



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

**INQUIRY INTO SUPERANNUATION: ASSESSING EFFICIENCY
AND COMPETITIVENESS**

MS K CHESTER, Deputy Chair
MS A MacRAE, Commissioner

TRANSCRIPT OF PROCEEDINGS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

45

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

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

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

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

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

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

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

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

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

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

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

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

Finally, we encourage the Productivity Commission to explore options to give consumers a greater voice in debates about the superannuation system. The superannuation system, as you know, covers
25 15 million Australians who collectively own 2.6 trillion in assets. We believe we need an independent and well-funded body that represents the interests of superannuation members. While Choice does our best to represent consumers in this industry, particularly in industry regulatory and legislative debates about superannuation, we're currently only able to devote half the time of one policy adviser to this sector.

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

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

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

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

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

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

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

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

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

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

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

25
MS MacRAE: Can I just ask you then about the dashboards, because it is something where we've made a specific recommendation, do you feel that the idea or the concept that we have of a one page dashboard for all products is achievable and what sort of timeframe do you think is realistic
30 to allow for member testing and then to have this sort of information available for consumers?

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

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

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

10

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

20

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

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

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

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

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

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

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

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

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

5

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

10

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

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

25

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

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

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45

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

10 **MS TURNER:** Yes.

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

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

25 **MS CHESTER:** Okay. Have you got any questions?

MS MacRAE: No.

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

MS TURNER: I think that's it.

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

MS TURNER: Will be working very hard on it.

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

MS TURNER: Thank you.

45 **MR VEYRET:** Thank you.

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

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

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

20 **MS HOORWEG:** And Carla Hoorweg, also from Challenger.

MS CHESTER: Thank you.

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

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

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

success than building it up in the first place.

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

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

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

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

phase at the moment.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR COOPER: Preclude, yes - - -

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR COOPER: Yes.

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

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

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

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

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

5 **MR COOPER:** It might. I mean - - -

MS CHESTER: Best in show and elevated MySuper.

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

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

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

20 **MS CHESTER:** The needs of members.

MR COOPER: The needs of members, yes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

15 **MR COOPER:** The Bernie Fraser quote?

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

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

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

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

45 **MR COOPER:** Certainly.

MS CHESTER: Thanks, very much.

MS MacRAE: Thank you.

5 **MR COOPER:** Pleasure.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MS MacRAE: Better off overall.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25

MS CHESTER: Okay, yes.

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

30

MS CHESTER: Okay.

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

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MR GEE: I do.

MS MacRAE: Yes?

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

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

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

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

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

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

35 **MS CHESTER:** Okay.

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

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

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MS CHESTER: And when you mentioned that if we took out the under 25s the premium of the broader pool would go up by 26 per cent, if we were to go down your route of going for - or the route that's been considered of having a very sort of low cost vanilla product for the under 10 25s of 30, 40 bucks a year, what then would be the premium increase?

MR GEE: We're still in the process of modelling that. The view is that the impact is minimal. The challenge you have is moving younger lives out of the pool effectively increases the risk of the pool in its entirety. So 15 there is some issues around that it's more the shape of the group insurance pool.

MS CHESTER: Okay. And you're going to give us all this wonderful information in a post draft report submission, Adam, in a couple of 20 weeks?

MR GEE: Yes.

MS CHESTER: That would be fantastic. The other little culprit that we 25 found in insurance that bedevilled us was income protection. Are you going to provide us with some guidance on what we should be doing around income protection given that it seemed to be the chief culprit of zombie policies and all the rest of it?

MR GEE: Look, yes, we have done some modelling around income 30 protection. There are some challenges and our view is that income protection is a great benefit for members when they use it. It also provides the ability for members to be rehabilitated over the course of a certain period rather than paying a lump sum just have a benefit where 35 members could potentially return to work at a later date. The challenge with income protection is it's expensive and it does erode accounts, but it provides a strong benefit for those members that do need it, albeit we recognise there are some zombie policies in existence. So we're more than happy to provide some information on that.

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

MR GEE: Yes. Yes, we can put some - we've done some modelling on 45 that one as well.

MS CHESTER: Excellent.

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

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

Are they all the questions that you have?

15 **MS MacRAE:** Yes.

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

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

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

MR GEE: Sure.

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

MR GEE: Thank you.

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

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ADJOURNED

[9.42 am]

15

RESUMED

[9.49 am]

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

MR RICE: Thank you. Michael Rice.

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MR JENKINS: And Tim Jenkins from Rice Warner.

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

MS CHESTER: Right, thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

30 **MR JENKINS:** Actually, can I - - -

MR RICE: Yes.

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

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

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

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

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

MR JENKINS: On entering the workforce.

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

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

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

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

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

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

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

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

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

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

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

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

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

MR JENKINS: True.

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

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

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

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

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

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

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

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

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

5

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

15

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

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

25

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

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

45

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

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

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

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

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

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

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

25 **MS MacRAE:** Yes.

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

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

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

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

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

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

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

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

MySuper authorisation.

MS MacRAE: Yes.

5 **MR RICE:** Yes.

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

10 **MS MacRAE:** Let's go to insurance.

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

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

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

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

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

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

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

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

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

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

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

MR RICE: Yes.

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

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

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

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

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

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

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

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

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

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

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

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

35 **MR JENKINS:** Yes.

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

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

50 **MS CHESTER:** Yes.

55 **MS MacRAE:** We're already in time.

60 **MS CHESTER:** Are we?

MS MacRAE: Yes.

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

5

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

MS CHESTER: You go first.

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

25

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

30

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

MR JENKINS: Correct.

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

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

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

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

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

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

25 **MR RICE:** Yes.

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

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

MS CHESTER: And I guess we then need to distinguish offering extra benefits on top of their in a top performing fund as opposed to offering extra benefits on an underperforming or an average performing fund - - -
40

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

MS CHESTER: Yes.

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

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

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

MR JENKINS: Yes.

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

MR JENKINS: Sure, yes.

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

MR JENKINS: Yes.

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

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

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

MR RICE: Okay.

35 **MR JENKINS:** Thank you.

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

MS MacRAE: Thank you.

40 **MS CHESTER:** And sorry for my misinterpretation earlier today.

MR JENKINS: No problems at all.

45 **MR RICE:** That's all right.

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

5

ADJOURNED

[10.25 am]

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RESUMED

[10.43 am]

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

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

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

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

40

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

45

and then how that trickles through to member harm.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

45

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

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

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

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

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

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

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

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

MR BERRILL: Who, sorry?

15 **MS CHESTER:** The new Financial Ombudsman Service.

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

20 **MS CHESTER:** I haven't worked on this directly, but my understanding is that new enhanced role, that is meant to cover super. So if people haven't gotten what they're expecting to get through super, they actually have the role of assessing the case and making sure that compensation or -
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25 **MR BERRILL:** But that's against the superannuation fund. So there must be an FSP, a superannuation fund that you're complaining about who's complaining against the employer.

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

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

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

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

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

5

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

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

20

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

MR BERRILL: Back four years.

25

MS CHESTER: If that were extended to insurance?

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

35

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

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

MR BERRILL: I do.

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

are.

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

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

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

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

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

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

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

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

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

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

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

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

15
MS CHESTER: I think the other vehicle that we can use, John, that we identified in the draft report is the insurance code was a bit underwhelming for us, particularly when we looked at what it appeared to be at the beginning and where it got to in the end. So we say that we want ASIC and APRA as confident pro-member regulators to sort it out, elevate it, bolster it, make it enforceable. In that context, I think in our draft report, we’ll probably have some things to say about areas where we want it to be enhanced, the code, and talking about of comparability of entitlements or the policies. I think that would be the avenue as opposed to best in show for us to pursue better design of insurance within super.

20
MR BERRILL: I suppose there’s design and design, isn’t there? If you’re looking at sort of minimum standards you could look at the issue around income protection, whether it be a two-year benefit or not. But if you’re looking at the sort of more detailed analysis such as standard definitions which you raise in the draft report, yes, that’s better dealt with in – and that is dealt with – sorry, it’s not actually dealt with in the code of practice.

35 **MS CHESTER:** Not now, yes.

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

45

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

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

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

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

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

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

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

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

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

MR BERRILL: Yes.

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

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

30 **MR BERRILL:** Yes, I will.

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

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

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

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

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

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

MR BERRILL: Yes.

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

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

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

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

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

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

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

MR BERRILL: It will.

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

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

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

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

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

MR BERRILL: You will.

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

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

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

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

5 **MS MacRAE:** Yes, thank you.

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

MR BERRILL: Thank you.

10

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

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

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

30

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

40

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

45

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We kind of focused on the approaching retirement and post-retirement phase as making sure that funds do have tailored products to meet their members' needs. For many members that might be the point in which financial advice, particularly if they're going into CIPR product, might be appropriate. We had some evidence this morning suggesting that that might not well be needed. It's just if you get the My CIPR product right, then it's steady sailing. It'd be good to get your thoughts around that because that's also going to feed back into what guidance an expert panel might need to look at when deciding on a best in show.
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PROF BATEMAN: I had trouble with the CIPR proposal from the very beginning that there would be one product which was appropriate for a fund membership because we know that people are so much different at retirement than when they start work. There's a lot of difference in background, financial assets, in home ownership, in household makeup. A whole range of things are different when people reach retirement. There's no reason these days when we've had choice of fund that people in a particular fund are going to be homogenous. So I had a lot of trouble with that from the very beginning.
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We also know from work that we've done and many other people have done that people stick with defaults. If you set a default, the odds are that 80 per cent of people are going to stick to it, whether it's appropriate for them or not. There's a whole range of reasons for that. I mean, a lot of them stick to it because they just procrastinate. But people stick to it because they think it's a recommendation that that's what they should be doing. So I had problems with the single CIPR.

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

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

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

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

moment?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

40
MS CHESTER: Just two thoughts there. One is we're not suggesting the way this is done is a set and forget. Given the size that the system is going to move to in the next 15 years, the government might want to revisit the parameters of the best in show. But we're still mindful that it's
45 making choice simpler and safer for members that's still the driving

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

45

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

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

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

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

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

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

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

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

MS CHESTER: Great. Thanks, Geoff.

ASSOC PROF WARREN: I have to now.

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

around life cycling in the report, Geoff?

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

MS CHESTER: Yes.

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

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

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

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

40 **ASSOC PROF WARREN:** Okay, yes.

MS CHESTER: That'd be great.

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

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

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

MS CHESTER: Thanks again for coming today.

10 **MS MacRAE:** Thank you.

