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Superannuation  
Productivity Commission  
Locked Bag 2, Collins Street East  
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## **Superannuation: Alternative Default Models**

Thank you for the opportunity to provide comments on the Productivity Commission's Issues Paper *Superannuation: Alternative Default Models* (SADM).

Ai Group is an employer association whose members operate in a broad cross-section of industries and pay superannuation contributions on behalf of their employees to a large number of superannuation funds. Ai Group is also a shareholder trustee of AustralianSuper which is a highly-regarded and strongly-performing industry superannuation fund named in a variety of awards and employment arrangements as a default fund.

### **An absence of competitive pressure?**

A premise of the current review appears to be that Australia's current default arrangements mean there is a system-wide lack of competition or that members of default funds are denied the benefits of disciplines associated with competitive pressures.

However, a fundamental characteristic of current arrangements is that most, if not all funds named as default funds also compete actively for members who do, or who might choose their superannuation fund. Funds compete both to entice active choices in their favour and to encourage members or potential members not to make an active choice to join another fund (or to establish a self-managed fund). As a consequence, competitive pressures and the disciplines that are associated with competitive pressures are felt by, and shape the behaviour of funds whether they are named as default funds or not.

### **Why defaults?**

Ai Group supports the need for default arrangements for employees who do not choose their own fund.

- As noted in SADM, there are substantial agency problems that arise from employer choice of employee superannuation funds. Many employers with discretion over the choice of default fund under current arrangements take a conscientious interest in selecting their default fund. Others may not devote particular attention to this issue and still others may be tempted to make the default decision on the basis of an offer of favourable terms on other financial products.

- The provision of financial services is characterised by widespread information asymmetries. It is generally recognised that disclosure requirements do not overcome these asymmetries particularly for disengaged consumers of these services. And there is plenty of evidence of the vulnerability of consumers of financial services to, for example, unethical advice, inadequate understanding of ongoing commissions, and misrepresentations of return expectations.
- SADM also notes that individuals can be overwhelmed with the variety of choice before them. They may not feel equipped to make a decision and may not feel that time invested will help them make a better choice.
- Given the generally strong performance of the funds nominated as default funds in Australia, it is very likely that Australia's default arrangements lifted actual or prospective retirement incomes for the many employees who have been disengaged from their superannuation and many who would have been vulnerable to disreputable practices.

We note that employers too can be overwhelmed when confronted by the prospect of making a choice from a large number of alternatives. Certainly, our liaison with businesses suggests that the costs to employers of undertaking a conscientious assessment rise with the number of eligible default funds they need to assess.

For these reasons Ai Group has supported, and continues to support the proposal to introduce a merit-based assessment filter for funds listed as default funds in awards and industrial agreements. In this context we note that the Financial Services Inquiry qualified its recommendation for the introduction of a formal competitive process to allocate new default fund members by suggesting that a review by 2020 might find this unnecessary. We suspect that, if the Fair Work Commission merit-based process were put in place, it would prove to be a relatively low-cost way of improving Australia's default selection processes.

### **Criteria for assessing alternative models**

Overall Ai Group supports the criteria put forward in SADM.

#### *Member interests*

We particularly support the member interest criterion and the inclusion within this of the idea of net returns. We see a major problem of associating member interest with the lowest fees or lowest administration costs rather than net returns.

We suggest that "maximising net returns" should be replaced with "maximising risk-adjusted returns".

We doubt the extent to which the "allocation of members to [default] products that meet their needs" is achievable given the variety of individuals' circumstances including their financial circumstances and prospects, risk appetites, age, health needs and life expectancies.

### *Competition*

While it appears an esoteric point, we see competition as a means that can often be used to achieve desirable outcomes rather than being a desirable outcome in itself. We certainly agree with the outcomes listed - particularly innovation and efficient long-term outcomes.

### *Integrity*

We strongly support this criterion.

### *Stability*

We strongly support this criterion.

### *System-wide costs*

We support this criterion merely cautioning that costs already included in the concept of net returns above should not be double-counted. Costs borne by employers and by governments in administering superannuation funds (and not recovered from the funds themselves) should be included.

In relation to managing the trade-offs between the criteria, we have no particular insights other than that arising from the comments above in relation to competition. For example, we would not see the value in increasing competition *per se* if, holding other benefits constant, it meant raising compliance costs or reducing risk-adjusted net returns.

## **Designing the models**

SADM invites comments on the suitability of the its three-step framework for designing alternative approaches to selection of default arrangements, it asks about other steps and invites comments about lessons from models used in other countries.

The three-step process looks a suitable way to develop abstract insights about alternative approaches. It does, however, seem to lack a connection with actual experience and expected results. In the end, regardless of what it looks like in the abstract, whatever process is put in place needs to come up with good results.

For this reason, it would be very useful for the Commission to compare how models in other countries actually perform against the criteria it has developed. While it may properly belong in a subsequent stage of the Commission's processes, it would also be useful to assess how the existing Australian approach has performed against these criteria.

## Options for an allocation model

### *Administrative model*

The criteria set out in section 156F of the Fair Work Act for the Fair Work Commission's compilation of a list of default funds, appear to be a sensible approach to the development of an administrative filter. As noted in SADM these include:

- The appropriateness of the product's long-term investment return target and risk profile;
- The expected ability of the fund to deliver on the product's return target, given its risk profile;
- The appropriateness of the fees and costs, given: – its stated long-term investment return target and risk profile – the quality and timeliness of services provided;
- The net returns on contributions invested in the MySuper product;
- Governance practices, including mechanisms to deal with conflict of interest;
- Appropriateness of insurance offered in relation to the MySuper product;
- Quality of advice given to a member; and
- The administrative efficiency of the superannuation fund.

### *Market-based model*

As noted above, Ai Group is concerned that the level of fees or administrative costs will be given excessive weight in default fund selection (excessive that is relative to the criterion of net, risk-adjusted return).

While this is a risk under all models, we note with interest the SADM discussion on the trade-offs under market-based approaches between simplicity (which could over-emphasise fees) and complexity which may raise system-wide costs and create opportunities for gaming.

We think that a range of considerations should be taken into account in any selection of default funds and, while we look forward to the Commission's discussion in the Draft Report, our sense is that the range of relevant factors and the need to assess trade-offs between them would be excessively complex to be adequately accommodated in a market-based approach.

### *Active choice by employees*

In relation to the idea of active choice by employees, we have a number of related concerns.

- Employers have a legal obligation to make superannuation payments on behalf of their employees. There are substantial fines and the threat of reputational damage if these obligations are not met. If, under the active choice model, an employee does not make a choice, the employer would not be able to meet his or her legal obligations.



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- Employers would be reluctant to be seen as pushing employees to make an active choice for a variety of reasons. They could see themselves at risk of breaching prohibitions against the provision of financial advice; they could fear legal action if, after urging an employee to make a choice, the employee felt they had been directed to a poorly-performing fund; they may not want to incur the costs of researching on behalf of the employee.

Thank you again for the opportunity to provide our comments. Please do not hesitate to contact me if you would like to discuss these issues further.

Yours sincerely

**Innes Willox**  
**Chief Executive**