



**Australian Government**  
**Productivity Commission**

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**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

		<u>Page</u>
	<b>PRICEWATERHOUSE COOPERS</b>	
	<b>MS C NANCE</b>	<b>165-178</b>
	<b>INDUSTRY SUPER AUSTRALIA</b>	
	<b>MR M LINDEN</b>	<b>178-199</b>
	<b>MR M FISHER</b>	
	<b>AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES</b>	
	<b>MS E SCHEERLINCK</b>	<b>199-214</b>
	<b>MS A GOODWIN</b>	
	<b>CBUS SUPER FUND</b>	
	<b>MR R MASSON</b>	<b>215-228</b>
	<b>MS R CAMPO</b>	
	<b>MR T RIDLEY</b>	
	<b>MR J MINIFIE</b>	<b>229-239</b>
<b>5</b>	<b>CONSUMERS FEDERATION OF AUSTRALIA</b>	
	<b>MR G BRODY</b>	<b>240-249</b>
	<b>ACTU</b>	
	<b>MR J MITCHELL</b>	<b>249-271</b>
	<b>MR T CLARKE</b>	
	<b>CORPORATE SUPERANNUATION ASSOCIATION</b>	
	<b>MR M CERCHE</b>	<b>271-283</b>
	<b>RESPONSIBLE INVESTMENT ASSOCIATION AUSTRALASIA</b>	
	<b>MR S O'CONNOR</b>	<b>283-293</b>
<b>10</b>	<b>ROLL-IT SUPER</b>	
	<b>MR M MacLEOD</b>	<b>293-301</b>

5     **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  
10     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.

15     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.

20     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.

25     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  
30     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.

35     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.  
40     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.

45     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.

5           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  
10       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.

15           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.

20       **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.

25       **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.

30           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  
35       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  
40       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.

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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.

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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.

15

**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.

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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:

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*The problems the Productivity Commission have identified have been there for yonks and there's been a hell of a lot of inertia.*

30

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?

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**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.

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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

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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.

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**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  
10 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  
15 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  
20 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  
25 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  
35 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.  
40

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  
45 or whatever, but just say where is the member better placed in those three

arrangements.

5 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.

10 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  
15 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  
20 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.

25 **MS NANCE:** That's right.

**MS MacRAE:** But I think it would be helpful to look at one case study that was a success.

30 **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  
35 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.

40 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  
45 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.

5        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  
10       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  
15       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.

20       **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  
25       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.

30       **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.

35       **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  
40       down that journey.

**MS NANCE:** Yes, I can do that.

45       **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.

5 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?

10 **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.

20 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.

30 **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?

35 **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.

40 **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

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5 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.

10 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.

15 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 20 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.

25 **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 30 you mentioned in your report.

35 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 40 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.

45 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.

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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.

10

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.

15

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**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.

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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.

35

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

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incredibly transparent process that was really only about a best in show that was in members' best interests.

5 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  
10 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.

15 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  
20 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  
25 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  
30 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.

35 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  
40 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.

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**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  
10 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.

15 **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  
20 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  
25 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.  
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**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  
40 – 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.

5  
**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  
10 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.

15  
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  
20 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  
25 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  
30 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  
35 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  
40 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  
45 diversification across listed and unlisted assets, coupled with efforts to

reduce the degree of financial intermediation between members and the underlying investments.

5 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.

10 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.

25 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.

35 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.

45 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.

5       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  
10       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.

15       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  
20       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  
25       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.

30       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  
35       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  
40       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  
45       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.

5           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 transparency 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  
10           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  
15           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  
20           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  
25           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  
30           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  
35           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  
40           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.

5 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.

10 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  
15 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  
20 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.

25 **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  
30 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  
35 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  
40 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.

5 **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.

10 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  
15 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.

20 **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  
25 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  
30 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  
35 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  
40 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  
45 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.

5           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  
10       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.

15           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  
20       helpful in your submissions.

**MR LINDEN:** Yes.

25       **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  
30       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.

35           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  
40       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.

45           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.

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**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.

15

**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?

20

**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.

25

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.

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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.

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**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

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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.