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

15

LUNCHEON ADJOURNMENT **[12.30 pm]**

20 **RESUMED** **[1.25 pm]**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

45

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

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

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

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

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

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

45

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

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

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

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

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

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

MS CHESTER: Yes.

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

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

10 Whereas if there is misconduct and misdeeds, that’s kind of like ASIC as the market conduct regulator, are there egregiously bad products, is there a clear breach of trustee duties of the directors. But it seems at the moment that APRA’s got a foot in both camps, ASIC’s kind of missing in action, and they’re the first to say that they want to do more in this area.

15 What would be the principal base clearer delineation in your mind between what APRA should be doing in superannuation and what ASIC should be doing?

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

20 then go to Parliament and become the law.

 But they do so not primarily as lawyers but as financial regulators, and often that’s finance economists or actuaries and so on. What you end up having then is you end up having rules that don’t fit well and are not

30 terribly easily enforced, because they’re drafted by people who aren’t lawyers, who aren’t experienced in seeing how all these things fit together and what you need to do in order to be able to mount a case in Court.

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

35 ambiguous or whatever.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

40 **DR DONALD:** Thank you very much for you time.

MS CHESTER: Terrific, thanks, Scott.

MS MacRAE: Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PROF HANRAHAN: Yes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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MS CHESTER: What needs to change?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

very close to consumer sentiment.

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

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

15 **PROF HANRAHAN:** All right.

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

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

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

40 **PROF HANRAHAN:** Indeed.

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

45 **PROF HANRAHAN:** Thank you.

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

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

MS CHESTER: This is collusive conduct.

15 **DR LIU:** Yes. I think my first comment is related to the fund governance. I'm going to make a comment on the independent director requirements or the fundees, 9.2. I think my research suggests that it's consistent with my colleague, Scott Donald's finding as well. There's no consensus in the economic literature regarding the value of independent director theoretically and there's no consensus empirically on the performance implication of having more independent directors. Basically, 20 if you're looking at the academic literature you will find that it doesn't matter it's in the public listing companies, mutual fund or pension fund, probably equal number of people argue for and against having more independent directors.

25 On the theoretical side some people argue having more independent directors will add value because the independent directors are more likely to be effective monitors, monitor the company management because of their independent status. However, the equal number of papers of authors argue the other way around. They say their interests are more aligned not 30 with the shareholders or fund members but aligned with interest of the director of the fund management, people who appoint them on the board in the first place.

35 Theoretically there's no consensus on the value and empirically if you're looking at the value-add, whether having more independent directors will help a firm to improve the performance or have a fund to improve their returns there's mixed results. Actually in the literature at the moment if we're looking at mutual funds and super funds, what we find what matters is not the lack of independent directors but the presence of affiliated 40 directors. So when we say affiliated directors we mean the directors of affiliated that fund service providers.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

10

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

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

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

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

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

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

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

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

10
DR LIU: I think in an ideal world we'd prefer to have a board that have both. They're competent, they have expertise but also act in the members' best interests. In practice, as the literature recognised, especially in the pension space, sometimes you do have this bit of trade-off. If you want to
15 have people who represent members those people don't necessarily have the investment expertise. That has something to do why we distinguish DB and DC funds. The literature suggests that in the DB world because you have the employer sponsors bears the ultimate risk and they're the people who actually have strong incentives and to actually appoint people
20 on the board to try to achieve that target.

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

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

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

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

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

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

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

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

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

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

DR LIU: In an ideal world, yes.

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

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

MS CHESTER: Who do you see making those rules?

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

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

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

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

15 **MS CHESTER:** You want two expert panels. You want one expert panel to set the criteria and then another expert panel to come in and implement the criteria.

20 **DR LIU:** Yes, they make decisions based on the criteria. I think the criteria development function can be an ongoing thing rather than we have it every four years. That can ensure consistency of the policy making.

25 **MS CHESTER:** Kevin, that was great. Is there anything else that you wanted to cover that we haven't gotten through?

30 **DR LIU:** No.

35 **MS CHESTER:** Thank you. The three buckets are really helpful to work through.

40 **DR LIU:** Thank you for your time.

45 **MS MacRAE:** Thanks, Kevin.

50 **MS CHESTER:** I'd like to invite our next inquiry participant for the hearings. It'd be great if you could join us.

55 **MR GROZIER:** Thank you very much. I'm Dick Grozier, Associate Director of Workplace Relations for the Australian Chamber of Commerce and Industry. Thank you very much for giving me the opportunity to consult with you today. I'd like to make a brief opening statement, if I could. Partly I thought it was important to deal with why we're here and what our interest in the superannuation system is because we're not a regular player and we're probably a bit of a discontinuity from at least the last two witnesses.

60 Our interest is on the employer experience of the superannuation system. In our view, employers play a fairly key role in the system,

although that's not always recognised. They're certainly not always recognised as part of it. They obviously have an immediate interest in the administrative and expenditure burden which is imposed on them by the superannuation system and in their interactions with funds, regulators and transaction system service providers. But they also have a clear interest in the system's overall efficiency, an interest we believe is shared with employees or fund members.

Whilst a number of the Commission's draft report findings and recommendations attract the Chamber's attention, perhaps the most significant from the employers' point of view are those directed towards default allocation. Under the current system employer default allocation is the way to give the employer somewhere to make contributions for default fund employees. Employees do need a fund to make contributions into. The current system requiring employer default fund allocation for each non-choosing new entrant employee supports unintended account proliferation and does nothing to support member engagement.

The current regulation of the range of possible defaults does not support beneficial competition for the market. Once-only default allocation and carry the fund, subject to employee choice, is now a technical possibility but it also calls the current regulated fund specification system into question. Carry the fund, subject to choice, also raises the prospect of contracting and lifting from employers the administration required by the current choice regime over time.

There's no systemic reason why an employer should choose a new employee's default fund but there are good systemic reasons why employers should not be doing this. Employer allocation risks conflicting principal age and interest. It creates an incentive for funds to market to employers rather than to members and it does nothing to support member engagement. Improving member engagement at its simplest, that is, being aware that you have a fund, like a TFN, and having a contact point for it, having it independently from the employer seems likely to at least support improved member engagement. It may also support improved timely contributions and assist with the early rectification of contribution errors.

MS MacRAE: Thanks very much, that's very helpful. We actually haven't heard much at all today from – haven't really talked at all about the role of employers. So if I might just confirm if I take from your opening statement that you see that employers would rather not be involved in the super system in the way that they currently are and that the Chamber would be supportive of the default option that the Commission has proposed in the draft report whereby the choice is made by the employee rather than the employer?

MR GROZIER: That's correct, Commissioner. There's not much recent evidence of which I'm aware, but certainly the studies around that 2009, 2010 – and I'm thinking mainly of the ones commissioned from Colmar Brunton – certainly indicated that – not all employers are the same obviously – but certainly indicated that the vast majority of employers were not well suited to allocation of employees into funds and were quite happy not to have the task. I think the research also fairly clearly indicated that where they made decisions they were not necessarily based on the employee's best interest even if the employer was in a sensible position to ascertain that.

MS MacRAE: Are you able to elaborate at all on the role of clearing houses in how the current administration arrangements work? Has that been helpful? Certainly from the take-up for the small business clearing house the ATO runs is well below the range that it could cover. I wondered if you could elaborate on that at all.

MR GROZIER: I think, Commissioner, in that question there's a bit of a point of time issue as well. I think with respect to the small business superannuation clearing house there was a profound initial reluctance and numbers of courses are attributed to that. The advent of SuperStream and its implications for small employers clearly significantly affected the numbers. Not so much the transfer from the Department of Human Services to the Australian Taxation Office but the change in security arrangements probably have had a detrimental effect on the carry through and I think is a reasonable part of the explanation for the relative decline in numbers.

My initial comment about point in time extends beyond the small business superannuation clearing house. I think particularly at the moment there is quite a lot of turmoil in the market and in decision. That's primarily coming from the implementation of Single Touch Payroll because although Single Touch Payroll on the face of it looks like the answer to many questions and up and running it will address a number of system errors, it also entails more change than was envisaged, for at least some employers, and certainly more costs than were envisaged. It is also leading to a redistribution of services across various service providers. So that if you were to look at the contribution of clearing houses at the moment it would probably be something of a different answer than it might have been two years ago.

MS MacRAE: Just in relation to the sort of centralised online service and the way that we've proposed that it might run, we have suggested that all employers and employees should be using electronic forms when

employees are first engaged. Do you see that as presenting any problems for particularly very small businesses?

5 **MR GROZIER:** If we look at SuperStream as some sort of analogy for the implementation, first of all, of Single Touch Payroll, because perhaps employees are slightly different – we have may to come back to that – it is clear that the residual part of SuperStream that isn't working is where there are businesses which don't have electronic payrolls or don't have access to the internet and things like that. So there is a small group of
10 employers for whom special arrangements are still being done with respect to SuperStream.

 In the introduction of Single Touch Payroll, that has been recognised and the designers of Single Touch Payroll are looking at solutions to try to
15 address the issue of people who do not have digital payroll systems and therefore don't have a system at the moment which is all that amenable to the hopefully light touch of Single Touch Payroll over the top of it. amenable to the hopefully light touch of Single Touch Payroll over the top of it. With respect to employees, there will be a great diversity. Clearly
20 there's a generational component to that as well. But there's no doubt that phone apps have taken on something of a life of their own. Whilst a government-run system like MyGov may not be the universal solution to an online databank of employee information or citizen information which can be released by that citizen whenever is appropriate, it would seem that
25 we are moving to an era wherefore a vast majority of people that seems to be an option.

MS MacRAE: By and large, having all of the superannuation – the work being done through an electronic sort of system would, you think, by and
30 large, suit most employers, be a preference to doing paper forms?

MR GROZIER: “Most” is a bit of a tricky word. There clearly are people – and there may be a small business on the side for whom the shoebox is still the filing system of choice. But I think it is fairly clear
35 that is reducing in scale and it's fairly clear that few younger people think in those sorts of ways. Can you get a hundred per cent? No. Are the percentages of people for whom an electronic solution is unviable? Is it static? No, I think it is declining.

40 **MS MacRAE:** Just one other issue which we raised only sort of tangentially in the report but it's come up a little bit in some of our discussions today. In relation to one of the issues that I know have been of concern to employers for quite some years is how many people are in the system and the small contributions that might be made in respect of
45 employees who might be casual and only very short term. So the

threshold that applies that brings people into the system currently \$450 a month – and it's been there since the introduction of the SG, so it hasn't been indexed for 25 years. We do mention in the report that had that been indexed that threshold would be more like \$1000 today. If that was to
5 change, do you think that would make much of a difference to the compliance burden from employers and would it be a welcome measure?

