 700 dollars, depending on the status of their membership.

MS CHESTER: Given your membership is largely financial advisers and people who are getting members into SMSFs, you'd probably be able to help us then. So when they're providing advice, do they actually want to know how much money they're going to eventually have in super to work out whether an SMSF is appropriate for them given the higher cost structures?

MR GEORGE: Absolutely. I think when we talk to our advisers, whether they're financial planners or accountants, that's definitely one of the conversations that they do have is about what are your long-term ability to keep making contributions and to reach scale. Very much we know that within our cohort of advisers they believe – and it's our association's belief – that SMSFs are not for everyone and that it would be improper to recommend SMSFs to people who may not get sufficient scale to actually be cost-effective.

MS CHESTER: What's the view amongst the planners as to what sufficient scale for them to get the good net investment returns that we've identified for that cohort over - - -

MR GEORGE: I think very much within the industry that the kind of – the figure that ASIC landed on in 2013 through the work done by Rice and Warner, around $200,000 for establishment in terms of being cost-effective against – I think that was pretty much based on retail products – is very much I think the view that goes across most of our guys is (indistinct) $200,000 establishment figure. However, I know that many of them - - -

MS CHESTER: Sorry, that's having $200,000 to begin with as a minimum?

MR GEORGE: Yes, as a minimum to begin with. That's a common figure used throughout the industry. Then in terms of where they reach from there, I don't have a consensus idea on what they believe long-term scale would be at this stage. But it's definitely something we can - - -

MS CHESTER: Because our analysis – and we agree the data wasn't ideal, so we've caveated it. But one thing that was really clear that if you don't get to a million pretty quickly you're not going to be getting the 5.9 per cent investment returns over the 10 to 12 year period. I mean, I think this is an area where the regulators under a (indistinct) is going to be doing some more work. So it would be helpful for us to know from your membership what do they consider to be sort of a cost-effective balance and what timeframe does the member need to get to it for an SMSF to be something they feel comfortable advising them to go into.

MR GEORGE: Yes, absolutely, that's something we can do and try to report in our submission in four weeks' time.

MS CHESTER: That'd be great.

MR GEORGE: I know we have done – the other thing that was picked up in the report the previous research about there can be other factors driving SMSF establishment too. It's not necessarily just about returns, even though that obviously should be a key focus of people. The more time savings you have obviously the better you'll be off in retirement is a pretty clear objective. But there are other factors there that do tie in to why people establish SMSFs.

MS CHESTER: I mean, our focus has been that it is the ultimate part of the choice segment; people are making the decision to do it themselves. And that's their entitlement, it's their money. But at the end of the day, we want to make sure that the advice is appropriate, given the evidence that we've discovered, and we need to have some pretty firm and contrary evidence to suggest that that $1 million pretty early looks about right to us. Indeed, we've had feedback from others. I'm very conscious as well that others in the industry are now starting to talk about the government stepping in and actually prohibiting SMSF being created.

So we want to make sure it's good informed choice in a world of engaged members deciding to go down the SMSF (indistinct). The more of an evidence base you can give us in the post-draft report submission, that would be really helpful.

MR GEORGE: Absolutely, we can definitely focus on that. I think that

goes to our strong belief around SMSF establishment too is that the best way to make sure it is appropriate is through high quality advice. So it's that ability for an adviser to sit down with an individual, gauge their understanding, gauge their knowledge of the obligations and the time – one of the other things is the time that they should take to be an SMSF trustee and the involvement required, as well as their financial capacity to make those contributions and to achieve scale. I think it's a very – we think it's a very well – a very holistic kind of advice picture you need to have and it does come with understanding of (indistinct) quality of advice provided.

MS CHESTER: Do you have more data then based on the work of Class and others that can tell us the story over time, like how quickly do members get from those that are under 100,000, which is your concern, or under 200,000, up to a million dollars? Then where are you seeing churn? People that started with an SMSF and then changed their mind and gone back into an institutional fund?

MR GEORGE: That is something we're currently working on. That's something we hope to be able to provide in our draft submission. We are speaking to some of the SMSF software providers and administrators in the sector because they do have the ability to extract that more granular data and also have a time series. We have tried to - - -

MS CHESTER: Who are they?

MR GEORGE: The main ones that we have the kind of relationships to work with and the biggest ones, so Class; they provide SMSF software. BGL who also provide software for SMSF, and Super Concepts who are an AMP-owned brand, and they do both software and administration of funds.

MS CHESTER: How much of the SMSF space would they cover?

MR GEORGE: I think they would cover almost 80 per cent.

MS CHESTER: That's pretty good.

MR GEORGE: It's just a question of being able to get them to extract data and then provide answers to different queries that we've had. Like you said, how quickly do people achieve scale over timeframes and looking at some different cohort things. So there's capability there I think to get a look at some of those issues you have raised in the report that you can't get from ATO data that's either because it's driven by tax returns or aggregated.

MS CHESTER: That would be terrific if we can get that in the post-draft report submission because we just want to make sure that it's well-informed choice, good advice and the more we've got evidence to sort of take us in that direction as opposed to other blunt ways of dealing with SMSFs or which others are suggesting is helpful.

MR GEORGE: I think that's definitely our intention to provide that and we value the Commission's comment that SMSFs are an important driver of choice and the effects they've actually had on the broader market. But like you said, it's important that people go into them with their eyes open and in appropriate circumstances.

MS CHESTER: Jordan, is there anything else you wanted to - - -

MR GEORGE: I think that covers off and we'll work harder in the next four weeks to pull those numbers together.

MS CHESTER: That'd be terrific. Great.

MS MacRAE: Thank you.

MS CHESTER: Thanks for joining us today. Folks, that ends day 1 of the super hearings. We will resume, I think at 9 am tomorrow morning – yes, I'm being nodded at by my colleagues – in sunny Melbourne. Thank you, linesman, thank you, ball boys; we're finished in Sydney.

MATTER ADJOURNED AT 4.20 PM UNTIL THURSDAY, 21 JUNE 2018 AT 9.00 AM

Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION: ASSESSING EFFICIENCY AND COMPETITIVENESS

MS K CHESTER, Deputy Chair
MS A MacRAE, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT 530 COLLINS STREET, MELBOURNE
ON THURSDAY, 21 JUNE 2018 AT 9.05 AM

INDEX

RESUMED **[9.05 am]**

MS CHESTER: Welcome everybody, good morning and we'll get things underway for the second day of our super-super hearings for our inquiry into the competitiveness and efficiency or the performance of the Australian super system. I'm Karen Chester, Deputy Chair and Commissioner on the inquiry. I'm joined by my fellow colleague, Commissioner in crime, Angela MacRae.

I'd like to begin today's hearings by first acknowledging the traditional custodians of the land on which we meet today, the Wurundjeri people of the Kulin Nation, and I'd like to pay my respects to elders past and present.

Today is the second of our three hearings, we had a very full day yesterday in Sydney with I think a world record of 16 participants in one day. We have a full day here in Melbourne, which is terrific, and then tomorrow we'll be heading off to Brisbane for a day of hearings there.

I just have to run through a couple of logistical things. Firstly, if you hear some fire alarms let's just follow common sense, find some floor wardens who are wearing the funny helmets and they will get us to some stairwells to get out of the building, do no use the lifts.

On a more substantive matter, the purpose of our hearings, hearings are an incredibly important part of our consultation process, it allows us to get frank feedback on our draft report, it allows people to tell us what we got right, what we got wrong and what we might have missed altogether. I'd like to think, or we would like to think that, given we have gone through a very three stage process with a lot of consultation, we haven't missed anything, but I think it's fair to say that there's things that we can agree to agree on and agree to disagree on and that's what the purpose of the hearings are.

A full transcript is being taken today and we are live streaming this event. As such, we can't take questions from the floor. The transcript from today's event will go up on our website but people can view the proceedings live and also the podcast, or whatever it is, of them on YouTube later on. We've found that this has been very helpful, particularly with our larger inquiries where there is a great deal of interest, just to make the hearings more accessible, people do not need to be here physically or wait a couple of weeks for a transcript to know what was said.

That's very helpful as well as we've got post-draft report submissions

in a couple of weeks' time and that way they can be informed by people knowing what was said and what was discussed in hearings and if they agree or disagree with that they can say in their post-draft report submissions.

Now, participants today are allowed to make some opening remarks but we ask you to keep them to under five minutes, it just really allows us time to have a really good conversation and us to ask some questions of you. We are the not-so Royal Commission so participants are not required to take an oath but we simply ask you to be truthful. We do have some rules for the media and if there are any here physically today they should identify themselves to our staff so they can provide them with information about the dos and the don'ts. I suspect there's none because they are probably all just watching this on their computers in their offices.

So I'd now like to, without any further ado, invite our first participant to join us, who is already here, Cathy Nance from PwC. Good morning, Cathy, thank you for joining us.

MS NANCE: Good morning, Karen. Good morning, Angela.

MS CHESTER: Just for the purposes of the recording, Cathy, if you could just state your name and the organisation you represent and then if you would like to make some brief opening remarks. Thank you.

MS NANCE: Thanks. Catherine Nance, Pricewaterhouse Coopers. So following your theme, Karen, what I'd just briefly cover in my opening remarks is what we support in your report and maybe where we've got questions, what we would like to discuss further and maybe some of those things where we think it may even could go further.

In terms of support, we think the report was a really clear assessment of what matters most to members, particularly investment, performance and fees. We agree with where you've highlighted that the super industry can do better such as the sustained underperformers that exist, unintended multiple accounts and associated insurance covers, choice proliferation and fees.

We like the fact that you have quantified the losses to members from those outcomes and the proposed solutions, we support them. We accept that some of them are not without risk or concerns and there may be some difficulties associated with them. But we basically believe that the industry does need to be restructured. We think that over a hundred MySupers, over 200 funds and 40,000 choice products can't be efficient and that the members are paying for that. So we support the recommendations.

Some further comments I'd like to make probably go to once only defaults, best in shows, clarity of the regulators roles and just the degree of difficulty that will be experienced in any, even an orderly, rationalisation of the industry.

Just probably maybe a few comments to make there before I finish is that it is very, very difficult for people to do themselves out of jobs. Sometimes, from time to time, industries have to be rationalised and there is some pain to be felt from doing that, and the pain will be felt here I think across everyone, service providers, industry organisations, ratings agencies, but most of all the funds themselves. A lot of people in those funds have tried to do the right thing by their members and it becomes very difficult to find ways to do yourself out of jobs. So I think that we can't estimate the difficulty that this will apply to the industry, but we believe it has to happen.

MS CHESTER: Okay. Thanks very much, Cathy. I just should say at the outset on behalf of the Commission we would like to really thank you and PwC, you've been with us along this three stage journey in terms of constructive and active involvement in submissions, and particularly the typical round tables in stage one, and a helpful sounding board in stage two as well, especially around issues of governance and mergers.

I guess coming back to the point that you ended on around not underestimating all difficult this all is, we were struck by a statement by ex-Reserve Bank Governor, Bernie Fraser, where he said:

> *The problems the Productivity Commission have identified have been there for yonks and there's been a hell of a lot of inertia.*

I guess, for us, stepping back just from a view of policy versus the role of the trustee board, why is it that industry and the trustee boards haven't done something about this sooner, these problems?

MS NANCE: I think it gets down to the fact that a lot of people, you know, whether they are within the fund themselves, the executive or on the boards, have invested a lot of their own energy in trying to do the right thing by their members. It's very hard for them to face the fact or want to hear the fact that their members might be better off elsewhere, and a lot of them inherently believe they are doing the right thing by their members. So, consequently, you tend to get their effort focused on preserving a situation rather than doing them out of their role.

I think because of that difficulty, I think that there was to be – like I counted 10 of your recommendations which actually go to trying to help, to sort of almost force that situation to happen a little bit more, and there even

may be some further things that need to happen. So do you want me to expand on that now?

MS CHESTER: Yes, that would be good.

MS NANCE: So I think out of the recommendations you made some of the really critical ones are the independent order of enhanced outcomes testing. I think to problem to date is when you're comparing yourselves a lot of people compare themselves to the median of over a hundred MySupers, it's almost a bit self-perpetuating that anyone can look good against some of those criteria when you're only comparing yourself to the median of over a hundred entities. So I think forcing an enhanced outcomes test and forcing an independent audit of it is one test where – I mean trustees and executives need to see clearly that although they've tried, the members would be better somewhere else, and I think that helps.

I think one of the really big things is publishing the dashboards, really readily available dashboards on the ATO online site, particularly best in show makes it more difficult to hide in terms of comparing yourself to the median, because now you've got a best in show, and I think trustees will have no option but to compare themselves to the best in show and I think that's a good thing that they do that.

I think APRA reporting annually to the Council of Financial Regulators on the status of mergers and that will be a good thing. I think that probably the reporting of merger activity to APRA and then the ASIC investigation of it, I've got a question about that because I think it diffuses the roles and I'm not quite sure there who ultimately is responsible if one gets reported to and the other has to investigate. But I'll leave that as sort of a question almost, that maybe that could do more, who ultimately will be responsible, I think we need to be clear whether it is APRA or ASIC.

In addition, what I think may help is that I think APRA may need to give some guidance to trustees on what they expect to see in expert reports such as a comparison against best in show. Also, I think the guidance should be what they do not want to see in an expert report on any potential mergers, which is anything to do with board positions, executive positions, staff positions, control, the number of times I see reports saying "you will lose control". I think it almost should be some insistence to say none of that should come into an expert report.

What should be compared is, from a member's point of view, where is their long-term interest, is it in Fund A, or Fund A plus Fund B merger or best in show, and almost whether you attack it by looking at the outcomes or whatever, but just say where is the member better placed in those three

arrangements.

I think that you've got to take off the ifs from those reports, I see reports that says, well, that combined fund will be sustainable because all you've got to do is find five other similar funds and make a back office deal about admin and then you'll be sustainable. So I think you've got to remove the ifs and just say, based on what they are now, where would a member be better off.

I also think that boards, because it is so difficult to ask executives and staff to do themselves out of a job, I think it's almost impossible, there's very few people who would be able to sort of do that without any self-interest coming into play at all. I think that boards need to take control of that process, as in briefing the expert advisers and receiving the reports directly back to them. Because I think it's too much to ask in a way, of executives to do themselves out of their jobs.

MS MacRAE: So, Cathy, could you perhaps just go through, I know you were involved in the Westscheme merger and that was one shining success story, so I guess it's possible, and I just wonder if you could give us a little bit of detail about how that ran and then, I guess, relating it back now to the other barriers that you've identified, well, we've talked about how we might better remove those.

MS NANCE: That's right.

MS MacRAE: But I think it would be helpful to look at one case study that was a success.

MS NANCE: So, I think that was a rare event in the industry and, to be honest, I think that Howard Rosario, the CEO, should actually be applauded for his role there because he was a CEO that didn't need to be told that their fund was currently a good fund, it was currently a good fund at that time, but he could see the future, that members wouldn't necessarily be better off in a 3 billion fund but they could be well better off in something much larger that would invest more for their futures. He took a view that they needed to do something sooner rather than wait until they actually were uncompetitive.

I don't think I've ever seen that elsewhere, where the executive is so clear about saying and so lacking in any sort of hubris or ego that they don't need to be told they are doing a good job now, but it was really about saying where would this member be better off in five years' time. I think Howard's leadership meant that because he was the CEO he was able to sort of convince the board that that was a really good thing, and then all the advice,

and we were the advisers, was simply about where would a member be better off.

There was no requirement to say how good they were or whether there should be any board positions, there was no stipulation of executive roles or board positions in any of the reporting or in any of the discussions with the funds themselves that they were considering merging with. That's why I think those things have to be taken out of the equation, because what I often see with reports to do with mergers is most of it is about executive positions, boards or control, this thing about you will lose control.

The other thing that I think maybe needs to go further is I really feel reporting potential MOUs to APRA and then ASIC investigating if they fall over, I think maybe there needs to be a pre-step that I think APRA is the body that should have intervention power to stop a merger. I think unsustainable Fund A merging with unsustainable Fund B to form unsustainable Fund A plus B and all the wasted member costs shouldn't actually be allowed to happen.

MS MacRAE: Cathy, you see that likely or actually happening today?

MS NANCE: I have seen that, and partly that's to retain control because some people feel that if they merge with something too much bigger than them they won't have any ability to maintain any control in executive positions or boards and I believe that that's actually a wasted cost on the industry. So I think in some ways APRA needs to have power to intervene, to say show us why a member now in your fund versus A plus B is not better off being in best to show.

MS CHESTER: So the idea of what you're suggesting in terms of APRA giving clear guidance as to what are their expectations of what would be a good independent assessment of the outcomes test I think is a good idea. It would be great if you're able to, in a post-draft report submission, just articulate what's best practice from your experience.

MS NANCE: Okay.

MS CHESTER: Because we can then go there in our final report in terms of making a recommendation, also giving some guidance to help APRA down that journey.

MS NANCE: Yes, I can do that.

MS CHESTER: On the point that you raise about which regulator is responsible, that's an area that we have really struggled with as well and

we're looking forward to getting some clearer guidance from APRA and ASIC on this matter, and they have undertaken to do that. I guess what we called out is that it wasn't clear to us, and indeed we had staff spend a lot of time trying to work out who should be doing what, all we worked out at the end of the day is that there were overlapping responsibilities and there were some gaps.

Wherever in the regulator world you have overlapping responsibilities and gaps you have no accountability, and thus things can become missing in action. Whilst we've all heard the war stories of mergers not proceeding for reasons disparate to members' best interests or, as you have said, you have seen instances where other factors have been taken into account in deciding whether a merger is appropriate, but there is just no regulator doing any strategic conduct regulation enforcement around that where, arguably, the trustee is not fully in keeping with their duties.

MS NANCE: That's right.

MS CHESTER: So stepping back for a moment then, if it's a strategic conduct role of going in and enforcing a breach of duties versus supering a trustee board to do the right thing, I guess that's where we're trying to see should APRA be doing the supering role for good health and hygiene in the conduct of doing all of this, but if somebody – if a trustee board doesn't do the right thing so it's then a form of misconduct, should that then be ASIC stepping in? So that's where we're kind of sort of trying to work out what might be best.

MS NANCE: So I think, as with everything, there's always a risk of what behaviours change as a result of sort of requiring anything. Look, I mean we were one of the ones opposed that, you shouldn't be required to report discussions before the MOU stage or you just might force discussions underground. But even reporting the MOU, unfortunately some people may choose not to enter an MOU until they sort of get further down the line in order to not risk ASIC coming in and investigating them afterwards. So I think it's really difficult, but maybe the regulator that's most ultimately responsible for the member maybe should have more power there, which is probably ASIC.

MS CHESTER: The other side of the barriers to mergers we're now hearing about is it's nearly like the supermodel question, what sort of thing are you prepared to get up out of bed to go and do for the catwalk. With the larger funds, them being able to digest the smaller, underperforming funds, particularly if you've got a cohort of members who aren't the young members with growing balances.

We kind of looked at it from a denominator perspective, if you've got a small fund, albeit a fund that is of an aged cohort, if they are being merged into one of the very larger funds and a good performing fund, we couldn't see how that would be a material disbenefit to that fund. But if you could just talk us through whether that issue is a real impediment and what might some ways that APRA and the funds can deal with that problem?

MS NANCE: So it used to be, pre-APRA, putting out their clarification on what successor fund transfers were involved, the hardest case for making a case for a successor fund transfer was often not on the small fund, it was on the big fund, because they were invoking costs but they couldn't prove that their members would be better off as a result of the transfer because the group coming in was too small to really impact their members. I think now, with a bit of clarification, that's all about equivalent rights, you don't have to prove that the big fund would be better off, because often times they are imposing a cost on them for not a lot of material impact in the shorter term on the fund. So I think that's one thing.

I think the other thing too is I was involved in the credit union industry throughout a lot of rationalisation as well and I know there that a lot of larger entities took on the smaller entities even though they might not have had the perfect loan book or anything like that, simply because they realised that they had an obligation to the industry as well to help the rationalisation process, so I think there is a factor of that. I think as long as the larger funds aren't held to prove that suddenly their members are going to be better off as a result of the merger, which is almost impossible to prove, that that should be just a consequence of it and sort of industry rationalisation.

MS CHESTER: So you see the biggest impediment then in terms of how a trustee board might be approaching whether a merger is in the best interests of their members versus any other impediments preventing them from happening going forward?

MS NANCE: Yes, I think so. I think it's are we expending costs here for something that doesn't really benefit our members, and it might be that longer term there's a small benefit extra scale but it might not be something very material if you're taking the really small funds versus the really large ones.

MS CHESTER: You're right in focusing on us making sure that we best manage what could be potential risks with any changes to the architecture to the system. The way that we have approached the changes to the default arrangements with just new job entrants was with a conscious mind to making sure that as the tail of entrenched underperformers gradually disappears and you have a competitive dynamic through best in show, we

didn't want to do that in such a way that it created a world of, as some have suggested, cosy oligopolies, albeit we're still struggling to work out how 10 funds every four years exposed to competition could be considered a cosy oligopoly. But we try to do it in such a way that, from a member's perspective, it didn't create instability.

So when you look at the numbers, so of the about $150 billion every year going in in terms of contributions to funds the new job entrants are about 1 billion, the switching and the re-entrants is about 2.2 billion and the turnover is about 16.5 so you've got about 19-and-a-half billion of the 150 billion that would be subject to the greatest amount of movement to the Top 10.

Even if you assumed a material uptick in switching rate including in default and from choice, it's still not enough to sort of herald a major change in the cash flows such that, apart from the tail slowly disappearing for the middle and larger size funds that are still good funds, they would still be having very healthy flows. That was the purpose of our transition modelling, just good to get your sense of the way we've structured it so they are the sort of flows that are being impacted and the sort of amount of consolidation that would then occur being digestible for APRA to help sort of sherpa that all through and for trustee boards to play their role as well.

MS NANCE: Yes. So I think for best in show, we think it provides a really good safety net for the small percentage that might end up being truly unengaged, because even your report highlighted that with the best in show it's probably going to be a lot less that actually don't make a choice. We also think it's a really good competition threshold for all other funds to sort of be able to benchmark themselves against and a good test for advice as you mentioned in your report.

It's hard to know the impact on the funds that will be just out of the best in show to be honest and I think that's where the concerns are. I personally think that it puts the pressure on them to identify what niche they are filling that's different to the best in show and what benefits they have. I can only relate I guess to my personal actions, is that a long time ago I switched out of a major bank into a credit union because I liked their service ethos. Now, whenever I saw cheap as mortgages I knew that the credit union would never be in that list or anything like that but that didn't make me want to go back to a bank because I knew they were offering me something different on the service side.

So I sort of think with the people who are outside the best in show, yes, there's an option to get in the best in show but may they won't, maybe because they are too focused on one particular industry that they won't

make it into a best in show, but then I think it does create that incentive to really focus on what their niche is about and not everyone wants to always go to the headline entity as well because there's other features that the others can offer.

So I think their concern is if they are not best in show will they eventually disappear and will they have no brand power, no marketing power and eventually they disappear, and I understand that concern, but I also don't think in practice that that's what would happen because I don't think that's how people behave, I don't think people necessarily just follow the headline entities everywhere, but it is one of those concerns that is expressed.

I think that the best in show does raise other risks which have been highlighted, which is the politicisation of the selection of them, the risks of getting the selection criteria right from that expert panel so it doesn't drive, and I know you've said you don't want it to be driven to lowest cost or worst or short-term investment performance, so I guess making sure that that selection criteria is right so it doesn't create the herd mentality or short-term investment performance and they are the risk that would have to be managed.

MS CHESTER: So maybe we'll go through to those risks. On the second risk first around the selection criteria for who should be best in show, we set out about a page of principles in our report which would sort of go some way towards mitigating the herd risk mentality by saying things like long-term net investment returns, innovation, products in accumulation and in retirement, data in knowing your members, good governance, so it's quite a holistic list.

I think we're hearing from the feedback post-draft report that we probably need to go further and be a bit more prescriptive to mitigate some of those potential risks. Indeed we had a very good conversation with AustralianSuper yesterday, with their very smart portfolio guy, Alistair, about how we could probably take those criteria further so they would be a substantive part of our final report to mitigate some of those risks.

On the risk of politicisation, and this is one that we've been giving some further thought to, we've very conscious that the current system, it's already well accepted that the appointees there are very politicised with the FWC, or the expert panel within the FWC, so that's kind of a given. Because we're dealing in a world of compulsion we felt that the expert panel needed to be accountable to government, needed to be accountable to the members. So the appointment by government to us was the way that they were accountable to government and accountable to members through having an

incredibly transparent process that was really only about a best in show that was in members' best interests.

I guess then people suggest, well, the government of the day, they are accountable to government of the day, the government of the day is making the appointment thus they will be a political beast then and of themselves. One other way of completely neutralising that, and perhaps we're doing a little bit of kite flying here but it would be good to get your thoughts about it, is what if the expert panel were selected by Caesar's wife, somebody who was completely above reproach, you could imagine a panel selecting the expert group chaired by the Governor of the Reserve Bank with two other statutory appointees that have some knowledge and expertise of investments and financial systems but with no direct involvement in the superannuation system.

If a group like that were to decide the expert panel, the statutory appointees, I don't think anybody could suggest a panel chaired by the Reserve Bank Governor could be politicised, thus if they were to recommend who the expert – well, if they were to say this is who we have decided is the expert panel, government, go forth and appoint them, does that get around your concerns about the potential politicisation of the process?

MS NANCE: I think it would. I think that would be a really good model because it has to get taken out of the political system. I think that would be really good. I think what you did say and I think we also had promoted was using the Australian Government Actuary to provide the technical support to that group is also a good idea. So I do think that that would be a good system because that type of person (a) it's only one appointment they are making, it's only every four years, it's not the sort of big day job they've got, there's lots more other things they are dealing with that's much more political than that, but you would expect that they would take a fairly rational view to that expert panel.

I think there might be some other things that need to happen such as maybe it needs to be made clear that if you're on that expert panel you cannot take a job with one of those best in shows for at least 12 months, you know, we've just got to make sure that there's no conflicts come into play here if anyone sort of gets on that expert panel, but I do think that that would work. I think your biggest problem then is maybe getting the governments now to agree that they lose control of that process.

MS CHESTER: There's other ways that you can do it, so having been involved in the PBO, the Parliamentary Budget Office process where it's

very difficult for a government to stray from what the selection panel decides.

MS NANCE: Yes.

MS CHESTER: So just to be clear, because we finding this isn't in our report, so you would have a selection panel chaired by the Reserve Bank Governor – mind you we haven't raised this with him but we'll have a chat later – with two other statutory appointees, you could imagine sort of Rod Sims, Chair of the ACCC being one because he's not directly involved in super, maybe Tax Commissioner, you could have those.

MS NANCE: So none of the regulators.

MS CHESTER: None of the regulators directly involved in super, so you would have those three. They would then, with support from the Government Actuary, go through a selection process of deciding who the expert panel should be, who are the practitioners either ex-CIOs or people with consumer expertise, who they should be to then go through the substantive process of deciding who is best in show.

So then coming to the best in show, coming to the panel then deciding, the expert panel deciding the best in show, what sort of skill set do you see apart from them not being directly conflicted at that point in time, what skill set would you see that we would want to make sure is on that expert panel?

MS NANCE: So I think they need to have a skills set in investments for a start because I think you have to be very careful with investment performance that you don't place everything on the last five years' investment performance to be honest, and understanding the long term nature of this and that long term investment decisions can make you out of cycle for even a period of 10 years potentially sometimes, so I think having that really deep understanding of investment markets. Look, you would go to say some exposure to the superannuation industry would be helpful.

MS CHESTER: Consumers' and members' perspective?

MS NANCE: Consumers' and members' I think would be a good perspective because I think it always comes back to them saying, for instance, what do members value the most and making sure we talk about wasted frills and things like that. I think the member perspective is always – I think member perspective on most boards is actually a really valuable perspective, so same here.

MS CHESTER: Great. So I think we've dealt with both those twin risks of changes to the system, coming back then to the second of our big risks around unintended multiple accounts. So we have suggested, and very much informed by the context of today's workforce and the needs of today's workers, we've suggested the default once.

The reason we've suggested default once is if we're in a world where we've got an elevated MySuper, so you've lopped off the tail and a best in show so you're making choice safer and simpler, defaulting only once means that they are unlikely over time to end up in the underperforming fund or product, but later over time if they want to make a choice and move away from their default only once they are in a better system within which to do it. Now, so that's one way of getting rid of unintended multiple accounts.

Since our draft report went out others have suggested another way of getting unintended multiple accounts is to have automatic rollover. So instead of the account being stapled to the member and going along with the member, it would be the member's balance. So every time a member changed a job, assuming it's not the same fund and product, they would take their balance and move it into the next fund. I don't know if you were aware of that idea, Cathy, or whether you've had time to think about it.

MS NANCE: I've heard of it. So when I come to thinking about alternative suggestions like that I always go back to what are the tests that we were trying to achieve. I think the tests we're trying to achieve there is that reducing the likelihood of a member in an underperforming fund by having the automatic default mechanisms we're trying to facilitate increased member engagement, because ultimately that will be a better thing, we're reducing unintended accounts and also we're reducing the employer involvement.

As I see it, small employers never wanted to be involved, but large employers, I'm working with large employers now, so they don't want to be involved in the default decision. 10 years ago they set up some funds on the master trust with their own brand all over it and now they don't want it. They don't want their brand on a super fund, they want the relationship to be between a super fund and a person without them being interspersed there because they have no control over that product and now they've got their brand all over it. So I think we have to accept the fact that employers basically want out of this deal.

I think the problem with that arrangement about the automatic rollover is if we're trying to reduce the likelihood of people ending up in underperforming funds, in a way that could exacerbate it because you're

not just setting up one new fund with new contributions but you're rolling over all our past moneys into that same fund. I don't think that facilitates increased member engagement, I think it keeps the employers in the role and I don't think it reduces the likelihood of ending up in an underperforming fund.

So as far as I see it, I don't think that's as good an option and I think the once only default option is a good option because, I mean, ultimately, it would be good if we didn't even have a once only default at all, people when they start work state their bank and they state their super fund and I think that's the model we've got to head to, but that's just a sort of protection mechanism to make sure an employer can pay an SG.

So I don't see it as being a better option than what is already proposed and I think within the industry we've all got self-interests, we're all impacted by these sorts of changes. I think the other thing you almost need to say is, putting aside members, who else benefits from that arrangement? Then I think that starts to drive where solutions are being proposed from and I think we've just got to remove those sort of other less obvious benefit and just focus on the member.