5           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  
10 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,  
15 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,  
20 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?  
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**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.  
40

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5 **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.

10 **MS CHESTER:** But you said that there are costs in defaulting only once, I don't understand what those costs are.

15 **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.

20 **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.

25 **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.

30 **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  
35 there's almost no risk in moving from a best in show list into the MySuper universe.

40 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  
45 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.

5       **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.

15       **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?

20       **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.

25       **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.

30       **MR LINDEN:** Yes.

35       **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.

40       **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?

5 **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.

10 **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.

20 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?

25 **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.

30 **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.

40 **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.

5 **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.

10 **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.

15 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.

20 **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.

25 **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.

30 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.

35 **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.

5

**MS CHESTER:** So our best in show list in the elevated MySuper list don't have underperforming products. If you're talking about - - -

10 **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.

15 **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.

20 **MS CHESTER:** Or are you talking about default MySuper products that are retail?

25 **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.

30 **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  
35 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.

40 **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.

45 **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 - - -

- 5       **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.
- 10       **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
- 15       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.
- 20       **MS MacRAE:** So you wouldn't show their existing fund so we would end up with a multiple again?
- 25       **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
- 30       automatically consolidate.
- MS CHESTER:** So you've said that they've started in a bad choice product.
- 35       **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.
- 40       **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.

5 **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.

10 **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.

15 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.

20 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?

25

**MR LINDEN:** Could you very, very quickly recap what it was? Sorry.

30 **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.

35

40 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

45



by the Governor of the Reserve Bank.

5 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.

10 **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.

15 **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  
20 it would be good to get your feedback on that.

**MR LINDEN:** Sure.

25 **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?

30 **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.

35 **MS CHESTER:** So let's set aside insurance, so just purely for superannuation what tailoring is required by occupation for superannuation in accumulation?

40 **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.

45

5 **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.

15 **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.

20 **MR LINDEN:** Yes.

25 **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.

30 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.

40 **MS MacRAE:** Would most industry funds have that?

45 **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.

10        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.

20        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.

30        **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.

40        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.

5           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  
10 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  
15 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.

20           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  
25 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.

30  
**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  
35 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'  
40 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  
45 Kevin Lu where there was some discussion around the governments

5 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.

10 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.

20 **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.

30 **MR LINDEN:** No worries. Thanks very much.

**MR FISHER:** Thank you.

35 **ADJOURNED** [10.32 am]

**RESUMED** [10.45 am]

40 **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.

45 Thank you.

**MS SCHEERLINCK:** Eva Scheerlinck, Australian Institute of Superannuation Trustees.

5 **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  
10 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  
15 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.  
20

25 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.

30 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.  
35

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.  
40

5 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.

10 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.

15 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.

20 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.

25 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.

35 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.

45 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.

5           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  
10 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,  
15 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  
20 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  
25 – 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  
30 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  
35 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.

40  
          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  
45 weeded out?



5 **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.

10 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.

15 **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.

20 **MS SCHEERLINCK:** You're talking about the Fair Work Commission process?

25 **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.

30 **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.

35 I think that that would be a reasonable thing to do.

**MS SCHEERLINCK:** Can I just – sorry.

40 **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.

5     **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.

10    **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  
15    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?

20    **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.

25    **MS CHESTER:** So it goes back to your good point earlier, that you want to encourage engagement.

**MS SCHEERLINCK:** Engagement.

30    **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.

35    **MS SCHEERLINCK:** Yes.

**MS CHESTER:** So what do you think needs to change to create a way for members to be more engaged?

40    **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.

45    **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.

5           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.

10           **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?

20           **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.

25           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.

30           **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.

40           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?

5     **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  
10    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.

15           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.

20           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  
25    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  
30    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  
35    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.

40     **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  
45    default.

5 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".

10 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.

15 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.

25 **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.

30 **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.

40 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.

45

5 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?

10 **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  
15 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.

20 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.

25 **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.

30 **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.

35 **MS CHESTER:** I think that world has moved on. Let’s turn to - - -

**MS SCHEERLINCK:** There are still some trusted financial advisors.

40 **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.

5 **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.

15 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.

20 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?