MR GROZIER: By change you mean the index back to roughly - - -

10 **MS MacRAE:** If it was put up to say a thousand to catch up with the indexation that hasn't happened since introduction.

MR GROZIER: Clearly there would be some employers for whom that would be welcome. There certainly are parts of the labour market where
15 short one-off engagements are the norm and don't incur very much in the way of salary or wages. Yes, there's no particular reason why those types of engagements shouldn't continue. For the vast majority of employers I suppose it's a technical issue.

20 **MS MacRAE:** Thank you very much for coming today. I think we're now breaking for afternoon tea. Have I got that right?

MS CHESTER: We are. Let's make it a short one, if that's okay, folks, so we can all – thanks very much, Dick. I'm conscious some people have
25 flown to join us today. I'm not looking at that clock anymore because it's not right. Let's resume at 5 past 3. How does that sound? Great. Thank you.

30 **ADJOURNED** [2.52 pm]

RESUMED [3.07 pm]

35 **MS CHESTER:** Folks, we'll get underway. We're in the final stretch. Three more groups to hear from this afternoon. I'd like to welcome the folk that have joined us from AustralianSuper. Thank you for coming and being here today. If you'd just like to each respectively state your name
40 and organisation for the purpose of the transcript recording. Then if you'd like to have a few minutes of some opening remarks and then we'll get into a bit of a chat.

45 **MR WEATHERHEAD:** Thank you very much. My name is Richard Weatherhead, head of insurance at AustralianSuper.

MR BARKER: My name is Alistair Barker, head of portfolio construction at AustralianSuper.

5 **MR WEATHERHEAD:** I'll just say a few words, if I may, about insurance and just focusing on the areas of the report where we had some particular input to make to your deliberations. First of all, we are passionate believers in group insurance because we think it's good for our members. And I'll talk a little bit about why that is. As we know, the
10 payout ratios for insurance and super are around 80 per cent of premiums. That compares with about 50 per cent of premiums for retail business. That's out of a KPMG report for group insurance in super.

AustralianSuper works really hard to maintain appropriate and value-
15 for-money insurance for all its members. Importantly it aligns with our needs and insuring that their retirement outcomes are not compromised. I think that's quite rightly brought out in the retirement that the core purpose of super is retirement. We are very conscious of not wanting the insurance provision to eat unduly into the retirement balance. So I'll say a
20 few more words about that as I progress through.

We use a lot of data on members to determine our default levels of insurance. We draw on data from the ATO which actually does provide splits of the overall population by salary level, part-time, fulltime, marital
25 status, dependent children, et cetera. That's one key input. There is also independent research around housing costs, costs of raising children, et cetera. We look at that and we look at that for younger members, older members, low income earners in particular. We look also at social security benefits that are available through Centrelink because they're
30 essentially providing some of the insurance needs of our members in the event that the worst happened for them.

That all goes into the melting pot to determine what underlying needs are. Having looked at needs, we then look at member preferences. We do
35 a lot of member research into their attitudes towards insurance. In particular, I'll just highlight that part of that research has asked members about their preference for insurance, both before and after them understanding the costs involved and how it impacts on their retirement balance. And you do see slightly different results coming out and such
40 good gauge on the impact on knowing cost on member preferences. So we take that into account.

I can say that broadly for our current default scale the influence of member research has been very much less for younger members and
45 actually less for older members. The closer members are to retirement –

I'm talking here about 50 onwards – the preference towards “gee, I'm worried about my retirement balance” tends to dominate over the needs for insurance. So our default levels of cover are actually less at older ages than they would be purely by looking at needs.

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Finally, affordability – and this is the really important one – we have an insurance principal which is now actually aligned with the code of practice which is that the cost of insurance shouldn't absorb more than 1 per cent of salary over the member's lifetime in super. Our current default scale at current prices actually absorbs 0.66 per cent of salary. That gets to the heart of the purpose of super being retirement and insurance not unduly eroding those balances. That's the equation that we sort of go through, the three considerations; needs, preferences and affordability.

15 A few innovations. As you know, AustralianSuper has put into the market Super Only. That's very much addressing low income earners and, again, that rightly comes out as a theme in your draft report. Super Only is there now for eligible employers and there is an assessment as to whether those employers are funding employees who are genuinely low income earners and therefore no insurance is really the best for them. Having gone through that assessment, the employer is going to have Super Only, which means no insurance at all, no erosion of account balance at all for insurance. That's now in the market.

25 We have a rehabilitation service. In the last 12 months – this is linked with the income protection product – in the last 12 months we've rehabilitated 374 members back to the workforce through the rehab service which is linked to our insurance program. Finally, in May we actually implemented a streamlined opt-out process for members to simply click online and their insurance is gone. That's for those members for whom they say, “Despite AustralianSuper's best efforts to set the default program up for us, we don't want it, so we'll just click a button.”

35 I will, before I hand over to Alistair, wanted to focus on one area which we had some concerns about. That is the possibility of not having default opt-out income protection. We're passionate believers in default income protection. There are some statements that members are not getting a benefit when they've got multiple insurances. For AustralianSuper 0.4 per cent of our insurance benefits are not paid because the member has multiple insurances. What that's saying is that our members generally don't have income protection elsewhere.

45 VNow, that's AustralianSuper's sort of population, if you want to put it that way. That's not to say it's not the same in the broader market. But it is something we look at closely to make sure that we're not providing

insurance that has little or no value. Insurance for casual workers, again, we pay income protection to casual workers as well. There's been some accusations that doesn't happen. Members who are unemployed, we'll pay benefits for up to 12 months after they first become unemployed.

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I guess the reason for going through these points is that we believe the right thing to do is do detailed analysis of membership and needs and really look at individual groups and design products around it. We do, as I said, believe passionately in opt-out income protection. Indeed, income protection is more important than TPD. TPD will pay a lump sum benefit for those with an extreme disability. In other words, they can never work again. In fact, for those members there is now the NDIS which will take care of the provision of some support services for those with permanent disabilities, but not those who are temporarily disabled and can't work for a period of time. For them, they need income replacement, plus the payment of superannuation guarantee contributions that are not being paid because they're not employed.

So those are broadly my opening remarks. I wanted to just pause there and perhaps let Alistair say something about investment.

MS CHESTER: Thank you.

MR BARKER: My remarks are framed from the context of an investment practitioner's perspective. I'm responsible, along with Mark Delaney, our CIO, for advising our board and our investment committee on our default investment strategy which has just almost \$100 billion in member assets invested. I think what we're really interested in is what's the impact on members from how we design our investment program, but also how might investors like ourselves and other funds react to the potential reforms that have been put forward in your draft report.

I'll cover three specific things and then we'll run through some questions. First is around how we think about performance and cost assessment. Second is about how we think about benchmarks, which features quite strongly in your paper. Third is around lifecycle and retirement products. With respect to cost and performance assessment, we have two principles which we've taken all the way through to our board and investment committee. The first is the fund should be a strong performing fund in relative terms because otherwise members should go potentially into another fund. So if we're not providing competitive returns, it's an important issue for us.

The problem is that's not something we can invest in or look at because we cannot know the actions of other people in the marketplace.

So it's not useful for performance benchmarking purposes. What is more useful – and this is, I guess, at the heart of our profit for member focus – is that we have to ensure over time that we put more money into members' accounts than what we take out in investment costs. A key principle when we're thinking about benchmarking is if we're spending members' capital on investing in an infrastructure project or backing an external fund manager to do active stock selection or bringing internal a team to run say active asset allocation, all those decisions are framed with respect to what the potential return to members is and the potential value-add to members is, compared to what the cost is. So we link cost and performance benchmarking.

One key implication for that is that when we think about the draft report it seems to us that linking those two things net benefit is really at the heart of what we think is in members' best interest. Secondly, when we think about performance in that context using a benchmark then provides a fairly unbiased measure of whether or not your investment program has been successful. That can be judged without reference to necessarily a peer group. But what we do know is that there is a bit of persistence in the bottom part of performance across superannuation funds. That does exist. And it would exist more if some funds hadn't either dropped out of the survey or merged.

In some senses that persistence is a little understated. But what we do see is that persistence in the top half of the distribution tends to move around a bit. So trying to identify a top 10 is a little bit harder in the sense that funds can move around the top half of the distribution, depending on whether exactly what they're doing at the time works in the economic cycle. If you're in a period where, as we have been in the last nine or 10 years, of fairly strong investment markets in a very elongated economic cycle, funds that are positioned for that environment and falling interest rates would have done quite well.

It's very sensitive to both the time period that you're in but also the timeframe over which you measure performance. With respect to constructing benchmarks, we're a big believe in using benchmarks. It's important to be able to attribute performance. One thing we do make sure though is that we try and set a benchmark portfolio that is fairly stable over time. The key point about that is that we're trying to set a benchmark which gives us the best chance of meeting the long-term return objective for our members.

Our members are generally low to middle income and, as a result, growing their account balance and having a fairly strong bias towards growth – 70:30 portfolio in your draft paper is a good example of that – is

an important aspect of making sure that we deliver those long-term returns. But we then have a risk envelope that we try and operate within that's set by the board. So it's a risk appetite where ideally we are taking more risk when we are being well-rewarded and less risk when we think that markets are difficult and we're being maybe not as well-rewarded.

We think it's really important to have a benchmark but we can't be bound to it and we can't end up from an investment practitioner's perspective being too stuck on a particular asset allocation or a particular strategy because markets do move around and it's important to have a dynamic view. So when we think about benchmarking and when we reflect on the Commission's draft report we don't have too many issues with the broad concept of a benchmark portfolio. But we would try and keep it fairly simple and fairly constant over time.

The main concern I think we have is that not so much the benchmark itself but how that marries with the potential best in show model. Really, I think the interest for us is that the draft report refers to behavioural economics in respect of member preference, member choice, which is a really important aspect of an appropriate model. What interests me and what concerns us is how will the industry from a behavioural perspective react to a model where a potential top 10 is what everyone is clamouring to try and get in to?

When we look at examples in the funds management industry, say for example, a benchmark relative portfolio, say S&P 500 or the ASX 200, there's clear types of behaviour like herding or crowding or even alternatively a contra strategy where someone does something very different to a peer group to try and get into the sort of upper echelons of fund managers. Our concern is probably that the design of the system has to support really good investment decision-making.

As part of my job, I allocate out benchmarks and allocate out what each of our different portfolio managers are responsible for and how those are framed is absolutely critical to getting great investment outcomes. So we have to be very careful about setting appropriate timeframes, about giving people appropriate risk budgets and ensuring that there is actually some freedom to make investment decisions. Yes, there's accountability at the end of the day. But innovation comes from giving people both the licence to be able to make an investment decision but also the accountability that if it doesn't work out and it's measured over a reasonable timeframe.