MS CHESTER: Any other questions?

MS MacRAE: No, not from me.

MS CHESTER: Cathy, thank you. I think that's been very comprehensive and we look forward to getting your post-draft report submission.

MS NANCE: Thanks.

MS CHESTER: Is there anything else that you wanted to cover that our questions didn't get you to today?

MS NANCE: No, that's everything.

MS CHESTER: Okay. Thank you very much for your time.

MS NANCE: Thank you.

MS CHESTER: I'd like to welcome our next participants from Industry Super Australia to join us. Good morning and welcome. If you would just like to each state your name and the organisation you represent just purely for the voice recognition and the transcript recording, and then if you would like to make some brief opening remarks and we can get going.

MR LINDEN: Sure. Thanks, Karen. Matt Linden, Industry Super Australia.

MR FISHER: Michael Fisher, Industry Super Australia.

MR LINDEN: Thanks very much. If you bear with me, I just wanted to put on the record a few important matters of context which I think will help with obviously the discussion and your question. Thanks for the opportunity to appear. Like others, I congratulate both you as Commissioners and also the staff working on the review in respect to your endeavours on this draft report, this is a task that few have attempted given the challenges with the data, complexity of the products and investment options in some segments and spurious arguments advanced to discourage comparison and to excuse poor performance.

From a standing start the Commission has done a very credible job of discovering the areas of underperformance and inefficiency in our superannuation system. The headline findings are not a surprise to anyone who understands industry and the data well, however, via constructive comment some pretty important things have either been missed or avoided in the interpretation of the data, explanatory factors and recommendations.

Understanding system outcomes can easily be overcomplicated and it can be difficult to see the wood for the trees. The simple fact is an awful lot about member outcomes is determined by the motivations and incentives of system participants, as they say, you have to follow the money. The key issues at play stem from the compulsory nature of the system and the vast sums of money at stake and regrettably the exploitation of members who are not investment experts, who necessarily depend on agents to act in their best interests.

In the final report the Commission would benefit from understanding this dynamic better and the ways in which commercial models have evolved in response to it. These dynamics will help the Commission to more fully explain performance difference and would likely lead to more effective recommendations that will have more profound impact on system efficiency than currently proposed.

On one hand the Commission would recognise a set of participants in the system actually act as fiduciary trustees. These not-for-profit funds don't seek to derive profits from members, they have almost universally structured their funds in ways to add value to members and keep costs low. Significantly, they leverage the scale and investment arising in the system by constructing optimised portfolios for default members with diversification across listed and unlisted assets, coupled with efforts to

reduce the degree of financial intermediation between members and the underlying investments.

The funds have simplified product structures and investment options helping to keep operational costs low. Generally, members are encouraged to trust the default options, not to choose, and instead let the fund to the job instead. It says something when a number of CFOs of major industry funds entrust their own retirement savings to the default balanced option relevant to most members.

These types of funds comprise most of the default market. The reports analysis is relatively clear on the outcomes for members defaulted into such funds, poor outcomes would seem to be in the minority. According to figures in your report just 15 per cent of member accounts and 13 per cent of member assets underperformed the default benchmark over 11 years. The vast majority of these underperformers are for-profit defaults. There is certainly room for improvement however the quantum of below par performance in the default segment, if monetised, is small compared to other parts of the system. We will be presenting some analysis to the PC in our response to the draft report which does just this.

This brings me to the other models of superannuation which the PC studied but avoided comparison to the default segment from an allocated efficiency viewpoint. Noting the not-for-profit model, other types of funds structure themselves quite differently, instead of leveraging the scale, the systems scale and investment arising, they do things which destroy these intrinsic characteristics. The unfortunate reality is most for-profit super funds atomise member value wherever you look, complicate complicated and archaic product structures, higher fees, sub-optimal asset allocation and related party gouging are geared to deliver to shareholders rather than actual members of their funds.

The commercial structure which is decided by trustees and the commercial entities which obviously appoint them places an emphasis on choice. As the submissions from Dr Wilson Sy noted, the trustees of full profit eschew investment responsibilities and instead leave members to select from thousands of investment options for which they need costly services of a financial adviser to navigate. These complex product structures and associated advice significantly add to our operational costs which are about twice that of industry funds.

In the full-profit segment choice is encouraged because the cognitive limitations of members are well-understood and profits can be easily extracted by encouraging switching, by triggering buy/sell margins not captured in the option return data used by the Commission, and the use of

costly intermediated investment products and options where fees are extracted through the investment value chain.

The Commission should reflect more deeply on the appropriateness of these models in a compulsory system rather than accommodate them under the misapprehension that they add value for any meaningful cohort of members. It is saying something when the staff of four proper conglomerates don't invest their super in this way, their staff funds mirror the not-for-profit structures with a limited number of investments with most members utilising the defaults. The Commission would also be aware the most successful fund in the APRA fund level data set for Goldman Sachs JBWere staff is similarly structured, although with a single investment option.

So the track rate record of choice, particularly in the hands of for-profit funds is not good, the simple equation and conflict is this. For-profit funds appear to prioritise their commercial endeavour over member outcomes. This is understandable, shareholders rightly expect a return on capital but it is harmful and difficult to reconcile with the system objectives which rightfully put the member at the centre rather than providing a means for economic grants to be extracted.

To cut to the chase, what is the significance of this in respect to the report's findings and recommendation. In essence the report identifies the symptoms but misdiagnoses the underlying causes. As a consequence prescriptions do too little to address systematic underperformance in the parts of the industry that have had two decades to lift their game but have not.

For the choice segment the Commission relies largely on better disclosure and tougher prudential oversight, something which the for-profit segment will strenuously resist and probably won't work. Like previous exercises, too much faith is placed in member choice and consumer sovereignty as a panacea notwithstanding clear evidence of market exploitation of choice is associated with higher costs and poor returns.

So the key challenge is how to connect members to good products without relying on informed consumers and then ensuring these members are not sold out of default except in their best interest. The informed choice model advanced by the PC is untested and will very likely, in practice, leave members too prone to the choice sales model.

We agree fully there needs to be a merit-based process, however, we continue to argue occupational linkages are valuable from a default perspective given the common characteristics of occupational cohorts

including age, education, income, geographic location, certain risk factors and as the system focuses more on retirement mortality. These are aspects which we'll expand on detail in our submission on the draft report.

Furthermore, we continue to argue the appropriate location for a merit-based quality filter is the Fair Work Commission, albeit with further improvement to ensure comprehensive coverage and approved transparence in decision-making. A transparent judicial process is important for this area of public policy and it's separation from the finance sector is a strength and guards against finance sector capture and political interference. We are very happy to elaborate further on these and other matters.

MS CHESTER: Great, thanks very much, Matt. You covered a lot of ground there so let's see how we can go through it. We might kind of start to follow your batting order. I guess the key finding of our report was that there seem to be twin problems in the system that are causing much harm to many members, and that is unintended multiple accounts and entrenched underperformance. On the entrenched underperformance and the unintended multiple accounts our report and the evidence base suggest that they are system wide, they occur in every segment of the system.

So I'm just sort of struggling a little bit with your delineating a governance model being the determinant of performance but we found entrenched underperformance across every segment of the system, be it the retail segment, the industry segment, the corporate segment, the government segment.

MR LINDEN: Okay. So, look, a few matters there and there's a few things in that question. When it comes to entrenched underperformance and persistence of underperformance the report rightly notes that persistence to underperformance is concentrated in the retail sector. That's not to say there aren't underperforming industry funds, there are a handful but they are very small and relative to the vast majority of members in not-for-profit defaults. The quantum in respect to the value lost in a systemic sense is very small compared to what we can see is occurring in the retail sector, particularly where you've got very large funds with very significant assets and lots of members underperforming very significantly.

MS CHESTER: Well, let's focus on the default segment because the default segment, the MySuper segment, should be the system exemplar and indeed it does outperform the choice segment as our evidence showed. But we did find when we managed to – albeit we probably killed three staff members in the process of doing it – managed to stitch together the three-and-a-half years of product level data on MySuper with another eight

or nine years reported to super ratings to get a long-term net investment return.

We found when we did that analysis there were 26 persistently underperforming default products and you mentioned that the overwhelming majority of retail, well, so the metrics are 12 of the 26 were retail and 10 were industry funds so I'm not sure what evidence base you're referring to when you say, at least for the default segment, that the overwhelming majority is retail.

Indeed, when you then look through to the member harm where we identified there's about $62 billion of assets and 1.7 million member accounts, which is still a lot of member accounts, appreciate it's not the majority, the good news there was of the 10 best performing default products they did have over half the members, so that was really the glass half full story for us.

But of the 1.7 million member accounts, 990,000 are with retail but 620,000 are with industry funds. So just trying to understand, if you're saying that it's the governance model that makes a difference why is it that we still have it occurring in both retail and industry, so that's why we found it was a system-wide problem. You're right in saying it's more concentrated and it is more egregious in the retail segment but it's alive and well with a lot of member accounts in every segment.

MR LINDEN: Look, we'll come back to the Commission with some further analysis, it is not helpful and I acknowledge that you have noted that the Commission is making use of some data which is not available in the public domain for its benchmarking purposes. It would be better if that data was made available.

MS CHESTER: So you've got super ratings data and you've got the three-and-a-half years of MySuper, you've been in this industry a lot longer than we have so you can do this analysis, we know Australian Super has done this analysis.

MR LINDEN: Well, the PC's analysis which you're referring to, and there's some different types of analysis in the report around defaults, one of which I referred to in my opening remarks, the PC's preferred approach is to benchmark against the products asset allocation. Since 2014 there has been no asset allocation data available for MySuper products, it's collected by APRA but for some reason – I suspect I know the reason why – it's not been made available publicly. So, as I said, I think it would be helpful for transparency for that data to be made available publicly because it's actually

central to the benchmarking approach which the Productivity Commission has utilised.

MS CHESTER: We have made public in our technical supplement for what data we have used, how we've analysed it, what assumptions we've made, so you can come back to us in your post-draft report submission with any feedback on that.

We had a technical round table which worked out the methodology with which we would applied back in stage one, which now seems a bit of a lifetime ago, but we're more than happy to look at, if you've done the data differently, we're happy to have a look at your data and review it. But the feedback that we have had from technical experts in the sector and including the feedback we had from Australian Super yesterday was that the portfolio benchmarking analysis that we've done is pretty consistent with what they've found as well. But we're happy to have a look at your methods as well, Matt.

MR LINDEN: So, look, this is important because it comes back to my comments. With the benchmarking approach your controlling for asset allocation, that's one thing, there's some adjustment which is occurring in respect to administrative expenses as well depending on the type of analysis, which we think is probably inappropriate if you're trying to understand some of the issues around efficiency because it lowers the benchmark for funds which have high admin and operational expenses.

Now, I note that there has been some technical analysis around the significance of that and you think it doesn't particularly change outcomes, that's probably a testament to the extent of underperformance which we see predominantly in retail products. But certainly we'll come back to the Commission in respect to our submissions.

But the benchmarking approach which you utilised which looks at the individual product, there's different ways to benchmark, and I did listen into Australian

Super's commentary yesterday, there's a lot of emphasis which is placed on the individual portfolio benchmarking that subtracts differences or value which is added by asset allocation, and there's that point which I made around the adjustments in respect to administrative costs which might result in lower benchmarks.

MS MacRAE: Matt, I think also in your opening statement you said that this was sort of landmark stuff, making these comparisons, and that one of the problems in the past has been that people have been able to hide behind various sort of complications about why we can't compare funds. So we

really went through a very tortuous process really to try and come out with what's the very best methodology we can come up with to make a comparison.

So that neutralising for that asset allocation was really the first time that we were able to compare funds that had those different allocations. So if we take that away, that's what you're suggesting there, we're back in the old of then it's all just about other things and we can't make these comparisons. So if there's another way of looking at the data and we can make some useful conclusions out of that, I don't think it negates what we've got here, you might have an alternative that would give us further insights and we would be happy to look at it.

But I'm very concerned that if we get into this argument again about this methodology that somehow or other there's going to be a holy grail of you don't have to equalise for anything, you don't have to take anything out of the data, we just want to look at the raw stuff and somehow we can make a comparison, we can't do it. So I think if you've got a suggestion about how we could do it better or how we could add to that, that would be really helpful in your submissions.

MR LINDEN: Yes.

MS CHESTER: But mindful of two other things. So, firstly, when we did make it asset allocation agnostic, that was for fund segment level, fund level and choice product, in MySuper we held a higher standard. Instead of saying for all the products, whatever your asset allocation, because we know that there's lifecycle products in there with peculiar asset allocations, for the most, for the analysis and the numbers that I just talked about that are in our report, we actually held them to a higher standard of the average asset allocation for a MySuper product. So that's not at play in the numbers that I just went through.

I think the thing to keep also in mind is we were trying to do distribution based on portfolio benchmarks, so are you adding or detracting from value in the market based on the industry's experience of what taxes do they pay, what admin fees do they have and what investment fees. But we then did sensitivity analysis to see whether or not those assumptions really have changed the outcomes and that's detailed in chapter 2 and technical supplement 4. So we've laid out exactly how we've done that and the sensitivity analysis suggests that the sorts of things that you're talking about just aren't material to the outcome.

It kind of leaves us in a world where, in addition, we also then settle for the absolute investment return for those different cohorts of

underperforming and over-performing and in the no-man's land. So we've kind of done it all, so I then sort of struggle with your opening remarks suggesting that there's no problems in the industry segment, it's all in the retail segment, when our evidence suggested that's simply not the case.

MR LINDEN: Yes, I didn't say that, I said the problems are less pronounced and that the quantum of the inefficiency is far less. Now, in respect to I've carefully gone through the technical supplement and in particular a very revealing table is table 4.23 where fixed asset allocations are utilised and there actually is some data around account assets and numbers which underperform. In the retail segment according to that table over the period 2005 to 2016 of static asset allocations, 94 per cent of assets in the retail sector underperformed and 96 per cent of accounts, the corresponding numbers for the industry fund segment is 17 per cent and 24 per cent.

MS CHESTER: Okay, we're back in the world of averages and that. But anyway, so let's get back to the policy stuff that really matters and what really matters for members. So we've identified twin problems, I guess you agree that unintended multiple accounts and entrenched underperformance are twin problems in the system, how would you fix them?

MR LINDEN: Okay, so the issue around multiple accounts. Up until now, largely, the system has relied upon individuals obviously to engage and if they have multiple accounts to consolidate them. The systems to do that in an efficient way are relatively new. I would argue, and I think many who understand the problem would argue, that it really shouldn't be incumbent on members necessarily to do this, the system should better address it.

Now, there are a number of way to potentially do that and obviously one way which the Productivity has put forward is essentially to have a single default for life, noting however there's obviously a good deal of people who are outside the default segment, and I ended up there somehow, so there would still need to be some mechanism presumably if they left that default in order to consolidate accounts going forward. So that's largely just a systems issue.

We have obviously put forward the proposition that multiple accounts could have and government, well before what was announced in this year's budget, could have had a far more active process around consolidation of inactive accounts where they arose.

MS CHESTER: So we've heard the government has made initiatives to try to mop up spilt milk but when you have a system that architecturally creates multiple accounts every time somebody changes job or the potential

to create unintended multiple accounts. We're not talking about an insignificant problem, it's 10 million of the 30 million, so one in three member accounts are unintended multiple accounts.

So wouldn't the good public policy solution be to stop them being created? So we've come up with default only once, are there other ways of stopping them from being created or can you agree that defaulting only once is really the only way of stopping them from being created? Because I think it's incumbent upon government, in a world of compulsion, particularly given the very progressive impacts that we've identified in the draft report of what these intended multiple accounts do to member's balances in retirement.

MR LINDEN: Sure. So there are a number of different ways to skin the cat I think. The PC has obviously advanced one potential solution, there are some downsides to that and we'll continue to make the point that occupational linkages and determination around defaults, if it works effectively right, and we're talking about and we've certainly advanced the proposition that there needs to be a merit-based process and fewer funds, that in itself, if people are remaining in the same occupations then that should tend to reduce the extent of multiple accounts in the system coupled with systems which actually consolidate accounts if necessary.

MS CHESTER: A couple of questions. So firstly we set out a lot of context in the report about the model workforce today and how it's changed since 27 years ago, when job turnover occurs today more than 50 per cent of the members, 50 per cent of workers actually change industry sector. Thus the incidents of unintended multiple accounts is only going to grow. The incidents of multiple jobs now is about 8 per cent of the labour market, it was about 2 per cent 27 years ago.

So we know that unintended multiple accounts are only going to become greater and the level of creation is going to become greater. So defaulting only once is what we've identified, you said that there's costs associated with defaulting only once, but what are the costs, Matt, for the member?

MR LINDEN: So this comes back to whether or not the default which they might go into – and again, under the model, it's not necessarily assumed that they would be defaulted into that, I mean under the choice architecture someone could select some other product from a menu given the way that single touch payroll has been rolled out. Obviously the Commission anticipates that a best in show 10 may not necessarily be stable over time so funds may come in and out of it.

MS CHESTER: So, sorry, if we've got a system in default where we've elevated MySuper so we've gotten rid of the bad tail and we've got a simple best in show to help members, so they've got a best in show to choose from and then they've got the MySuper authorised products, which are the good products, where's the risk of defaulting only once in that system?

MR LINDEN: Well, I think that's what the Commission has articulated, that the person would be defaulted only once.

MS CHESTER: But you said that there are costs in defaulting only once, I don't understand what those costs are.

MR LINDEN: Okay. So, the point I was making is if a person has defaulted into a single fund from best in show, it may be the case that that fund no longer remains in the Top 10 list over time.

MS CHESTER: They would still have to have MySuper authorisation, so you've got your Top 10, which will change over time and we want it to, but then the MySuper authorisation are all good funds, none of them are in the tail, so I don't understand the cost to the member.

MR LINDEN: Well, okay, so I guess that's assuming that the MySuper authorisation process, in terms of the quality filter that applies there, has significantly improved from what exists today.

MS CHESTER: Yes, otherwise we wouldn't want them defaulted once, we wouldn't want them defaulting once in today's world.

MR FISHER: Can I just say about the MySuper authorisation process, the Commission is aware obviously that there is considerable variation in performance between MySuper products, some offer CPI plus 3, some offer around the CPI plus 5. So what the Commission is recommending is, in effect, that the MySuper authorisation process which result in such a levelling of net performance outcomes among MySuper products that there's almost no risk in moving from a best in show list into the MySuper universe.

Now, what the Commission has proposed in terms of strength and elevation standards, we would welcome that emphasis on stronger standards but we don't think it's sufficiently strong enough to not only remove improved performing MySuper products but to actually actively lift net performance outcomes across the whole MySuper system that make them roughly a proxy for the best in show list. So what you might get is a CPI plus 5 fund in the shortlist and then somebody moving into a MySuper product which is CPI plus 3. Both, under the Commission's proposals,

might be judged to be in the best interests of members but there's a 2 per cent performance difference.

MS CHESTER: I don't think anybody has suggested that best in show is based on a single investment strategy, there's a number of principles guiding best in show and it would be dynamic over time. I think at the end of the day what we're saying is there will always be a distribution of performance, we just want to lop off the entrenched underperformers. We would like members to have default into good performing funds or top performing funds.

MR FISHER: Yes.

MS CHESTER: Anyway, so the other, is Industry Super Australia still proposing – and this is something we've read in the media – the balance rollover model, I'm just trying to make sure, is that something that you have recommended in the media?

MR LINDEN: Well, look, I mean I think for about the last five or six years that we have suggested that the issue of multiple accounts is something which is addressed in a systemic way, so obviously automatic account consolidation is one way to do that and it will need to be a necessary part of the system going forward, regardless.

MS CHESTER: So talk us through, because, okay, so we've got two options on the table for getting rid of unintended multiple accounts, ours would just default once unless the member decides to go somewhere else. The other option is, so the member's account is stapled to the member and goes with the member.

MR LINDEN: Yes.

MS CHESTER: The other option that you've put forward is that the balance stays with the member, so every time the member changes a job their balance goes to the next default product?

MR LINDEN: Unless they affirmatively stay with an existing default, which they have.

MS CHESTER: Well, I think we've already established that when job turnover occurs today half the people go to a new industry sector so they are likely to be going to another. Just talk us through then how many turnovers would be occurring with the balance rollover situation every year given the current labour market, how many people are you having them flip to a new account? I'm just trying to work out, coming back to the point that

was raised earlier today, how many super funds are you expecting a member to go through in their working life under the balance rollover model?

MR LINDEN: Look, we can come back to the Commission with some thinking around – we'll have a look at the data around labour force turnover and occupational occupation changes over time. As I said, I think the Commission has probably realised though that having a model which is based on, effectively, the first timer pool or the turnover model with a best in show, it's going to be a very slow process in terms of dealing with multiple accounts unless there's actually an affirmative system-wide process to actively consolidate accounts.

MS CHESTER: Yes, and so we've got a whole bunch of recommendations building on tax office and government work there, that's still in with mopping up the spilt milk, we want to make sure that we get the architecture right so we don't create the unintended multiple accounts going forward.

So let's keep talking then about the balance rollover. So you'll come back to us with how many I think, and we're doing some work on this as well because this is a proposal that you guys have put on the table as an alternative to default ones, so it would be good to know how many rollovers, we'll do our analysis. How do you deal with people with multiple jobs?

MR LINDEN: So, look, in those circumstances it's most likely that they are better having a single fund, I'd agree. Now, again, it would depend upon whether or not multiple jobs which they have are in different industries or not, or whether or not they are working in a single industry, but it's likely to be, potentially, a single default.

MS CHESTER: The evidence will show you they are across more than one industry sector when they have them and it's now 8 per cent of the population working force. How do you deal then with, if they are rolling over every time they change a job, with eligibility insurance, we hadn't even thought of that, it was put to us by an inquiry participant yesterday that that would be extremely problematic.

MR LINDEN: I'm not sure that it necessarily would be.

MS MacRAE: I think it's the way the tax arrangements work when you have a rollover from a previous fund – this is as explained to us yesterday so we haven't done further work on it ourselves yet – but the amount of the TPD summary you would receive is the tax free amount you receive is based on the timing from the precursor fund before you rolled over. So

continually rolling over is short, it reduces the amount of tax free benefit you get once you roll into a new fund.

MR LINDEN: So I mean this would be, if it is an issue, it would be one which potentially would be occurring at the moment. I haven't heard of this issue raised before but certainly we can have a look at it.

MS CHESTER: Again, our counterfactual is not what's happening today, what would happen comparing default once only with your proposal of the balance rolling over. So there's a whole bunch of things that we would like to hear back from you in terms of trying to consider the relative merit of the two, because we agree that they both get rid of the initiation of the unintended multiples except for multiple jobs.

So I guess we want to know how many rollovers per year, what would be the additional admin costs attached to them, how you would deal with the change in investment strategy and how you would deal with, in market events, of any potential sequencing risks for the members, how you would deal with problems of insurance, how you would deal with multiple jobs. I think that's probably it.

MS MacRAE: I think there's also issues around compliance for employers, particularly where you might have multiple jobs. So how do you signal to an employer if someone has moved to another fund now and they may then need to go, at what point, if they are signing a multiple job, does the employer then have to move to making contributions to a separate fund and those issues as well.

MS CHESTER: Because I think it would be helpful for us because, going forward, I think we've all agreed we want to stop unintended multiple accounts from occurring, we want to make sure government is doing the best with the ATO to mop up the spilt milk. But going forward we've got two options on the table, between now and finalising our report we have to assess the relative merits of them.

I mean, we can't expect you to have absorbed all that today so we'll send you a list of the unintended consequences of the balance rollover model but it would be great for you to assess in your post-draft report submissions.

MR FISHER: Could I just say, just a comment on the unintended consequences perhaps of the emphasis on continuity of membership that the Commission has embraced. Of course, the big risk there which we don't think the AAC model is particularly good at and is particularly weak at, is that members are sold into a product early stages in their lives, into a poor

quality product perhaps via their bank when they open their first bank account, and they remain in that product for the rest of their lives if they don't engage and it appears at the top of any screen they encounter and therefore they tick it because that is a reasonable way to proceed.

MS CHESTER: So our best in show list in the elevated MySuper list don't have underperforming products. If you're talking about - - -

MR FISHER: No. But it does say existing default at the top, your existing fund, so your existing fund could be a fund that you have joined by the bank.

MS CHESTER: Yes. So I guess what we're trying to do is create then a healthy competitive dynamic in both the default segment and you're talking I think then about products in the choice segment?

MR FISHER: Yes.

MS CHESTER: Or are you talking about default MySuper products that are retail?

MR FISHER: I'm talking about an employee who finds themselves – perhaps because they were sold into it by a bank when you open a bank account – in a poor performing fund and that fund remains with them because they are disengaged, effectively, for most of their working life. That will cause significant cost.

MS CHESTER: So you're right if it was somebody who is not a new workforce entrant under our model but goes to the ATO website to get their tax file number and then is prompted to a best in show list and a MySuper authorised list. Under the current world, if you had a new job entrant that had none of those protections and they could be sold an underperforming product, that's a problem of the current system. Under our system, for the new job entrant, they make the choice when they go to get their tax file number, they've got the best in show list and the elevated MySuper list, so I'm not sure how they are going to have it put in front of them.

MR FISHER: Well, my understanding is when they encounter the form, their existing fund will be listed at the top of the form, the onscreen, is that right, and that existing fund could be a poor quality fund that they had been previously sold into or nudged into by their employer.

MS CHESTER: So if it's a MySuper authorised fund under our system the duds would have been removed and they would no longer be in it. If they are in a choice fund - - -

MS MacRAE: I think your point is right though, if you're in an existing choice fund, you go to a new job, you've got to fill out the form, the first thing you'll see will be your existing fund, yes.

MR FISHER: Yes, which many people will actually think, well, that's my existing fund, I may as well stick with that.

MS MacRAE: Well, so then the question is then would they still choose that fund and say I still want to stay with that, or if the alternative is then my balance moves with me to a new default fund, but I've made a choice before. I'm not sure it would be that different for you to say, well, you've got a fund or you can default into – we're going to move this balance with you to some new default which we're going to move you to. So are you saying that you wouldn't show it, how would you deal with the person re-entering a workforce or a change in jobs?

MR FISHER: Well, I would have a fund connected to the workplace that has gone through the quality filter and then automatic consolidation when they move.

MS MacRAE: So you wouldn't show their existing fund so we would end up with a multiple again?

MR FISHER: Well, no, I wouldn't use the approach that's been proposed by the Commission so I would have a default linked to the workplace that has been through the quality filter so there's a good default and they join that when they join the workforce of that employer, and then when they move they join an appropriate default fund in the new employer and automatically consolidate.

MS CHESTER: So you've said that they've started in a bad choice product.

MR FISHER: Yes.

MS CHESTER: So you're saying you get rid of any choice and everybody gets defaulted? Sorry, we're probably going to waste too much time on what's a bad line of discussion.

MR FISHER: I think we've started talking at cross-purposes.

MS MacRAE: Yes, that's right.

MS CHESTER: But anyway, let's treat that as diminishing marginal returns and move on.

MS MacRAE: I do get your point though and it's something we can look at. I understand the point you're making.

MR FISHER: Okay.

MS CHESTER: We do want these changes to really lift performance in the retail choice segment as well for people that are not in the default MySuper segment which is a lot of our changes are about. We do want these changes to trickle over, for people to think, I've got a choice product, here's a best in show, what return am I getting for my choice product, what could I get from MySuper authorised or a best in show product.

So we are wanting the changes in the default system as the exemplar, and it needs to be the exemplar, to trickle through very quickly and the regulators to be paying a far more active role in looking at the appropriateness and the fees in the choice products today.

Best in show politicisation. I think we won't go through all the quotes that we could use historically about the politicisation of FWC appointments so let's not go there. I don't know if you were here a little bit earlier, Angela and I proposed a way of depoliticising the appointment of who would decide was the expert panel, it would be good to get your thoughts on that?

MR LINDEN: Could you very, very quickly recap what it was? Sorry.

MS CHESTER: So if you didn't – I think we can all agree that history has shown, indeed many smart, wise folk, there's hundreds of quotes that we could say about how politicised the FWC appointment process is. People have then suggested we wanted the best in show to be accountable to the government of the day, who decides best in shows is accountable to the government of the day in two ways, (1) the government of the day makes those appointments, but (2) the process is incredibly transparent and open such that that panel, in deciding who is best in show, will be the most highly scrutinised selection process in Australia.

Now, people have suggested that we can't escape politicisation of who is the expert panel for the best in show because the government would be making the appointment. One idea we have suggested is to say, well, what if you were to have a selection committee deciding the best in show panel and that selection committee could not be seen to be politicised. So that selection committee, for example, and we should have mentioned this to the Reserve Bank Governor before we decided to kite fly it – would be chaired

by the Governor of the Reserve Bank.

Two other statutory appointees, perhaps the ACCC Chair because, again, statutory appointee, knows investments, financial markets and is not – as a statutory appointee has no fear or favour, but not directly in the super system, and one other, maybe the Tax Commissioner. So if those three were to decide who was on the expert panel for the appointment of the expert panel, that is an idea that we're suggesting is a way of depoliticising.

MR LINDEN: Sure, we can give that some further thought. I mean, I think I can see obviously it's attempting to defuse the potential effects around political influences around selection, albeit indirectly, because those statutory appointments that you refer to ultimately will be appointed as well. But I can understand where you're coming from.

MS CHESTER: So the Reserve Bank Governor is for seven years, Chair of the ACCC I think is five years, the Tax Commissioner is for seven years. So without fear or favour they would be able to decide the expert panel and I think that's about as depoliticised as we think we could get. Anyway, so it would be good to get your feedback on that.

MR LINDEN: Sure.

MS CHESTER: The other thing in terms of wanting to keep it all in the workplace system, I guess two questions there. Firstly, in the context of a modern workforce where half of people, when they change jobs, going forward, are changing to a new industry sector, what tailoring is required to a superannuation for a default member in accumulation by their occupation?

MR LINDEN: So I think obviously there's some examples which the Commission has considered, so for those working in high risk industries obviously insurance is a relevant point.

MS CHESTER: So let's set aside insurance, so just purely for superannuation what tailoring is required by occupation for superannuation in accumulation?