25 **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.

30 **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.

40 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?

45 **MS MacRAE:** Implies cost for employers.

**MS GOODWIN:** Yes. So we were here and we will address those issues in our submission.

5 **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?

25 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 - - -

10 **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.

20 **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.

30 **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.

40 **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.

45 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.

5 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.

10 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.

20 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.

30 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.

35 **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.

40 **MS CHESTER:** I think it does matter who makes it, Eva, because you want it to be - - -

45 **MS SCHEERLINCK:** To give trust.

5 **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.

10 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.

15 **MS SCHEERLINCK:** Sure, yes.

20 **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.

25 **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?

30 **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.

40 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.

5 **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  
10 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  
15 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  
25 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.

30 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,  
35 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  
40 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,  
45 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.

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**MR MASSON:** Rod Masson from Cbus.

**MS CAMPO:** Robbie Campo, Cbus Super Fund.

10 **MR RIDLEY:** Tim Ridley from Cbus.

**MS CHESTER:** Thank you.

15 **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  
20 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  
25 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  
30 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.

35 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.

40

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.

5

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.

10  
15 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  
20 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  
25 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.

30 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  
35 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.

40 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.

45

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.

5

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.

10

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.

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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.

25

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.

30

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.

35

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.

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**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

45



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.

5 **MS CAMPO:** Yes.

10 **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.

15 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?

20 **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 - - -

25 **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.

30 **MS CAMPO:** Yes.

**MS CHESTER:** What percentage of your workforce is on the 30th floor with nothing around them?

35 **MS CAMPO:** So we think it's around the 70 per cent mark are in the blue collar component of - - -

40 **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?

45 **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 - - -

5

**MS CHESTER:** Is the exclusion because the insurer just won't underwrite it across a pool?

**MS CAMPO:** Yes.

10

**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?

15

**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.

20

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.

25

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.

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**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?

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**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

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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.

5     **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  
10    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.

15    **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  
20    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  
25    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  
30    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  
35    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  
40    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.

45

5 **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.

10 **MS CAMPO:** But a very common transition. So we have quite a significant portion of our members who are also our employers.

15 **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 - - -

20 **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 - - -

30 **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?

35 **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.

40 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.

45 **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.

5 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.

10 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.

15 **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  
20 - - -

**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  
25 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 - - -

30 **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.

35 **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  
40 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  
45 pricing the group policies at the moment.

**MS CAMPO:** Yes.

**MS CHESTER:** Yes, that would be helpful.

5

**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.

10

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.

15

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.

20

25

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.

30

35

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.

40

**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

45

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.

5           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  
10 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  
15 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.

20           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  
25 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.

30           **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.

35           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  
40 balance outcomes through the simulations using a Stochastic approach but also using an historic approach as well.

45           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.

5

**MS CHESTER:** Happy to take the growth off the table.

**MR RIDLEY:** Yes.

10 **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  
15 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  
20 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  
25 have quite a long investment horizon once you retire.

**MS CHESTER:** Yes, and once you've de-risked, people don't up-risk again.

30 **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  
35 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  
40 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?  
45

**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.

5

**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.

10

**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.

30

**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.

40

**MR MINIFIE:** Yes, my name's Jim Minifie, I'm with the Grattan Institute.

5 **MS CHESTER:** Jim, did you want to make some opening remarks then we'll get into a bit of a discussion?

10 **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.

15 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.

20 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.

30 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.

35 **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.

40 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.

5           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.

10           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  
15           the last couple of days observations on dimensions on which this might have unintended consequence, and I think those are worthy of additional attention.

20           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.

25           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.  
30           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.

35           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.

40           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.

45           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.

5 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.

10 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.

20 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.

30 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.

40 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.

45 **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.

5        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.

10       **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  
15       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.

20       **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.

25       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.

30       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  
35       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.

40       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.

45



5 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 - - -

10 **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.

15 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.

20 **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.

25 **MR MINIFIE:** Yes.

30 **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?

35 **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.

40 **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.

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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.

5 **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.

15 **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?

20 **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.

30 **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.

35 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.

40 **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.

45 **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 - - -

5 **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.