Finally, just a couple of brief remarks on lifecycle and retirement product design. We've done a number of reviews. The first one was

immediately post-2009 of our default. We think the principles for lifecycle are fine, but their application in the industry has been very mixed and I think your draft report points out the fact that there has been a very, very mixed outcome. For us, wealth is really critical factor. Most of our members, over 99 per cent, get at least some form of government age pension and the majority of our members either retire with a full age pension or actually retire and actually take their savings from the fund as it stands.

Building their savings is important and, as a result, the bulk of their retirement income is coming from the government age pension. So our lifecycle approach leads to us de-risking very late in the piece. What we tend to find is that it doesn't compare to international experience because most people who are doing lifecycle strategies that de-risk very early are doing it because they're converging towards purchasing an annuity. In Australia the popularity of annuities is not phenomenal. People value flexibility. People value a number of the features of the existing account-based pension. So we have to be mindful that we're actually working towards a slightly different trajectory. It's even more the case for us given our membership.

But I don't think that necessarily results in us saying that lifecycle is a particularly flawed concept. There are a few funds in the country who have membership basis with very high account balances and those funds are responsible for delivering the bulk of someone's retirement income. They probably should think about their design in a slightly different way to what we have. That differentiation is something which the MySuper reforms helped. The problem is it's actually made it very difficult to compare, very difficult to understand. I think, going back to my original remarks around benchmarking, the need for benchmarking is about attribution and comparability, which is undeniable, and lifecycle can't be used as a way to hide that.

MS CHESTER: Thank you very much, Richard and Alistair, for what were very good opening remarks. I didn't intervene because a lot of things you were saying were areas we wanted to go get to with you. So I'm sort of working out what we need to talk about. But we do have quite a bit. So let's start maybe with investments first, then we might get to insurance, if that's okay. Alistair, the point you make about benchmarking is right. It's just about performance attribution analysis and we wanted to be able to do that across a system, agnostic of asset allocation, which is how people kick dust up in the air and say, "Well, our performance is less but we've got more risk off the table," and all the rest of it. That was the purpose of doing the portfolio benchmark.

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Going forward, it's not something that we would see as a tool for the best in show. The best in show is really about the long-term investment track record when you're looking at it from an investment perspective. That's at one level. Then it's about innovation. Then it's about understanding your members. Then it's about product design and accumulation in retirement. So we've got a whole page about what best in show would really be about which tries to address any of the perverse incentives that you've raised, which are real perverse incentives that could occur and we want to make sure that we address them.

One thing that would be really helpful for us if you were to have a look at the principles that we've suggested would guide the expert panel in doing best in show, if there's areas where we need to be more prescriptive to avoid any of those perverse incentives being created, that'd be great to get that feedback from you. Where we do see the portfolio benchmarks having a role to play going forward is under an elevated MySuper arrangement. So this is MySuper authorisation. Again, this is an area we'd love to get your feedback on.

We've got a scale test that really didn't work. We've got an elevated outcomes test that's now subject to new legislation and we're actually trying to put some more belts and braces around the elevated outcomes test. One addition – so it's not the key driver – would be in a going forward world for a fund that persistently underperformed their own portfolio benchmark over a five-year period by a modicum of 25 basis points, should they still get MySuper authorisation?

Our thinking there is elevated outcomes test should knock off a large part of the tale of woe. But then going forward you don't want it to reappear again. But we want to make sure that that's implemented in a way that you wouldn't knock out a good fund. So we're trying to think of circumstances where a good fund could persistently underperform for five years by 25 BIPS their portfolio benchmark that product. We'd love you to help us in a post-draft report submission identify any scenarios that you could think where a good fund might do that because we're not looking at pipping off a good fund. We're trying to do that as an insurance to stop a tail of underperformance regrowing.

MR BARKER: I think the comment you raise about timeframes is very critical. Your funds take a particular position based on where asset allocation is against what they might have as an average asset allocation at the time, then there has to be some flexibility for trustees to make that decision if they believe it's in members' best interests. If I can give you an example. If we're entering a period where we're almost 10 years since our last major fall in markets and certain trustees are already making

decisions about saying, “Well, I’d prefer to actually take some risk off the table,” in the interest of trying to protect members’ balances, then we need to be able to make sure they have the safe harbour of an appropriate timeframe. I think we would - - -

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MS CHESTER: But if they take that risk off the table, they’ve adjusted their strategic asset allocation and thus the benchmark adjusts with it, thus – for me, it merely takes SAA decision-making out of the equation. It’s like you’ve made your SAA, if you still get it wrong you still can’t at least get the market index with your SAA. There’s got to be something wrong with you as an investor.

MR BARKER: Potentially. What you’ll tend to find is that because persistence is fairly strong you might review performance every five years but whether the return timeframe you’re looking at is 10 years I think is the question. I think you could almost delink the timeframe over which you’re measuring performance and the frequency with which you need to actually look at those funds and challenge them. If you’re taking asset allocation off the table as far as that timeframe is concerned, sure, that’s one aspect.

MS CHESTER: I’ll let you have a think about it because I’ve thrown it out today without any warning. You can see what we’re trying to do. We don’t want the tail regrowing over time. We know that regulators perhaps aren’t as confident as we would like them to be in implementing scales and outcomes tests. So we thought that would lend a little bit of discipline.

MR BARKER: As I’ve sort of highlighted in my remarks, the challenge that regulators have is often the challenge that we have with our fund managers, which is where whichever benchmarks or measurement or incentives you set, the mind wanders to exactly what type of behaviour that will incentivise. We see it across the industry, across the fund management community, putting aside the superannuation community. I think we’re keen to make sure that some of the mistakes that we’ve seen over time and that academics refer to aren’t repeated in this process.

MS CHESTER: I think we can all agree to agree, particularly (indistinct) economists, that this is a system that’s incentives on steroids. Coming then to lifecycle – and I appreciate you have done a nuanced reading of what we’ve said about lifecycle in the report. We were very careful with what we said about lifecycle because there’s a range of ways that funds are implementing it. So it is a good, bad and ugly story. But you mentioned an international analogy, Alistair, when you said – and I want to make sure I’ve got this right.

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Where sequencing risk is its greatest at retirement, when someone's effectively doing a complete drawdown to buy an annuity and that's where you sort of want a de-risking to have occurred so they don't potentially crystallise large capital loss of (indistinct) market movements at that point in time. Is that right?

MR BARKER: In effect, yes. An annuity is primarily backed by – has a lot of backing with long-dated fixed interest investment. So if you're trying to purchase an annuity at the time the most sensitive factor is interest rates. If you are looking to buy an annuity you would be converging towards something where you're hedging that risk that interest rates move - - -

MS CHESTER: You're basically flipping your investment strategies so extraordinarily at one point in time you want to de-risk it as you do it.

MR BARKER: Yes, you do, but - - -

MS CHESTER: So you don't have markets working against you.

MR BARKER: Yes, correct. But the challenge with lifecycle is that, depending on how it's structured, what it does is just move the de-risking earlier in someone's lifetime frame, in which case you may well create a sequencing risk by doing that process anyway. That's sort of often what you have to grapple with is that whatever you're doing, you are crystallising an investment in the equity market and transferring it to something else.

MS CHESTER: Yes, you're paying the price of insurance policies - - -

MR BARKER: Yes.

MS CHESTER: And you don't know what that price is going to be. It depends on where the market is at. That's why smarter people than Angela and I at the Commission who could do the funky stochastic modelling approached it that way. In that world then where the sequencing risk is the greatest and for your membership a lot of them with the lower balances are doing large drawdowns at retirement – and that might change a bit as the system continues to mature and their balances get up a bit – but I guess where we're struggling a bit is lifecycle being in the default segment, unless it's done in a very, very smart way.

At the moment any lifecycle could be in MySuper authorised product. So that's what we're kind of grappling with. Again, don't want to put you

on the spot now, but how can we – if lifecycle remains in MySuper authorisation world, how can we ensure that it's a smart version of it where you don't need to know a lot about the member and what risks they're prepared to take off the table, given how they're going to deal with their balance on retirement?

MR BARKER: It's a challenging issue and I think one of the challenges we have is we have a sort of multi-polarity with our various reviews going on at the moment. Having just finalised our submission on the CIPR policy, that's a particularly live issue. How the default system dovetails with choice in retirement but also how it dovetails with what an appropriate safety net or default is really critical. It sort of feels like there's a number of different reviews under way where we're all trying to seek some form of convergence and consensus about what's appropriate.

The challenge is – and I'll call out my wife in this particular example. She's a doctor and all of her friends are doctors. They're on very high incomes but they have no idea about what a default setting is. And they probably should have a slightly different default to what the average Australian super member is. So for a few occupational schemes – and this will be a challenge if we move to a best in show where occupational schemes mean less – the difficulty will be around how do those occupational schemes that have cohorts of people that they can identify – and that would be the test for me – specific cohorts of people where we say we can do better than just an average.

There are a couple of funds out there who've shown that that can be done. I think our position for AustralianSuper is it's not as relevant for us and our members, but we don't have a fundamental problem with it. The challenge is trying to create comparability and investment discipline and not have asset allocation, as you say, cloud an understanding of who's actually good and who's struggling.

MS CHESTER: If we were to look at your submission to treasury on CIPRs, would that give us some guidance on the questions that we've raised about CIPRs in our report?

MR BARKER: No, not exactly in the sense that we believe CIPRs are a choice product. I think Treasury have been reasonably clear in our discussions with them that it is providing an alternative choice to a simple traditional account-based pension. What we have certainly raised concerns with is that any product that requires a particular choice for our membership who aren't used to making choices in a number of cases is a challenge. Our biggest challenge as a fund is getting people to choose a retirement income, not to choose a particular retirement income product.

So we are at a fundamentally different – we have a fundamentally different challenge ahead of us, which will evolve because our demographics are maturing.

5 The average balance of members will increase as they have a lifetime of SG contributions. But we have a slightly different challenge on our hands. CIPRs are most likely a very viable alternative to some people but more of a choice product.

10 **MS CHESTER:** I think that's kind of where we're heading as well and some financial advice might be required before you sign up.

15 **MR BARKER:** We're very keen to make sure that if whatever retirement income products are developed, that there's demand for them. The challenge is to make sure that people can actually exercise those choices easily.

20 **MS CHESTER:** Especially in a world where if something becomes a soft default or a nudge by government, all of a sudden, demand is created and it's not informed demand.