MR LINDEN: So we'll come back in our response to the draft report, talking a little bit more around occupational characteristics which we think could be relevant, I mentioned some of them in my opening remarks in respect to age, educational status for specific occupations, income, geographic location, those risk factors which I refer to, and mortality probably may well be an important one, particularly as the system becomes more focused in respect to retirement income products.

MS CHESTER: So if you could do it but separate out insurance because we do realise there is an issue with high risk employees in, say, construction work or the like where they might need different insurance. But I guess the purpose of superannuation is superannuation, not insurance, and we know that that's a hard juggling act for the trustee boards to do. But apart from that example we're yet to have hard evidence put to us, particularly given that we have moved away from a world where new a job entrant today is a construction worker for the rest of their life, that people are actually changing jobs across segments. But if you've got other data that you could share with us on that, that would be great.

MS MacRAE: I guess on that, we have found it hard to identify examples in the way that funds are currently structured where the superannuation side of the fund is different according to occupational difference. So if you had examples of existing funds that could show us how superannuation was structured differently according to different characteristics of the cohort they cover on the superannuation, not the insurance side, that would be helpful.

MR LINDEN: Yes.

MR FISHER: I think one issue that is perhaps relevant to that is the question of employer compliance, so there are certain industries where employer compliance in SGOs are a real systematic problem, such as in construction but also in hospitality and so on. Now, in those sectors the industry funds that serve those sectors have their own proactive compliance processes, they actively chase and identify arrears, partly through a collector vehicle run through IFS, but also they will sometimes have their own in-house arrears collection process.

We think that's a very valuable service to members, it takes serious the fund's fiduciary duties, they proactively pursue arrears, some of the big funds collect up to $30 million a year in unpaid SG. Now, there is obviously a risk that if an industry that is just construction or hospitality becomes much more diversified, including funds that don't have any proactive compliance function, I think I'm right in saying that almost all retail funds do not have a proactive compliance function, that diversification will be a risk to members because you'll have more employers who think that they can get away with non-payment of SG.

MS MacRAE: Would most industry funds have that?

MR FISHER: Yes. So there's two ways they do it, some do it in-house, like HostPlus, some run it through an organisation called Industry Fund Credit Control.

MS CHESTER: Okay, thank you. Matt, coming back to a point that you raised at the beginning which is a really important one, we also want to better understand the drivers of underperformance because there is a material systemic difference between the performance of industry funds and retail funds. That's something we could only do a little bit of initial analysis around, that it didn't look like it was strategic asset allocation or size of fund. We want to do more work on that to better understand it.

You, as I understand it, think it's all about the governance model, albeit all the trustees of super funds have to be not-for-profit so it's kind of like a bit of a – but that said, whether related parties providing services, we can understand conflicts come into play and thus the (indistinct) profit is just lurking outside, but it's also lurking outside of the industry funds where you sourced from wholesale providers as well, but you might be doing it better, industry funds might be doing it better.

So we were hampered by doing that with the fund survey, we just didn't get the net investment returns by asset class and fees and costs by asset class and related party incidents of transactions and the fees and costs. So, as you know, we've gone back out to CEOs of the funds, and I think from the feedback we're getting from the team – smiling at the poor team member who's doing the survey – that the funds now, all of a sudden, this time of the year are now magically engaged and wanting to be helpful. So we're hoping that in about six weeks' time we'll be able to share that analysis in terms of really what is driving the systemic difference of performance between retail and industry funds.

MR LINDEN: I think you've received a number of submissions, you would be aware of the previous APRA research on this issue around related party arrangements. So previous APRA research by Bruce Arnold and Kevin Lu around related party transactions was pretty stark in respect to the engagement of related party service providers. There has been no subsequent types of analysis of that sort undertaken by APRA, however the APRA annual superannuation bulletin does include some tables around the use of service providers, those which are either in-house, independent or related.

The retail sector appears to have a far higher concentration of service providers which is either in-house or related party in terms of the quantum of dollars. Now, the submission I think which is made by Kevin Lu who I think was at the hearings yesterday in Sydney, stepped through the relationship of the governance to the commercial model and then the structure. So, really, I think in his submission and the academic research he has undertaken, and drawing on obviously his previous work at APRA,

he explained how, as I mentioned in my opening remarks, there's a commercial endeavour in respect to full profit funds and the RSEs can indeed be full profit.

So RSEs can distribute dividends to shareholders, that does occur, it's not necessarily transparent but if you go through the financial statements you can find the sorts of dividends. I think CBA in the last three years, across one of its RSEs, has distributed half a billion dollars in dividends back to the parent entity. So that is just the tip of the iceberg because obviously there is the related entities which also too are generating margins.

Look, I do hope that in respect to the survey there is better quality data that is made available, you would obviously know it is a very challenging area. The central benchmarking that you have done I think starts to explain what's going on, so we can see the difference between the relevant benchmarks for the sectors would be explained by asset allocation, then there is some value-add which obviously the not-for-profit funds have been able to achieve over their benchmark.

In the retail sector there is significant underperformance relative to the benchmark and it's not explained by explicit admin fees. So what's going on there essentially is there's value that has been captured between the underlying asset classes and what members are receiving, which isn't necessarily transparent. As you know the APRA data collections suffer very significantly at the moment in respect to transparency around fees, costs and expenses and, really, many retail funds have structured themselves in a way to shelter themselves from that sort of disclosure and they've lobbied vigorously to resist disclosure, and limiting the extent of that disclosure to the RSE entity itself rather than a related party.

MS CHESTER: So we've got a tranche of recommendations around governance, for fund governance and for system governance, but particularly for fund governance around sort of disclosure and making sure the right people are on trustee boards, we focused on skills, not band-aided numbers of different sorts of people and how they're appointed.

But do our governance recommendations go far enough in terms of getting greater disclosure around related party, making sure that the right calibre people are around the trustee board table, regulators being members' champions, are there areas where you think our recommendations don't go far enough, or there's recommendations that you think aren't right in dealing with the problem, Matt?

MR LINDEN: Yes. So, look, I did listen to the testimony yesterday with Kevin Lu where there was some discussion around the governments

recommendations. The issue of affiliation and the affiliation of directors on boards is a major issue. As I said, the fundamental conflict which exists within full profit entities is that there's a commercial endeavour that's underway and it appears as if they're not reconciling their conflicting interests and duties between members and obviously the commercial imperatives adequately.

There are provisions in the SIS Act at the moment which are intended to address those issues if they don't appear to be effective. There needs to be, look, regardless of the regulatory regime, I would anticipate there is all sorts of ways and means in which these institutions will try and gain regulations in order to continue to extract outsized margins from superannuation, it's a significant glaring issue in the system. As I said, I'm not sure necessarily the idea that continuing to accommodate it is a sensible thing.

MS CHESTER: Well, I think we can all agree that wherever these things lead to entrenched underperformance across the system we want to make sure that they're removed. So thank you both, Matt and Michael, for joining us this morning. I'm sorry that we've run over time but it was a very good discussion to have and we very much appreciate it. We look forward to getting your post-draft report submission. I can now invite you to have a lovely cup of coffee outside, as I suggest that we all take a break for 10 minutes. We are now running behind but I thought we would with today's participants. Thanks very much.

MS MacRAE: Thank you.

MR LINDEN: No worries. Thanks very much.

MR FISHER: Thank you.

ADJOURNED **[10.32 am]**

RESUMED **[10.45 am]**

MS CHESTER: We'll resume our hearings here in sunny Melbourne, and I'd like to welcome our next participants from the Australian Institute of Superannuation Trustees, thank you for joining us. If you would both just like to say the name and organisation, just for the purposes of the transcript recording, and then if you would like to make some brief opening remarks. Thank you.

MS SCHEERLINCK: Eva Scheerlinck, Australian Institute of Superannuation Trustees.

MS GOODWIN: Ailsa Goodwin, AIST.

MS SCHEERLINCK: Thank you so much for the opportunity to present at the hearing today. I too would like to acknowledge the significant amount of work and thinking that has gone into the draft report, in particular I want to acknowledge the performance analysis undertaken by the Commission.

The Commission's analysis found on average the default sector has outperformed the system over the long term and the Commission concluded that the vast majority of members and assets in the system are in products that have performed reasonably well over the long term

The proposed new design, including the concepts of default once for life and 10 best in show funds, is an interesting idea. It would deserve close examination by policymakers faced with a blank slate to devise a new superannuation system from scratch. However, this is not the situation that we are in. Australia has a well-established existing default system, it's been repeatedly ranked in the top three in the world by the Melbourne Mercer Global Pension Index.

The Commission itself, having assessed the performance of the system, has concluded that it works reasonably well for most members, and in light of this, AIST does not accept that there is a case for going back to the drawing board.

The Commission's recommendation for a new default system is predicated on the need to fix two problems: multiple accounts and a tail of underperforming funds. We agree that these are serious problems and they need fixing. There is, however, no need to dismantle the existing default system in order to do so. It would be better for members to take timely and targeted action to fix each of these problems in turn.

AIST agrees that multiple accounts should be removed from the system, existing measures which require members to consent to account consolidation clearly do not go far enough. AIST is a longstanding supporter of automatic consolidation, rather than a process that involves members' savings being physically transferred to the tax office; we support direct fund-to-fund auto consolidation using cross-fund matching.

It's AIST's longstanding view that there is no place for underperforming funds in the default system, well designed criteria for default fund selection can address this problem. Using long term net returns to members as a key criteria for selecting default funds will address it. The shortcomings of a Fair Work Commission process identified in the report can be overcome with changes to legislation.

Dismantling the existing, well-established and highly regarded default system has several potential adverse consequences for members. Setting up a separate system for new entrants to the work force creates risk for existing members of funds that are not selected as one of the proposed 10 best in show funds.

Recognising the Commission's intention of putting members' interests first, the majority of members are already in the system and we don't see any research on the implications of these proposals in the best interests of the existing member cohort, especially those that are in funds that are exceeding the benchmark.

There is also a real risk that requiring members to choose a fund once for life when they first enter the workforce will compound member disengagement, and this is contrary to the Commission's statement in the report.

The Commission's analysis has uncovered systemic problems, not just in the default sector, we urge the Commission to go further to improve members' retirement outcomes into key areas, first in relation to choice and SMSF members. While underperformance issues are identified in the draft report, recommendations to fix these are absent or largely absent. The majority of retirement savings are in choice, so this can impact the most people, and then secondly, fees and costs, particularly for members of retail funds.

The Commission's performance analysis concluded that, overall, choice members received lower returns than default members. The main recommendation for improving the lot of these members is to implement dashboards for all investment options. We have long called for the choice dashboard regime to be implemented and we welcome the recommendation. However, while it's important, disclosure recommendations do not go nearly far enough, given the Commission's findings that the sector is saturated in underperforming products and most people are best served by a basic no frills product.

Many people also choose to move to these underperforming funds on the back of advice that is not in their best interests. Greater regulatory

intervention is, therefore, warranted to reduce the number of choice products and also the number of people switching into them, and we think the Commission can strengthen its recommendations in this regard.

Secondly, the Commission concluded it's difficult for members to compare fees and costs, we agree, we've long called for accurate comparable fees and cost data for every investment option. However, given the Commission's analysis found there is a cohort of retail products that have consistently high fees, relying on disclosure alone is not enough, so further action is required.

Alongside this, AIST welcomes the Commission's finding that there is a need to improve the quality of advice. Funds are well placed to advise their members about retirement planning strategies and, where appropriate, retirement income products. This requires funds to consider the financial situation of the entire household and the member's age pension eligibility. However, many funds do not have this information about members, and further action is also required to ensure that members get the advice that they need, and the funds have access to the right information. Happy to answer your questions.

MS CHESTER: Thank you very much, Eva, and thanks for keeping to time and putting a lot of points. You've set a big batting order for us to work through with you. So this is really embarrassing, sorry. We have to – uni student earning her way in life. We had 16 participants yesterday, we've earned a coffee. So turning first to your opening remark about Australia's superannuation system being in the top few, based on the Mercer Index. I think it's important just to distinguish that the Mercer Index is really about measuring inputs in terms of sustainability of retirement balances, which is really what's our SG, and it's compulsory, versus our task was really about assessing the performance of the super system, its competitiveness, its efficiency.

Is it really delivering for members? I think we found, when one in four funds persistently underperform, when one in three default products persistently underperform, when one in two retail products, choice products, persistently underperform, and when you've got 10 million out of 30 million unintended multiple accounts, we don't think that that's a good report card, we think there are some serious problems with the system.

You agree with the twin problems, as we understand it, from your opening statement, so let's turn first to persistent underperformers. How, without our proposed changes, would we get rid of persistent underperformance? How would you see persistent underperformance being weeded out?

MS SCHEERLINCK: Well, certainly the MySuper authorisation process needs to be strengthened, as you suggest. In fact when MySuper first came in it was pretty much a surprise to everyone, I think that almost everyone that put in an application for a MySuper licence got one. So that perhaps the starting standards weren't particularly high enough and the regulator perhaps hasn't been doing enough in order to make sure that those standards that are part of our current regulatory regime are actually being met by funds, there's not enough pressure in relation to that.

We absolutely believe that there should be merit-based criteria and that those should be rigorously applied, and those that don't make the cut shouldn't get default status.

MS CHESTER: So how did the current processes – and we were very careful to make sure that we looked at what are the current arrangements versus what's legislated and we've assessed both. How do they get rid of underperformers? They just decide who gets access to the keys to the kingdom, they don't then weed them out over time.

MS SCHEERLINCK: You're talking about the Fair Work Commission process?

MS CHESTER: Yes. Because when you look at sort of our underperforming tail and default segment, of the 26, 15 are ones that the FWC had decided should have default award status.

MS GOODWIN: So I think that a quality filter that has a strong focus on long term net returns will take you – and is running the filter regularly, will partly deal with that problem. But I think you've got a valid point, and maybe there is also a case for giving the expert panel or whoever it is, I don't want to sort of get distracted having a discussion about that, giving it one extra power which is to pull funds that become underperformers within the cycle so that they don't stay in the system for the full course of a cycle. I think that that would be a reasonable thing to do.

MS SCHEERLINCK: Can I just – sorry.

MS CHESTER: So for anybody to decide to say, "Okay, you no longer have award status, you've underperformed", would require that body to have done its own independent analysis. That's kind of not the way the FWC works. The FWC works with people presenting their cases, interested parties come and present their cases, and as the system currently works or is envisaged to work, yes, there would be a filter, but that filter is about who

then – who's new getting access. It doesn't take those off; it doesn't mean that it's the best products that are attached to an award.

MS GOODWIN: Look, we have always supported a filter that focuses on long term net returns, and I guess what we're saying is if that's not enough to deal with somebody becoming an underperformer during the course of a cycle, then there is – it's possible to give the merit-based selection body, whoever that is, the power to pull a fund out of the system too.

MS CHESTER: The other point that you touched on in your opening remarks, Eva, and let's deal with performance first and then we'll come to unintended multiple accounts, that might be the best way to deal with the buckets, is we were also trying to deal with the twin problems of entrenched underperformance, unintended multiple accounts, but also in a world that made member engagement more likely, made it safer and simpler. How does the current system, which you would like to retain, encourage engagement in the default segment?

MS SCHEERLINCK: We think a lot of the structure in the system is right, but it needs tweaking in order to lift it. So it's not quite right in saying that we support the status quo, we would support a heightened status quo, if you like. I've completely forgotten the question, sorry.

MS CHESTER: So it goes back to your good point earlier, that you want to encourage engagement.

MS SCHEERLINCK: Engagement.

MS CHESTER: Or you want to just – and even the behavioural economist told us yesterday, it doesn't even have to be engagement; it can just be an interest when a decision can be made or an interest over time. So what do you think that needs to change in the current system to – because there's no engagement in default at the moment.

MS SCHEERLINCK: Yes.

MS CHESTER: So what do you think needs to change to create a way for members to be more engaged?

MS SCHEERLINCK: But there would be no engagement in your proposed model either, when people are defaulted only once, and when they change jobs there's never another nudge about superannuation at all.

MS CHESTER: Well, I don't think that's right, because we're now saying for new job entrants, when you enter the market, you get your tax file

number and then you make a choice, a supported, assisted, safe choice from a best in show list, but if you want to go further, there's an elevated MySuper authorised list.

So we are creating that, and indeed, the behavioural economists that we heard from yesterday in Sydney suggested that this was a unique way to create interest and engagement right at the get go. And it did, I think they're going to share some evidence that they've got around how that would create greater engagement and interest over time.

MS MacRAE: At that point I think importantly as well, the experimental survey that we did would suggest that about 95 per cent of people will actually make the choice in that environment, and we know that that doesn't happen under the existing arrangement. So if we want to get that engagement to the levels that we think we might get with the best in show list, certainly for new entrants and at the point of job turnover, I guess the question is what would you see about changing the current environment that might get that added engagement that we would anticipate from the model that we're proposing?

MS GOODWIN: So I think – firstly, I don't know that promoting engagement at the point of people entering the work force is the right objective or constant engagement is the right objective, but I'm looking forward to what the behavioural economists have to say about that.

I think that engagement, it's appropriate that engagement is selective, not ongoing. I think that if there was – and there isn't – if there was an effective simple way for people to actually make a comparison, then it would be a good thing if they did that each time they changed jobs. That would be about right, keeping in mind your data about how often people change jobs. But there is no mechanism for anybody to do that at the moment.

MS CHESTER: So in a world – and we agree completely on, let's go for simple, one page MySuper dashboards, make the regulators just make it happen, across all products, so we're dealing with the choice segment as well. But even in a world of all those MySuper dashboards, we heard yesterday from the behavioural economists that that's still too much for members to absorb, particularly given the current number of products in default, let alone getting into the choice segment.

Behavioural economics took us to a best in show of up to 10, because members did have a point of comparison, whether they be a default or in choice. So if we've agreed that we want to get member interest and engagement at the right moment, so we want them to be able to make

informed choice, how do we get it without a best – what's your idea, different to ours, in terms of how you can achieve that with the current system, with your tweaks?

MS GOODWIN: I guess where we diverge from you is I don't know that we equate engagement with necessarily people making choices and moving. So I think that you can be engaged and be very happy with your default fund, I think that's probably the right thing for the majority of people. Your report finding that in the accumulation phase most people are actually best served by a no frills, low fee, balanced growth product, reinforces the fact that the default system should just put people into those high performing products, and they're probably well placed to stay there.

I want to be really clear that while we have lobbied for a very long time for the implementation of the choice dashboard regime, and we strongly support your recommendation about that, and it's – I would just note that ASIC in the last couple of weeks has again deferred the implementation of that regime, this time not for one year or two year, but I think it's for three or four years this time.

We don't think that that is going to be enough to deal with the problem of underperformance that you are seeking to address and that we acknowledge exists. It's a necessary starting point, because at the moment there is no transparency about the performance of the choice sector, which you have found underperforms overall and is a big part of the tale.

But I think let's get real about this; people are in those products because they've been sold into them, that's what choice means in practice. It means they get sold into them, and you have acknowledged that there is an ongoing problem with the quality of advice, recent history is telling all of us that the future of financial advice reforms hasn't fixed that problem.

Increasingly, particularly in a post-FOA world, many of those people are also in those products as a result of straight and out cross-selling, which is basically unregulated. So I would encourage you to think really carefully about the fact that that's what choice means. And while dashboards are really important, it's not going to be enough to get those members out of those funds, or those funds out of the system.

MS MacRAE: Just in relation to our top 10, I think one of the misperceptions I think about that top 10 is that it's only going to affect people in default and new workplace entrances, it's not really going to change the rest of the market very much, why are we so concentrated on default.

The important thing is that that top 10 is a signal to the rest of the market. So in relation we would agree with you that there's problems with advice at the moment. One of the problems that people have is when they go to see an adviser they don't have an easy benchmark or a reference that they can refer to, so that if they're recommended a particular product, it's very hard for them to say, "Well, what questions should I be asking".

It's pretty easy to say, "I've got these 10 products here, with really key metrics on them, and I can see that this one looks pretty good and you're trying to sell me this, what's the difference and why do you think this product would be better for me than that". More than that, I think we've talked about the problems with FOFA, but ASIC themselves, and we mentioned this in our report, are saying that if that top 10 list was made available, that they could then use that as well to hold advisors to account.

So where they're trying to press this, is it in the member's best interests, they've also got a much clearer benchmark to be able to go after advisors that do the wrong thing to say, "If you didn't recommend one of these top performing funds, or at least one that's equivalent with the good MySuper funds, what was different about this client that put you there".

MS GOODWIN: Yes.

MS MacRAE: So I think there's a misunderstanding that this – all our recommendations are about default. We want the default to be the pebble in the pond that quickly spreads with impacts throughout the system. So I guess without that top 10, we also see problems in trying to address the advice and the choice options that people are making outside the default segment, and I'd be interested in your views about how we might best deal with that if we didn't go with a top 10 best.

MS GOODWIN: So I understand the strategy. If you had an effective default system and there were no underperforming default funds in the system, you should be able to do that now. Advisors should, I think now, be required to say to everybody who they switch; this is how much better off you're going to be compared with the default product you're in now. In fact I think if you look at the switching rules, they are required to do that, but it doesn't happen.

I would be really interested in ASIC's view about whether when ASIC does surveillances about the quality of retirement advice and switching advice now, whether they do an analysis of that now, whether they say for each file how much better or worse is this person going to be at retirement as a result of this switch and whether they do the projection.

So I agree with the strategy, I just think that a strong default system would enable both of those things and in fact they should be already happening now, and when I encourage you to think more about going – using dashboards is a really important starting point, but going further, that's exactly what I'm thinking about. Why can we have 11 million accounts and a trillion dollars in the choice sector when we know that it underperforms? How have those members been put in that position?

MS CHESTER: So I think that's why we see members in that segment being able to make informed choice. Comparability is not even an aspiration at the moment, so even if we get transparency, even if we deal with intervention powers of ASIC to get rid of really inappropriate products, trailing commissions, inappropriate fees, even if we sort of begin to mop up the egregious, for that member to make a choice in a world where there's still so many products without something as a benchmark, behavioural economics led us to the best in show to work in default segment and it led us to the best in show to help meaningful safe choice in the choice segment as well.

So I think we're sort of on the same page in terms of we want the same outcome for members, we want members out of bad products and underperforming products.

MS GOODWIN: Yes. I think that's right. But what I often wonder is how the behavioural economics accounts for the role of intermediaries, whether that's cross-selling or advice, because I'm not convinced that a dashboard of a best in show list is going to overcome the impact of advice for those people, in the way that you are.

MS SCHEERLINCK: Yes. And whether people will trust an ATO website, a Government entity drop down list of, say, 10 best in show funds, compared to a trusted relationship with an advisor. And how does that work out.

MS CHESTER: I think that world has moved on. Let's turn to - - -

MS SCHEERLINCK: There are still some trusted financial advisors.

MS CHESTER: I think there are. And I think we should be careful not to suggest the whole financial advisory industry is what it's been suggested to be.

MS SCHEERLINCK: Yes.

MS CHESTER: Let's move to unintended multiple accounts. When I was explaining this to some students I – remember Fantasia, Mickey Mouse being the Sorcerer's Apprentice? No, I'm showing my age.

MS SCHEERLINCK: Goes back a long way, yes.

MS CHESTER: I'm not going to use that as an analogy then. Some in the audience might remember this. So the way we've dealt with unintended multiple accounts to date is to put the entire onus on the member to do it, and we know it just doesn't work. Then we put the onus on the ATO and Government initiatives to try to promote auto-consolidation and to get the members to do it and to get maybe some funds and employers to help out as well.

We know from the evidence base today that one in three member accounts, or 10 million accounts, are unintended multiples. So clearly mopping up the legacy is not enough, we continue to create them with the way the architecture of our system works. So our public policy imperative is let's stop creating unintended multiple accounts.

We've come up default once; there could be other ways of doing it. But I guess my question is do you agree that – mopping up the legacy is still important, but do you agree that a public policy imperative is to stop them from being created?

MS SCHEERLINCK: Yes. It's just the mechanism of how you do that, right. So we've long been supporters of auto-consolidation, that's still our position. Obviously the recommendation from the Commission in the draft report is something that we're now looking much more closely at and consulting with members on.

MS CHESTER: So auto-consolidation would be similar to the ISA proposal of balanced roll over, every time a member changes job. And we know that as members change jobs today, just over 50 per cent of them actually change industry sector, so they're more likely to have unintended multiple accounts today than they were 27 years ago.

So in that world, and I think you were here before, there's a little shopping list that needs to be addressed about what would be unintended consequences of the auto-consolidation regime for a new job entrant going forward today. So that are things like they still have multiple jobs, the additional admin costs, potential, albeit modest, sequencing risk, how do you deal with insurance problems – what else was there?

MS MacRAE: Implies cost for employers.

MS GOODWIN: Yes. So we were here and we will address those issues in our submission.

MS CHESTER: Great.

MS GOODWIN: But I think that technology will enable auto-consolidation to happen quickly, cheaply, and when you're looking at people in multiple jobs I think it's also really important to remember that a lot of those people are earning very little in each of those jobs and actually not being paid super at all. So I think we need to be really clear about the size of this issue and the ability of technology to overcome these problems, because I think that there is capacity – hasn't been historically – but there is capacity for auto-consolidation to basically happen seamlessly and very quickly.

MS CHESTER: I think that's right for dealing with mopping up the legacy, but in a forward looking sense, if we're trying to create member engagement, if we deal with unintended multiple accounts through the auto-consolidation, that means a new job entrant today is going to make their way through six or seven super funds before they retire. If we've all agreed that we want members to have engagement where it's appropriate for them to have engagement, or interest, or whatever else the behavioural economists call it, how do we do that if we're switching them?

It was a point that I think Cathy Nance made earlier today, and indeed we heard through the academics yesterday that do lots of consumer surveys and choice experiments in this world, how do we do that if we're expecting them to keep up with seven funds, six or seven funds during their working life?

MS GOODWIN: So just to be clear, I don't actually think we're on a completely different page here. When we talk about auto-consolidation I think that we're talking about something that's happening simultaneously with people changing jobs, essentially. I think that it will give people confidence in the system, more broadly, if they feel confident that when they change jobs their super will follow them.

MS CHESTER: But it's only the balance, it's not the super account, they have no relationship with the fund. Which is I thought what funds would want.

MS MacRAE: So as one of the behavioural economists said yesterday, when I change jobs I don't change my bank account, why would I change my superannuation, I don't get it. Aren't young members going to say,

"Why are they moving me, it's got nothing to do with changing my job. I've got a relationship with my fund, I'm just starting to get to know them, they're starting to get to know me, I'm familiar with how they communicate, I've got an app that I can go to for my fund now. I'm comfortable with all that, now I've changed my job and you've moved funds for me. Why have you done that? That's making my life more difficult". So from a member perspective - - -

MS GOODWIN: I don't know that that – sorry.

MS MacRAE: Sorry. From a member perspective there's a question about what is the advantage to the member in being moved when they move jobs compared to being able to stay with the one fund and getting a long-term relationship that might be more like any other product; we don't change things when we change our jobs.

MS GOODWIN: Well, I reckon there might be benefits to people, consumers, of changing banks more often, so that would be a point I would make about that. I think that there are benefits of being in occupational-related super funds, and we'll address that in our submission, but I think you're hearing from one of our members next, because I can see them there, and I would really encourage you to ask them about all the work that they do chasing unpaid super for the construction industry, because if people – if that is dispersed by funds having huge memberships across all kinds of different industries, I wonder about the capacity of Cbus to do the great work that they do chasing that money and the incidence of unpaid super is concentrated in particular industries, unfortunately.

MS SCHEERLINCK: I'm also not convinced that by making people choose a fund when they first start in the work force that that creates an ongoing engagement with that fund. It is very potentially a set and forget, I've made my choice and now I can forget about it. I don't think that – I'm not yet convinced, like Ailsa I'd be very interested to see what the behavioural economists have to say, but I just don't see how doing that once at the start of your working life gets you into a relationship that's not happening for members at the moment.

MS CHESTER: I guess the counterfactual that was suggested to us yesterday, and these are my words, not theirs, is you have a moment to begin a relationship with the fund, a safe fund over time. At the moment it's not "set and forget", at the moment it's "I don't know, I have nothing to forget" in the default arrangements.

So I guess be careful that our counterfactual has to be the current arrangements compared to what we're recommending, but if you've got

other ways of – although we're now at draft report stage 3 – of thinking of – because I think we are on the same page in terms of what we're trying to get for member outcomes.

I think you were here before when we did a little kite fly, which the Commission doesn't do all that often. We've heard a lot of feedback and it's something that we've tried to grapple with around getting de-politicisation of the selection of the expert panel for best in show. We won't go through the history of politicisation of the FWC appointment process because I could quote many people on both sides of politics there, but we won't, for the benefit of time.

So the suggestion that we've got is we want the expert panel to be accountable to government of the day, because government of the day is the one that's compelled people to save through their superannuation, and the two ways we see that working is that the Government would make the appointment and then the process would be incredibly open and transparent, and it's every four years.

So we think that injects a level of accountability, but people would still suggest, and rightly so, that a government of the day is still making those appointments. So our suggestion, our kite flying suggestion, is if we were to de-politicise it by having a selection committee comprised of people who are above reproach, who have no fear or favour to a government of the day but can represent the government in making that decision, so a small panel, selection committee chaired by the Governor of the Reserve Bank with two other statutory appointees, they would decide who the expert panel is.

I know that that's something we're just floating today and you may not feel comfortable commenting on it, but that was the biggest criticism that we had from the expert panel doing the best in show. So be good to get your thoughts on it, either now in your post draft report submission.

MS SCHEERLINCK: Yes, okay, thank you. So it wasn't in the report and so it was the first time we did hear about it was today, and we'll consider it. However, I think more important than who makes the decisions is what is the criteria. Because if the criteria is sacrosanct and addresses the right things, then it almost doesn't matter who makes those decisions, provided that they're bound by applying those criteria.

MS CHESTER: I think it does matter who makes it, Eva, because you want it to be - - -

MS SCHEERLINCK: To give trust.

MS CHESTER: - - - an expert panel that have been selected, to know that they are more likely than not to get the choice right. Because at the end of the day, with any selection process, with any prescriptive criteria, there is still a modicum of good judgment and you want people who understand investments, understand members and are unconflicted in doing that.

But we do want to get feedback on – we've set out some high level principles for the criteria for the panel to apply, we're very conscious we don't want to create perverse or unintended consequences – indeed, we had a very good discussion with AustralianSuper on that yesterday – and so we'll probably go much further with the level of prescription we'll have around those criteria for our final report. So we would like to get feedback on that, that would be very helpful.