10 **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.

15 **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.

20 **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.

25 **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.

30 **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.

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40 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.

5 **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.

10 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.

15 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?

20 **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.

25 **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.

30 **MS MacRAE:** Sort of why not.

35 **MS CHESTER:** Yes.

40 **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?

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**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.

5 **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]**

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## **RESUMED**

**[1.19 pm]**

15 **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.

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**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.

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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.

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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".

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Noting that it is difficult for individual consumers to represent themselves, the Commission also said there was a "case for increased public

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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.

5 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.

10 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.

15 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.

20 **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.

25 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?

30 **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?

5 **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.

10 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.

20 **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.

25 **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?

30 **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.

40 **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?

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**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 - - -

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**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.

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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.

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**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.

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**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.

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**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

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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.

5 **MR BRODY:** Yes.

10 **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  
15 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  
20 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.

20 **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?

25 **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-  
30 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.

35 **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.

40 **MS MacRAE:** Okay.

**MR BRODY:** Thank you very much.

45 **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]**

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**RESUMED**

**[1.47 pm]**

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**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.

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**MR MITCHELL:** My name's Joseph Mitchell. I'm the Workers Capital organising officer at the ACTU.

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**MR CLARKE:** Trevor Clarke, I'm the director of Industrial and Legal at the ACTU.

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**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.

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The inquiry recommends a complete overhaul 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.

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5 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.

10 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.

20 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.

25 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.

40 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.

45 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

5 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.

10 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.

15 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.

30 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.

35 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.

45 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  
5 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  
10 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  
15 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  
20 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  
25 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  
30 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  
35 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  
40 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.  
45

5 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.

10 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  
15 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.

20 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.  
25 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  
30 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.

35 **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  
40 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.

45

**MR CLARKE:** Yes.

5 **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.

10 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.

20 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 see why we view that the entrenched underperformance is like Jersey agnostic, it occurs across all segments of the system.

30 **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 - - -

35 **MS CHESTER:** Yes.

**MR MITCHELL:** What was the question? Is that the question you were asking or?

40 **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.

45

**MS CHESTER:** That's access. We're talking about the existing ones in there, how are they removed?

5 **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?

10 **MS CHESTER:** Yes, yes. Just talk us through how that would work and what evidence base the FWC would look at in doing that?

15 **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?

20 **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?

25 **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.

30  
35 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  
40 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?

45

**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,  
5 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,  
10 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  
15 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?

5 **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.

10 **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.

15 **MR CLARKE:** Yes.

**MS CHESTER:** Assuming that that's the case, then it's just a matter of who should decide best in show.

20 **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?

25 **MS CHESTER:** But you're talking two and 15 per award.

**MR CLARKE:** That's right.

30 **MS CHESTER:** We're talking 10 for the default segment.

**MR CLARKE:** Yes.

35 **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.

40 **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.  
5 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  
10 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  
15 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  
20 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  
25 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  
30 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  
35 issue of accountability to government of the day because the superannuation system is people saving at compulsion of government.

**MR CLARKE:** Yes.

40 **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  
45 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.

20 **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 we've got entrenched underperformance and it's in all segments, albeit more concentrated in the retail segment, particularly in the choice segment.

25 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 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.

35 So how do we stop unintended multiple accounts from occurring? We've come up with default once, unless you choose to move somewhere 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.

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**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.

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**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.

15

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**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 - - -

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**MR MITCHELL:** Yes, that's right. So there's various financial education programs that each fund offers.

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**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.

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**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

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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.

5

**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?

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**MR MITCHELL:** I couldn't answer that. I don't have those statistics around.

20

**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?

25

**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.

30

**MS CHESTER:** Do you want to share the metrics with us?

**MR MITCHELL:** No, I don't. I don't have them with me.

35

**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.

40

**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?

45

**MS CHESTER:** I can't recall off the top of my head.

**MR CLAUDE:** Yes.

5 **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  
10 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  
15 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.

20 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.

25 **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  
30 segment and SMSF?

**MR MITCHELL:** No, I don't think that's how I categorised it. To all workers.

35 **MS CHESTER:** Yes.