MR BARKER: Yes.

25 **MS CHESTER:** We will have a look at (indistinct) to that, so we'll save some time now but we might come back to you later, if we're allowed to do that. Let's move it then on to insurance. We had already benefited from some earlier discussions with AustralianSuper as part of our consultation to get an understanding about what funky stuff you were doing with your members in terms of understanding the data around the cohort, using ABS data in a smart way. I guess a couple of key things that
30 would be helpful for us, Richard, was firstly, the decision for your under-25s with insurance. We understand the decision and we understand the analysis that informed it.

35 Two questions. Knowing other funds out there, do they have the sort of information or data around their membership to make that decision about under-25s in the vein that AustralianSuper did? Secondly, we've heard about a world of Armageddon if our draft recommendation is followed and under-25s are taken out and insurance premiums for the rest
40 of the pool will go up by 26 per cent. So it'd be good to see what your counterfactual is given you've just done this.

45 **MR WEATHERHEAD:** Yes, thank you very much. In terms of other funds, the short answer is yes, they should be able to do it. The key factors for us were, first of all and primarily, examining where all the

benefits were going. For the people, for example, dying below the age of 15, between 10 and 20 per cent of that money was going to dependents; and that might be a spouse, partner or direct to dependent children. The rest was primarily going off to the parents of the members because there was nowhere else for it go. That's probably loose language, but you can understand my point.

For us that's the case of saying why have a default arrangement where really only 10 to 20 per cent of your members really have a need for it. So any fund can go through their claim file and work out where they pay the money. That's the short answer to that. The other reason for us was – and this is a fact behind affordability in a sense. We did feel that there was a real desire for people joining from below age 25 to see a material retirement pot developing early. So the premiums, whilst very small, do actually erode the account balance, albeit only by a small amount. We just felt that – and this came back from – I talked about member preferences in the research – came out from that research and also came out from our own sort of understanding of the membership that we felt psychologically it would be good for members to actually build that early pot and not have too much distract them from that until age 25.

Then we talked about ATO data and family status. We know that the demographics around that many people who are – have status partners or dependents. So all that data is available. Any fund can see and use that data, either their own data or broader market data. Having said that, it doesn't necessarily have to be a one size fits all. But there are funds – I'm here relaying to you messages that I have had from other funds. But there are funds, for example, that have a lot of members in rural Australia where people do tend to have partners and get married and have children younger. There are certain industries where that tends to happen as well.

So yes, it could be that it's not appropriate for some. But certainly in our (indistinct) it was absolutely right for our membership. Perhaps just remind me of the second question.

MS CHESTER: I've got to remind myself.

MS MacRAE: The impact, so a 26 per cent, what we were suggested there'd be a 26 per cent increase in fees for the rest of the pool. I guess what taking the 25-year-olds out of your pool would do for your - - -

MR WEATHERHEAD: Sure. For AustralianSuper it will happen gradually but it will take out about 100,000 members out of our 2.2 million members who have insurance. That's the number of members below age 25, assuming that none of them actually opt in for cover. So

that's the impact. The broader impacts I think you were talking about, the budget changes and so forth – AustralianSuper already has that 13-month cessation of cover provision, except for death and TPD, it does continue if you've got at least \$10,000 in your account. Following the budget and the recommendation of the Productivity Commission report, if we remove that \$10,000 piece – so that's everyone that gets the 13 months of inactivity – that will take 8 per cent of our members will not have insurance because it's been – so they're essentially the members who've been more than 13 months inactive and have more than \$10,000 in their account.

And I talked about the 100,000 members and I talk about the 8 per cent. If you look at the provision to cease insurance for anyone with an account balance less than \$6000, that one will take out – you can use a number of 22 per cent. So the combined effect of that, plus the 13-month cessation, is 30 per cent of our members. Now, in terms of premiums, the number is about 18 per cent of premiums. That's the numbers which - - -

MS CHESTER: So that 18 per cent is cumulative across all those policy changes?

MR WEATHERHEAD: Yes. It's 30 per cent of members, 18 per cent of premiums across all those changes.

MS CHESTER: Sorry, I might have missed it. You just unilaterally taking out the under-25s, what impact did that have on the premium pool for existing members?

MR WEATHERHEAD: About \$5 million a year of premium. But, of course, that – \$5 million per annum out of \$580 million of premiums overall, which I haven't done the maths, is about 1 per cent, isn't it?

MS MacRAE: Well done.

MR WEATHERHEAD: That's because obviously prices are much lower (indistinct). AustralianSuper has a policy of not cross-subsidising members at different ages. For example, our younger members do not cross-subsidise all the members, which means insurance is a lot cheaper at younger ages, which is why when - - -

MS CHESTER: Is that common practice in the industry?

MR WEATHERHEAD: No. I mean, I know there's one other major fund I know does the same. Apart from that, I'm not aware of too many that do that. And I know that's one of the recommendations of the draft

report and it's something we would absolutely support. I haven't said it to you before, but for example, we've done analysis of cost by gender. That can be very emotive. I know the EU has gone down the road of no discrimination which is essentially where AustralianSuper is at the moment because we don't. We've done some work – we don't believe for our default package that the cross-subsidisation between genders is material. By material I mean it's less than 10 per cent. But we do monitor that. Again, it's one of the things we monitor and our executive are very interested in that obviously on an ongoing basis to make sure that there is no perceived discrimination in that area.

MS CHESTER: You also mentioned income protection. We found it a little bit of a problem child in our report. It explained a lot of the incidents of the ugly zombies. You found that was low incidence in your membership.

MR WEATHERHEAD: Yes.

MS CHESTER: You cited the 0.4 per cent not paid because of a double policy. How does that track back up to across your membership how many people would have unintended multiple accounts that might have income protection? Because that's only across the claims which is I'm assuming a much smaller – so what percentage of your membership would make a claim against income protection? I'm just trying to work out what order of magnitude 0.4 per cent represents.

MR WEATHERHEAD: It's about sort of 1.3 per cent of members a year. So we've got 2.2 million members and we have about 2700 new IP claims a year. That's the total IP claims.

MS MacRAE: Of that 2700, 0.4 per cent of that number - - -

MS CHESTER: Had doubles.

MR WEATHERHEAD: The 0.4 per cent is by amount rather than by number. One of the things I didn't say in my opening remarks was that the fundamental difference between income protection and total and permanent disability – because income protection we found is actually better understood by members because they'll essentially start paying you a benefit if you're unable to carry out the duties of your job. It's pretty much we have a definition of what important duties of your job are. But essentially it's really well understood. And it's a broader coverage, whereas TPD by its name is covering those with very severe disabilities. The reason we get more complaints for TPD than we do for IP is because people have a disability, and there's no doubt about that, but it's just not

quite severe enough to be called permanent. That's where the issues of TPD come in because I think as a product it's actually more problematic than income protection is.

5 **MS CHESTER:** With your income protection policy you've obviously managed to do it in a cost-effective way to get your budget envelope down as low as you have.

MR WEATHERHEAD: Yes.

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MS CHESTER: How many years does it run for?

MR WEATHERHEAD: It runs for two years. That's one of the reasons – yes.

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MS CHESTER: Which isn't common in the industry.

MR WEATHERHEAD: It probably is the majority actually. But you're right, there is a lot of income protection to age 65 and that is very expensive. You'll find those funds that have IP to age 65 are generally breaching the 1 per cent cap. That's the way it would work. But it is interesting for us that, as I say, complaint rates for TPD are double complaint rates for IP. In fact, complaints about denied claims for TPD are five times those for IP. We think about that and we think why is that? It's because IP is simpler and, we'd say, perhaps more aligned with the purpose of super in the sense that it's paying you temporarily to get you back to work and it dovetails with that rehab program to assist people back to work. Apologies, I'm doing a bit of a marketing job, but you can tell we feel passionately about the valid subject.

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MS MacRAE: I mean, it's a bit more catastrophic too. If you think you're on the borderline of TPD and you're refused you'd probably find it harder than you would if you thought I'm going to lose benefits for a few weeks or even a few months and I'll get back to work.

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MR WEATHERHEAD: That's right, I agree entirely.

MS CHESTER: We've covered a lot of ground this afternoon, gentlemen, thank you so much. We'd really look forward to getting a post-draft report submission from you on the issues that we've raised with you this afternoon but any others that you'd like to give us feedback on. In particular, it's good to see we're not the only people that are obsessed with the value of portfolio benchmarks when used appropriately over the right timeframe. So thank you very much for joining us this afternoon.

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MR WEATHERHEAD: Thanks for the opportunity.

5 **MS CHESTER:** I'd like to call our next participant to join us, Douglas Bucknell. Douglas, I'm just mindful of time because we've got two more participants to go through and we need to finish up about 4.30. Would you mind if we read this into the transcripts as in evidence and would you just be able to give us a high level couple of minutes snapshot of it?

10 **MR BUCKNELL:** Look, I will give you a high level snapshot.

MS CHESTER: That'd be much appreciated.

[Inserted into transcript as per Commission's instructions]

15 1. Our interest, unlike most others, is principally in the efficiency of the system in allocating default members to products – **that is the Default Investment Option within a fund, not which fund.**

20 2. Allocating members to tailored investment options lifts retirement outcomes by \$5+ billion yearly, being four times the \$1.3 billion estimated by the draft recommended '10 best in show approach', without the radical disruption.

25 3. We appreciate the positive references in the draft report to our prior submissions, and Smart MySuper Defaults, however Page 196 of draft report **as written is false and may mislead.** It should read that:

30 a. Sufficient data is held by all MySuper funds (age, balance, contributions, to produce the FSI recommended projected retirement balances per member) in order to implement an initial version of a Smart Default.

b. Explaining a Smart Default to members is only a little more complex than the current explanation of the associated funds Choice investment options and Age Based life cycling.

35 c. Tailoring existing investment options (Australian Shares, Aggressive, Balanced, Conservative etc.) is a classic case of 'a small change that can have a real impact in retirement' as highlighted by the Treasurer in the ToR.

40 d. Smart Defaults are the only major 'default product allocation' innovation provided to the Commission that is on the horizon and implementation ready.