MS SCHEERLINCK: Sure, yes.

MS CHESTER: I guess the other thing, at the end of the day, having a panel that is still accountable to the government of the day, whereas the other process that we have at the moment is not accountable to anybody, it's a judicial body, so we kind of struggle with that, that's a bit of a deal breaker for us.

MS SCHEERLINCK: We'll consider that in our submission.

MS CHESTER: Great, thank you very much. Was there anything else that we should have asked you that we didn't, that hasn't given you a chance to say what you would like to have said today?

MS GOODWIN: I just want to really reiterate the point about the fact that the choice sector is the sector that is performing the worst, and you have a real opportunity to do more about that. We talked about people in that APRA-regulated choice sector, but the same is also true for SMSFs. So like people in choice APRA-regulated products, the SMSF members didn't just drive down to a shopping centre and choose an SMSF, they're there because they were advised to by accountants and by financial planners.

There is nothing in this for them, because the default system quality filter, whatever that looks like, isn't going to fix their problem. Even though we strongly support a quality filter, dashboards aren't going to fix their problem, we strongly support dashboards but that's not going to help them at the point that they are sold into their SMSF.

Your findings, which I think are really clear, are that people with a balance of under a million dollars are worse off in their SMSF than they

would be in the APRA-regulated sector as a whole, let alone if they were in a really high quality default fund.

MS CHESTER: So we agree completely with all of that.

MS GOODWIN: So I would encourage you to do something about that. Now, the obvious thing that has been talked about for the last – you know, I have been listening to this discussion for years and years and years, is establishing a threshold for people to leave the APRA system and end up in an SMSF. Nobody's been brave enough to take that step yet. Arguably, regulators should have, and that hasn't happened, but I would really encourage you to think about that.

MS CHESTER: I think the only thing I'd say there – and look, I think we're on the same page in terms of its quite egregious, particularly if it's very questionable advice, if it's gotten some poor punter with a low balance into an SMSF. Indeed, we're now starting to see a lot of churn of people going into SMSFs and coming back out again and with low balances. Indeed, we've asked the SMSF Association yesterday and the hearings do show us the evidence. So we can better understand the distribution across time of member balances within SMSF.

But we're also mindful that the Government has compelled people to save, and while SMSF is the ultimate form of choice, people do attach a value to control. It's fine for a member to do that, to attach a value to control, as long as in doing so they know how much it's going to cost them – what am I taking off the table when I retire. So for us it becomes a question of them having better information about that and having advice that's not questionable when they're making those decisions.

So we kind of struggle with what's the best way of dealing with the problem, doing a $1 million cut-off is quite a blunt instrument when we're still compelling people to save, they might want to pay that price for the control. But we're also mindful that it's taxpayers subsidising that as well, so - - -

MS GOODWIN: Yes, and I'd want to make that point too. That's all very well, but I have never seen anybody be able to model or demonstrate how you would, in a meaningful way, trade off control for savings. I've never seen a – I've looked at a lot of pieces of SMSF advice in a previous life and nobody does that well.

But also, it is a compulsory system and there's $30 billion of tax concessions going into this system every year, and that's a good thing, because that's compensating people for their deferred consumption, but I

reckon a lot of those tax concessions are going to SMSFs because they're the high balance members. So at some point public policy has to kick in and say, actually, you can't trade off retirement savings that include lots of tax concessions for control, which is probably illusory anyway in many cases.

MS CHESTER: Well, it's a bit perverse because those that aren't doing well in SMSF are those with the smaller balances that aren't getting all those tax concessions we're talking about. So I agree, we think that there is an issue, we're trying to make sure that the advice component works best and some transparency. Indeed, the feedback that we've had post release of the draft report is a lot of people who have SMSFs and have balances under $1 million are actually asking their advisors should they be staying in an SMSF.

MS GOODWIN: So a good way to progress that conversation that those people are now having with the advisors is to force the advisors to do a projection and demonstrate this is where you will be when you retire if you stay with this strategy and this is where you will be if you go back to the APRA-regulated system. It shouldn't be buried in a 50 page SOA, it should be – I mean, it's a bar graph isn't it, with two columns on it.

MS CHESTER: I think that's a good suggestion, because we're in a world now where ASIC has indicated to us that they want to play a more active role in the super space, particularly around advice and products. They've already given us an indication of how best in show would help them with FOFA advice in the choice segment, but equally the evidence base that we've got on SMSF, they could also use that for guidance along the lines that you're talking about. So that's something we might take up with them and, indeed, we'll probably look at addressing in our final report. So thank you, that's a really good idea.

On that positive note, we will say thank you for appearing today, thank you for being brave.

MS GOODWIN: Thank you.

MS SCHEERLINCK: Thank you.

MS CHESTER: We look forward to your post draft report submission. I know that we're running a tad late, so with no further ado I'd like to welcome the good folk from Cbus that are here to join us. Good morning, thank you very much for being so kind to agree to join us, and we were hoping that you could, because there are some important issues that you have an insight and a lens to that others in the system don't. So perhaps just

first, if you could each just state your name and the organisation you represent, just purely for voice recognition for our technician doing the transcript, and then if you would like to make some brief opening remarks, that would be great. Thank you.

MR MASSON: Rod Masson from Cbus.

MS CAMPO: Robbie Campo, Cbus Super Fund.

MR RIDLEY: Tim Ridley from Cbus.

MS CHESTER: Thank you.

MS CAMPO: So I'll make a few opening comments on our behalf. So thank you very much for the opportunity to appear in relation to your draft report. We do intend to make a submission on the report, but we thought today we would focus just on three main issues that are our key focus, in particular your recommendations putting forward alternative mechanisms for default allocation, your recommendations proposing certain exclusions on offering of default insurance, and your findings in relation to lifecycle products.

So your draft report obviously proposed quite significant changes to the manner of allocating a default fund to a member who doesn't select their own fund upon starting a new job. Whilst Cbus is supportive of there being a merit based selection of default funds to ensure that there's a very high bar and only quality funds are able to offer themselves as defaults, we would urge you to think about the nature of your recommendations and the impact on funds such as ours which are focused on an industry and which offer products and services which are very tailored to the needs of the members working within that industry and their demographic, as is the case with Cbus.

So your recommendations pose somewhat of an existential threat or crisis for Cbus. We could be a best in show fund. We're a fund that regularly features among the cohort of the highest performing funds over all market conditions. However, moving to such a system would not be good for our members, who currently benefit from being in a fund which has a very strong industry affinity.

We provide products, in particular our insurance offering, and other services which are specifically tailored to the unique needs and industry conditions in which our members work.

On the basis of your recommendations, if a member failed to make a choice within 60 days they would be defaulted to a product via a sequential allocation, without consideration of the industry in which they're working, and the specific insurance or other needs they might have.

In addition, the fund for life concept would not cater for those who move jobs, so we might have a member who is in the construction industry, which obviously is a much more hazardous industry than most, so were they to start in another fund and then move into construction, they might not have the benefit of the insurance that we offer. So there are many other products that offer default insurance which specifically exclude many of the occupational categories and working conditions in which our members work, so they would be completely excluded from the insurance offering.

That said, we do support a merit based selection process for default funds. We do think that retaining a strong connection with the industry does make it logical to retain the connection with the industrial framework for allocation of defaults. We see that there are elements of it that are not inconsistent with your recommendations, but certainly we do think that operating under the auspices of a semi judicial body is actually desirable. So I suppose we noted with interest the discussion with the previous witnesses in relation to that.

We do think the process though could be further enhanced through your recommendations about enhancing the MySuper authorisation process, and we do strongly think that, to be playing in this space, actually to be offering superannuation at all, you should really be meeting a very high threshold in terms of your offering.

Turning to insurance, insurance offers very significant value and is an important element of a super system, but is particularly so for those members working in physically demanding and hazardous occupations such as those in building and construction. As a relative newcomer to the industry, my visits to the work sites where our members work is very eye opening, because even though there is a very high regard for health and safety standards, it is an inherently hazardous environment. Standing up on top of a half built 30 storey building, there are just inherent dangers that exist.

So while we're supportive of the overarching policy objectives of protecting super savings from undue erosion by insurance premiums and ensuring that Australians are not paying for insurance they do not need, we would strongly caution against some of the unintended consequences of the blanket application of exemptions.

Cbus is very concerned that were your recommendations to proceed, default insurance coverage would remove access to insurance for many of our members who need the cover, who rely on the cover and for whom we have a very successful track record of honouring claims.

This includes many members from the ages of 21 to 25. So we treat members under 21 differently to those over 21. We know from 21 to 25 they're definitely relying on that cover, but also our inactive members, and we might go into a little bit more detail about the different profile of our inactive members.

We also note the draft report's comments and questions regarding lifecycle products and their inclusion in MySuper. We have conducted research on this matter and the research found that the investment case for de-risking or lifecycle in the accumulation phase is not strong. We found that de-risking provides very little down side protection over a rank of de-risking periods. Generally foregone returns during better investment periods is material, and either offsets or more than offsets the protection during adverse investment periods, and we know this is consistent with your findings.

A large number of Cbus members have low to modest balances during a shorter working life, and low salary progression through their working life, 98 per cent of our members receive some form of age pension and 48 per cent of members have around 80 per cent of their retirement income provided by the age pension.

That might shift over time, but currently we certainly think members are in a better position if they maximise the opportunity for growth throughout their working life rather than managing risk at or near the end of their working life, resulting in a smaller lump sum to fund retirement.

On the back of this research we determined that our MySuper option would not incorporate the lifecycle investment approach. We were conscious though that this meant we did need to cater to members in terms of offering advice and other support so that they understood and knew what their options were if they wanted to reduce their exposure to risk.

As a final point, Cbus supports the PC's findings or draft recommendations that a default option is not warranted in the MyRetirement space. So I think we have a few other comments and observations, but probably time that we took some of your questions.

MS CHESTER: That's great; Robbie, thank you, and you've set a good working agenda for us to work through with you this morning. I guess the

starting point really should be getting a better understanding of the Cbus membership and why it is that tailoring might be required. I guess we're sort of struggling with we're trying to do a system-wide review.

MS CAMPO: Yes.

MS CHESTER: So we look at the changes in the modern workforce today, not that job turnover is higher or job tenure is lower, it's actually not, even though people suggest otherwise. But we know that when people do change jobs they tend to move to different industry sectors and we know that people are holding more multiple jobs than they have historically. So that's kind of the backdrop for us.

Then it's important to kind of understand, well, where might it be different than the averages of the system. So for the Cbus membership, is it fair to say that of that membership, how much of them are actually in the construction industry in the high risk cohort that you've identified that requires the insurance?

MS CAMPO: So probably between 70 to 80 per cent of our membership. So we have - - -

MS CHESTER: Are in high risk jobs? So they wouldn't be - - -

MS CAMPO: Are in the commercial construction industry.

MS CHESTER: So there's commercial construction which could be like me, sitting behind a desk, and then there's commercial construction that's on that 30 – and I get nervous just thinking about that.

MS CAMPO: Yes.

MS CHESTER: What percentage of your workforce is on the 30th floor with nothing around them?

MS CAMPO: So we think it's around the 70 per cent mark are in the blue collar component of - - -

MS CHESTER: So that's blue collar. Are blue collar all considered to be high risk in terms of losing eligibility for the types of insurance that can be offered for default – under default super?

MS CAMPO: So if you're working in that environment the chances are that you're working at heights. So the exclusion of certain types of coverage, and we have just recently done a benchmarking exercise to look

specifically at this issue, so different other alternative group insurance covers don't all have the same types of exclusions. But it's very common for there to be an exclusion for anyone working above 10 metres. So that would see all members working in that sector - - -

MS CHESTER: Is the exclusion because the insurer just won't underwrite it across a pool?

MS CAMPO: Yes.

MS CHESTER: Or is the exclusion because they would if you required it in the policy, but it's just going to cost a lot more?

MS CAMPO: Well, I guess it's a combination of both. So I suppose the creation of exclusions in other group policies is in an effort to get a better pricing. So certainly we know that the insurance that we provide is incredibly good value and delivers our members insurance that they would either not be able to get or certainly not be able to get for the price that we're able to get it, and certainly with the generosity of scope and terms.

But it certainly affects our pricing. So were we to be in an environment where we're competing for the whole – any work within the economy, it wouldn't make sense to have those tailored arrangements, because while they've very beneficial and represent very good value for our membership, it's not the cheapest insurance on the market, because it does have coverage of working conditions in occupational groups.

Even down to the way we have definitions in place that recognises if you're a steel fixer and you become injured, your capacity to go off and retrain and do a number of other things is going to be more limited. So even in terms of the way in which the product is structured and the definitions that are put in place is reflective of that tailoring to the unique circumstances of our membership.

MS CHESTER: So would it be possible to understand then, so say in a world where Cbus was not in existence, so we had a top 10 best in show. If it were a requirement that the top 10 best in show were to ensure that if there were any high risk employees in their membership, that that was a feature of a policy to apply, would we know what premium uplift that would be across a larger pool of individuals? I'm just trying to work out – am I making sense?

MS CAMPO: So I think that having all of those – creating a group which is really targeted to that group of workers in the economy who have that exposure makes sense. I think were you're trying to ensure that every fund

was able to accommodate that, I think you would – I just don't think it would be a very efficient way. I'm not sure if I've misunderstood your question.

MS CHESTER: But if the underwriter looks through to the cohort and you know what occupation there in, they would only price it for the number that are actually at that risk. So one of the problems that we've identified in our work is that a lot of the group policies don't really have a look through – you're an exception because you do know the occupations of your membership very well – but a lot of them actually don't have a look through, so they deal with it by excluding because they can't price it in.

MS CAMPO: Yes.

MS CHESTER: I'm thinking of a world with a large best in show where some of the members might be in high risk occupations, but if you've got a look through to what their occupations are and you're across a big pool, you could still cater for that policy entitlement, but it wouldn't be a hike across the entire pool. Because the underwriter is actually pricing for it according to what cohort might be eligible for it. Does that make sense?

MS CAMPO: So we can certainly have a look at this in terms of the submission we provide. I mean, I think one of the things is because we know the cohort that we're providing for and we create very clear parameters around our offering which we know are more expansive, it does create a high degree of certainty. We know that – members know that when they claim that their claims are going to be honoured.

I think one of the things about if you had particular requirements and you're trying to cover a much broader group, there's normally conditions attached to being able to make claims against, you know, if there's only a certain proportion that are covered by the high risk component. So the minute you make things more conditional, you increase disputation and you create much more uncertainty about whether claims are going to be able to be successfully made.

MS CHESTER: The other thing it would be good to get a handle on is of your membership, how much of them are in construction for life? You would have members coming and going, based on young members entering the construction industry or related industries and then some of them – a lot of them actually don't work through to an older age in that industry, for obvious reasons, particularly if it's physically demanding work, so you're being able to cater for them throughout their working life in a default once only world.

MS CAMPO: Yes. I mean, we do see in our statistics that there is a proportion of our membership who move into other industries. I think that the more common progression for our membership is to start off as an employee and then make the transition into self-employment and becoming an employer. So that's actually the more common transition. It's true that it's physically taxing work and you can't be a steel fixer for your whole life.

MS CHESTER: But you can be an employer of a steel fixer going forward.

MS CAMPO: But a very common transition. So we have quite a significant portion of our members who are also our employers.

MS CHESTER: So with the tailoring for your membership, it's largely around insurance where things have to be different. It's not so much about what your default investment product offering is for accumulation.

MS CAMPO: No, I'd probably disagree with that, and I might - - -

MS CHESTER: No, it's an open question, I'm asking.

MS CAMPO: Yes. So I think that actually the point we made about our consideration of lifecycle did take into account the fact that we know that our members tend to retire earlier, they do have a shorter working life and they actually have a shorter life. So this is not something that – this also informs the design of product. So I don't know if you want to - - -

MS CHESTER: But apart from saying no to lifecycle trigger analysis, and we'll come back to that in a moment, is there anything else that's kind of different for your membership that informs the default investment strategy?

MR RIDLEY: Yes, I'll comment on that. In relation to cash inflows, that's quite important in terms of the liquid assets that we can invest in. So we tend to have a higher allocation to the liquid investments versus some other super funds, and that's partly because of the cash flows that we have coming into the fund.

We stress test that each six months to make sure that it's still applicable, and it still is, and as we look out over the next few years it doesn't seem likely to change. So we're able to tilt our investment strategy to have more liquid investments like infrastructure, property, private equity and those sorts of investments.

MS CHESTER: Because we are sort of making sure that we look through the risks of a best in show default once. I think with the default once, it's kind of like default once unless you choose to do something else.

So there is kind of like a safety valve there if an employee goes to a workplace where Cbus has a relationship with the employer, there's – and indeed we've got some very carefully crafted words in our draft report that suggest that we wouldn't want to preclude that from continuing, where hopping off the best in show or not going into a best in show would be in the best interests of that member for a cohort like yours.

So that's one safety valve that we've got in mind with the system in terms of where good employers working with good unions and a good industry fund could still play a role in a best in show world. The defaulting only once again it's only – so the members still have the choice, it's not like once they've made that decision to default that they would then be stuck with that throughout their working life.

MS CAMPO: Yes, that would still have an impact on the way our risk pooling works, because the minute you introduce an element of choice or opting in, the underwriter has to assume that those who are opting in are doing so for a reason. So it's that issue of self-selection. So I think that the - - -

MS CHESTER: That's opting in for insurance, but that wouldn't be if they chose to leave, they could have defaulted into best in show number 1, but they decided not to because they went to their workplace, the employer spoke to them about Cbus and the insurance situation, so they go to their ATO, MyGov and then they choose Cbus. Cbus may not be on the best in show, or it is in the best in show, or it's – we'd like it in best in show, I know you would - - -

MS CAMPO: We'd like to think that we would be there.

MS CHESTER: Definitely MySuper authorised elevated, and then they just go and choose that one. So that still wouldn't be them opting into the insurance, that's them opting into your default product.

MS CAMPO: Yes. I think insurers are very careful when they're constructing their underwriting arrangements, so I think there would be an assumption that insurance is one of the key features of our product and so were workers in our industry able to decide or there was less defaulting naturally into Cbus, then I think they would make some assumptions about those who choose the product are doing so for the purposes of the insurance.

MS CHESTER: If you could confirm that, Robbie, because that's quite an important issue for us to understand in terms of how the underwriters are pricing the group policies at the moment.

MS CAMPO: Yes.

MS CHESTER: Yes, that would be helpful.

MS CAMPO: Yes. We can certainly make sure that our submission addresses that. I know that there's obviously other proposals on foot that have necessitated us to really examine this in a lot of detail. So I know that the broad nature of our risk pool is central to our capacity to get a really good outcome for our members. So any changes to that will have the impact of either increasing the pricing across the board, but also increasing the likelihood of exclusions having to be applied.

So we undertook a really substantial re-tendering of our underwriting a couple of years ago that resulted in changes to our product, different treatment of those under 21, so we did look at our younger members and know that for Cbus actually from 21 our members are often working full-time, they tend to settle down younger.

I had a very amusing exchange on a building site where one of our members was talking to me and he found out I had a teenage daughter, and we were the same age, and he said, "God, you had children so late". And he was ready for grandchildren, same age as me. So that really brought home to me the very different lifestyle patterns that comes with blue collar work and starting as an apprentice and working from a much younger age.

So our insurance - - -

MS CHESTER: That's the difficult trade-off we've got where in a situation where we would have liked the industry to have gone further, like Australian Super and yourselves, and tailored the insurance offering for the needs of your membership, and thus avoiding the problem where in other industry segments where under 25s get no value from life insurance, yet they're paying those premiums.

It then becomes a bit of a blunt instrument by then ordaining something across the entire system which can then affect a cohort. So we are trying to work through and better understand what those unintended consequences might be from the broader approach to address an underlying problem where other funds haven't don't that work that you guys and some of the other larger funds have done.

MS CAMPO: On a related point then, we would really encourage you to distinguish between the instance of multiple accounts as opposed to inactive accounts. So we know that in our industry members will often feature or

look like they're inactive and it's not necessarily the case that they've commenced work elsewhere and have opened another account and have the benefit of insurance elsewhere.

So it's very often the case that members look inactive because your engagement in construction is typically per big job that you do, so if you work on Collins Arch, you'll work for 14 months and then there will be a break. So they often have breaks between those engagements and they also have periods where they're engaged as a contractor or self-employed. So engaged in a capacity where they're not entitled to SG.

MS CHESTER: Yes. So again, we need to be careful when we're turning on and off things, that we know that an automatic turn off is about to happen, we need to make sure that the member's comfortable with that as well, as a bit of a protective mechanism, so we sort of avoid those unintended consequences. Indeed, we learned yesterday something that we hadn't heard before, about turning on and off around TPD, it's not good for the member. We'll be looking at that in the context of defaulting only once versus balance rollover with members. So it's quite problematic.

We might then move to lifecycle if that's okay. It's good for us to – because lifecycle was actually an area we weren't planning to do a lot of work on, until we discovered that 30 per cent of MySuper products were lifecycle products, which kind of caused us to pause. So we did some Stochastic modelling around it. So it would be good to understand the work that Cbus has done, because hopefully that gives us a little bit of feedback in terms of the analysis that we've done that we're trying to then apply across the default segment more broadly.

MR RIDLEY: So I'll take you through that very briefly. We undertook this analysis in 2013/2014, and at the start of the analysis we envisaged that we probably would consider this quite closely and we thought there's a possibility we introduce lifecycle. But we wanted to do a lot of analysis around that.

So what we did is we commissioned Frontier Advisors under our guidance to do some analysis around that for our default members. What we did is look at de-risking over a number of different profiles. So we looked at de-risking from 45 through to 63, 53 to 63, and we looked at the balance outcomes through the simulations using a Stochastic approach but also using an historic approach as well.

In both cases what we found is in most occasions the members will be worse off if they went down the lifecycle route. There were occasions where that wasn't the case, but that was a small percentage of the time. So

when we looked at the analysis, what we came to the view of was that lifecycle wasn't going to be suitable for our default members. We thought there were some members that may want to de-risk, and as Robbie alluded to, they were best catered for elsewhere through advice and different products. But in terms of the default, this wasn't the best way of a path forward for our members.

MS CHESTER: Tim, of the small cohort that could have benefited from a lifecycle – a well-crafted lifecycle product, what were their characteristics that made them – that the insurance policy was a benefit for them?

MR RIDLEY: It was more in relation to the timing of the de-risking rather than the member themselves. So some members, if you include the members preferences for a moment, so if you just looked at what happened through time, it's really when the de-risking occurred. So if you were fortuitous in terms of the timing of the de-risking and we looked at the historic analysis for example, you could end up with a better outcome versus other times. So it's really in relation to the timing rather than - - -

MS CHESTER: So it's timing with market cycles?

MR RIDLEY: Yes. It's the timing of the market cycles. So if you looked at the worst three year return and the worst five year return, those sorts of things, and said, if you were fortuitous and de-risking at exactly the right time, what would be the net benefit over say a five or a three year period. Generally it was quite small.

Because one of the things you have with de-risking is the de-risking event, say a GFC, that lasts for about 18 months, but you're typically de-risking over a longer time period. So there's an opportunity cost prior to the GFC with de-risking because you get very strong returns, and also you have very strong returns from March onwards, most 2009 onwards.

So you're foregoing that strong return period for the negative event. So you need to look at the total in effect. So you do get the benefit during the GFC in that case, but you also lose on the way up and lose on the recovery phase out of the GFC.

MS CHESTER: So then it's only with the benefit of hindsight you could tell a member by their age who would benefit from lifecycle where they'd get a net benefit. Which is kind of the same with any insurance policy, you can only know with the benefit of hindsight whether or not it's paid off for you.

MR RIDLEY: It was primarily the timing – there is a net benefit potentially from a risk preference perspective. So you might have a member who is quite risk averse and they don't want to live through a negative event. And they may be one client to switch.

MS CHESTER: Happy to take the growth off the table.

MR RIDLEY: Yes.

MS CHESTER: So that then sort of gets us to where we haven't had a draft recommendation but we were sort of leaning towards, that for us to default a vanilla member into a lifecycle product, which 30 per cent of the current MySuper products are lifecycle, didn't to us make sense based on that Stochastic analysis. You'd really need to know the member's risk preferences, what their age was, what sort of balance that it would have at retirement, i.e. what sort of sequencing risk they might face at retirement, to make a call about whether lifecycle is something that's appropriate for them, which kind of took us into the world of choice with financial advice, not making it a default product. Based on the work that you've done and based on having a look at what's in our report, do you think that's a reasonable landing point?

MR RIDLEY: Yes, I think it's a reasonable landing point. The other consideration is there's a lot of time in retirement as well. So you actually have quite a long investment horizon once you retire.

MS CHESTER: Yes, and once you've de-risked, people don't up-risk again.

MR RIDLEY: Yes, that's right. So for us and it was probably a more broader conclusion that you're making, it doesn't make a lot of sense to have a lifecycle approach. It may do for some membership places which have different risk preferences and very strong risk aversion coming through, that wasn't the case in the context of our membership. We thought it was better to try and maximise the balances as we move into retirement, rather than having a de-risking phase going into retirement.

MS CHESTER: Might just pop back to insurance just for one other little quick question. Income protection, we called that out as a little bit of a culprit, but it tended to be a culprit associated with unintended multiple accounts. But it is also an expensive form of insurance, particularly if it's a policy that goes beyond two years. Has Cbus done work around this, Robbie, and where did you land on income protection for your members in terms of value for money?

MS CAMPO: So we haven't, and the reason is that most of our members – we don't have a default income protection offering. Most of our members - - -

5 **MS CHESTER:** It's moved, okay.

MS CAMPO: - - - have income protection through workplace arrangements, and so there are separate workplace arrangements that apply to most of our membership. So we do offer it but members choose it. So
10 there's no impact - - -

MS CHESTER: So why don't workplace arrangements then cover the other insurance for your members? Why is it just income protection that they've covered? Is it just the way the contracts historically have evolved?
15

MS CAMPO: I guess so. I think maybe because there was a period where – this is my best guess, so we'll clarify in our submission perhaps – I think that initially super funds offered death and TPD but not income protection, that followed. So I think that in that intervening period there was the
20 development of these other schemes and so they continued to offer that type of insurance for most of our membership.

MS CHESTER: That's terrific.

25 **MS CAMPO:** If I can make one other point?

MS CHESTER: Sorry, I was just about to say, is there anything else you'd like to say?

30 **MS CAMPO:** Yes. So I noted the observations made by AIST in relation to SMSFs, we still see reasonable numbers of members who exit SMSFs, their typical balance is only around 100,000. We know that because our membership is so skewed to men, it's about 90 per cent male, which makes it atypical, but we also know that most of our members are also the primary
35 breadwinner in their families. We also know that because they work in the construction industry they're quite attracted to investing in property.

So there are a number of factors we know that make that more attractive, but we also think that the benefits which form the basis of the
40 recommendations for them are around tax benefits, control, but we really think that for most of those members their circumstances are going to be much worse as a result of shifting into an SMSF.

So we provide information and really encourage them to think about
45 whether such a move is in their interests, but we do think that the current

regulatory settings really do need to be reviewed to make sure that the protections are there for those both at the entry point but also for those who are in the system. There does seem to be still not enough protection for members in that category.

MS MacRAE: Will some of those members who choose to go to an SMSF keep a small amount with you to keep that insurance going?

MS CAMPO: They do, yes.

MS MacRAE: Then is there a potential that they get caught in that inactive thing as well?

MS CAMPO: Yes. We do know that there is an element of our membership who leave a small balance, so under 10,000, and we guess that most of those people do it to retain insurance. So that would be another part of our membership that we know are inactive but intentionally so. We also do see some members now coming back, so refugees back.

MS CHESTER: I think you were here when we did make some really healthy advances talking to AIST about how we could deal with that with maybe the regulator giving further guidance to the financial advisors. This may be something you don't have a sense of, but of the members that have gone into SMSFs, are they more likely than not to be getting financial advice to do that? So is it sort of it could be potential questionable advice, or is it something that they still just want to have that sort of control and looking to invest in property themselves?

MS CAMPO: So we think it's an advice, often an advice-driven – yes.

MS CHESTER: That's helpful to know, thank you. Thank you very much for appearing, it's been incredibly helpful. I'm not sure we're going to be able to – we look forward to getting your post draft report submission and we might have to come back to you, because there are some issues that you've raised that we want to make sure that any policy changes we finalise don't have the unintended consequences, and you have raised a couple today that are very important, so thank you.

I'd like to call our next participant, who has the lucky timeslot of coming between us and a sandwich, from the Grattan Institute. Morning, Jim. Seems you've been at this table before for us. Just for the purposes of the transcript recording, Jim, if you could just state your name and organisation.

MR MINIFIE: Yes, my name's Jim Minifie, I'm with the Grattan Institute.

MS CHESTER: Jim, did you want to make some opening remarks then we'll get into a bit of a discussion?

MR MINIFIE: Yes. So overall, having carefully reflected on your report, I'm broadly supportive of your cost and efficiency assessment of the system and I think the recommendations that the PC are putting forward have got the prospect of making quite a significant positive difference for members in the system.

Just to break that down a little bit more, I think your assessment about the fact that average costs are higher than they need to be, there's a very significant tail of underperformance, that that underperformance is driven by a combination of excess fees and underperformance at the asset level, that inactive accounts are having a particularly strong impact on younger members and members with lower balances, all look very well supported.

Your observations that in general the default or workplace segment of the system on average performs better than the choice or advised part of the system also looks correct. I just make the observation that – I think this will be consistent with what's in the report – that it's really quite striking that the level of underperformance persists despite a very clear legal obligation on the part of trustees and board members. So that's why I think what I perceive as a combination of interlocking complimentary policies designed to shift the basis of competition and improve the quality of competition are well-founded.

Now, having said that, there are still some questions in my mind about whether alternatives might be better with different risk profile - - -

MS CHESTER: We would be disappointed if you didn't have some, Jim.

MR MINIFIE: So therefore I can see that there's a program of work that might be valuable to dovetail into what I'm sure you've already got planned over the next few months. So perhaps I could just make some observations about that.

In some sense, the question at this stage in your report from my point of view is whether PC's recommendations to, if you like, more vigorously shape the sector by shifting the basis of competition in defaults towards net performance through a short-listing process, through aggressively moving to prevent the proliferation of unintended multiple accounts, to toughen up authorisation, including potentially making the prospect much more real

that a MySuper product might lose authorisation for underperformers, and then finally a set of programs to make better and more salient information available for those in the choice or advice part of the market.