**MR MITCHELL:** So those who are non – what was the term I used?

40 **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.

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**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.

15 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  
20 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?

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**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.

30 **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  
35 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  
40 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.

5 **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.

10 **MS CHESTER:** So you distinguish underperformance base then on the governance model of the fund, whether it's for profit or not for profit?

15 **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.

20 **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?

25 **MS CHESTER:** No, that they should be held accountable as well.

**MR MITCHELL:** Well all trustees are accountable for their performance in superannuation.

30 **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.

35 **MR MITCHELL:** Yes.

40 **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?

45 **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.

5 **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  
10 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  
15 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.

20 **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  
25 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.  
30

**MS CHESTER:** Well, these are their representative bodies, so ACI and COSCO is it?

35 **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  
40 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  
45 or whatever. They would still be the one that had to make that choice.

5 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".

10 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.

15 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  
20 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  
25 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?

30 **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  
35 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.

40 **MR MITCHELL:** Yes, yes.

**MS MacRAE:** The employer is not involved any more in making that choice.  
45

- 5 **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.
- 10 **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.
- 15 **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 - - -
- 20 **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
- 25 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).
- 30 **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.
- 35 **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".
- 40 **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
- 45 job entrant and we make it simpler and safer by a top performing fund.

**MR CLARKE:** Yes.

5 **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.

10 **MR CLARKE:** Yes.

15 **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  
20 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.

25 **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 - - -

30 **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?

35 **MS CHESTER:** No.

**MS MacRAE:** No.

40 **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.

45 **MS CHESTER:** Which, we don't have those protections in play today.

5       **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.

10       **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  
15       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  
20       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  
25       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.

30       **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  
35       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  
40       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.

45       **MS CHESTER:** Okay.

**MR MITCHELL:** Thanks so much.

**MS MacRAE:** Thank you very much.

5

**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 of 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.

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**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.

15

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.

20

25

What's proposed here is significant and it affects us significantly, because not one of 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.

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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

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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,  
5 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  
10 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.

15 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  
20 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.

25 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  
30 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  
35 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?  
40

**MR CERCHE:** Yes.

**MS MacRAE:** Yes.

45 **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 - - -
- 5 **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.
- 10 **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.
- 15 **MR CERCHE:** We're 50 billion under - and we've got 274,000 accounts.
- MS CHESTER:** So how many corporate funds are left?
- 20 **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.
- 25 **MS CHESTER:** No, no, that's fine.
- MR CERCHE:** Yes. I don't know how many of those there are. There's many.
- 30 **MS CHESTER:** So you don't represent them?
- MR CERCHE:** Some we do, some we don't.
- 35 **MS CHESTER:** So how many are your membership?
- MR CERCHE:** Thirty one.
- 40 **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?
- 5 **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?
- 10 **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.
- 15 **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.
- 20 **MS CHESTER:** Why is that?
- MR CERCHE:** Because we're not public offer. Only employees of our organisations can become members of our funds.
- 25 **MS CHESTER:** So do your fund's products have MySuper authorisation at the moment?
- MR CERCHE:** Of course.
- 30 **MS CHESTER:** So we're not proposing anything that would lose your MySuper authorisation?
- MR CERCHE:** No.
- 35 **MS CHESTER:** So how are we dealing you out of the system?
- MR CERCHE:** We can't be a default fund.
- 40 **MS CHESTER:** Sorry, if you're a?
- MR CERCHE:** Your list will - - -
- 45 **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.

5

**MR CERCHE:** Yes, well, we would be that.

**MS CHESTER:** Yes. So how are we then dealing you out of the system?

10 **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.

15 **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.

25

**MR CERCHE:** A new employee to us, if they want onto your list, they wouldn't see us.

**MS CHESTER:** Yes, they would.

30

**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".

35

**MR CERCHE:** So do you think our members would go to other than the top fund?

40

**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.

45

- MR CERCHE:** Yes, in the top segment. But we wouldn't be on that list.
- 5 **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.
- 10 **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.
- 15 **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
- 20 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
- 25 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
- 30 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
- 35 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.
- 40 **MS MacRAE:** Why can't they choose you though?
- MR CERCHE:** Only our employees can choose us.