4. Regarding the comment that “the Commission is cautious about recommending the replacement of simple life-cycle products with ‘smart’ alternatives at this stage”; we seek guidance on how the Commission’s caution might be removed? Our submission provided a method for the Commission to run the test. We hold auditable reports on funds, consistent with the Outcomes Test on over 100,000 members and \$30 billion in assets, proving the 100+ bps p.a. average uplift. We have tried to engage with the executive without avail, although they reported soundings by entrenched interests. Further starting in the Choice segment is a fallacious proposition, inconsistent with the ToR.
5. This draft expression of caution is in stark contrast to the lack of caution being shown in the Draft Report in effectively culling up to 90% of the MySuper industry by the Best in Show recommendation.
6. The Draft Report approach has dropped the ball on Dynamic Efficiency, instead treating member’s financial retirement outcomes as equaling annual net investment return of a MySuper Funds single balanced default option. Consistent with the SIS Act, system purpose and ToR, we reject that approach as a secondary indicator only.
7. Trustees should focus on member’s retirement, not funds return and not be so simplistic. The bar is set too low.
8. We fundamentally **reject propositions that placing members in the same investment option for life is efficient**, regardless of their investment horizon (time to retirement or age) and regardless of if they will retire on a million dollars or the full Age Pension. MySuper members are not all the same and hence one-size-fits-all is wrong.
9. Financial planners acting in a one-size-fits-all manner would be banned. Trustee obligations are different and higher.
10. Age Only life-cycling does lower average retirement balances, however the Draft Reports approach of appearing to ignore higher growth options earlier in life by comparing the same \$129,000 starting balance of a ‘one-size-fits-all balanced option’ appears flawed. It again shows disregard for dynamically changing investment options over time.
11. Despite the poor data quality, the Draft Report uses restricted growth option performance above the default option, but the reverse for conservative options, inconsistent with equity premium axiom and many other studies.

12. Smart Defaults are complementary to the draft recommendations of account consolidation and (retirement) Outcomes Tests however the Draft Report has started chilling innovation and investment decisions already.
- 5 13. Elimination of innovation in MySuper in respect of big data, contraction to internally indexed single investment options by an oligopolistic few and proliferation of current inefficient practices is the likely ‘best in show’ result.
- 10 14. Draft report arguments in support of this best 10 approach, are not equally used in respect of the Smart Default alternative of allocating MySuper members to products (investment options), although of equal relevance.
- 15 15. The crux of the difference is that the draft recommendation would move members to better performing funds, where the alternative, Smart Defaults would move members to better tailored investment options within their existing fund. Leaving consolidation to the new APRA Members Outcomes Test, a market rather than a bureaucratic process.

20 **MR BUCKNELL:** For the record, Douglas Bucknell, CEO Trustee Tailored Superannuation Solutions as it’s known. Thank you for having me today. Our major point here is that we believe that allocating default members to products, that is, default investment options within a fund, is far more important than allocating members to which fund. Our analysis, which is analysis on over 100,000 members and \$30 billion in assets, shows that the uplift across those funds is 100 basis points on average.

25 That is a \$5 billion per year benefit compared to the 1.3 billion benefit that you have in best in show.

30 So we think this is a very, very important aspect that the Commission should be looking at. We have made submissions in relation to the first round. We didn’t in relation to the second round, which is about default allocation to funds as we read it, but we have in the third. I guess the other factor that we’d really like to point out without reading the whole statement is that we really see outcomes as what happens to a member’s projected retirement balance or income. This idea that you can measure

35 outcome as net returns of a fund’s default balanced investment option is anachronistic to us. We think that changing investment options over time, that is, a dynamic efficiency over time, is a very, very important aspect that the Commission should be looking at.

40 There are other points that we’d like to make, in particular page 196, which says that there is currently insufficient data held to run a smart default. We want that clarified and we want that corrected, if we can. We know that every fund that we have touched has sufficient data. That data they require to run a smart default is age, balance and last year’s

contributions and those figures are put together combined in our methodology to a projected retirement outcome. That projected retirement outcome is what was recommended in the financial system inquiry 2014 report. A lot of super funds are actually putting that on statements already.

We're just asking funds to use those projected retirement balances and allocate members to their existing investment options based on that projected retirement outcome. That produces the 35 per cent improvement in retirement outcomes. As I said, that compares very well to your 1.3. It's 5 billion. And we think it's worth testing. Look, I guess the other part that we would point out a little bit is that the treasurer highlighted the very small changes in the system can have very significant impacts on outcomes. This is a very small moderate change that we're asking for, particularly compared to, for example, the best in show, which we see as quite a radical change to the size and structure of the industry. All we really are asking is for funds to use their existing choice options – aggressive, balanced, conservative – for their default members, not the 40,000, just maybe five.

That's essentially what we're about. We see this is something the Commission really should study. We asked for that in our last submission and we're yet to see that in the report.

MS CHESTER: Thank you very much. Just so we can understand, your company, Tailored Superannuation Solutions, advises superannuation funds on how to take members through tailored investment options over time. It's effective a lifecycle glide path.

MR BUCKNELL: It's not a lifecycle glide path. It's multiple lifecycle glide paths. I think the example that we had in the last submission that we provided to you – and some of the speakers earlier today have highlighted how different outcomes for different members can product different glide paths. So what we would say is you will have glide path for members who are going to end up on the full age pension, one that might end up on a part age pension and one for members that are going to retire on 1.6 million.

Fundamentally, if you're a financial planner and you put everybody into the same investment option for life regardless if they were 18 years old or 64, regardless if they were going to retire on the age pension or 1.6 million, you'd actually be banned. The Royal Commission has come up with some fairly strong comments on that. What we would say is that you should tailor those options based on the projected outcome of the member.

5 **MS CHESTER:** We did some analysis around lifecycle products in our draft reports, Stochastic analysis that we've had some feedback from other technical experts on. What you're proposing, would it be fair to describe it as more of a smart lifecycle dynamic product over time and thus our Stochastic modelling didn't really capture what you're proposing?

10 **MR BUCKNELL:** Look, that's correct. We do have a question for – well, actually two questions for you on that. I think it comes back to supplement 4 on page 35. It says that you used \$129,000 starting balance for two members and compared them. But, of course, if you're in lifecycle you're in higher growth options earlier. So that 129,000 starting balance wouldn't be the same.

15 Now, whether that's how you've looked at it or not I'm not sure. But what we would be saying is that single age-based life cycling does reduce average retirement balances; we're consistent on that. If you use multiple glide paths and tailor that to the member's outcome – that's not net returns but projected retirement outcomes or income – then you can actually increase that outcome by 35 per cent.

20 **MS CHESTER:** Is that putting them into higher growth as they approach retirement? As their balance gets greater you've got them in a higher growth before they retire.

25 **MR BUCKNELL:** Yes. So you'll have 25-year-olds, one who's going to retire – projected to retire on 1.6 million in high growth options up until age 50 and then they might slowly come down to aggressive. You'll have another 25-year-old who'll be - - -

30 **MS CHESTER:** Sorry, when you say slowly come down to aggressive - - -

MR BUCKNELL: Sorry, from aggressive to the conservative option, for example.

35 **MS CHESTER:** But why would you be taking risk off the table at age 50?

40 **MR BUCKNELL:** That's just one glide path. You might have another glide path for a member who was going to – had projected to retire on the full age pension at age 25 and their glide path will be a slightly different shape. So that the tailoring is tailored to the outcome of the member and it's a more efficient use of that member's investment horizon. It's not going to be able to be explained here in the 20 minutes that I have in front
45 of you, but we - - -

MS CHESTER: I understand it doesn't make sense.

MR BUCKNELL: - - - have provided quite a lot of detail on that.

5

MS CHESTER: I've read the submission. It still doesn't make sense. The advice that you're providing to super funds today, are there any products that follow this smart, dynamic multiple glide path model that you've got in mind?

10

MR BUCKNELL: We have run the model on around about 100,000 members, as I said, and about \$30 billion worth of assets. We're aware that - - -

15

MS CHESTER: Sorry, those members are in those products and these are the outcomes they're going to get or you've just used their data?

20

MR BUCKNELL: We used the member demographic for that fund and we used the investment option return and loss ratios that are published for that fund and put it into a report that looks very like the APRA outcomes framework test that they've got. Then we can peer test that against a one size fits all default. That's the methodology that we've asked the Commission to use and for federal treasury to use on the full 15 million MySuper account data that you've got.

25

MS CHESTER: When you're dealing with the trade-off between keeping growth on the table as the balance grows so you have the highest retirement balance versus potential sequencing risk at the point of retirement, the order of magnitude of the sequencing risk depends on how much you expect the member to draw down at the time of retirement and then the member's preferences. How would it default well do you know that?

30

MR BUCKNELL: What we do know is we know all members' projected retirement balances in the fund and we rank members into life stage retirement bands based on their projected retirement balance. That is regardless of whether they're aged 18 or whether they're aged 64. The trustee will then have a different glide path, if you put it in your terms, the amount of trade-off between sequencing risk and growth, as that member ages. Those that are facing a full age pension retirement might have more sequencing risk taken off the table. Those that are about to face a \$1.6 million projected retirement outcome will keep their growth on for longer; in fact, may stay in a balanced or a 70:30 type option through the retirement phase.

40

45

5 **MS CHESTER:** Why does a member with a low balance that's going to be eligible for full age pension have low sequencing risk when they're going to be at greatest risk of a large drawdown and that's where the sequencing risk occurs at retirement?

10 **MR BUCKNELL:** If you were facing a full age pension retirement your glide path will be more conservative when you get there. Perhaps I could show you that in a diagram, but we're talking multiple glide paths here. Importantly, it's the trustee that would set those glide paths. It's not set by us.

15 **MS CHESTER:** But the trustee doesn't know what the member wants to draw down at retirement and the trustee doesn't know the member's risk preferences. Thus, we're heading in the direction of saying that we think there are smart lifecycle products like the ones that you're looking at that can work well for some members in superannuation. But you need to know that about the member. The trustees don't know that about the member and thus it should be in a world of choice and advice.

20 **MR BUCKNELL:** What we would say and the data that we provide in an auditable way member by member puts those members into retirement cohorts. We know what the return ratio is, for example, lifestyle retirement band 2, which are the members that might retire on full age pension, versus those that might be in band 3 or 4 that are self-funded retirees.

25 **MS CHESTER:** But the issue is we still don't know how much the member wants to draw down at retirement, which defines what sequencing risk is, plus what are their risk preferences.

30 **MS MacRAE:** I mean, I guess just coming to the core of it, you said the only data you'd need is age, balance and the amount of their last year's contribution.

35 **MR BUCKNELL:** Correct.

40 **MS MacRAE:** But there's an awful lot of other stuff in there like their marital status. So is there one or two of them at retirement? If they're partnered, what's happening with the other person? That will impact on whether they get the age pension or not and that'll be based - - -

45 **MS CHESTER:** Do they have a mortgage left to pay?

MS MacRAE: Will they still have dependent children?