The question really is do all of those combination of reforms have a strong likelihood of making things better and a very low likelihood of making unintended negative consequences? So I've tried to give some thought to those observations. That's led to I guess a set of arenas where I think more work could be done.

I think the first one is around just really strengthening the analysis around the extent to which shifting the control of the super system away from the industrial system and employers does have unintended consequences. You've heard from several other of your discussions over the last couple of days observations on dimensions on which this might have unintended consequence, and I think those are worthy of additional attention.

I mean, my sense is, on balance, that the risks are of relatively small unintended consequences, but nevertheless, I think further work would be justified in that area. Just to give you one example, there's a sort of an interesting tension about how the representative board or trustee membership structure on industry funds will increasingly drift away from the membership over time.

So that if you're a member of an employer association or a union and you're on the board or are a trustee of an industry super fund, over time as the link between your membership and your – if you like, your institutional base, drifts further as it's likely to do under the proposed shortlisting model. There is a question about whether that's a good outcome and whether that's something that requires further thought about the governance of those funds.

Obviously you've put forward a set of recommendations about the value of increasing the expertise quotient on some of those boards that might be complementary to that.

Just another sub-point around this breaking the link with the workplace, others have made the observation, but the Fair Work panel has never been implemented and I think it's, just from an analytical perspective, worth going through the exercise of comparing your best in show model to what might come out of a Fair Work process.

You can imagine that there would be a shortlist, there would be some improvement, but the coverage is not necessarily going to be as great, the

competitive tension might not be as great. But there may be some upsides in terms of matches to particular occupational requirements.

Similarly, although on a somewhat different dimension within this overall category around the links to employers, when you come to evaluate whether assisted employee choice is better than assisted employer choice, I think a bit more work could be done to try to understand the way that employer-driven defined contribution retirement systems have developed elsewhere could be valuable.

So one observation that we came across in our work is that there has been quite a significant decline in average costs in the 401 case sector in the US, there's still quite a big dispersion, and what's driven that decline and supports that continuing dispersion, the relative prospects I guess in an Australian context I think it's worth just trying to spell out a bit more clearly.

I think the second area that is worth some more analytical attention would be around understanding the contribution of different components' fees and gross returns to net investment returns. We did some, admittedly, not fully comprehensive work that suggested that the persistent component of gross investment returns was relatively small, particularly once you control for asset allocation and then even more so once you control for factor exposures, whereas fees are strongly persistent over time, both at the investment product level, the wholesale level, and obviously at the consumer level, the member level, including admin fees.

The reason why this is of more than just academic interest is it speaks directly to the weight that you might put on those different dimensions in designing the short-listing process. So there might be a point of view that says, well, look I've seen you've performed really badly over time and so you're not going to make the shortlist, but if by contrast there's a fund that's performed very well over time but we know that they've or there's evidence that they've taken significant investment risks, then you might not want to give that gross investment performance a lot of weight.

There are ways to investigate this in the data that could be valuable and materially affect the weight that you ought to apply to different components. That's my second sort of major point around potential additional work that might be done. I'll skip over some other observations which perhaps we could pick up offline, I'm aware of time.

MS CHESTER: That would be good, Jim, but if I had my debater's bell, I would have rung it about five minutes ago.

MR MINIFIE: That's right. So the third point would be around the likely effects of the proposed model, and here I think it would be very, very valuable, and you've received this feedback from others, to refine and stress test that model further by showing the impact of how many funds you're choosing, the period of assessment, the weight of fees versus performance in different periods, the use of benchmarks versus absolute performance, consideration of the impact of whether you're looking just at new entrants to the workforce who are a broader set. All of these things can be simulated and you could give greater confidence to decision-makers about the likely effects of their decisions, if you were to do that.

Then a final point that I'd just like to make is around more work that could be done around reforms to improve outcomes in the choice or advice part of the market. Here, while I think your recommendation is very sensible, there's a question about whether they go far enough. Because my reading at least of the evidence around engagement is that there's not much evidence that more informed or better information does lead to better decision-making at the consumer level, and I think just being realistic about whether more work is required along advisor obligations in particular might be a stronger tool in that space. So those are my sort of opening shots, if you like.

MS CHESTER: Terrific, Jim, thank you. You always set us homework when you come to appear, but let's see how we go at setting some for you as well in your post draft report submission. Look, I should have said at the outset, and on behalf of the Commission, thank you and Grattan Institute so much for your constructive engagement and involvement throughout the – not even just the three stages of this inquiry, but some of our precursor work around post-retirement super and housing decisions of older Australians, your involvement in the technical roundtables where we sort of tried to wrestle the beasts of how we could compare apples and zebras, so for that we are very grateful.

Coming I guess first to a point that you've made, and it's something that we've thought about but we haven't really put to people in the hearings so far, when we did our fund governance survey, 85 per cent of the fund CEOs said they do regular performance attribution analysis. Indeed, the benchmark portfolio analysis that we did is kind of like basic performance attribution analysis by – so funds are doing this, they say, 85 per cent of them. They do it for their own products and their own performance, we did it by system, segment, fund and product, and that's what was new and novel.

So if we take what the fund CEOs said as truthful, and we are, that would suggest that the trustee boards of all the persistently underperforming

funds know that they are persistently underperforming funds and they've been persistently underperforming funds and products for 10 to 12 years.

So that then raises a really stark question of what is it about our system that hasn't meant that they haven't exercised their trustee duties in recognising that their performance isn't up to scratch for their members, and indeed, if they were exercising those duties they would have shepherded their members to a better performing fund.

MR MINIFIE: So I haven't participated in those internal processes of the funds, you could imagine that potentially an individual fund might form the belief that if they were successful in growing so that they're able to achieve the benefits of scale and if they were able to improve their gross performance, they would realise their obligations to members fully, and perhaps there's a bias towards optimism there. I think there is also a question that's raised, just about the effectiveness of the regulation which ought to be ensuring that those funds are being realistic rather than optimistic.

MS CHESTER: Yes. The other point that you raised about – and I'll group the two together – the role of the industrial relations system and funds in terms of the not-for-profit governance model, and then also the relative merits of assisted employee choice versus assisted employer choice.

Firstly, we've now had evidence from the employer representative organisations that employers want out, they want out. So we now have a system where there are some groups that want it all to stay within the industrial relations system, but employers do not want to be involved in making the decisions on behalf of their employees.

So if we take at face value what those representative groups are telling us, we're getting a signal that employers no longer want to be doing that, and we're going to hear a little bit more about that this afternoon with another inquiry participant. So that's today's modern reality. On the drift of governance, I could see a situation where the drift of governance would change with the not-for-profit in the current IR system if it stopped being a not-for-profit and became a trustee board within a for-profit mothership. I could see that drift changing.

But we already see in the current governance models of the industry funds that there are some unicorns that actually don't follow the same, there's one in particular I'm thinking of, that doesn't have that traditional representation, they're a high performing fund, they are an industry fund, but they've already drifted, and yet it hasn't affected their performance.

So if they still retain the trustee entity of a not-for-profit, and we know that there are a lot of good performing not-for-profit entities in other areas of endeavour and activity, does that sort of address your concerns? Or is the concern that it might drift if they then became part of a mothership with for-profit? I'm just trying to work out - - -

MR MINIFIE: Well, yes. So it's not so much – I would just put, others have made this observation, it is quite striking that there's a large average difference in performance between for and not-for-profit systems and funds in our system and that, I think, is worth reflecting on why that is.

Now, I'm purely observing that if you transitioned the basis, if you like, the basis of allocating members to products away from the industrial system but the governance structures remain linked to the industrial system, at a certain point you have to ask the question, well, why do I have a particular composition of those boards on those funds. So you would want to weigh – and I suspect your recommendations to move towards more expertise-based, remaining non-profit, may well be the best answer.

MS CHESTER: We don't make any recommendations about the nomination processes or, indeed, we don't make any recommendations about the number of independent directors.

MR MINIFIE: Yes.

MS CHESTER: We have views and findings about what we think might be best practice to manage conflicts, but at the end of the day, where we've focused on is making sure that there's transparency and accountability around those trustee board members being the best, being the best in show themselves, with the right skills and expertise, and free of conflict, and where not free of conflict, very transparent around related party. So you mentioned before some of the governance areas you didn't think we'd gone far enough. Do you think we've gone far enough in that area?

MR MINIFIE: Look, I haven't done as much in our work, we didn't do a lot of analysis of the governance structure, so I wouldn't regard myself as really expert to make that assessment.

MS CHESTER: The other thing you mentioned was contemplating FWC as legislated, as opposed to FWC as practised, and we did actually do that in the report. I think the two keys things that were kind of – three things that were missing in action for us there, even if it was done as legislated, it still doesn't introduce competition for default, it's still not an accountable body to the government of the day, and its DNA is different in terms of how it makes decisions.

It doesn't weed out underperformers and it only looks at what's presented by the interested parties. It doesn't do its own evidence analysis. So we actually kind of want an expert panel to basically do their own analysis when assessing the selection criteria for best in show. To not just take what's provided to them as evidence of here's our proposal, take it at face value and now make a decision, without actually robustly doing their own analysis around that.

MR MINIFIE: Yes. I think there's a strong case to do that, but just as – from my point of view, just in terms of crossing your Ts and dotting your Is, I think to the extent that you can flesh out and substantiate the likely performance under those alternative systems and compare them really explicitly, that just gives the senior decision makers a lot of confidence that they understand those trade-offs in as quantified a way as possible.

MS CHESTER: You're right in saying that we have to be very careful with the criteria that the best in show expert panel applies, that we address any unintended consequences, and indeed, we've got about a page at the moment of how we see them working. If you've got any thoughts and feedback on how we can bolster those to make sure we avoid those unintended consequences, and we know we're going to be hearing that from others, that would be really helpful.

On the issue of better information making better decision-making, I guess we're saying at the moment super's a world where comparability is an impossibility. So the role of best in show, the role of a one page product dashboard, the role of getting rid of the tail of underperformers is to consolidate the system, get some comparability, but at the end of the day we still don't expect a member to go and have a look at 60 MySuper product dashboards.

A best in show allows two things: it allows a member a reference point, a trusted reference point, but it also allows – and this is the point that Angela keeps bringing home – it allows the advisors a reference point. So say you're in a world of FOFA with ASIC, if questionable advice is occurring the choice segment, it could be a case of if not, why not. So why with that client did you recommend them to go into this choice product when there's a best in show.

MR MINIFIE: Yes. I agree that would be an improvement over today's situation. Although having said that, it's not hard to find that your products have been dominated and today, that doesn't seem to have prevented a lot of members in that advised part of the market staying in dominated products.

MS CHESTER: On your point around fees and costs and persistence, we found – our analysis came to the same landing that your good analysis and, indeed, we leveraged your good analysis and how we approached doing our analysis as well – that where there are high fees they do persist over time and there is an ugly tail there. What we did find with our distributional analysis of performance over time and, albeit, it's just a 12 year period, is there is – the distribution is too wide and there's persistent underperformance that you would not expect in a market that's operating properly.

MR MINIFIE: At the gross level. Because the spread is much bigger than what you would get just from fees, that's right.

MS CHESTER: Well, we're doing net investment returns, exactly. So there's more at play here than just a bad fee story in explaining the underperformance, indeed, we know that the egregious fee tail is large – well, it's 100 per cent retail?

MS MacRAE: Yes.

MS CHESTER: So we know that that's a retail story, yet when we looked at the persistent underperformers, particularly in the default segment, it was 12 retail, 10 industry and then the others. It was worse in the choice segment, that was more dominated by the retail segment than it was by others.

MR MINIFIE: Yes. So I just make two observations, if you have a very, very undiversified investment strategy, you may do very well for a period or very, very badly for a period, and that might tend to reverse over time. If you think about this, if you like, the performance of different funds with different strategies fanning out over time, you will have a combination of these kind of growing tails of very persistent under and over performers.

Some of the super performers are taking inappropriate risks, and I guess the reason why to my mind this is very important is, you want to make sure that your performance incentive system is providing a steady incentive for continual appropriate management of risk, as well as for good performance.

MS CHESTER: But if we have the net investment performance over a long enough period of time, Jim, we've corrected for those that might be taking an excessive risk strategy.

MR MINIFIE: You will get a few freaks even then at the top, just as you do at the bottom of the distribution. That's the worry. So let me give you an example - - -

MS CHESTER: But it's over say a 20 year period and the net investment returns have been highest over a 20 year period, that can't be an inappropriate risk allocation, because you've been through three and a half market cycles.

MR MINIFIE: That's right, there are going to be very, very few over performers over that period of time, due to taking persistent excessive risks, that's true. But over shorter periods, it's not the case.

MS CHESTER: Yes. Which is why it's important then for the best in show to be a very established track record over a longer term period, and then we make sure that the other principles around governance, innovation, fees and costs, understanding their membership, getting it right in accumulation, means that they're more likely to continue that going forward, for the best in show.

MR MINIFIE: Yes. I think that's right. I don't think that the model that you've put forward poses significant risks of creating incentives to take inappropriate investment risks, but it's something that I think is just worth being as explicit about, I think.

MS CHESTER: Yes. I think you're right, and others have suggested it, we probably need to be a bit more prescriptive in the criteria, to guard against that.

MR MINIFIE: Even if you're just putting forward a model that then the ultimate system is – you know, may deviate from. I think that would be appropriate. So I just want to emphasise again, to my mind one of the important dimensions is around the applicable flows. I know you've discussed that in the report and you've had some discussions with people already, but there is a case to be made that says only making this product a default for when you enter the workforce means that you're going to be phasing in over many decades and is that the right pace.

There's a case that says, look, it's a big complex system, it's been subject to repeated government policy changes over time, and so you want to do this in a progressive fashion. But the counter-case would be, well, you're starting in year one with less than one per cent of the inflows the system. So in the first decade you might get 60 or 70 billion, but out of a system that by then is going to be 800 or 900 billion.

MS MacRAE: We're damned if we do and we're damned if we don't.

MS CHESTER: Yes and no. Others will suggest we're already going too far. But it is like the pebble in the pond, to quote a smart person sitting next to me. So think of it this way, your 10 best in show – so you've lopped off your tail with your elevated MySuper authorisation. So you've gotten rid of hopefully most of the entrenched underperformers. Then you throw the pebble in the pond with the best in show.

It's not just the new job entrant that gets the benefit. There's people that are changing jobs and switching, then it's anybody else that has their default with that best in show also gets all the benefits of what the best in show winner has offered. Then in the world of choice, all of a sudden you've got a trusted list of top performers and a world of FOFA, where It's more difficult for financial advisors to put them in the underperforming products in the choice.

I guess the question that hasn't been asked or posed to us and answered is we've got a level of MySuper authorisation for the default segment to make it a safe list of providers. We're relying on the market at the consumer to do that in the choice segment. We're hoping best in show will make it easier, but is that still going to be enough for the choice segment? I think that's the group that you're more worried about in terms of the gradual impact of what we're proposing?

MR MINIFIE: Yes. I think that's right. Look, I would expect that you're going to have a modest impact in the choice part of the market, but it's possible that a real focus on advisor obligations and monitoring their compliance might make a difference in that space.

MS CHESTER: Yes. Indeed, I think it's hidden away in one of the chapters, I can't remember if we said it in the overview, we actually got ASIC in writing saying best in show would actually be part of their guidance to advisors in the choice segment going forward under FOFA.

MS MacRAE: Sort of why not.

MS CHESTER: Yes.

MS MacRAE: Can I just clarify one thing in your opening statement? You talked about the role of employers and the shift from employers and some concerns around that. I just wanted to clarify, so as I understood it as you went on you talked about the shift from sort of employers and unions in the governance structure. You weren't implying were you that you supported an employee choice model over an employee choice model? Do you still want any employers involved in that?

MR MINIFIE: Yes. So just to be clear, my observations are not really based on research that we've done that suggests that your recommendations are wrong. In fact, it's the reverse, based on our research. It's much more based around what you can do to further stress test the recommendations. I think they're very solid recommendations, but I'm aware that there are areas where at least my confidence about the evidence is not as strong as potentially a senior decision maker would like.

I think in this context there is a point of view that says an assisted employer choice would retain a degree of – if you think about it, I guess the more corporatist or institutionalised version, less individual choice version of the system would say, well, many firms will have an expert that's more across and is able to provide a bit more - - -

MS MacRAE: I think the idea of many firms is - - -

MS CHESTER: Well, anyway. Jim, if we get that evidence, that's great, but we're not hearing it now.

MR MINIFIE: Yes, I'm not saying I think that's true, but similarly on the union side, I mean you've already heard from people this morning arguing that there's a role that the industry funds can play in an occupational or an industry context that will be difficult for a more detached or dispersed system to play, and I just think it's worth stress-testing those.

MS CHESTER: It's interesting, because given our analysis, and we're not going to be prescriptive about who's going to win best in show, we'll work more on the criteria, but if the top performing funds are industry funds, their members will continue to be with them.

MR MINIFIE: Right.

MS CHESTER: Jim, is there anything else that we haven't covered? I know we've covered a lot of ground.

MR MINIFIE: No, I'm just aware of time.

MS CHESTER: So are we.

MR MINIFIE: We can follow up subsequently. So thank you very much, and congratulations to the team on putting together a good draft.

MS CHESTER: Thank you very much, Jim.

MS MacRAE: Thank you.

MS CHESTER: We are going to pause for a well-earned calorific break. We will be resuming, our next participant is 1.20, so if we could resume at 1.15 to make sure we're all here ready to roll, that would be great. Thank you.

LUNCHEON ADJOURNMENT **[12.30 pm]**

RESUMED **[1.19 pm]**

MS CHESTER: We'll resume our period for this afternoon and I'd welcome our next participant, Gerard Brody with the Consumer Action Law Centre joining us. Thank you, Gerard, for attending this afternoon. Just for the purpose of the transcript, if you wouldn't mind stating your name and organisation and if you'd like to make some brief opening remarks and then we'll have a chat.

MR BRODY: Great. So my name is Gerard Brody. I'm appearing on behalf of the Consumers Federation of Australia, in fact. My day job is the CEO of the Consumer Action Law Centre. But the Consumers Federation is a peak body for consumer organisations in Australia representing a diverse range of consumer organisations including most national consumer organisations. Just to clarify, Consumer Action, we don't do a lot of work in superannuation due to our resources and capacity and that impacts some of the comments I'll make today, which are really about the benefits of investment in consumer advocacy including with respect to superannuation.

So Consumers Federation is an unfunded peak body that runs on a very small budget made up membership income. CFA has two part time staff members and very limited capacity to support its members being national and state based consumer organisation to provide input to policy development processes.

The Productivity Commission in its 2008 inquiry into consumer policy noted that "confident and empowered consumers secure better outcomes for themselves and for society as a whole when there is effective consumer input into policy making". The Commission said that "Consumer input should lead to better policies and generate greater support for those policies".

Noting that it is difficult for individual consumers to represent themselves, the Commission also said there was a "case for increased public

resourcing for consumer research analysis and advocacy". It noted and I quote, "the benefits of participation in advocacy are often seen to fall well below the costs. This is largely due to the collective action problem. So where public policy and regulation should reflect diverse public interests, members of the community at large will, not unreasonably, question why they should devote a lot of time and energy when everyone else is free riding on those efforts".

Ultimately, in that inquiry, the Commission accepted that "There is a general case for governments to help ensure that consumer representatives have the financial wherewithal to make an effective input into policy", and it specifically recommended "additional public funding to support the basic operating costs of a representative national peak body". Unfortunately, this was the only recommendation from that 2008 inquiry that was not acted upon by the Federal Government.

Last year in its research report into consumer law enforcement and administration, the Productivity Commission lamented that "gaps remain in terms of consumer input into policy proposals" and it found that "There are grounds to revisit that recommendation from the 2008 report", that is, "The Commonwealth Government should provide additional public funding to support consumer research and advocacy". The Federal Government has not responded to that report from last year.

The Productivity Commission has also previously found that specific sections require specialist consumer advocacy. For example, in its 2011 inquiry into urban water reform, the Commission recognised the need for consumer advocacy and research in the area of water services. In its 2013 inquiry into electricity network regulatory arrangements, the Commission also supported the establishment of a national energy consumer advocacy body. Ultimately, such a body was established by the COAG Energy Council. Energy Consumers Australia today is an influential participant in energy policy debates and is also full member of the Consumers Federation.

This inquiry, of course, is about superannuation. While many of CFA's members conduct effective consumer advocacy and some do get involved in superannuation, it is fair to say there are limited contributions from consumer voices to superannuation policy and debates. I looked at the submissions to this inquiry and out of over 100 submissions, only two were from organised consumer groups, neither of whom specialised in financial services or superannuation.

Further, unlike sectors like telecommunications, health or energy, there is no public resources dedicated to consumer advocacy in financial services and superannuation. Consumer advocacy that is conducted in this sector is

largely via community legal centres or through bodies like CHOICE. This might be contrasted with other countries, like the UK, where there is a separately funded and established financial services consumer panel which exists to be a consumer advocate and critical friend of the regulator in that country.

There are other reasons that justify the need for consumer voice in super. First, it is compulsory. People are in it whether they have the skills to navigate it or not. This creates an obligation on government to ensure the system works in consumer's best interests. The law attempts to do this, but it's proven of itself to be insufficient. Giving consumers a voice in policy making is another powerful way of ensuring the system works in member's best interests.

There is also an exceptionally large number of well-resourced industry bodies in superannuation, as I'm sure you will be aware. Actually, far more than other sectors. These bodies are actually resourced off the back of consumer's retirement income savings. While they are well meaning, they struggle to distinguish the interests of their members from those of consumers.

There's previously been a proposal to support a specialist consumer advocacy body in Australia for superannuation, but it's yet to achieve reality. The concept of the Super Consumer Centre was first raised by choice as a contribution to the Cooper Review. Then Minister for Financial Services, Bill Shorten, raised the possibility of it in a stronger super state than in September 2011 and announced a 10 million contribution from Federal Government in October of that year.

A business case was developed which recognised the role consumer advocacy and research could play in an industry that suffered from a lack of consumer trust. Drivers of trust included: disappointing returns, conflicts of interests, costs versus perceived value, and policy volatility. The business case proposed three interventions: advocacy, assistance and education. I'll touch on each of those.

Advocacy. This involves influencing government policy and industry practise as well as targeted research and analysis and providing a consumer perspective on emerging issues. This would help by ensuring more balanced and consumer oriented outcomes on matters of importance to consumers.

Second, assistance. This might involve triage and referral services for consumers who's experiencing problems with their super. This would not only help individuals navigate the complexity of the system but it would

enable the gathering and dissemination of intelligence of consumer risks and issues. This would, in turn, help regulators enforce and improve the rules applying to super.

Third, education. Provision of information sharing and awareness raising and this might include social media and peer to peer education. Such activities may influence consumers to act in their own best interests in managing super and help them make better decisions.

The 2013 proposal relied on an industry contribution in addition to government which would provide for a corpus, the earnings of which would fund the centre. The beauty of this model is that once the corpus was established, the centre would be free of conflicts of interest. I'm sure you'll agree that effective consumer advocacy requires independence from all parties, industry and governments so that consumers have sovereignty.

It's worth noting that the Super Consumer Centre has been established as a legal entity with a constitution and board. It has ASIC and ACNC registration, thus it provides a working model, if only it can now secure the funds to do its work. A well-resourced and effective Super Consumer Centre would aid the implementation of many of the Commission's positive recommendations for super. It will provide further analysis and research as well as provide a strong voice in face of vested interests that too often hold back policy and law reform but further the consumer interests. I'm happy to take any questions.

MS MacRAE: Well, that was a great potted history of consumer interests in this space. As you know we, ourselves, have had trouble sort of hearing that member perspective on these things. So I guess you could say we've got a sympathetic ear in terms of trying to find better ways of contacting and getting member's views directly.

I'd be interested in your views as a start on where you see the role of regulators? We've talked in our report about the regulators becoming the champions and taking more of a member focus rather than what might necessarily be in the interests of the funds. How do you see the role of regulators currently in the super space and how would you see that interacting with this super centre, if it was to be established?

MR BRODY: Well, regulators obviously do and should act in the public's interests, and that's in the interests of all stakeholders, but particularly the consumer's interests. Regulators that are established to oversee particular markets, the market is designed to deliver on consumer interests and the regulator has a key role in ensuring that participants in that market are kept to account and there are good consumer outcomes.

That said, a regulator, necessarily, has to balance difference views and perspectives and interests when coming to do its work and it, necessarily, does that. So I would see this, a super consumer centre, being an important adjunct to support the role of the regulator providing the consumer perspective directly to it in its work, whether that's rule making, whether that's research, whether that's analysis that it undertakes, just as industry do today, and really providing that counterbalance and perhaps even, as I said, acting as a critical friend to the regulator.

The UK financial services consumer panel, which I mentioned in my opening remarks, plays that role. It's actually a statutory established body with its own staff and it does research and releases policy statements. But most of its work, I understand, is behind closed doors and in discussions with the regulator, influencing the regulator at a senior level to be more consumer focussed.

MS MacRAE: So would you see a similar kind of role here to that critical friend sort of model?

MR BRODY: Yes, I think that's an important role that a super consumer centre could play, but I also think it would be helpful to be a public advocate as well, to be out there speaking publicly in public debates for consumer interest and superannuation. And it can also, as I mentioned, play a role in educating consumers and potentially assisting some consumers as well. I think when it comes to consumer organisations, there is value in having some direct assistance or case work type experience to inform your broader advocacy so that you really understand what the issues and impacts are for consumers on particular issues.

MS MacRAE: So what sort of size did you see for the business case that was made, at the time when it was made? What kind of budget was it looking at? What kind of resources was it planning to have? We had some numbers that were helpful, and you may or may not have these, from choice in the evidence they gave us the other day about the number of effective full time equivalent – they're the industries doing this sort of work.

MR BRODY: Yes.

MS MacRAE: The centre that you propose in the business case, what sort of resources would you have in relation to the industry, if you got the sort of body you were hoping for?

MR BRODY: Well, the proposal that was put forward some years ago, and the Federal Government did contribute $10 million to the corpus. The

idea was that industry was going to contribute, I believe, another 20 million, so it would be a 30 million corpus of which the centre earn off – rely on its earnings. Now obviously, that depends on market rates and what earnings can be, but I think the idea that that would return, say, $3 or 4 million a year, off which the centre could run. So, under that guidance, you imagine it would have between 20, 25 staff across those various areas.

MS MacRAE: The idea of the centre would be just focussed on superannuation, presumably? It wouldn't be insurance attached at the moment. It would just be that focus or financial services more generally?

MR BRODY: The focus on the Super Consumer Centre is to focus heavily on superannuation, you know, particularly given it is a compulsory financial service for most people or workers. I think there's an important role to enhance the consumer advocacy. I also think there is a case, generally, for broader consumer – support for consumer advocacy in financial services more broadly. But there are, you know, a number of consumer advocacy organisations working in that area already. There's actually involved in superannuation.

MS MacRAE: And in terms of our report, and again I'm not sure whether you only wanted to talk primarily about the centre today, but if you've had an opportunity in any detail, do you feel that there's any areas that we've missed in relation to areas of consumer harm or detriment that we haven't addressed in our report?

MR BRODY: I think your report, it's remarkably comprehensive in fact, in a range of areas. I do think that to get a lot of those ideas or proposals into reality is another thing. And so that's where I see the role of consumer advocacy playing an important role. We know that policy making and legislation making is a contested space and we need to have an active voice championing for consumers to ensure that those recommendations actually become a reality.

MS MacRAE: And just in relation to consumer empowerment, I just think when we're thinking about the superannuation space, we're talking about members, and the work the Commission's done in looking at various models was to look at whether members themselves would be best placed to make the choices about where their super money would go or whether employers should be involved and what the role of other intermediaries might be. In terms of the default model and where we've landed in terms of our recommendations, draft recommendations, around employees making their own choice, so effectively consumers practically making their own choices in this area, is that something you think is appropriate given the role you see of consumers in this industry?

MR BRODY: As a consumer advocate, I support efforts to enhance consumer choice, but obviously choice can be difficult when there's many and it's hard for consumers who don't have the information or tools to make that choice. So I was attracted to the proposal in your draft report about there being a best of lists that helped sort of facilitate a choice. There was still a consumer part of that choice, but there was also some assistance in making that choice. I think that recognises the real challenges and difficulties people face when making choices.

The behavioural resource tells us if you're faced with more than seven choices then you give up and that tendency to default to no choice or just do what's easiest is really, really strong. So I think if that policy is accepted by government, there'll be a role to ongoing – to monitor it and assess it, is it working, does it mean that people are making active choices, is that leaving them better off? They're the sorts of things that, I think, a super consumer centre could assist with.

MS CHESTER: Just on the governance model, I'm quite curious about, the UK went for a statutory model. The model that you're proposing here would not been a statutory model and I can see pros and cons of those.

MR BRODY: Yes.

MS CHESTER: I guess, given the role that you want it to have in terms of keeping the entire system honest from the perspective of the member, the consumer, and being a constructive critical friend of the regulator, being a statutory agency, I would imagine that would make it much more difficult to do that in a public advocacy way. So was that the thinking behind it not following the UK model completely and being a non-statutory body?

MR BRODY: Yes, I think that's right. And I think that reflects, I guess, consumer advocacy in Australia generally. I think a strength of consumer advocacy in Australia is, when you look at things like the Consumers Health Forum, the Energy Consumers Australia, the Australian Communications Consumer Action Network, these are all independent bodies, independent of government. They're not backed up by statutory. And it gives them a certain independence and strength to be able to speak out, and that's different to the model in the UK where there are largely statutory bodies that speak for consumers.

MS CHESTER: Excuse our - my ignorance - Angela's made – I'm not going to share ignorance with you guys, I've got my own - who they would make the appointments, who becomes - is there like a board above the SEC and they decide then who are the CEOs and the CEO then appoints?

MR BRODY: That's right.

MS CHESTER: So who decides who on the board?

MR BRODY: Well, I think that that would have to be determined. There are various mechanisms.

MS CHESTER: How did it happen with the other examples you talked about in energy and - - -

MR BRODY: So for choice, for example, they are an independent organisation and they have their own members of choice. So that's one model that you could use, a membership model that would choose the board. So there might be interested, active people, superannuation consumers, that want to be members that could elect a board.

