

12 July 2018

Chair Peter Harris, AO
Deputy Chair Karen Chester
Productivity Commission
Locked Bag 2, Collins St East
MELBOURNE VIC 8003

Lodged electronically

Re: Productivity Commission - Superannuation: Assessing Efficiency and Competitiveness - Draft report

Dear Chair and Deputy Chair,

We would like to lodge this submission for the draft report of the inquiry into Superannuation: Assessing Efficiency and Competitiveness.

We are superannuation researchers at the University of New South Wales Business School and the University of Western Australia Business School. We have undertaken extensive research into superannuation in our current roles, and in Kevin's previous position at APRA.

The PC may now refer to the academic version of our submission (Submission 92) as it has passed the double-blind review process and has been accepted for publication in *Accounting and Finance* (a top-tier academic journal). We have attached the published version for your reference. All the empirical results and the findings remain the same as Submission 92.

Fund Performance

Regarding *Information Request 2.2 "Aside from administration fees, asset allocation and tax, what other factors might explain differences in investment performance against benchmark portfolios of the superannuation system, as well as segments such as for-profit and not-for-profit? What evidence is available to test the influence of such factors?"*, we would like to draw the PC's attention to our previous submission (Submission 92). Our empirical research findings indicate that the use of related-party service providers and affiliated trustee directors is an additional factor that explains differences in investment performance between segments.

Fund Governance

Regarding *Draft Finding 9.2 "Best practice governance for superannuation trustee boards would involve a 'critical mass' (at least one third) of independent directors. However, ensuring boards have processes in place to recruit highly skilled and experienced directors is at least as important as the number of independent directors."*, our empirical research findings indicate that the actual governance concern is the presence of service-provider affiliated trustee directors rather than the lack of

independent directors. It is important to note that service-provider affiliated trustee directors are not synonymous with non-independent trustee directors. Our findings show that other types of non-independent trustee directors (e.g. employer/employee representatives) are not associated with underperformance.

Regarding the issue of 'critical mass' (at least one third) of independent directors, it is our view that this is unlikely to be sufficient to ensure best practice governance for superannuation trustee boards, especially in retail funds.

The empirical findings of our research (Submission 92) show that:

1. At the trustee-director level, retail funds are more likely to use affiliated trustee directors. On average, 78 per cent of retail fund trustee directors are affiliated.
2. Retail funds with a higher proportion of affiliated trustee directors are more likely to use related-party service providers.
3. Both the use of related-party outsourcing arrangements and trustee-director affiliation in retail funds is strongly negatively related to fund members' investment performance.

As this governance practice is significantly detrimental to fund members' interest, it represents a major source of inefficiency in the superannuation system. The 'critical mass' (at least one third) of independent directors does not sufficiently address this particular type of affiliation (i.e. with service providers), as it implies that these funds can still have a majority (i.e. up to 2/3) of affiliated trustee directors.

Our recommendations:

To address the above-mentioned issue, our recommendation is to impose a cap (with or without the implementation of the minimum one-third independent director requirement) on the total number of trustee directors who are or have been affiliated (during the preceding 3 years) with fund service providers.

1. For superannuation funds that provide MySuper products, less than one-third of trustee directors shall be affiliated*.
2. For superannuation funds that can be included on the "best in show" list, no more than one trustee director shall be affiliated*.

*A director is affiliated if the director is, or has been at any time during the preceding 3 years:

- a) an executive officer of a fund service provider or a related entity within the service provider group;
- b) a director of a fund service provider or a related entity within the service provider group;
- c) an employee of a fund service provider or a related entity within the service provider group;
- d) a shareholder (who has more than 5% shareholding interest) of a fund service provider or a related entity within the service provider group; and
- e) is or has been involved in a business relationship (at any time during the preceding 3 years) with a fund service provider or a related entity of the service provider group.

If you have any queries in relation to our recommendations, please don't hesitate to contact us.

Yours sincerely,

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