5 **MR BUCKNELL:** Perhaps if I can answer that. We quantified that benefit for each of those cohorts. On average, it is 35 per cent higher projected retirement balance outcome. If you have a 35 per cent higher average retirement balance you can do an awful lot of different things in retirement no matter what those factors are. What we would also say, as highlighted elsewhere in your report, let's not think that the best outcome is defeated by a better outcome.

10 Over time – and this is what we found with big data elsewhere – we would include things like insurance. This methodology does take into account career breaks, not making contributions for a year, bonuses, increases. There is an element in it that lags by one year. So it takes a lot of those factors that you're talking about into account but notes that we've only got certain amounts of data at the moment. In five years' time we
15 would expect that there'll be a further version of this that creates further tailoring. The moment the regulations only allow for these factors and those are the factors that we use.

20 **MS CHESTER:** I've just got one final little question. And we will go back and have another careful look at your submission and discuss it with our stochastic model as to make sure we've understood it all. But if you're taking growth off the table as someone is about to retire, how do they end up with a 35 per cent higher retirement balance?

25 **MR BUCKNELL:** I think this is why it's very important to go through the numbers and get them audited. And that's what we've asked for on a member-by-member basis. So if members – and it depends on the demographic of the MySuper population. But typically MySuper members are younger and their balance obviously grows in size as they
30 get older. So you've got a number of different factors that are competing as to what the outcome is and you really need to break that down into each of those cohorts and add up what that impact is over a lifetime.

35 If you simply take what the net return of the fund is this year you're not measuring what the member outcome is; you're just measuring what the outcome for that fund is. We really think this should be a member - - -

40 **MS CHESTER:** That's not our counterfactual. Our counterfactual is what the member would have got if they stayed in a high growth or a balanced growth portfolio throughout their whole working life versus a glide path that de-risks them approaching retirement. That's where, I guess, I was struggling with how do you get a higher retirement balance when you're taking growth off the table.

45 **MR BUCKNELL:** Well, you're taking greater risk when the members

are younger for longer.

MS CHESTER: So you're dialling up the aggressive upfront.

5 **MR BUCKNELL:** Yes.

MS CHESTER: Which you could do anyway and not take any risk.

10 **MR BUCKNELL:** And members are preserved.

MS CHESTER: That's great. Douglas, thank you so much, that's been really helpful.

15 **MR BUCKNELL:** Thank you.

MS CHESTER: I'd like to invite our lucky last participant for our first day of super hearings to join us. Good afternoon, thank you for joining us. If you'd just like to state your name and the organisation that you represent for the purposes of the transcript and then if you'd like to make
20 some extraordinarily brief opening remarks that would be much appreciated.

[Inserted into transcript as per Commission's instructions]

25 First of all, I would like to thank the Productivity Commission for the opportunity to appear today at this hearing and for previously engaging with the SMSF Association as part of the Commission's work. The SMSF Association is the peak body representing the SMSF sector which is comprised of over 1.1 million SMSF members who have \$712
30 billion of funds under management and a diverse range of financial professionals servicing SMSFs.

35 Today, I will focus my comments on SMSF issues that the Commission addressed in the draft report but before I do that I will make some high-level comments on the Commission's report.

Without making specific comments on the individual recommendations, we broadly support:

40 ☐ Preventing account duplication and savings erosion by ensuring that people are only ever allocated one default account.

☐ Enhancing choice in the superannuation system by empowering
45 individuals to choose their own superannuation product. This includes maintaining the role of SMSFs as a choice superannuation vehicle and

preserving the ability, and in some instances opening up the choice, to have an SMSF as a retirement savings vehicle.

5 □ Ensuring insurance premiums do not erode low account balances or those of younger fund members.

□ Improving superannuation data for improved policy analysis.

10 We are also pleased that the Commission recognised the role that SMSFs play in providing a competitive force within the superannuation sector and the effect this has had on fees across the sector.

15 I will now address the specific areas concerning SMSFs that the Commission focussed on in the draft report, starting with draft finding 2.2 regarding SMSF returns.

SMSF returns

20 We are pleased that the Commission's assessment of SMSF investment returns showed that returns in the sector are broadly equivalent to that of large funds. This is an important draft finding and supports the rationale for many people establishing SMSFs.

25 However, we are concerned by the draft finding that SMSFs with balances below \$1 million deliver lower returns than large superannuation funds. We believe it is important all SMSF trustees consider the cost-effectiveness of their SMSF and the long-term viability of having an SMSF compared to other superannuation options.

30 While this point is important, caution must be taken regarding the Commission's analysis of SMSF returns. I note that the Commission caveated the difference between APRA-fund and SMSF data and the issues this creates in comparing the sectors. This is especially relevant to how return on assets (ROA) is calculated, with the Commission's Technical Supplement 4 illustrating that the difference between APRA's and the ATO's methodology for calculating ROA can create a 0.6% difference.

40 In addition, the ATO's ROA methodology which uses a crude average assets basis can distort net returns for funds when they are established. This is because new funds may be established earlier in a financial year but contributions/roll-overs are made towards the end of the year. This larger end of year balance can increase the average assets figure, reducing the overall ROA calculation, while the true amount of assets exposed to risk/return has been far lower for much of the year.

Accordingly, further work and analysis is needed to make better judgement of the returns of SMSFs under \$1 million.

Finally, on this issue, we would be concerned that a \$1 million balance was seen as a required balance to establish an SMSF. A \$1 million balance is a good aspirational goal for SMSF trustees to achieve to ensure their fund has appropriate scale and is efficient. Considering that this would represent \$500,000 per member in a two-member SMSF, we do not believe that this is an unattainable or unrealistic figure.

SMSF costs

Again, in regards to SMSF costs the Commission pointed out the difficulties in comparable data across the sector yet made the draft finding that costs for low balance SMSFs are particularly high. SMSF trustees should be aware of how costs affect their retirement savings, particularly when deciding on whether they should establish an SMSF.

Similar to our views on returns, we are concerned by the implications that poor data and different reporting methods across sectors may have on the Commission's draft findings.

In regards to costs, establishment costs of a capital nature can grossly distort net returns and cost ratios for SMSFs with small balances when established. These costs distort comparisons with large funds, especially for lower balance SMSFs which may have been recently setup. Similarly, advice costs for SMSFs are of a different nature to those incurred by APRA-fund members, further distorting comparisons on cost.

How costs are accounted for also affects comparison between SMSFs and large funds. For instance, costs of maintaining a direct property investment are recorded as investment costs to the SMSF but where a large fund invests in a property trust, costs of that trust are more likely to be accounted through reduced returns.

In regards to costs, the Commission noted that, "It is unclear to what extent the presence of small SMSFs in the system is necessarily a problem." We believe that these smaller funds do not represent a problem and cite the research undertaken by Class Ltd, an SMSF software provider in 2016. Analysing the funds that use their software Class found:

□ For the 2015 financial year around 50% of funds with less than \$50,000 were either newly established in the year or entered this bracket due to drawdowns or rollovers during the year.

□ Class' findings point to the dynamics of funds with balances of less than \$50,000 being similar to "that of an airport transit lounge, with

constant arrivals and departures". On average these funds stay in this bracket for around 2 years.

5 We also note ATO data which showed that in 2012, of SMSFs that lodged for the first time, 51% reported total assets of \$1 to \$200,000. Comparatively, this asset range made up only 20% of funds still active in 2016.

10 SMSF advice

15 Finally, I will address the Commission's draft finding on financial advice. Part of the SMSF Association's mission is raise the standards and professionalism of financial advice provided to SMSF trustees. Given the draft finding of the Commission, revelations at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and recent comments from ASIC, it is clear that more is needed to raise the standards of financial advice.

20 In regards to SMSF advice we believe it is critical that those providing advice to SMSF trustees have undertaken specific SMSF education or qualifications. SMSF advice should not be seen as part of superannuation or retirement advice but a specialist advice area. This is necessary given the unique aspects of being an SMSF trustee and the complexities of superannuation and related laws. While general standards of financial advice are being raised to a minimum bachelor degree level, at the moment there is no additional requirement for specialist education in SMSF advice. We strongly recommend that completing specialised SMSF education or accreditation be a requirement to provide this type of advice.

30 **MR GEORGE:** Jordan George, SMSF Association, I'm head of policy for the association. I will cut down the thousand word opening statement and give you the brief gist of it. Very much I think the association definitely supports the measures and recommendations in the report about making the system more efficient in general and making sure that over the long term that people's accounts aren't eroded. I think the benefit for SMSF is obviously that when people do choose SMSF that there is a higher balance (indistinct) going forward. So I'm not going to make too much more around those broad proposals because that's not our association's remit.

45 What I will focus on more in this short statement is three key areas that I think we would like to interact with the Commission on going forward from the report. That was SMSF returns, cost and financial advice. I think they were the salient areas for us to comment on. In

regards to returns, we were pleased with the draft finding that SMSFs generally have a similar profile to large funds. But there are some concerns about funds that have less scale. I think the figure that the Commission (indistinct) less than \$1 million in assets.

5

What we are concerned there is pretty much – and I think the Commission flagged a lot of this and had a lot of caveats around quality of data and comparability of data – is that it is really hard to actually make comparisons between APRA-regulated funds and SMSFs and because of that some of the return figures for lower funds can be distorted. I think one of the key things that we have focused on is the difference between the ARPA methodology for return on assets and the ATO methodology.

I think in the technical supplement number 4 it showed that if you apply the APRA method to SMSF, SMSFs could have a 60 basis point uplift in return on an aggregate figure. So it does show it's quite hard there to make comparisons and we do wonder how does that actually impact on analysis of funds with low balances. One of the things we are concerned about – and we know that the Commission has not made a draft recommendation about this – is that if people do take this million dollar figure to be the minimum amount needed to establish an SMSF, we don't think that is an appropriate figure for that.

The reality is that many people may start off with smaller SMSFs and achieve scale over time and that million dollar figure is probably a good aspirational figure, especially when you think of a two-member fund, which 70 per cent of SMSFs are, that'd be about \$500,000 per person, which would be what we would regard as a good amount for people to aim to to save for super in their SMSF.

30

Summarising that, we think more work needs to be done and potentially better data sources as well on calculating returns for SMSFs because we know that the reality is that the ATO collect SMSF data through the SMSF annual return which its primary job is to collect revenue, not statistics. So (indistinct) best it can with what's given to them and we think that more work could be done definitely around data which we know the PC has said in general about a industry-wide working group on data.

In regards to cost, I guess we have, again, similar concerns around the analysis is driven by the quality of data available on SMSF costs and comparing those to APRA-regulated funds. We are aware that the idea that smaller funds who have particularly high cost ratios compared to APRA fund members is a concern to many people throughout the super sector and has been highlighted again by the Productivity Commission.