In other sectors, so for example, Australian Communications Consumer Action Network, ACCAN, their members are other community organisations and not for profit organisations. I think they've got over 500 members or more that have some interest in telecommunications. It's not their primary function, but they have an interest and so that membership plays a role in appointing the board. With Energy Consumers Australia, it's slightly different, that has, I think, one of the COAG Energy Ministers is the member of the company. So it's effectively COAG Energy Council that appoint the board members.

MS CHESTER: I think it's be helpful for us, through the CFA given it represents the broader church, broader umbrella of organisations, if you could give us some guidance, because we do appreciate what you're saying. And consistent with what the Commission's found in the past of a role here, indeed given what we're saying about regulators and what we need regulators to keep going forward probably, but it's very timely that this gets represented now, but it'd be good for us to get a little bit more guidance to visit the – around the funding.

MR BRODY: The funding, yes.

MS CHESTER: Particularly given what returns are at the moment, if it's a – well, it depends on what investment strategy you decide to have.

MR BRODY: Yes.

MS CHESTER: But whether that's adequate now to staff, about 25 people within the organisation, how the governance model might work and who

would make the appointments, given that we're in the world of any selection process at the moment seems to be highly politicised for everybody.

MR BRODY: Yes.

MS CHESTER: So that would be very helpful for us. I guess, the other thing, you've talked about advocacy, assistance and education. Well, underpinning the advocacy and education, would have to be a lot of self-initiated research that the centre would do. It was funny, we were talking about this just before, I rewind the clock four or five years, maybe five or six years ago, and ASFA used to do a lot of research in the super space that was very member friendly. Indeed, they were one of the first that came up with the very robust estimate of unintended multiple accounts, but that doesn't seem to be occurring any more. So I think it's elevated the case of nobody else is really doing that work, apart from when we get tasked to do it by the government or when somebody is anyway.

MR BRODY: Yes. No, I would agree with that.

MS CHESTER: So that'd be great if we could just get a very short post-draft report submission, would be very helpful. And on the funding, are you still comfortable with government industry co-funding model, so it's got a joint ownership, a joint support, sorry?

MR BRODY: Well, the proposal initially was a once off amount, so the amount would be there as a corpus if you like and it wouldn't rely on external ongoing support. But there was a benefit in that as well, because it recognised that the government and the industry benefit from well-resourced and effective consumer advocacy.

MS CHESTER: Especially in some of the areas that we've identified that we want the industry to lift its game around insurance and all the rest.

MS MacRAE: Yes. I think that's all the questions we have, unless there's anything else you wanted to raise?

MR BRODY: Wonderful. Nothing else from me.

MS MacRAE: Okay.

MR BRODY: Thank you very much.

MS CHESTER: Thanks very much, Gerard. We're running a little bit ahead, which means that our next participants may not be here. Have we

got the representatives from the ACTU? We might just take a little pause. Stretch our legs for five minutes folks and we'll come back and we are running a little bit ahead of time.

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ADJOURNED **[1.41 pm]**

RESUMED **[1.47 pm]**

10

MS CHESTER: All right, folks. We'll resume. We've got a six minute efficiency dividend because the gentlemen from the ACTU are here early. So thank you very much for joining us this afternoon. The ACTU's been very helpful for us throughout the whole three stages of our inquiry process for submissions and appearing at our hearings and we do appreciate that. For the purposes of today's hearing though, if you could just individually state your name and the organisation you represent, just for voice recognition for the transcript recording. But then, if you'd like to make some brief opening remarks, then we'll get into some questions.

MR MITCHELL: My name's Joseph Mitchell. I'm the Workers Capital organising officer at the ACTU.

MR CLARKE: Trevor Clarke, I'm the director of Industrial and Legal at the ACTU.

MR MITCHELL: So thanks very much for having us here today. Throughout the inquiry, the ACTU has questioned the motivation, the appropriateness and the core assumptions and the approach taken by the Commission. The Commission has accepted a politically motivated assertion by government that the default arrangements are not comprehensive enough, inefficiency or ineffective at various times. The draft report seeks to affirm this assertion and find any alternative default system it has deemed competent and efficient. The ACTU also objects to the implicit object of this review, which is to increase the market share of bank owned for profit super, despite their systemic underperformance, poor governance and high fees.

The inquiry recommends a complete overall of the current structure despite the default system working well for the vast majority of members. The inquiry also neglects to take on its previous recommendation that the framework as legislated, which the Commission itself was an architect, run for 10 years.

An objective review of Australia's superannuation system would find that the default distribution system is among the best in the world. Like most effective systems in Europe and North America, default or profit to members superannuation member funds are at the heart of our retirement model. The ACTU is a staunch defender of the default system as it has delivered the best outcome for the vast majority of members since its inception. And all profit to member default industry funds have delivered excellent results for members and should be allowed to do so.

The Commission justifies this overall with a baseless claim that the Fair Work Act no longer covers enough workers for it to continue operation. Using the Commission's own figures, the Fair Work Act has coverage of the overwhelmingly majority of employed persons, around 71 per cent. Of the 29 per cent of the employed persons outside its coverage, the majority, around 27 of the 29 per cent, are either not employed in employment relationships, 17.2 per cent of the 29 per cent, or are State Government public servants.

The Fair Work Act can constitutionally regular non-employment working relationships. If the Commission is concerned about the default super coverage of independent contractors, it can recommend at the Fair Work Act be amended to address this. In relation to the public servants States, presumably there is no need to provide default coverage in the Federal sphere.

Most employees covered by the Fair Work Act are covered by awards and, for a large proportion of them, the award determines the conditions. The Department of Employment estimates that only 1.9 per cent of employees are paid the national minimum wage and the figure includes people paid at the same rate as the national minimum wage via an award. That means, we can confidently say that less than 2 per cent of employees are either - without either an award or an agreement. Whilst 22.7 per cent of employees are paid exactly an award rate, up to 25 per cent are employed under the terms of an award including a super provision but paid at a higher rate.

If you add that to the around 30 to 33 per cent of the workforce that's covered by enterprise agreements, then you have near universal coverage for default super provided in the Fair Work Australia platform. For those not covered by the platform should be and the ACTU argues the default system should be extended to all workers.

The Commission similarly claims that the method by which to select default should be extricated from the Fair Work Commission. The basis for this is unfounded. The Fair Work Commission has a good track record of

selecting default funds in awards and its ability to renew default selection has been frustrated by the government in a political attempt to damage the superannuation system. The ACTU rejects the case made by the Commission that a new ministerial appointed body is required to select default funds.

There is little, in essence, to distinguish the triaging process for producing a short list of funds that are suitable to be defaults between what the Commission is proposing and what currently exists in law. There are experts appointed by the Minister in both the Commission's first model and what it is proposing now. The only material changes recommended in the structures are that any body other than the Fair Work Commission should be responsible for the shortlisting.

In 2012, the Productivity Commission accepted the outcome of is recommended short listing would result in quite a long list, and now it doesn't. It 2012, it was content for members to move super funds when they moved employment, it now – but now it isn't. In 2012, it was content for a selection of short listed funds to be selected for each award based on the judgment of which products best meant interests of relevant employees. It has now rejected its own idea. And, in 2012 it recommended the Fair Word System run for 10 years before being reviewed. There is no reason for a new body to be established to run a process already outlined in law. The Productivity Commission should have called out the government for frustrating the process, presumably to the detriment of members.

The National Workplace Relations Tribunal is the most obvious place to deal with the issue of what is in the workers best interests. It does this day in, day out beyond traditional notions of paying concerns including dealing with issues that have wider social dimensions such as flexible working arrangement to support caring and parenting and victims of domestic violence.

The ACTU again rejects the baseless assertion that industry super funds should have a majority or mandated minimum number of non-representative directors on boards. The Commission cites the Cooper Review which simply claims the model as best practice. Industry super funds governed under the equal representation model, have systemically outperformed for profit super funds. The equal representation model ensures that members of the fund have a greater say in how their retirement savings are invested and that members are represented in the governance process.

Worse than delivering poor returns to members, for profit super funds have been exposed numerous times for ripping off customers lying to

regulators and implementing illegal advice models to entrap workers in their underperforming products. The Commission's plan is to impose a failing governance model on the best performing part of the superannuation system. If funds do not have a minimum number of directors, they would be excluded from default eligibility. It is a political action at the expense of members which would either damage the best performing sector or exclude members from those funds.

The Commission considers it preferable that a disengaged employee has a fund for life, irrespective of its ongoing performance, rather than being placed in a fund whose performance is reviewed every four years, by default when they change occupations or industries. This is potentially a high price for a worker to pay against the risk of duplicate accounts that are more than capable of being handled either administratively or through self-regulation or compulsion or through some requirement to give notice, again, which could be implemented through the Fair Work Act.

The Commission neglects to outline the case where a fund drops off the list of 10 after four years and never regains default status due to poor performance. The single fund for life does not avoid performance risk and for significant cohorts, workers, it may exacerbate them. The ACTU is disappointed that the Commission did not look further into the systemic underperformance of for profit super. It is evident from the Commission's owned figures that if bank owned super funds were excluded from the system, then the vast majority of members would be better off. I'm happy to take any questions you might have.

MS CHESTER: Thank you for those opening remarks. It's helpful. And we now better understand the thinking of the ACTU and we look forward to getting post-draft report submission. Indeed, it's helpful having the hearings before the post-draft report submissions because in the discussions we come up with greater insights into what you're thinking and then we're able to allow you to provide some evidence to us in your post-draft report.

So we might go to the evidence situation first. I think the most important thing is just a little correction for the record and we'll do it in the transcript that it's important to read our report and not interpret our report from what's in the media, especially on the point of we nowhere in our report make any recommendation mandating a number of independent directors on a board, nor is it impacting eligibility for MySuper authorisation, nor is it impacting for best in show. So just so the record's corrected on that. Don't believe what you read on page 3 of (indistinct words 1.56.34) review all the time. It should've been corrected and it hasn't been, but we corrected it in a couple of public opportunities that we've had.

I guess, the other thing that's probably worthwhile correcting for the record is that, yes, we did do a body of work in 2012, and indeed Commissioner Craig was on that good work. That was a very different terms of reference where the government of the day asked us to come up with ways of improving the default arrangements within the current architecture, and that's what the Commission did. Indeed, we were able to draw on from the body of that work to help inform our current work and analysis.

I guess, the other thing that's different today is we have a very different terms of reference, and that terms of reference actually flows from the financial system inquiry that asked us to do, which has never been done before, and that's to assess performance of the Australian super system. It's upon that evidence base that we were asked to revisit the current default arrangements to see if they could be improved, if lifting the performance of the super system was found to be needing. I think we've set out very clearly and forcibly and comprehensively in our draft report, a quite substantive body of evidence to suggest there are some problems with the current system.

We've identified what we think are the two largest problems in the system, firstly of entrenched underperformance and that's not particular to any segment, it's across all segments of the system, it's worse in one segment but it's evident in all segments; and unintended multiple accounts. So I guess my first question is just to ask you, do you agree that they are two problems in the system today and given the evidence base that we've identified in the report?

MR MITCHELL: They are definitely problems. So systemic underperformance is a huge issue and obviously dominated by the for profit super sector. The vast majority of underperforming funds are for profit funds and it's not really a coincidence when the average fails the benchmark that the Productivity Commission sets, but also systemically underperforms relative to not for profit funds.

MR CLARKE: Can I just supplement that in relation to underperformance? There was an architecture that envisaged, at least insofar the default system through awards was produced, that every four years there would be a merit based re-examination of the funds that were eligible to be default funds. Now that clearly hasn't happened as envisaged for very obvious reasons.

MS CHESTER: We did, we assessed that against all the other models that we looked at.

MR CLARKE: Yes.

MS CHESTER: But let's just go back to the evidence of entrenched underperformance first, so I think you're right in saying when you look at segment level, the choice segment clearly underperforms the default segment. When you look at the choice segment, it's dominated by the retail funds and indeed the odds get worse. So we found that one in four funds underperform, one in three default products underperform, and one in two choice products underperform.

But let's focus on the segment where the funds that you have an ongoing relationship with and the system that you support dominates, and that's default. And I guess why does the default segment matter so much for us in a world of super and compulsion? It's because when members change jobs, we know that about two-thirds of them end up defaulting. They represent just over half the members in the system and only a-quarter of the assets. So that tells us which part of the income distribution we're looking at, and thus we think the default segment does need to be the exemplar.

When you said that the underperformers are overwhelmingly retail, it's interesting because when we finally did the analysis that hadn't been done before, by stitching together enough MySuper default product performance analysis over a longer term period of 12 years, we found 26 underperforming default products. You've seen this in the report. Of those 26 underperforming default products, 12 are retail so, yes, they are the most, but then 10 are industry funds. So from our perspective, you can why we view that the entrenched underperformance is like Jersey agnostic, it occurs across all segments of the system.

MR MITCHELL: Yes. Like Trevor said, I mean, if a fund is a default fund and underperforming, then the Fair Work Commission process should be able to relieve that, if it was allowed to operate. Are you - - -

MS CHESTER: Yes.

MR MITCHELL: What was the question? Is that the question you were asking or?

MS CHESTER: So just talk us through the mechanism of the proposed legislative system and how that would weed out the underperformers?

MR CLARKE: Well, it would weed out the underperformers because you'd have a merit based test about who was in the club.

MS CHESTER: That's access. We're talking about the existing ones in there, how are they removed?

MR CLARKE: How are they removed? Well, the process is a continuous one. It happens every four years under the law which can't be practically implemented at the moment.

MR MITCHELL: Are you asking about the exit of underperforming funds?

MS CHESTER: Yes, yes. Just talk us through how that would work and what evidence base the FWC would look at in doing that?

MR MITCHELL: I don't think that either this process or the FWC would maintain the exit of underperforming funds. It's actually a chief concern about this process, as outlined, would be that if a fund dropped off the short list of 10, they would still retain those default members as well. Is that what you're asking?

MS CHESTER: No, I'm still trying to understand. You're saying "Don't change the system. Let's implement what was legislated". I'm asking how would the legislative system work in removing the 15 funds that are listed in defaults in awards that are in the 26 underperforming fund products? How would that work?

MR CLARKE: Well, they'd go through their first stage process every four years to run through their merit criteria of who was eligible to be in the list. And those funds would be identified as underperforming, so they wouldn't make it to the list and they, therefore, wouldn't be eligible for the second level allocation of which ones are more appropriate for particular industries and (indistinct). They just simply wouldn't be there.

So you would have members who - in employment, presumably these things would take effect on 1 July as most of the major determinations for the Fair Work Commission do - they would say, "Well, you're a default fund member, but A, B, C fund is no longer a default fund, so you're going to be put into another one". That obviously does raise the related issue about what you do about multiple accounts. Now we think there's probably a number of administrative solutions to that. But, yes, they'd simply come off the list and people wouldn't be able to make default contributions to them anymore.

MS CHESTER: What evidence base would the FWC draw in making those decisions?

MR CLARKE: Well, anything you want really. I mean, the draft report that's been released doesn't identify any particular deficiencies in the merit tests that exist in the Act at the moment. It says, "Look, the merit tests with some amendment", something like that as I read it. It didn't say, "Well, these are all completely wrong".

What it did seem to object to was what writing was next to the coat of arms for the people who sat in chairs making those decisions, which I found a little incredulous because, the other features, institutional features as well, there have got to be people who are experts. Well, the existent law already does. There have got to be people who are on five years terms. Well, existing law already does that. You've got to be able to hear from superannuation funds. Well, the existing law already does that. It started to seem, a little bit, to my background, silly to say "Well, anyone but the Fair Work Commission". It reminded me when, in 2015, the recommendation was the National Workplace Relations Tribunal isn't the right body to set the minimum wage. It just seemed a bit bonkers, frankly.

MS CHESTER: So let's distinguish between getting rid of underperforming funds, which is about MySuper authorisation and that's APRA's role and deciding who's, in our view, best in show and whether that should be the FWC or another body.

MR CLARKE: Yes. No, sorry, in case I've misinterpreted your questions, yes, there should be an APRA, MySuper identification process, "Are you" – "Do you have your ticket or you don't have your ticket".

MS CHESTER: Yes.

MR CLARKE: Then you've got your default process where there's a merit based test that looks at the field and says, "Well, here's a group that are okay", to – for people to be put into as defaults and then - - -

MS CHESTER: I guess where we're going now is when we looked at the performance of the system, we want them to be better than okay. We actually want them to be top performing of those.

MR CLARKE: Yes. You won't find any objection to us from that, provided that, as you say, there's been some misinterpretation of some of the language in the media and people are taking, well, best in show, or short list, or whatever, as code for using some proxy criteria. It's like, well, no one has been a –best not be on a best in show list. Nobody who's ever been a union official can be on the board of directors, I mean.

MS CHESTER: So you'd be happy with having a best in show list, the top performers for people to default into as long as it was the FWC making that decision?

MR CLARKE: It's got to be a merit based selection process. Now exactly what that looks like - there's a merit based selected process in there at the moment in terms of what's appropriate and what's not. Do we need to play with the merit test? Do we need to tighten the merit test? These are all things that, in our mind, are, of course, worthy of examination, right.

MS CHESTER: So we've gone through and identified criteria or, in principle, criteria for a best in show list. Behavioural economics said it would be good to make it about 10 so it's easier for members in both default and choice segment to find themselves getting to the top performing funds.

MR CLARKE: Yes.

MS CHESTER: Assuming that that's the case, then it's just a matter of who should decide best in show.

MR CLARKE: Well, yes, with the exception that the two to 15 – the actual best in show across the whole sector might be longer than that as was anticipated in 2012, but the industry cut up of that – I mean, the Act says somewhere between two and 15, you say 10. What's the difference frankly?

MS CHESTER: But you're talking two and 15 per award.

MR CLARKE: That's right.

MS CHESTER: We're talking 10 for the default segment.

MR CLARKE: Yes.

MS CHESTER: To make it easier for members.

MR MITCHELL: But, from the member's perspective, they're defaulting into a fund through their award. They're seeing 10 funds or 15 funds.

MS CHESTER: Well, we're envisaging a world of members actually making a choice. It's who then decides best in show. I'm just trying to work out, is – anyway.

MR MITCHELL: Yes.

MS CHESTER: With the FWC then, with the expert panel deciding the best in show, we identified five principles that we want that panel to be able to do. So the first is that they would be independent of any conflict. They would have expertise in financial investments, consumer perspective. They'd be able to create and consider their own evidence, like do their own analysis. They could consider evidence from any parties, it didn't just need to be interested parties, and they were accountable to government of the day. I think that's where we just struggle with the FWC being the right body, because the FWC is an organisation that will listen to interested parties, not create its own evidence base, and is not accountable to government of the day, given it's a judicial body.

MR CLARKE: It does create its own evidence base in other proceedings. There are provisions, ultimately little used, for the Commission to have one of its members go off and do a report or do some research to inform a particular proceeding. And if you take the national wage case, for example, as part of the national wage case programming every year, they have research conferences and they say, "Look, these are the issues that we think are really important to examine to get a better understanding of where the national minimum wage is", and they draw up the scope of those research parties and they have academics and whatnot and people who help them refine that.

Then the research gets published and says, "Well, this is the research that's been conducted to assist the national wage case this year and anyone who wants to make a submission", whether it's me with my union hat on or me with my car enthusiast's hat on, "is welcome to do so and by the way you should read this research that we've had done to help inform the process". So that's happening already in other parts of the Fair Work Commission's operations.

MS CHESTER: I think there's a body of work that the Commission's already done in relation to that, that's helped inform our thinking about how that would work in practice in the super system. I guess, then there's the issue of accountability to government of the day because the superannuation system is people saving at compulsion of government.

MR CLARKE: Yes.

MS CHESTER: Anyway, the FWC isn't accountable to government of the day.

MR CLARKE: No. See, we have difficulty accepting that independence from government is a problem. I mean, if we did have a tertiary qualification in western civilisation they'd probably teach them.

MS CHESTER: But your decisions aren't accountable to government today or subject to any external review.

5 **MR CLARKE:** Sorry?

MS CHESTER: The decisions of the FWC, as I understand it and correct me if I'm wrong - - -

10 **MR CLARKE:** Yes.

MS CHESTER: - - - aren't accountable to government and aren't subject to any further external review.

15 **MR CLARKE:** They are subject to external review, but the external review ground is illegal, effectively.

MS CHESTER: Yes, that's what I thought. All right. So problem number one then, so we agree – I think we agree, but correct me if I'm wrong – that
20 we've got entrenched underperformance and it's in all segments, albeit more concentrated in the retail segment, particularly in the choice segment.

Then on the unintended multiple accounts, and we did a body of work in our draft report around how the workforce, the labour market, has
25 changed since 27 years ago, which means the incidence and the likely future incidents of unintended multiple accounts are going to be greater over time. We did some analysis that found that 10 million of the 30 million accounts today are unintended multiples and that's very harmful for members and very regressive in its impact, which is something that I know would
30 definitely resonate with the ACTU and your DNA and your raison d'être for the good work that you do.

So how do we stop unintended multiple accounts from occurring? We've come up with default once, unless you choose to move somewhere
35 else later, as a member. The ACTU doesn't support the default once model, as I understand it from what I've read in the media, but again I should be careful about what I read in the media. What's your solution to getting rid of unintended multiple accounts?

40 **MR MITCHELL:** So when it comes to default once, it's not appropriate for all members because each – a lot of industry funds tailor their products to suit the workforces which they cover and that's an excellent thing. So CBUS will offer a fantastic insurance model for people in high risk industries and high risk workers, and the same thing with Rest and Hostplus

will offer tailored insurance models depending on the kind of cohorts of workers.

MS CHESTER: Yes.

MR MITCHELL: So the idea that the money would follow you, depending on which industry you go into, is our preference. So if you move from being a hospitality worker and then you become an electrician, the hospitality account would close and then that money would go into your construction account and be more appropriate for your workplace and more appropriate for your working arrangements.

MS CHESTER: I guess that is certainly one way of addressing unintended multiple accounts. So we need to then look at the relative merits of the default once and the rollover model that you're suggesting and a few others, like ISA, are. We agree that for a small cohort of members that have specialist insurance needs, there is an element of tailoring in high risk industries. We haven't had any evidence on high risk industries, apart from CBUS today. But it's all about a small percentage of members and it's about insurance. It's not about the super fund product.

MR CLARKE: Yes. See, it's also about engagement, because if you – Joseph can probably speak to this better than I can, but a workplace that has almost all of its staff on the one superfund, is able to get the reps from the super fund to go out to talk to people about their super, to talk to people that matter in their super about what's the financial advice thing they have and the financial education and - - -

MR MITCHELL: Yes, that's right. So there's various financial education programs that each fund offers.

MR CLARKE: It's out of my comfort zone there, but - - -

MR MITCHELL: Especially, where there's a single fund in a workplace. And it's only really economical to do that where there's a single fund in the workplace, or a cohort of workers that's represented. Similarly, the members in that workforce are represented through their unions and through their member elected representatives on the industry funds to invest in ways in which that cohort of workers wants. So you see CBUS tailoring their investment programs to reflect the needs and wants of their members, investing in assets and infrastructure projects which then members build and creating a great virtual cycle of investment performance return.

MS CHESTER: Well, be careful what we attribute to Cbus because we had them here this morning and that's not how they described how their

investment strategy works. So I guess we're looking at trying to do - create a system that gets rid of unintended multiple accounts and deals with the reality of a modern workforce. So if we're looking at the relative benefits of default once unless you choose to go somewhere else.

MR CLAUDE: Yes.

MS CHESTER: And a member could go to a great employer who has a great relationship with an industry fund and tell their new job and – their new worker, "Have a look at this one instead", and we make way for that in our draft report. But just tell us how the rolling over would work in a world where people are likely to have five or six jobs during their working life. When people change jobs today now, more than 50 per cent change industry sector. People have multiple jobs. So I'm just trying to work out how many would you expect to be rolling over every year of the workforce under your model?

MR MITCHELL: I couldn't answer that. I don't have those statistics around.

MS CHESTER: Someone suggested it's around half a million, so that's a lot we're dealing with. Then it's good to know how would you deal with multiple jobs?

MR MITCHELL: Yes. So that's something we need to think deeply about. People with multiple jobs are a relatively small sector of the workforce and people with multiple jobs in multiple industries are an even smaller section.

MS CHESTER: Do you want to share the metrics with us?

MR MITCHELL: No, I don't. I don't have them with me.

MS CHESTER: There's 8 per cent of the workforce today have multiple jobs, so it's actually grown from 2 per cent 27 years ago. So it's not a majority or a significant minority, but it is there and it is growing.

MR CLAUDE: Do you have a breakdown of which ones work in a different industry in their second job or third job?

MS CHESTER: I can't recall off the top of my head.

MR CLAUDE: It's in the report, is it?

MS CHESTER: I can't recall off the top of my head.

MR CLAUDE: Yes.

MS CHESTER: We need to work through, given the modern workforce today, how would the rollover occur. If we all agree that we do want a modicum of member engagement, we heard from behavioural economists and consumer experts yesterday and this morning that said every time a member changes job if their balance rolls over with them, that means they might go through anyway from three to six super funds. They said that would undermine member engagement during their working lives.

So these are the sorts of pros and cons we need to work through as we assess the relative merits of default once unless you choose to do something differently, including an employer or a union encouraging you to look at another option when you change job, to having the balance roll over every time. The additional admin fees that's associated with that. Also, if there are market risk events, you do have a window of time if they change strategy that they could crystallise a loss, a sequencing risk.

So it'd be good for your post-draft report submission if you could work through how you see the job rollover model getting rid of unintended multiple accounts and dealing with those potential risks that's created in a modern workforce, because that's how we'll - we need to assess it against that evidence for our final report. Great, that would be helpful.

MR MITCHELL: Yes.

MS CHESTER: One of the things you mentioned in your opening remarks, is the default system being extended to all members in the choice segment and SMSF?

MR MITCHELL: No, I don't think that's how I categorised it. To all workers.

MS CHESTER: Yes.

MR MITCHELL: So those who are non – what was the term I used?

MS MacRAE: Yes, those that aren't covered - - -

MR CLARKE: That in a non - - -

MS CHESTER: Okay.

MR CLARKE: The superannuation guarantee system has provisions that - - -

MS CHESTER: Yes.

MR MITCHELL: Yes.

MS CHESTER: No, no, it prompted another idea that was nothing to do with what you were suggesting though, because one of the things that we're struggling with is we make default the exemplar by elevating MySuper and getting rid of the tail of entrenched underperformance and now we'll also have a best in show, the competition for default, and we can agree to disagree on that.

But we make the segment that's performing the best, perform even better by getting rid of entrenched underperformance and we hope that some of that will trickle over to the choice segment. That will trickle over, hopefully, over time in terms of members in the choice being able to make better informed comparable choice against the best in show list and elevated MySuper products. But that will only happen gradually. It does raise the question about whether or not some form of authorisation should be required them for all superannuation products across the entire system.

MR MITCHELL: As opposed to RSC licensing in general or?

MS CHESTER: Well, given what we've discovered in the choice segment, I'm not sure RSC licensing achieves what we're thinking of trying to achieve by getting rid of underperformance across all segments.

MR MITCHELL: Yes. So if the reform were to carve out a significant chunk of underperforming funds, that sounds like a great idea. As long as the carve out does end up being in the best interests of the members, it's not an issue, especially where you have funds which are egregiously underperforming, paying below CPI on cash funds, which some bank owned funds do.

MS CHESTER: One thing that was suggested this morning in one of – by one of our inquiry participants was – and it was elegant in its simplicity and it was said so professionally and politely, but it's quite a stark thing that when we did our fund governance survey, 85 per cent of the funds' CEO say that they do performance attribution analysis. That means that they assess themselves against their own benchmark portfolio that's done across the system which means of your 26 underperforming default products in the default segment, those trustee boards, if they were actually doing their

performance attribution analysis, know that they've persistently underperformed for 12 years.

MR MITCHELL: Yes, I don't have a response to you on that, other than in the vast majority of cases, industry funds are doing the right thing by their members and returning good returns. But I would question the motivations of the for profit funds who were governing underperforming funds and happily governing underperforming funds which gauge the customers.

MS CHESTER: So you distinguish underperformance base then on the governance model of the fund, whether it's for profit or not for profit?

MR MITCHELL: I think that there is significant evidence which shows that it does contribute quite a bit. The bank owned funds have been engaged in unconscionable conduct in some cases but consistently underperform, and without any due explanation of that underperformance.

MS CHESTER: But you would require the same of the 10 industry funds that represent $22 billion of member's assets in 620,000 member accounts that have persistently performed over the last 12 years.

MR MITCHELL: That they should hit performance benchmarks?

MS CHESTER: No, that they should be held accountable as well.

MR MITCHELL: Well all trustees are accountable for their performance in superannuation.

MS CHESTER: No, I'm just struggling that the retail segment is joined by the industry funds in underperformance in the default segment. So when you keep reverting to script about it's – all the problems are in the retain segment, we just need to make sure that we're sharing the same evidence base here.

MR MITCHELL: Yes.

MS CHESTER: So what you're saying about retail funds and their trustee boards when they underperform, would equally apply to industry funds and their trustee boards when they underperform persistently?

MR CLARKE: Yes. It's the first time in a long time I've (indistinct) to a bargain based mechanism. But if you get the default system right and the underperforming industry funds, to the extent that they exist, are knocked out of the short list on the merit grounds, they're not going to have the scale

to continue to operate in the choice sector anyway. I mean, they're just going to go, "Well, show's over, boys", aren't they? I mean, seriously, if they get – if that's where traditionally, their strength has been, they're not going to operate in the "for choice". If they get kicked out of the default market, they're going to have to close up shop anyway, aren't they?

MS CHESTER: Well, unfortunately, most of the money's in the choice segment.

MR CLARKE: Yes, right.

MS CHESTER: So only a-quarter of the assets are in default and the rest is in choice and - - -

MR CLARKE: Is that true for industry and retail?

MS CHESTER: I think industry funds are more reliant on default flows than retail funds, that's correct.

MR CLARKE: Yes. Because I would've thought if you found some ancient gill based industry fund that is just – doesn't do anything anymore, if you think there's a problem there and it doesn't get – there's a sensible merit criteria and there's a short list, and we can argue about how long it is, for whatever reason this fund's not on it because they're underperforming, once you take the easy flow from them in terms of members they'll wither on the vine, effectively.

MS CHESTER: No, that's right. Yes, yes.

MR CLARKE: And they'll cease to be offered in the choice market.

MS CHESTER: That's exactly right, and that's the mechanism we're trying to create with elevating MySuper authorisation, which means they lose those automatic cash flows.