5 **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.

10 **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".

15 **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.

20 **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  
25 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?

30 **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,  
35 Mark.

**MR CERCHE:** Well, with respect, I don't think so. Now if we take the -  
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40 **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.

45 **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.

5       **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.

10       **MS CHESTER:** Sorry?

15       **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.

20       **MS MacRAE:** So would it - - -

**MS CHESTER:** If we could – sorry.

25       **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.

30       **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  
35       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  
40       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?

45       **MS CHESTER:** No.

- 5       **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 - - -
- 10       **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.
- 15       **MR CERCHE:** Well, what about the insurance issue?
- MS MacRAE:** Sorry, can you just - - -
- 20       **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.
- 25       **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
- 30       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?
- 35       **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 - - -
- 40       **MR CERCHE:** I would draw 17 per cent and - rather than – Unisuper (indistinct words) 17 - - -
- 45       **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”.

5 **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.

10 **MR CERCHE:** I better talk to Mr Barrett, I’m sure he’s - - -

**MS CHESTER:** No, not that he’d - - -

15 **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?

20 **MR CERCHE:** About six. UniSuper is one, Maritime Super is another, off the top of my head, along the public sector fund.

25 **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.

30 **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.

35 **MR CERCHE:** You probably don’t, but do you want to know my thoughts about what you’re proposing?

**MS MacRAE:** Sure.

40 **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  
45 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.

5       **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 - - -

10

**MR CERCHE:** Never had it before though you haven't. People don't switch very often.

15       **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.

20       **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.

25       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,

30       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

35       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

40       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.

5 **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  
10 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  
15 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.

20  
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  
25 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.

30 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.

35 **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  
40 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?  
45

**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.

5

**MS CHESTER:** I'll catch you in a moment.

**MR CERCHE:** Thank you.

10 **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.

15

**ADJOURNED** [3.02 pm]

20

**RESUMED** [3.18 pm]

25 **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.

30 **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  
35 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.

40 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.  
45 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.

5       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  
10       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  
15       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  
20       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  
25       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,  
30       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  
35       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.  
40       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  
45       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.

10        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  
15        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  
20        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  
25        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.

30        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  
35        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.

40        **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  
45        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.

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**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.

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**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.

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**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?

30

35

**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.

40

45

5 **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, analysts, 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 murkyed 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.

15 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?

20 **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

25 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.

30 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

35 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.

40 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

45 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.

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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.

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**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.

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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 - - -

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**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.

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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.

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**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

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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?

5 **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  
10 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.

15 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  
20 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.

25 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.

30 **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  
35 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.

40 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  
45 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.

5

**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.

5       **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.

10       **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.

15       **MR O'CONNOR:** Sure.

**MS CHESTER:** Can we leave you with all that wonderful homework?

20       **MR O'CONNOR:** Yes, sure.

**MS CHESTER:** This is the part that we like. But I think you can actually really help us here.

25       **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.

30       **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.

35       **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?

40       **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

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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, see 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?

5     **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  
10     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  
15     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.

15     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  
20     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  
25     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  
35     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  
40     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.

45

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?

5     **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  
10     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.

15     **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  
20     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.

25     **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  
30     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  
35     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?

40     **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  
45     member to leave or come in. So that's the challenge. But in saying that if



5 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.

10 **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?

15 **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.

20 **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?

25 **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  
30 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  
35 mixed up.

40 **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?

45 **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.

5     **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 - - -

10     **MS MacRAE:** Eighteen per cent.

15     **MS CHESTER:** Coverage of the assets in the choice segment with long-term investment returns.

20     **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.

25     **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?

30     **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.

35     **MS MacRAE:** Do you use the existing MySuper dashboards at all or do you find they're - - -

40     **MR MacLEOD:** Yes, we link through to the dashboards and the PDSs of

funds.

5 **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?

15 **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.

20  
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.

25  
**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?

40  
**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.

5       **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.

10       **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.

15       **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.

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**MATTER ADJOURNED AT 4.03 PM UNTIL  
FRIDAY, 22 JUNE 2018 AT 1 PM**