45

One of the issues we do look at there is though that often this is driven by establishment costs which are capital in nature and – I know the draft report focused on this. Once again, it would be great if we were looking at to get data that would strip out the nature of some of these costs and
5 have more (indistinct) analysis rather than the aggregated figures we get through the ATO and through the SMSF annual return that the ATO get.

Also, just in general, the nature of costs in an SMSF are different to those in APRA-regulated funds. Often we're talking about advice and
10 investment costs, which are quite different to what an APRA-regulated fund provides to their members. Advice is obviously a direct cost. It's very transparent in SMSF and reported through the annual return, while for many APRA funds it's kind of – the way that cost is spread throughout the fund is quite different and it's meant to be reflected in an
15 administration cost or an investment cost as it would be in an SMSF.

Also, costs of investing in different assets. One example would be SMSFs investing in direct property. The cost of holding that property would be reflected in the SMSF as an investment cost while APRA-regulated fund may invest through a property trust and those costs are
20 probably reflected as lower returns on that investment rather than direct cost. So there's things like that which need some consideration when we're already breaking down what are the cost differences between SMSFs and large funds.

The final point I'll make about cost is that the Commission made the statement it is unclear to what extent the presence of small SMSFs in the system is a problem. We don't think it is a problem because they generally do achieve scale over time or they are exiting the sector. So we
30 think that those funds that the very small funds with funds under \$100,000 in assets are either going one way or the other. They're either going out or they're going up in scale.

There's some interesting research done by Class Ltd who are a SMSF software provider. So one of the companies in our sector who does have access to more great newer data per SMSF and per member and they showed that in the 2015 financial year that 50 per cent of funds with less
35 than \$50,000 were either newly established or were entering this bracket due to drawdowns and rollovers. So they very much were in the process of probably winding their fund up.

I think this Class report actually is a really good description. They say this bracket between zero and \$50,000 is a bit like an airport transit lounge. There's lots of people coming and going in and out of the
45 bracket. The found that on average SMSFs were only in that bracket for

about two years. So they're either drawing down and rolling out or they were on the way up and waiting for more contributions to get scale.

5 The final point I will touch on is around SMSF advice. I think this is a common theme coming through in numerous inquiries we've had over the years. There are some positive changes happening. The increase of education standards for financial advisers is something that's going to be kicking in from 1 January 2019 and there's a five-year transition there to bring the industry up to at bachelor's level requirement to provide financial advice.

10 But one thing we are concerned about is there's no requirement to have specific SMSF education to provide SMSF advice. We think that is definitely seen as important given the complexity of self-managed super funds and that they are quite different to the rest of the super system. So the idea that you may have covered off superannuation in retirement in your studies to be a financial adviser but not necessarily SMSF – and if you take a 12-week course, probably SMSF is two weeks of that – you're not getting the expertise that we believe you actually need to advise people on their retirement savings through an SMSF. We would definitely encourage consideration that those who are advising SMSF trustees should have specialist SMSF education or accreditation to do so. That's our summary of where we are and report.

25 **MS CHESTER:** Terrific. Thanks so much, Jordan. I guess first before we get into some questions around the data and the investment performance story, just to understand, so your association – what's the membership profile?

30 **MR GEORGE:** Our association is the vast majority of our members are advisers, so either financial advisers, accountants, lawyers, auditors. But we also do offer a category of membership to SMSF trustees. So we have about 700 now SMSF trustees who engage with us mainly on an education basis. So we have a website which we call our trustee knowledge centre where they can go and get independent information on the super laws, tax laws, how to run their SMSF. The idea of that is that they can get better quality conversations with their advisers, which touches on the idea that you had in the report about providing independent sources of information to allow people to evaluate how well – what kind of advice they're actually getting. So that's one of the roles we perform in the sector.

MS CHESTER: How many members does the association have to date?

45 **MR GEORGE:** About three and a half thousand professional members and around 700 trustee members and (indistinct) trustee database about

7000 who are actually - - -

MS CHESTER: Are the trustee members paying for the educative database or are they part of your advocacy membership?

5

MR GEORGE: Some of those members do pay subscription fees, some of them have been brought in through corporate offers and things like that. But a subscription fee has been \$99 for the year to access that trustee knowledge centre.

10

MS CHESTER: What do the other members pay?

MR GEORGE: Our professional members pay anywhere between 500 and 700 dollars, depending on the status of their membership.

15

MS CHESTER: Given your membership is largely financial advisers and people who are getting members into SMSFs, you'd probably be able to help us then. So when they're providing advice, do they actually want to know how much money they're going to eventually have in super to work out whether an SMSF is appropriate for them given the higher cost structures?

20

MR GEORGE: Absolutely. I think when we talk to our advisers, whether they're financial planners or accountants, that's definitely one of the conversations that they do have is about what are your long-term ability to keep making contributions and to reach scale. Very much we know that within our cohort of advisers they believe – and it's our association's belief – that SMSFs are not for everyone and that it would be improper to recommend SMSFs to people who may not get sufficient scale to actually be cost-effective.

25

30

MS CHESTER: What's the view amongst the planners as to what sufficient scale for them to get the good net investment returns that we've identified for that cohort over - - -

35

MR GEORGE: I think very much within the industry that the kind of – the figure that ASIC landed on in 2013 through the work done by Rice and Warner, around \$200,000 for establishment in terms of being cost-effective against – I think that was pretty much based on retail products – is very much I think the view that goes across most of our guys is (indistinct) \$200,000 establishment figure. However, I know that many of them - - -

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MS CHESTER: Sorry, that's having \$200,000 to begin with as a minimum?

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5 **MR GEORGE:** Yes, as a minimum to begin with. That's a common figure used throughout the industry. Then in terms of where they reach from there, I don't have a consensus idea on what they believe long-term scale would be at this stage. But it's definitely something we can - - -

10 **MS CHESTER:** Because our analysis – and we agree the data wasn't ideal, so we've caveated it. But one thing that was really clear that if you don't get to a million pretty quickly you're not going to be getting the 5.9
15 per cent investment returns over the 10 to 12 year period. I mean, I think this is an area where the regulators under a (indistinct) is going to be doing some more work. So it would be helpful for us to know from your membership what do they consider to be sort of a cost-effective balance and what timeframe does the member need to get to it for an SMSF to be
20 something they feel comfortable advising them to go into.

MR GEORGE: Yes, absolutely, that's something we can do and try to report in our submission in four weeks' time.

20 **MS CHESTER:** That'd be great.

MR GEORGE: I know we have done – the other thing that was picked up in the report the previous research about there can be other factors driving SMSF establishment too. It's not necessarily just about returns,
25 even though that obviously should be a key focus of people. The more time savings you have obviously the better you'll be off in retirement is a pretty clear objective. But there are other factors there that do tie in to why people establish SMSFs.

30 **MS CHESTER:** I mean, our focus has been that it is the ultimate part of the choice segment; people are making the decision to do it themselves. And that's their entitlement, it's their money. But at the end of the day, we want to make sure that the advice is appropriate, given the evidence that we've discovered, and we need to have some pretty firm and contrary
35 evidence to suggest that that \$1 million pretty early looks about right to us. Indeed, we've had feedback from others. I'm very conscious as well that others in the industry are now starting to talk about the government stepping in and actually prohibiting SMSF being created.

40 So we want to make sure it's good informed choice in a world of engaged members deciding to go down the SMSF (indistinct). The more of an evidence base you can give us in the post-draft report submission, that would be really helpful.

45 **MR GEORGE:** Absolutely, we can definitely focus on that. I think that

5 goes to our strong belief around SMSF establishment too is that the best way to make sure it is appropriate is through high quality advice. So it's that ability for an adviser to sit down with an individual, gauge their understanding, gauge their knowledge of the obligations and the time – one of the other things is the time that they should take to be an SMSF trustee and the involvement required, as well as their financial capacity to make those contributions and to achieve scale. I think it's a very – we think it's a very well – a very holistic kind of advice picture you need to have and it does come with understanding of (indistinct) quality of advice
10 provided.

MS CHESTER: Do you have more data then based on the work of Class and others that can tell us the story over time, like how quickly do members get from those that are under 100,000, which is your concern, or
15 under 200,000, up to a million dollars? Then where are you seeing churn? People that started with an SMSF and then changed their mind and gone back into an institutional fund?

MR GEORGE: That is something we're currently working on. That's something we hope to be able to provide in our draft submission. We are speaking to some of the SMSF software providers and administrators in the sector because they do have the ability to extract that more granular data and also have a time series. We have tried to - - -
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MS CHESTER: Who are they?
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MR GEORGE: The main ones that we have the kind of relationships to work with and the biggest ones, so Class; they provide SMSF software. BGL who also provide software for SMSF, and Super Concepts who are an AMP-owned brand, and they do both software and administration of funds.
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MS CHESTER: How much of the SMSF space would they cover?

MR GEORGE: I think they would cover almost 80 per cent.
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MS CHESTER: That's pretty good.

MR GEORGE: It's just a question of being able to get them to extract data and then provide answers to different queries that we've had. Like you said, how quickly do people achieve scale over timeframes and looking at some different cohort things. So there's capability there I think to get a look at some of those issues you have raised in the report that you can't get from ATO data that's either because it's driven by tax returns or
40 aggregated.
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5 **MS CHESTER:** That would be terrific if we can get that in the post-draft report submission because we just want to make sure that it's well-informed choice, good advice and the more we've got evidence to sort of take us in that direction as opposed to other blunt ways of dealing with SMSFs or which others are suggesting is helpful.

10 **MR GEORGE:** I think that's definitely our intention to provide that and we value the Commission's comment that SMSFs are an important driver of choice and the effects they've actually had on the broader market. But like you said, it's important that people go into them with their eyes open and in appropriate circumstances.

15 **MS CHESTER:** Jordan, is there anything else you wanted to - - -

MR GEORGE: I think that covers off and we'll work harder in the next four weeks to pull those numbers together.

20 **MS CHESTER:** That'd be terrific. Great.

MS MacRAE: Thank you.

25 **MS CHESTER:** Thanks for joining us today. Folks, that ends day 1 of the super hearings. We will resume, I think at 9 am tomorrow morning – yes, I'm being nodded at by my colleagues – in sunny Melbourne. Thank you, linesman, thank you, ball boys; we're finished in Sydney.

30 **MATTER ADJOURNED AT 4.20 PM UNTIL
THURSDAY, 21 JUNE 2018 AT 9.00 AM**