MR CLARKE: Yes.

MS CHESTER: Indeed, they lose their current default members. They're the guys that should have their members shepherded to a top, good performing fund.

MR CLARKE: Yes.

MS CHESTER: But they're not just small guys, that's part of the problem.

MR CLARKE: Yes. I'm showing my ignorance here.

MS CHESTER: When we look at the metrics of – no, no, that's fine.

MR CLARKE: Yes.

MS CHESTER: And it's a new evidence base that we've developed to identify. I've got one other question, central to the system that you'd like to see remain in place is the role of the employers. We've now got employer groups telling us that employers want out of the decision-making of where their members should be in funds.

MR MITCHELL: So the default provisions should be extended to them. So a proposition we would support would be that where an EBA or an enterprise agreement in a workplace doesn't have a nominated super fund, it reverts to the award nominated default fund under – sorry, it would revert to the award nominated default fund which the member could choose from. So it would remove them from the equation.

MS CHESTER: So the whole role of the employer then, in terms of being involved in nominating to the trustee boards of the super – so if employers want completely out of this equation, which is the evidence that we've heard, do you see that then flowing through to them being on the trustee boards of the super funds? If they don't want to have a role here - - -

MR MITCHELL: Well, I'd be curious to hear which employers said that they didn't want to be involved in the governance of funds which represent their industry, because the employer trustees are doing a fantastic job, along with the union trustees in stewarding the industry funds.

MS CHESTER: Well, these are their representative bodies, so ACI and COSCO is it?

MS MacRAE: Well, I think what - - -

MR MITCHELL: Neither of those are on industry boards, I don't think.

MS MacRAE: No. Well, perhaps, Cathy Nance is the exception, but otherwise we've been talking more about the employer's role in administration and such. If we were to adopt the legislated but not implemented Fair Work arrangements, just so I'm clear, it would still be up to the employer under that arrangement that, if an award had 15 funds nominated in it, the employer - if the employee didn't make a choice, the employer would still be the one that had to choose which of those 15 or 12 or whatever. They would still be the one that had to make that choice.

And that's the element, I think, that we say employers are indicating to us, "We don't want that obligation of making a choice. We're not financial advisors. We don't pretend to be. We don't have the expertise. And we think it would be much better if the member themselves made that choice".

What we've tried to do with our best in show list is to say, "Well, how do we give members the information they need to be able to make that choice most easily?" From the work we've done in our choice experiment, it would appear that with an easily accessible list at the point of entering the workforce that those people, if given a list of 10 performing funds with some information about them, people will make a choice at that point, 95 per cent of people will make a choice.

So our reliance on the default system becomes less, and the onus on the employer to make that choice, when they often – even if they do want to take employee's interests at heart, often won't know the other circumstances of that employee, especially if they're new to the workplace, do they have kids, have they got a working spouse, what arrangements might be most appropriate for them, that it's better for the employee to make that choice. So I'd be interested in your views about whether or not you think it's desirable to have the employee involved in that decision and whether you can see, from the evidence we've had from employer groups about the difficulty they had in choosing even within the bounds of an award that might have more than one fund listed, the decisions that they have to make under the existing arrangements that they make – if they're not to have?

MR MITCHELL: In the legislated arrangements aren't employees given a list to choose from as well, and then if they don't choose from that list the employer makes the choice? So I don't see it as incompatible they'd default into one of those funds without the employer making a choice. As long as it's still distributed through the award, the member receives that list of 10 funds or list of 15 funds when they start employment and they choose one of those funds. It's the same process.

MS MacRAE: The employer though isn't asked to make that choice. In our model, if the employee doesn't choose then it just goes to a sequential allocation of 10 list and we just choose one of those.

MR MITCHELL: Yes, yes.

MS MacRAE: The employer is not involved any more in making that choice.

MR CLARKE: Yes. This is where you're going to start to run into the issues about what we were talking about before with having large segments of the workforce in an enterprise under what fund being able to have those sorts of connections and service offerings that if you've got a random number generator pumping each of us, 10 of us into different funds, you're not going to be able to build that relationship, whereas if the employer says, "All right, well for everybody who does make a choice, it's going to be this place", then you're going to get a critical mass of people with the one fund.

MS MacRAE: I guess it depends how much you think that's essential to get – make sure the funds do their job of making sure that people know where they are and what they're getting.

MR MITCHELL: I don't see it as essential. It just improves the ability of funds to engage with a particular workplace. It's really it.

MR CLARKE: Some of the regulatory burden arguments that are here, I don't know, maybe I'm just getting a bit old and cynical, but here's a - - -

MS MacRAE: It's more than that though. I think it's also a concern from some employers that they just don't feel adequately qualified to make that choice, and it's not their business so I can understand why they would say that. So it's partly out of their concern for their employees that, "I don't want to have to make that choice for you because I don't feel I've got the necessary information to do it or the expertise, because I'm not a financial planner and I never intended to be one. And it's hard enough to make the choice for myself. And I feel obliged now I have to make a choice for you and I'd rather not". So it's not just (indistinct words).

MR CLARKE: I mean, they do that under awards all the time. Look at meal allowance provisions, you either give them the food or you give them the money.

MS MacRAE: It's a slightly bigger decision though, isn't it?

MR CLARKE: Yes. But this is saying, "There's been some government sanctioned process to arrive at a list of performing best in show funds and from that list, there's a list in this award that are most connected with the industry. You comply with this award by ticking one of these boxes".

MS CHESTER: So say the employer's out of the equation. So every time an employee changes job, then they face another list and another choice for themselves to be made, if not they default. We're trying to create a world where it's a very simple choice for them. They make that choice as a new job entrant and we make it simpler and safer by a top performing fund.

MR CLARKE: Yes.

MS CHESTER: And indeed we know, based on some of the analysis, who's likely to dominate the top performing funds in terms of segments of the system. They then make that decision. It's their decision. And, as they move through their working life, they remain engaged with that fund unless they make a decision to move to another fund.

MR CLARKE: Yes.

MS CHESTER: Whereas, in your world, every time a member changes a job they have to go through the whole process again of deciding on another account - another fund, another account, knowing the details, knowing the process, knowing what app to have on their phone. So from the behavioural economics about what's in the best interests of members having some form of a modicum of engagement in the super system, default once gets rid of the unintended multiple accounts but it also creates an environment in which members can make a safe choice and be engaged during their working lives.

MR CLARKE: Yes. But they're making that safe choice at the front end without, necessarily, knowing whether or not that fund's going to fall off the list in four years' time.

MS CHESTER: But if the fund does fall off the list in four years' time, it's fine because they'll still be a very good fund because they're on the elevated MySuper list. The only time a default member - - -

MR CLARKE: Doesn't that start to undermine where the whole thing's coming from though, isn't it, that you're quite strict about the best in show and then somebody saw there and they're disengaged and it made the selection once and it's all right for them to continue to be on an underperforming fund, potentially?

MS CHESTER: No.

MS MacRAE: No.

MS CHESTER: Because elevated MySuper is good funds, they're not underperforming. We've gotten rid of the tail within elevated MySuper.

MR CLARKE: Right.

MS CHESTER: Which, we don't have those protections in play today.

MS MacRAE: I mean, I think the intention of MySuper, as originally envisaged, was that it would, that it was supposed to weed out the underperforming, and our analysis shows that it hasn't done that job.

MR CLARKE: Yes.

MS MacRAE: And it hasn't done that job because the threshold is too low.

MR CLARKE: Right, okay.

MS MacRAE: So we've made quite a number of recommendations about how to increase that threshold and be interested in your views about that, and if you wanted to comment on those things and if there's more we could do to elevate that further if you felt that was necessary, then that would be very welcome.

But being certain then, and that's why it's very important that you wouldn't have the top 10 list unless you elevated to MySuper, because we agree with you, what we want – we want to be sure that if the person is in a top 10 fund and then that fund comes out of the top 10, as long as it doesn't lose MySuper authorisation, we can still be sure that member's in a good fund. It won't be the top fund at the moment, but there's going to be shifting in that top 10 anyway. We would expect that and that's what we want to get that competitive element going between those funds. But they're not going to fall down back into a tail and we're hoping – well, the intention of the policy as we see it is that once we've elevated that MySuper, with that elevated threshold there, that tail can't then grow. So we've lopped it off and it stays off with that elevated MySuper test.

MS CHESTER: I think we've covered a lot of ground, which has been very helpful for us and, hopefully, helpful in terms of some of the areas we'd like to hear back from you on in your post-draft report submission, especially looking at the relative merits of defaulting once only unless a member chooses another fund versus the balance rollover occurring every time a member changes a job. And the other area that Angela identified, the elevated MySuper list, the best in show list, that would be really helpful. And I'm sure there's lots of other things you'd like to tell us as well, that we look forward to reading. So thank you very much for coming this afternoon. Is there anything else that you wanted to say that we haven't covered in the questions that we've been able to work through with you?

MR MITCHELL: No, I think that's fine.

MS CHESTER: Okay.

MR MITCHELL: Thanks so much.

MS MacRAE: Thank you very much.

MS CHESTER: Thank you very much, gentlemen. Let's do that then. I'd like to ask our next inquiry participant from Corporate Superannuation Association to come join us. Thank you for joining us and also thank you for your involvement, especially in our stage one work year before last, where you gave us a submission and you appeared at one our – one of your colleagues appeared at our round table. Just for the purposes of the transcript, if you could just state your name and the organisation that you represent today, and then if you'd like to make some brief opening remarks.

MR CERCHE: My name is Mark Cerche. I represent the Corporate Super Association. The Corporate Association represents involved employers. We represent funds that – we were the first funds that provided superannuation benefits in Australia and are still committed to doing that.

Generally speaking, we are not for profit in any sense of the word. We don't pay fees to trustees, except independent trustees. We don't pay fees to unions or anybody else. What we do do however though is provide a governance model that's unconflicted and we typically outsource all of the major components of our business to experts with the ability to change them. That's resulted in significant overperformance against the retail funds or the industry funds. We are proud of our history and we are proud of the fact that we still deliver superior benefits.

What's proposed here is significant and it affects us significantly, because not one or our funds will appear on the top 10 list, even though we're probably four of the five top performing funds in Australia. And the reason for that is we're not public offer. We have the benefit of employed by committed employers who provide superior benefits to the SG, often defined benefits still. Also, as corporates, we usually meet insurance costs because we think it's extremely important that young members get TPD cover, even if they don't die on the job. That's a bit sinister, but we're miners, we're petroleum explorers, we sail boats, we do all sorts of things which involve risk, and we feel that, as good employers committed, we ensure that our members are covered even if we pay for it ourselves.

Now we're in a state of flux. We used to be the only funds. We're now a minority of funds in number, but a lot of our members and funds are sub-funds within the retail sector. A few are within the industry funds, but those industry funds have abandoned to find benefit work and move that to a fund called Equip, which I am a director of, which I should also disclose

to the Commission. So we're pretty proud of what we do. You've excluded us from default options by these rules, which can't be right and we can't, I think, tolerate our members losing benefit that don't cost them anything. I'm here to answer your questions. And you'll see in our submission that, we'll try and tone it down from the draft in front of me, but we're pretty angry.

MS MacRAE: We've been tasked with looking at a system wide assessment of the super system and be forward looking. It's been an extremely difficult task to us to try and look at, across all sectors, all funds and find a solution that's going to work for everybody. In relation to the corporate sector, we've got a relatively small amount of data to go on and we're also aware that it is a small and, I think you'll agree, a shrinking part of the market.

So in trying to accommodate what works best here, I guess I'd be interested in your views on these employers that are very proactive and interested and, I think you'll agree, do - certainly adding value in the sense of providing these funds to their employees, how active those employers can be in promoting these funds as an alternative. Although we'll have a best in show list and there'll be a default there, these are for people who won't make a choice or choose not to. They don't make an active choice.

But where an employee is going into employment where there is an employer base fund of this sort and, as you say, may be offering benefits and services that might go beyond what's available in the default, how you see the role of the employer in promoting that when an employee joins? I mean, you'll be aware of when a new employee comes into a workplace, how you go about actually promoting that fund to employees when they come.

MR CERCHE: The employers do, but the funds don't often. The funds become aware of a new employee when they get a choice of fund for or not, or they get an entry on the pay roll that they can't match to a member and then it's sorted out. So these are big organisations. They employ people all around Australian and outside Australia.

MS MacRAE: And would it be fair to say that most of the people in a workplace would belong to that fund?

MR CERCHE: Yes.

MS MacRAE: Yes.

MR CERCHE: Most would, but some don't.

MS CHESTER: Well, maybe you could take us through the metrics, because as Angela said, we're trying to do a system that will - - -

MR CERCHE: You're trying to create a playing field where we're ahead of the game. You're trying to reduce us to - - -

MS MacRAE: No, I can tell you, we're definitely not trying to reduce you.

MS CHESTER: No.

MS MacRAE: We're trying to make it as even across the field as we can, appreciating that there are some small elements within the system that are difficult to accommodate in that.

MR CERCHE: We're 50 billion under - and we've got 274,000 accounts.

MS CHESTER: So how many corporate funds are left?

MR CERCHE: How many standalone corporate funds? About 50.

MS CHESTER: So there's 50 and - - -

MR CERCHE: In this equation, you must count the sub-funds of the Mercer Master Trust.

MS CHESTER: No, no, that's fine.

MR CERCHE: Yes. I don't know how many of those there are. There's many.

MS CHESTER: So you don't represent them?

MR CERCHE: Some we do, some we don't.

MS CHESTER: So how many are your membership?

MR CERCHE: Thirty one.

MS CHESTER: But there's 50 corporate funds and then there's some more that are on platforms?

MR CERCHE: Yes, correct.

MS CHESTER: Yes. And of the 50 that you think represent the more generic corporate funds, what's their assets under management?

MR CERCHE: Well, ours is 50 billion. Telstra's not a member, they've got 12 billion. It would be a hard figure.

MS CHESTER: How many member accounts?

MR CERCHE: Telstra's lost 8000 overnight. I don't know. I've got no idea of the number of – I know the number of our members, which is 274,000, that's quarter of a million one account. Yes, they usually only have one account.

MS CHESTER: So when you say we've dealt you out of the system, that's - - -

MR CERCHE: We wouldn't be a default fund, couldn't be a default fund under what you're proposing.

MS CHESTER: Why is that?

MR CERCHE: Because we're not public offer. Only employees of our organisations can become members of our funds.

MS CHESTER: So do your fund's products have MySuper authorisation at the moment?

MR CERCHE: Of course.

MS CHESTER: So we're not proposing anything that would lose your MySuper authorisation?

MR CERCHE: No.

MS CHESTER: So how are we dealing you out of the system?

MR CERCHE: We can't be a default fund.

MS CHESTER: Sorry, if you're a?

MR CERCHE: Your list will - - -

MS CHESTER: No, no, there's two lists in the default system that we're proposing? There's the best in show list for new jobs entrants.

MR CERCHE: Yes.

MS CHESTER: Or for anybody in the system, there's the best in show list. Then there's the elevated MySuper authorisation.

MR CERCHE: Yes, well, we would be that.

MS CHESTER: Yes. So how are we then dealing you out of the system?

MR CERCHE: We're not in the top 10. We can't be.

MS MacRAE: You don't have to be in the top 10 though to be able to accept default contributions.

MR CERCHE: Well, how do we get default in your system?

MS CHESTER: Well, you'd continue to get default in our system, because - let's go through the flow. So each year there's $150 billion of new contributions that go into the default segment and of that 1 billion is new job entrants, so that's who we're targeting with the best in show list. Then there's switching, which is 2.2 billion. Then there's re-entrants and turnover, that's 16.5 billion. So there's 19.7 billion of the 150 billion is really what the best in show is more likely to be about. So I think that's just to clarify your point.

MR CERCHE: A new employee to us, if they want onto your list, they wouldn't see us.

MS CHESTER: Yes, they would.

MR CERCHE: How would they see us?

MS CHESTER: Because it's a twin list. When the new job entry goes to My Gov, gets their tax file number, then they go to the next page which says "Now you need to choose a super fund. Here's a list of 10 top performing funds, and here's a list of good funds that are MySuper authorised".

MR CERCHE: So do you think our members would go to other than the top fund?

MS CHESTER: I'd say it's more likely than not that a new job entrant would go to the top 10 and that's what we want a new job entrant to do, because we want the new job entrant to get into a top performing fund to create competitive dynamic in the top segment.

MR CERCHE: Yes, in the top segment. But we wouldn't be on that list.

MS CHESTER: Well, you could decide to go public offer, but that's a decision that corporate super will not make, which is - - -

MR CERCHE: Well, that destroys our advantage.

MS CHESTER: So the advantage you've got at the moment is you can rely on new job entrants being defaulted regardless of the performance.

MR CERCHE: No, we can rely on our employer reaching out to their employees.

MS CHESTER: We don't stop that, Mark. I think, Angela - - -

MS MacRAE: Sorry, that was what I was trying to get at in my original question. So there's nothing about our arrangements that says anyone has to go into the top 10. Anyone can still go into any fund they like. Now it's true that, under our proposals, when you go onto the central online service, if you don't currently belong to a fund, when you enter the workforce you'll be present with a "Here's the top 10 and here's all the other authorised MySuper. Any of these funds can take your money, or you can choose something else altogether if you want or a self-managed super fund". So everybody still has the opportunity to get into any fund that they choose to, even their own SMSF if they want to.

What the member will see though is that these 10 have been viewed as having past all of the – their best in show. Now it is true that your funds won't be there, but they will still appear as "authorised MySuper".

MR CERCHE: And they wouldn't be able to do that. Yes.

MS MacRAE: And that list of "authorised MySuper" would also appear on the centralised online service. So "Here's the top 10 and here's a list of all the other MySuper authorised funds and you can choose from any of these". Then last of all "If you want to you can choose something else".

MR CERCHE: But they can't. They can't choose us.

MS MacRAE: Why can't they choose you though?

MR CERCHE: Only our employees can choose us.

MS MacRAE: But in that instance, because you've got MySuper authorisation - so this is a matter of detail, I guess, in how the administration would work, but given that you've got MySuper authorisation, your name may not appear on everybody's – like, we'd need a mechanism to know that they would be – that it would be available to you.

MR CERCHE: If that was the way you were thinking, you would need a third list and you would need to say, for example, "The following are non-public offer funds. They're traditional super funds. In order to become eligible to select one of these, you have to be an employee of a participating employer in that fund and the participating employer is 32 subsidiaries of Rio Tinto".

MS MacRAE: I'm sure we could work something out. I mean, we're certainly not intending to cut you out. If you've got MySuper authorisation, then people should be able to choose you.

MR CERCHE: Well, Mr Shorten had to amend the Fair Work legislation to include us last time. I'm very serious about this. We function and we rely on new employees coming in and we want new employees to come in, because we want our funds to thrive and we want to deliver superior benefits, and we want to insure our younger people to ensure that if they lose their lives, their parents might get some money. But they're 19 year old miners. They may have two kids and at that time, perhaps even two wives. And we pay for the insurance. So those sort of things need to be taken into account, in my opinion.

MS CHESTER: Are you saying that's across all the corporate funds?

MR CERCHE: No, I'm not saying that at all. I'm saying some of them do, some of them don't. It's a movable feast.

MS CHESTER: It's a movable, but it's a declining movable feast in the corporate super world, it's fair to say, even under the current arrangements, Mark.

MR CERCHE: Well, with respect, I don't think so. Now if we take the - - -

MS CHESTER: So corporate super has declined over the past 10 years in size, in terms of the number of funds, the number of accounts that's under management and the number of members.

MR CERCHE: Yes. And there's a whole range of reasons for that. But, for example, BHP is a significant employer. It doesn't run its own fund any

more. It's in a master trust. But it's still a significant fund. It still provides benefits for its employees' superior.

MS CHESTER: So what's the average size now of a corporate super fund in Australia, given it's, across what you've said, quite a relatively small membership cohort across for your (indistinct words) balance.

MR CERCHE: We have significant account balances.

MS CHESTER: Sorry?

MR CERCHE: What's the size? I could find out and let you know, but we'd know our membership. We could certainly get that to you very quickly. But if we look into the retail master trusts and – that have taken corporate funds and still run them as a corporate fund, because the contributions are different, the insurance arrangements are different. We can bring all that out for you.

MS MacRAE: So would it - - -

MS CHESTER: If we could – sorry.

MS MacRAE: Sorry. I was just going to say, look, in principle, I think we're agreed that if you've got MySuper authorisation, we would still want your employees to be able to choose your fund. So there's administrative mechanisms that we would need to work out to do that.

MR CERCHE: So would we.

MS MacRAE: So I would assure you that our intention was not to cut you out, if you've got MySuper authorisation from saying that you would no longer be able to take in new members. We would see that if you've got MySuper authorisation that your employees should be given – or one of the alternatives that they should see when they're looking to joint their fund when they start their first job, if they were to come to you in their first job, they would see that. If someone was to come to your – one of your employing organisations, already had a job, then as with everyone else that already has a job, when they first see that – go onto the online service, they will see the existing fund as "This will be your default unless you move to something new". But still, given that we would want to put you on the list of other ones that they would see as alternatives they could look at, we would still want that to occur as well. I can't see any problem with that, can you?

MS CHESTER: No.

MS MacRAE: No. It's very helpful that you've appeared, because it's something that I hadn't thought through sufficiently, thinking that it would appear on my list anyway. But you're right, they're not public offer, so they're going to – we don't want them to appear to everybody because they're not going to be available to everybody. But where they are available, then there's - - -

MR CERCHE: There will be great confusion.

MS MacRAE: Well, there might not be, depending on how clever we can be in how we design the online arrangement. So I think it's something we'd definitely work through.

MR CERCHE: Well, what about the insurance issue?

MS MacRAE: Sorry, can you just - - -

MS CHESTER: Well, you're going to provide us with some evidence as to how many corporate funds actually still pay fully for the insurance of the member so we can understand your - - -

MR CERCHE: They provide fully or they provide in part or they provide other support.

MS CHESTER: Well, it'd be good to get the evidence in a submission from you, Mark, so we can understand the extent of the benefit, because I guess, at the end of the day, we just want to make sure that members are finding their way to the top and the good performing funds that give them investment performance and features that they attach value to.

MR CERCHE: Would it be of interest to know that we contribute to 21 per cent, rather than 9 and a-half?

MS MacRAE: It would. I mean, on those, in relation to the features of your fund and what might go onto a dashboard about what people are – when people are making a choice about the sorts of things, the benefits that different people will have and what might go onto their dashboards, they're the kinds of things you might want to put in your - - -

MR CERCHE: I would draw 17 per cent and - rather than – Unisuper (indistinct words) 17 - - -

MS MacRAE: If that's the sort of thing that you wanted to put into your submission too about well what sort of metric should be on that dashboard

for a fund, corporate fund, that might offer those kinds of benefits. You might want to say, "These are the kinds of thing we'd want included".

MS CHESTER: It's interesting because UniSuper didn't raise this as an issue and they know that they've been dealt out of best in show because they're not open offer, that they didn't consider themselves to be getting new job entrants because they'll be MySuper authorised.

MR CERCHE: I better talk to Mr Barrett, I'm sure he's - - -

MS CHESTER: No, not that he'd - - -

MR CERCHE: Well, it'd be interested. Well, open defined benefit funds? A member has a chance to get in a defined benefit fund once in their life and - - -

MS CHESTER: How many open DBs are there in Australia, Mark?

MR CERCHE: About six. UniSuper is one, Maritime Super is another, off the top of my head, along the public sector fund.

MS CHESTER: That's not what I was told by UniSuper last week when I had a meeting with them. But anyway, let's be careful that we don't quote what people are doing when we might have had conflicting evidence from them directly.

MS MacRAE: But look, you've raised some important issues. I think if you could put a submission to us in terms of your concerns and, I think, in principle you could take away today, if you've got MySuper authorisation, we're certainly not wanting – the intention of our reforms here, is not to count anyone out of the system who's got MySuper authorisation, that people who want to go into any MySuper fund and have that as their default function be excluded from doing so.

MR CERCHE: You probably don't, but do you want to know my thoughts about what you're proposing?

MS MacRAE: Sure.

MR CERCHE: Picking 10 and then reviewing in four years, is going to be an interesting exercise and the people who do that exercise will need to be very careful because funds that go off the top 10 will be vulnerable and the members who don't move will be vulnerable because there will be promoting themselves as on the top 10 and not on the top 10. The question is whether – what dynamic you see for the people who are not interested?

Because if a fund significantly loses membership, the remaining members invariably suffer.

MS CHESTER: So I think we've crafted the system in such a way, with the metrics I mentioned before in terms of how the best in show is more open to that group of 19.7 billion out of 150 billion each year, you would have to assume an exponential increase in switching rates to move away from that, and we're yet to receive any evidence to suggest that would be the case. So it'd be good to have a think about that in the context of how we - - -

MR CERCHE: Never had it before though you haven't. People don't switch very often.

MS CHESTER: That's right, so that's why what we're proposing doesn't create the level of system instability that some have suggested.

MR CERCHE: Well, the evidence will reveal itself, I suppose.

MS MacRAE: I mean, we've done as much as we can to model – we've got some data from APRA about fund flows. We've looked at a percentage of people that would go. Obviously, we haven't identified the top 10, but we've had a rough idea about who might be up there and the – what we can assume from – if the current behaviours persisted, what would be the flows. And then if we assumed that there was some higher level of switching because we've now got a better identified group of 10 and that there might be more member response to that group of 10, that that switching rate, even if it increased quite dramatically from where it is today, we feel that given the flows that we've been able to identify from our transition modelling, that we wouldn't get any system – we wouldn't get an unmanageable level of system instability.

I think people just forget that it's not just the top 10. It's everyone else that's MySuper authorised can still – would still retain all of their default members and the contributions for those default funds, unless those members then switched up to the 10. So, unless you get an awful lot of people suddenly engaged in switching, the flows within the system for those default funds – well, for the MySuper funds overall other than the tail which, through our elevated MySuper, we hope we might move on more quickly, but for that substantive part of the well performing part of the system, we don't see that there should be such dramatic shifts that there's problems for members of those funds.

MS CHESTER: So, Mark, one final question for you, our report did identify two problems in the system, entrenched underperformance across all segments and unintended multiple accounts.

MR CERCHE: Yes.

MS CHESTER: It's interesting that ex-Reserve Bank Governor Bernie Fraser said those problems that the PC has identified have been there for yonks, but there's been a hell of a lot of inertia. Why is it the industry hasn't done anything about those two problems?

MR CERCHE: The regulator hasn't enforced the rules. There's been three or four attempts to merge funds. People who hold the money are resistant to it and find every reason not to. The regulator has let them get away it. It's a sign of age, I guess. When MySuper was introduced, there was a transition period where all accounts that weren't MySuper accounts had to be transferred to a MySuper account. So that led to every man and his woman and his dog applying for a MySuper licence so that they could transfer them into MySuper.

Now the regulator has tolerated underperformance at a significant level in retail and, indeed, in industry funds in the MySuper space without revoking their licenses. They keep changing the rules. They'd scale, it didn't work. They've now got something else. Unless they actually enforce the rules, which are very, very fair. You don't hear us complaining about – we try and get the funds together. We like big account balances because we – it's better. We'd also like the APRA levy to fair – to be capped in a different way, but that's for another place.

The things that are affecting corporate funds are the fact that we pay this proportionate APRA levy per member because we're not large enough to fall in under the cap. We report quarterly at significant cost of something that doesn't really change much. Anyway.

MS CHESTER: Thanks. We've covered a lot of ground, Mark. We look forward to getting your post-draft report submission and, hopefully, we've been able to address some of your concerns.

MR CERCHE: Well, I hope so. I would like to think that we could still survive because we do better. We'd love to do better and that.

MS CHESTER: Thank you.

MR CERCHE: Can we go off the record for a second?

MS CHESTER: We're doing a transcript, so we might speak to you later.

MR CERCHE: I'd like to just mention something that you mentioned in passing, but it's not appropriate for me to comment publicly.

MS CHESTER: I'll catch you in a moment.

MR CERCHE: Thank you.

MS CHESTER: Thank you, Mark. All right, folks, we're going to suspend and have a little bit of a break so we can get a caffeine hit which is probably much needed for most. It's just after 3 so let's aim to resume at 3.15 if we could please? Thanks.

ADJOURNED **[3.02 pm]**

RESUMED **[3.18 pm]**

MS CHESTER: We've had a chance for a wee caffeine break, which I hope is helpful for our next inquiry participant who I'd like to welcome to our hearings. Thank you for joining us. If you wouldn't mind just stating your name and the organisation that you represent for the purposes of the transcript recording and voice recognition. Then if you wouldn't mind making a few brief opening remarks and then we'll get into a bit of a chat and some questions. Thank you.

MR O'CONNOR: Great, thank you. It's Simon O'Connor, the CEO of the Responsible Investment Association Australasia. Thank you for the opportunity to be able to be here today and present today. I would like to make an opening statement and just firstly, we really welcome the draft report from the Productivity Commission and we really welcome its focus on the efficiency and effectiveness and competitiveness, but importantly, with the ultimate focus on that being on improving outcomes for members. That's where we come from for today's contribution.

Just by way of background, the Responsible Investment Association, we are a peak body of responsible, ethical and impact investors across Australia and New Zealand. We have around 220 member investment organisations who manage in the order of $9 trillion of assets under management globally. Our members include about 21 superannuation funds, including about 15 of APRA's largest 50 regulated funds. Interestingly, our membership in the superannuation industry is across

industry, not-for-profit funds, public funds, retail funds, bank-owned smaller retail funds as well; so a cross-section of funds to which we are presenting today.

As I said, we believe this focus on improving outcomes for members is really important and I wanted to, I guess, contribute today some additional consideration that we think is important that the Productivity Commission keep on its radar in its final recommendations from the report. We believe really importantly that as at today it's very clear that to be delivering on the promise of stronger performance and stronger outcomes for members it is critical that superannuation funds and other institutional investors are considering issues that traditionally have been deemed as non-financial; that is, environmental issues, social issues, corporate governance issues, what we call responsible investment, that is, a systematic approach to understanding these issues that are traditionally not found on the financial statements of the assets they're investing within.

I want to support that by saying that any part of improving the superannuation system in Australia really needs responsible investment to be considered as a core component of leading practice. For one, very importantly, this is all about underpinning strong investment outcomes and strong financial performance. So the reason today in Australia where one in every two dollars invested is committed to responsible investing – you've got 80 per cent of the top 50 largest super funds in Australia have committed publicly to responsible investing – is because understanding these factors are driving investment outcomes and returns.

To not be considering these environmental, social and corporate governance issues really blinkers an investment outcome and prevents, really, the strong delivery of performance outcomes for Australians. I also note that when looking at the top 10 performing super funds in Australia based on analysis of 10-year returns you find eight out of 10 of those have strong public commitments to responsible investment. When you look at the 10 worst performing funds, none of those have any consideration of responsible investment as a process that they're considering.

But there is a strong body now of empirical evidence to support this, that it helps to inform better investment decisions, and I'm very happy to sort of refer to those or probably put them in a submission in support of this. It's interesting to note how this is flowing through now where we have some of Australia's regulators talking to these issues, signalling that these are important issues that trustees and, indeed corporate directors are considering. That's climate change risk, acknowledging that these have become part of a core financial stability type issue for Australia and is absolutely core to long-term investors who are investing over decades on

behalf of their members.

Our members understand that and I think it's really important that this is built into any consideration about a strong superannuation system. Interestingly, the UK and the EU are both starting to legislate to this effect to require pension funds to consider these issues and to report on how they're considering them.

Secondly, when we talk about meeting the expectations of consumers and our members and Australians it's really equally important to understand that we're investing in a manner that is consistent with the values of Australians. That effectively means investors ensuring that they're avoiding doing harm in the way they're investing. I think we've seen a large amount of consumer research, including our own, that's indicated a vast majority of Australians expect their super to be invested in a way that, as a minimum, does no harm.

We've got statistics from our own consumer research that nine in 10 Australians are expecting their super is invested responsibly and ethically. Seven in 10 Australians would rather invest in a responsible super fund that considers environmental, social and governance issues as opposed to a super fund which considers only maximising financial returns. And I note and I emphasise that this is not a trade-off between returns and responsible investment, as I mentioned earlier. But we're seeing this desire by Australians feed through to the superannuation fund industry. It is one part of the reason why in the last three years we've seen about 35 of our major funds divest tobacco stocks from a realisation that Australians ultimately do not want to build their retirement savings off the basis of investments that do harm and actually worsen the world they're likely to retire into.

So these are important considerations in terms of delivering on the performance outcomes and meeting member expectations. Really, my purpose for coming today was to ensure that is fully considered in the Productivity Commission's final recommendations. How this flows through I guess specifically to your recommendations in terms of allocating defaults, we don't intend to be giving you an assessment of whether one particular model is better than another. But what we do intend to stress is that any future model should require responsible investment as a critical criteria of assessment for eligibility.

We have the knowledge now that this is all about delivering on returns and member outcomes, so we think that's critical. Member engagement, we agree with the conclusion from the Productivity Commission that members need better, not more, information. But we would add to that more relevant information. I think there's a number of good solid examples

now where a way of engaging Australians in their superannuation is to talk about the issues that Australians care deeply about and there's a number of funds using responsible investment as a tool to enhance and improve engagement to then talk through more financial literacy type issues around risk returns, et cetera. But responsible investment can be a great conduit to building that engagement and, as a result, we see some of Australia's fastest growing super funds are those who talk very forthright around their responsible investment practices.

Dashboards we think should be enhanced. We note important elements of the dashboards and transparency requirements such as portfolios holdings requirements have been deferred in legislation a number of times now, so we think this is an important part of it, and requiring meaningful disclosures are a part of that. So they're sort of some of the elements as to how we think this feeds through and I just wanted to start with that as an opening statement. Thanks.

MS CHESTER: Thanks very much, Simon, and we do appreciate your interest in our inquiry and having known a little bit about the beginnings of ESG in the investments community in my previous life and incarnation and seeing how it plays through to the risks around cash flows of long-term investments particularly in the infrastructure space – so I guess where – the evidence that you point to – and it's evidence that would be good for us to have a closer look at because certainly my understanding of it is now quite dated – is this correlation between long-term net investment performance and responsible investment. Responsible investment, I think people see that as a broad umbrella term but I probably don't, so correct me if I'm wrong.

It's really where when you're as an investor, institutional investor, looking at building out a portfolio over time you're looking at very explicit factor risk exposures and ESG are very critical factor risk exposures to take into account. It's sort of like a micro that's needed underneath a strategic asset allocation, so within each asset class you're conscious of what factor risk exposures you've got, whether they be environment, social and governance. Is that kind of right?

MR O'CONNOR: That's spot on and yes, that's right. I think there's both the micro element, but the macro thematic elements that also influence portfolio allocation and strategic consequences.

MS CHESTER: Where it's helpful for us then to understand that evidence is when we're looking at best in show and MySuper authorisation, which are kind of like the two quality filters that we're looking at applying – one for the top performing and one for good performing – at the moment one of the most heavily weighted criteria for both is really net investment

performance over time. Easier to do for best in show. For MySuper authorisation it's through an elevated outcomes test, although we've identified elevating that further with saying if you don't meet your benchmark portfolio going forward over five years and you miss (indistinct) pool by 25 basis points, then maybe you shouldn't keep MySuper authorisation.

For us, it's sort of identifying is the net investment performance over time enough of a guide to capture people that are doing that sort of more responsible bespoke portfolio construction, which it should be – and that's why we want the evidence – or do we need to go further and be more prescriptive for best in show that there would be an expectation, although not mandated, that they would be ESG sensitive or responsible investment in their investment strategy. So we do identify investment strategies. I think the one thing that would be helpful for us going forward is there's about a page in your default chapter where we talk about our principles for guiding the best in show determination. It'd be great if you had a look at that and then also shared the evidence you've got on the correlation to see whether we need to do anything further in your thinking to be more prescriptive about that to help the best in show panel get the best in show.

MR O'CONNOR: That's great and I think you're absolutely right. That should feed through just the net returns effectively. But I think there's probably a difference there as to whether that is systematically being applied to systematically and consistently deliver those net return superior performance or whether there was some luck in – so I guess by requiring the specific pooling out of a systematic approach to responsible investment means that might not just be a lucky five-year window or something, but actually there is a concerted process to managing external managers, to managing the investment approach to considering these risk and strategic asset allocation as opposed to just someone fluked it. But you're absolutely right, I think – but I'm happy to - - -

MS CHESTER: Which is important because at the moment we can only look at history.

MR O'CONNOR: Yes, that's right.

MS CHESTER: Plus other factors, other qualitative factors around your governance, your investment strategy to then guide are you likely to reproduce that history going forward.

MR O'CONNOR: That's right, yes. I think the world that superannuation funds are investing into over the next coming decades is very different to the last couple of decades.

MS CHESTER: Indeed, when you talk to some of the really smart CIOs that are looking at structural breaks in particular industry sectors around cash flows and performance, a lot of these are ESG factors.

MR O'CONNOR: Yes, exactly. They may not be called that, but that's precisely what it is.

MS CHESTER: What would also be helpful for us to get is your kind of list across the Australian Super Fund space as to who's doing responsible investing or ESG, who signed up and who's doing it well, because we can sort of actually do our own – I'm looking at the person who might be doing this – we can actually look at then our distribution of performance over time which we've created that others haven't done before and then see if we can establish a correlation as well. So we'd like to see your international evidence base but we might have a look at doing our own little domestic evidence base.

MR O'CONNOR: That'd be great, and we just released about two weeks ago an analysis of the top 50 largest superannuation funds in Australia and we have a leader's list in that effectively of those we think have a very comprehensive approach to responsible investment. That is a really diverse bunch of funds from faith-based investors to very large industry funds and the largest to retail-based funds as well. So we don't think it is something that can only fit within a certain type of superannuation fund either, which I think is an important element to it.

MS CHESTER: I guess where one important distinction needs to be made – and this is something that we talked about when we were looking at what's the requirement in the choice segment versus what's the requirement in the default segment is some superannuation members may be prepared to take some investment performance off the table for ethical investing. That, as I understand it, is quite distinct from responsible investing. They don't need to be inconsistent. So they're not mutually exclusive, they do a lap. But sometimes an ethical investor might be prepared to take some returns off the table for ethical investing. Is that correct?

MR O'CONNOR: That can be the case, but certainly evidence would even support that ethical investing is just as likely to receive good risk adjusted returns. But you're right in that distinction of the responsible versus ethical and the fact that there's not mutual exclusive. Like I think there's more of a grey zone today than there ever was in the past. But no, you're absolutely right, so there is – and certain segments there that would be willing to prioritise values and ethics over financial terms.

MS CHESTER: On then preaching what you practice and then applying that to our super system around more relevant information – I guess this is trade-off in the world of good governance in the ESG world is about disclosure. And it's not just for the member, it's for informed agents, being media, analysists, academics, to be able to follow the money and be able to identify where problems may be emerging. I guess what we found though is that the world of disclosure in super kind of hasn't delivered on the latter and, indeed, then its murkied the former because the information that's there for the member – firstly, it's difficult to find, and (2) once you get to it, it's just incomprehensible.

We've had evidence from some of the academics that they've set it as assignments for their third year finance students to find the dashboard and to understand the not-so-dashing dashboard. Do you sort of distinguish then between what's meaningful for members from a behavioural economics perspective versus what should be there for disclosure for transparency and accountability for informed agents?

MR O'CONNOR: We do. I guess there are two elements to that, and it's interesting to think of for whom is the audience effectively for what part of information. I think there's a lot of like much greater disclosure across a whole lot of factors is important for just informed agents interested in this industry. From a consumer perspective though, we are starting to see requirements come into play just – there's a report from the UK Government this week, in fact, and one from the EU in terms of requiring pension funds to be writing annual statements on how they are asking their members of their preferences around sustainability, ethical issues, climate change related issues. So direct reporting and annual statements on how they're actually engaging their members on this.

I guess simplified in a sense as to how that comes through. I think there are pros and cons of things such as full portfolio holdings disclosure. Nine thousand plus stocks, how meaningful is that? I think at a principles-base level we believe really strongly that is something that should be available to investors to understand where their money is being invested. But currently out of those top 50 funds in Australia only six provide full portfolio holdings disclosure, and that's part of the legislation that's been held up in Australia.

So there's that sort of how useful or – but I think when you look at global markets I believe Morning Star data says Australia is probably the worse out of 30 global markets on their disclosure requirements around portfolios. So we really are leagues behind the rest of the world in terms of the amount of information you can get on your portfolio. But then when you talk about it at a dashboard level I think there's more – still we find any

information around responsible investment, ethical investment is buried deep, deep, deep in PDSs. It's often not very meaningful. I mean, we have a certification program where we assess this to make sure it is meaningful and it's true to label. And it's hard to get the right information.

I think it's buried. But we are starting to see dedicated reporting from some of the leading super funds on their responsible investing strategies, what it means and, importantly, what the outcomes are, any targets in place, so being much more accountable. I think that's sort of a big shift that's occurring now.

MS CHESTER: I guess from our perspective what we're trying to do is make sure that the information that goes to the member is what they need for a window of interest to help them make an informed decision. We're not going to be overly prescriptive about that. We'll be very prescriptive about what disclosure should be for an informed agent, but for the member we think that the regulator should work with the behavioural economists and the people that do the choice surveys and understand the nudges of the world to identify what should be on a one-page MySuper dashboard.

Unless there was a strong evidence base that the member needed to understand is my fund a terrific ESG investor or to understand my fund will actually give me really strong solid net investment returns over the long term of my working life. So you see we're kind of - - -

MR O'CONNOR: I do, yes. I mean, I think we put in a policy submission around that legislation that's around disclosure and dashboards that there should be a requirement to disclose something around your responsible investment commitment at the dashboard level. We think this is one element of superannuation that unfortunately many Australians find this stuff pretty boring and dry. This is one area where we have a chance to actually talk about some of the good impacts that are occurring from the capital allocation decisions being made by that 2 and a half trillion dollars out there.

By having a fund actually state upfront on a dashboard a commitment that does exist and is board endorsed, it is something that is actually meaningful in an organisation, potentially is one signal to a consumer that they're thinking about stuff. There's some values alignment, there's a consideration of things.

MS CHESTER: Do you have evidence that – so partly what we've also tried to do is to understand what's important, what does the member value separate to an educative process for members going forward. But have you got evidence that suggests that members do value understanding or thinking

that their good net investment returns are based on responsible investing? Is that something that you've got an evidence base you can point to for us?

MR O'CONNOR: It's interesting. We've done some consumer research here in Australia over the last few years. It was very clear, more so maybe it was the structure of the questions actually in the New Zealand consumer survey, that there is a belief that they want very good investment products, plus they want values alignment. Like they don't want a trade-off there and there is an expectation that there is not a trade-off there. So we do have consumers understand that there should be not be a trade-off, which was pleasing to us because the traditional sort of mythology around this has been the trade-off perspective.

It's probably something I'd like to have a look at and come back to you and whether there's some indicators by proxy of that through some of the movements in the market that are occurring now. Like if you look, for example, at a lot of the start-up small funds that have been come to market recently, nearly all of them are basing their marketing around values alignment, around sustainability, around a way you can actually engage much more strongly with Australians. I think it is an indicator that Australians are willing to engage with super, are willing to think about it and ask some questions.

But we need to start with issues that they care about and think about in their daily life and make some explicit connections as to how that relates. I think this provides potentially a really strong gateway to improve engagement with Australians with their super.

MS CHESTER: The other area that would be helpful, because you're advising INSTOs on what they should be looking for in terms of best practice with ESG, to some extent what our regulators require of super funds in terms of disclosure is nearly like the role of an INSTO investor in saying this is what we should be seeing super funds doing. Around related party is an area that we kind of struggled in terms of the disclosure of the incidents of related parties, the fees and costs associated with related parties and was a business case really established to have that related party transaction be executed.

It would be good for us to kind of know what you see as best practice in the investments world and do we see our super funds practising that with their disclosure to their members as their customers, because that could maybe inform whether or not we strengthen what we expect the regulator to do in that space because you want the regulator to nearly be an ESG investor on behalf of the members in terms of what they require the super funds to do. So if you could give us some guidance on where there might

be gaps in terms of best practice what you would expect in the ESG world of an INSTO investor versus what the regulator is expecting the super fund today who's a unique investor on behalf of members who are compelled to give them their money.

MR O'CONNOR: Sure, yes, and I think we're seeing some emerging themes around that, that is, how super funds are reporting on climate-related financial risks, et cetera which we're starting to see through the taskforce for climate related financial disclosures requirement and mandating that in certain jurisdictions to do better reporting. But yes, that's certainly something we - - -

MS CHESTER: I guess I'm emphasising the G in ESG here, not – so while I agree ESG is really important for portfolio composition, the G here for the super fund is what I'm getting at. If the regulator was an investor in a super fund today, would they give them a tick under the G?

MR O'CONNOR: I think that's variable.

MS CHESTER: We think so too. But you're the expert, so tell us where the gaps are on the G.

MR O'CONNOR: Sure. Again, our recent report looks a lot at the disclosure from super funds whose reporting what and how detailed that disclosure is. So we can certainly include some of that information.

MS CHESTER: The other part of the G that's kind of interesting then is around the trustee board and the calibre of the trustee board. We didn't kind of get into the world of recommending and mandating a number of independent directors, although we thought it makes a lot of sense in a world of complex and related parties that you'd want a critical mass of independent directors, but we don't mandate it. We then looked through to the quality of the trustee board and how you assess the skills and make sure you've got the right skills today in going forward and there's independent assessment of that performance of the board and the investment committee and their skills.

Again, we've got some recommendations there. It would be good for you to let us know whether or not we've gone far enough in terms of what's best practice about what's expected in the governance under that G in the institutional investor world today.

MR O'CONNOR: Sure.

MS CHESTER: That'd be great.

MR O'CONNOR: I think we, yes, made comments to some of those elements in previous submissions and things. So yes, we can definitely talk to that.

MS CHESTER: Because we're now at a stage where we've got – we're at the pointy end. We've got draft recommendations on the table. We need evidence to either strengthen them, change them, delete them or leave them there. So that'd be great.

MR O'CONNOR: Sure.

MS CHESTER: Can we leave you with all that wonderful homework?

MR O'CONNOR: Yes, sure.

MS CHESTER: This is the part that we like. But I think you can actually really help us here.

MR O'CONNOR: That's good.

MS CHESTER: There's areas where we're a bit light on. We've had some terrific help from some really smart people in academia and in the consulting community who know a lot about the coalface of governance here in Australia. But I guess you've got the added advantage of you're looking at it internationally as well in terms of what's best practice.

MR O'CONNOR: Sure, and there is a lot of movement on the legislative front around these kinds of elements internationally. Great. Thank you.

MS CHESTER: Thank you so much, Simon. We appreciate you coming along and we look forward to your post-draft report submission.

MR O'CONNOR: Cheers.

MS CHESTER: Thank you. We are running outrageously ahead of schedule. How did that happen? Although our next participant may have just arrived, which we'll find out in one moment. Good afternoon. Are you Mark MacLeod from Roll-it Super?

MR MacLEOD: I am.

MS CHESTER: Excellent. We're really pleased you're running early. Just take your time, settle in and just when you're ready, Mark, if you'd like to take a seat up the table. But we'll change your organisation from the

Responsible Investment Association of Australasia to Roll-it Super with the wave of a magic hand of a staff member. Mark, thank you for asking to appear at our hearings today and welcome. Just for the purposes of the transcript, if you wouldn't mind stating your name and the organisation that you represent and then if you'd like to make some brief opening remarks and then we can get into a bit of a chat with some questions.

MR MacLEOD: Yes, no problem. I'm Mark MacLeod, I'm the founder of Roll-it Super and we're a superannuation start-up launching in a few months' time. In terms of our submission, I guess opening comments, we thought it was a fantastic report, very well researched and a really great summary of the sector. With the recommendations, our submission really focused on ensuring that private enterprise can innovate off the back of the recommendations. We've seen that work extremely well with other initiatives, whether it's SuperStream or Single Touch Payroll or clearing house services, these initiatives. When there's participation by the ATO, government and enterprise it means that there's a bigger chance of getting universal participation at what the initiative is and ultimately that stands to benefit members' interest as well.

Our submission really had a number of responses to specific guidance that you provided and where it was silent on whether I guess private enterprise had an opportunity to innovate against that, just some recommendations to put that in place, not just focusing on say MyGov portals or the like. That was the general comment. But I think a fantastic initiative. I particularly like the use of the choice model. I think it's going to do really good things for the passive members of employer-sponsored plans.

MS CHESTER: Just before we get into questions, can you just explain your business plan a little bit better so we understand where you fit into the super system?

MR MacLEOD: Yes, absolutely. We're looking at really how do we get people more engaged in their superannuation? We started to look at the behavioural biases and some of the behavioural economics around that. There were some pretty insurmountable challenges that people had. Really the biggest one is default bias where you can elect to do nothing, sae yourself a really challenging and difficult decision and just take what the employer provided you. We looked at that challenge and we looked at just the general challenges around getting people engaged in super and then how can we get involved and sort of bridge the gap to get people engaged in their super and making active healthy decisions towards where their super is going?

We started to look at the default model, which is predominantly how

people were engaging and, I guess, purchasing super. We wanted to provide value for the employer and the employee by looking at the overall financial wellness of the employee and as it related to their super, provide an easy way for them to understand their current fund and investment option and how that tracked against every other possible default or choice fund and investment option in the market and allow them to push a button and switch and we'll take care of the switching and the admin around that.

We wanted to do that as an independent service so we weren't getting commissions or any sort of bad sort of economic incentives for us to do that. (Indistinct) enough value have the employer pay for that and allow that free to employees and allow them to compare and switch at the push of a button, remove the friction out of the comparison and switching process. So that's what we built. We have every public offer fund available to employees. They can track their current fund and investment option against the market and allow them to initiate a rollover after that to any other fund. That's the model as it relates to the super component of what we do.

We looked at these changes and hopefully it means we can accelerate people getting actively involved in their super. So we're big supporters of this and if there's any way that we can – we've got a couple of years of runway before this sort of starts to hit the market and if there's a way that we can facilitate and educate people on that process, then we'll be big supporters and want to do that.

MS MacRAE: Could I just ask then if you've looked at the report you've seen our suggestions around the best in show list. How do you see that facilitating your business model?

MR MacLEOD: With employers and employees there's often services that they are already using. With employees, they might have intranet sites, employee portals, other platforms that they're already using and engaging with. Having the assisted choice options and information available through those portals and services they're already using is a very good way to get participation as opposed to saying, "Look, until you've gone to MyGov and make a selection, you can't sort of" – we don't want to have people defaulting sequentially into one of the short list. So you want to find ways to get to where people already are.

So we looked at the assisted choice model and that creates a short list that can be accessed via a chart, portals, services like ourselves and there's a range of things that people are already engaging with and where private enterprise can get access to the information and get access to help people make those decisions, then we want to make sure that that's facilitated.

MS MacRAE: Would that be – and I'm sorry if this is an ignorant question – would you then be providing kind of IT solutions to join up what a business currently has with what the ATO might be offering?

MR MacLEOD: Absolutely, yes. The analogy would be when SuperStream came along – the ATO built a small business clearing house, for example. But it wasn't the only clearing house in the market. Westpac had theirs and – so a whole bunch of them. If we just said the ATO is the only clearing house that can be used, then a lot of innovation, a lot of work and effort would have gone into employers changing the way that they worked in order to use that new service. They didn't have to because service providers stepped into that and then built easy-to-use frameworks and tools and software to make that easy for everyone to go through that transition.

I don't see this is any different. There's some recommendations in there that maybe when an employer, employee or a member has expressly said where they want to go, service providers will be in a easy position to be able to facilitate that through the ATO or whatever services is centralising those enrolments.

MS MacRAE: Have you looked at any of the existing arrangements that – super arrangements that the ATO has with things like SuperStream where some very small businesses in particular have been finding it difficult because they either don't use an electronic package or they have one that's not compatible? Have you looked at any of those existing arrangements and facilitated any of those or is this more - - -

MR MacLEOD: Yes. A lot of the new accountancy packages and payroll systems make this a lot easier for employers. I guess where they don't go is they don't often go that extra mile and make it easy for members. That's especially as it comes to making decisions around where their super goes. So that a lot of them at the moment services focused around the servicing employers. There's not a lot of services that are servicing employees at the moment. That's where there's innovation and opportunity.

MS MacRAE: I'm just trying to think in the way that we're envisaging the centralised online service would work, that you rock up to your employer and on your first day they say, "We've got this electronic form that needs to be filled in and that's going to give you a drop-down box of the best in show," or whatever, and we are conscious that the ATO have already mentioned to us issues around difficulties where the employee might be inserting details that would be on the employer's computer that maybe they wouldn't necessarily want the employer to have some of that.

There might be things that they're looking at and seeing that they wouldn't want as history on a computer in the workplace. Is that the kind of problem that you'd be looking to overcome?

MR MacLEOD: Yes, so there's services that can be – the privacy and the information can be secure for the employee, that the employer doesn't have access to. But those decisions can still be facilitated through to the ATO, for example. So the employer might offer that service up to the employees, but the login and the information that's provided in there is confidential to the employee.

MS MacRAE: That's the kind of add-on that you'd be providing and providing it across to the employer but saying there'll be benefits for you and your workforce in making this available.

MR MacLEOD: Yes, that's right. I guess our model would be to have the assisted choice list but also we'll make it easier to find choice of fund as well. So whether it's ethical or indexed or MySuper or growth or whatever it may be. They might have other needs that aren't on that assisted choice list. But we'll definitely be putting that out there and saying, "Here's the assisted choice list and then here's all the others as well," and just make sure that these are – remove the information asymmetry and make sure that people can find what's of value to them.

MS CHESTER: Mark, with the work that you're doing at the moment and obviously maybe has helped – assisted by our assisted (indistinct) choice model – you're helping the – so an employer hires you, you come into the workplace and with IT solutions you help their workers make their own choices. This isn't corporate super. This is just an employer wanting to help their members make a choice because they don't want to make the choice on their behalf. Is that right?

MR MacLEOD: Yes, that's right. We don't believe that employers are in a position to make the best choice for employees and we want to educate and support employees to find the right super fund and investment option for them.

MS CHESTER: Is there anyone else in the market that's doing this, apart from yourself?

MR MacLEOD: I don't think so and it's been challenging to do that. A lot of the systems you need access to it's a bit of a Catch-22 where you need to be a super fund in order to facilitate the service, but most super funds have a lot to lose by providing a frictionless liquid open market to get a member to leave or come in. So that's the challenge. But in saying that if

you've managed to overcome all of that, there is – SuperStream has facilitated a frictionless rollover between funds if you're willing to lose members at the same time as gaining them. With us, we've got no vested interest in maintaining funds under management or fees, so it's an easy solution for us. We don't have a revenue model that I guess is conflicted to what we're trying to achieve.

MS CHESTER: When you find a fund that's making it difficult for a member to depart and to go somewhere else, when you hit that roadblock, what do you do?

MR MacLEOD: There's certain employers and employees that are going to be off limits to begin with under the EBA arrangements. Luckily with all public offer funds they don't have much choice but to be open to rollovers via SuperStream. So that's not a choice the fund has. A member wanting to leave or join them is facilitated by that.

MS CHESTER: Apart from where there's an EBA involved, that's more a historical issue. Then when you're providing information to the employee in the workplace to help them make choice in the free range choice segment, what information are you providing them? What data are you giving them access to so they're making an informed decision?

MR MacLEOD: Definitely educating them on risk and return and how super works, but our key focus is a net compounding return between one, three, five, seven and 10 years. Fees, both the total expense ratio and then other fees. And then benefits that the fund may offer on top of that. But our weighting is heavily towards net compound in return and fees. Then we allow people to look at breaking that down into ethical or indexed or other investment options that are a values based or a thematic style that they'd like to invest in, we make that easy to find them. But if you're looking just straight it's typically around net compounding returns and fees and allowing people to break that down into growth, balanced or conservative so they're not sort of getting the three I guess risk weightings mixed up.

MS CHESTER: We kind of struggled, indeed, we nearly killed a few staff members, in trying to do the – for us, it's really the longer term investment performance that matters by product and by fund. How did you find creating that dataset yourself or did you buy it from the Super Ratings or something like that?

MR MacLEOD: We worked in partnership with one of the research companies to look at that. We spent a really good six months working together to work out what a sensible list would be and then how to go about

achieving that. But we think a net compounding return and then setting the return horizon at sort of a default flight to seven years was a sensible thing to do.

MS CHESTER: How did you go getting coverage of the choice segment? We kind of really struggled there in terms of – I think we could only get what was a 15 per cent coverage or something with the assets - - -

MS MacRAE: Eighteen per cent.

MS CHESTER: Coverage of the assets in the choice segment with long-term investment returns.

MR MacLEOD: Some of the products are new, so you're just not going to get them, especially the lifestyle products, they just haven't been around for 10 years. So you'll struggle to get that. But I guess the data becomes more comprehensive sort of the one to three years. But as you go out a lot of the funds either are closed to new members – so from our perspective we stopped looking at it – or they just haven't been around. So happy to compare notes. But yes, you'll see that that tapering off happens just through the churn of products through the sector.

MS MacRAE: If the recommendations that we were making were to come through in that the online service would include the product dashboards – and we're hoping that they will be simplified and streamlined compared to where they are today – would you pick up those dashboards and use that in conjunction with your information?

MR MacLEOD: Yes, so I think we've said in here we'd absolutely want to have access to all the product dashboards. But also if the government is publishing guidance for pre-retirees, that guidance can be republished through other platforms and websites as well. I think that ensures some consistency, also some legitimacy to the information that's getting provided. It's very easy to sort of be selective in the information you provide members. So having a source which is trusted and can provide consistent messages I think is really important. So the ability to republish that and then definitely get access to and republish dashboards is really useful. If we looked at what we do we have to create our own dashboards and then we link through to product disclosure statements and the like to try and provide that coverage.

MS MacRAE: Do you use the existing MySuper dashboards at all or do you find they're - - -

MR MacLEOD: Yes, we link through to the dashboards and the PDSs of

funds.

MS MacRAE: In relation to the service you're thinking about helping employees, have you got any comments about how smoothly and effectively the clearing house arrangements are working? As you said, here we've got the ATO small business clearing house, we've got other private sector clearing houses that people can choose from. Would you say that that model has provided levels of innovation and do you think we've reached the maximum sort of efficiency and innovation we can in those clearing house models? Have you looked at that as – is that another area you'd be interested in operating?

MR MacLEOD: I'm not interested in operating there. I've been part of that in a previous life. So I've done this before. I don't think the innovation is finished there. The thing about it is when private enterprise is there they'll be looking to things like the new payments platform and other innovations as it comes through and how they can adopt it and then push that out through their customer base. So we want to be on the front foot with that.

Similar with – if we can move – when clearing houses can move away from SAF files and these sorts of things that are getting provided and just push a button within an employer system and it pops out and it goes to the funds and the data goes through SuperStream, that's where it's going and that's what private enterprise and innovation with deal. They'll incorporate NPP when it comes. They'll keep smoothing out the friction for employers because it is an advantage on doing that in the market. It's not sort of a one-time thing. It will continue. I guess that's the challenge with a government service that they will have to continue to invest and innovate as well. It's not one of those things you can do once and stop.

MS MacRAE: Would you say at the moment – the take-up of the ATO small business clearing house is – I guess I was expecting that that would be – that the take-up for that would be quite high – higher than it is, given the proportion of businesses that could be using it. Would you say that's because the – I don't know much about the private sector clearing houses. Would you say that they're more efficient and helpful to employers and have they got innovation already that the government clearing house doesn't have?

MR MacLEOD: Yes, I'd say so. Again, employers will be using processes and systems and service providers that were already in place before that ATO clearing house arrived. Therefore it's easier for the employer and less effort to continue with those arrangements. It'll be no different with this as well. If there's things already in place that the

employee and employers can use and they can facilitate this, then your chances of getting universal coverage would be just significantly higher.

MS MacRAE: I think that's all from me, unless you've got anything else you want to raise with us?

MR MacLEOD: No, that was it. Thank you.

MS MacRAE: That's been terrific. A good way to finish the day.

MS CHESTER: Thanks very much, Mark.

MR MacLEOD: Thank you very much for your time.

MS MacRAE: Thank you.

MS CHESTER: Folks, that means we can now draw to a close day 2 of the super super hearings. We will resume tomorrow in sunny Brisbane at 1 pm. Thank you, linesmen, thank you ball boys.

MATTER ADJOURNED AT 4.03 PM UNTIL FRIDAY, 22 JUNE 2018 AT 1 PM

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]**