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By email: super@pc.gov.au

Ms Karen Chester
Deputy Chair
Productivity Commission
Canberra ACT 2600

Dear Ms Chester,

Re: Inquiry into the Assessment of the Competitiveness and Efficiency of the Superannuation System

Thank you for the opportunity to make a submission to the Commission's inquiry into the competitiveness and efficiency of the Australian superannuation system. Deloitte Touche Tohmatsu (Deloitte) strongly supports any efforts being made by the Government and the Productivity Commission to improve our superannuation system which will ultimately result in a higher level of confidence and outcome for the 12 million Australians who have accounts in the system.

Deloitte is a major provider of superannuation advisory services to employers and the trustees of all forms of superannuation funds. The services we provide that are relevant to this submission include:

a. Benchmarking;

b. Administration, asset consultant and insurance reviews; and

c. Tender management including default fund selection for employers.

We believe the work we carry out in these areas places us in a unique position to comment on market competitiveness from an unbiased perspective.

In this submission we particularly want to comment on the competitiveness of the system and whether:

a. That level of competitiveness produces better superannuation outcomes for the members of funds; and

b. There are barriers to competitiveness that reduce the efficiency of the system.

Prior to the introduction of Award superannuation in the late 1980s approximately 25% of the working population were provided with superannuation benefits. These employees tended to work either in the public sector, for banks or insurers or for large North American and European multi-nationals. The introduction of Award superannuation, led by unions in the manufacturing and construction industries, required employers in specified industries to pay 3% of wages into nominated industry funds. There

were some exceptions where employers had existing superannuation benefits to re-direct contributions to existing funds or off-set the 3% against already provided fully vested contributions however for the vast majority of employers Award superannuation meant no choice and contributing to industry funds.

The advent of the Superannuation Guarantee (SG) in 1991 extended compulsory superannuation to the vast majority of employees with some grandfathering for existing superannuation arrangements and employers given choice of funds for non-award employees. For the sake of simplicity many employers paid contributions for all employees into industry funds while others chose to ignore the award requirements and paid contributions into existing corporate funds and master trusts. Generally no action was taken against non-complying employers by the unions except where the employers either under-paid SG contributions or failed to pay them at all.

In 2005 the Federal Government introduced Choice of Fund legislation which gave employees, except certain government employees and those employees covered by Enterprise Bargaining Agreements, the right to choose to have their SG contributions paid into a complying fund of their choice.

In 2013 the Federal Government, following the Cooper Inquiry, introduced the concept of funds selected by employers as default funds offering a default MySuper option which was required to meet certain minimum standards. While it was suggested that this would mean a new range of products being offered to members the reality was that most industry funds re-badged their Balanced option as the MySuper option while retail funds tended to introduce life-cycle options as their MySuper options. The result for most industry fund members, in particular, was no change from the option that they were invested in prior to MySuper.

Based on the most recent statistics from the Australian Prudential Regulatory Authority (APRA) there are currently 136 public offer funds offering a MySuper option. Each of these funds are regulated by APRA and are required, in addition to meeting all the APRA licencing standards, to show to APRA on a regular basis that they are sustainable and offer a competitive product to their membership.

These current standards are considerably different from the late 1980s when Award superannuation was first introduced and there was a clear need to have default funds which fully vested contributions, provided death and disablement insurance to all members and did not pay commissions to intermediaries or agents.

As a result of these changes and the growth of the superannuation industry to over $2.2 trillion with the top 10 industry and retail funds each exceeding $50 billion in assets we are in a completely different environment to that of 30 years ago. Industry funds now compete against each other as opposed to the days when one fund would not attempt to take members from another's "turf".

In our opinion the services offered by industry funds are now comprehensive and on an equal footing to those offered by the large retail funds.

Deloitte regularly carries out administration and outsourcing tenders for corporations that either wish to wind up their existing standalone fund and move to a pooled fund or who wish to review the existing provider of their employee's superannuation default arrangements. Corporate tenders carried out in the last 4 years have ranged in size from funds or sub-funds of $10 million through to $1.2 billion. In each case we encourage the employer or trustee to consider both industry funds and master trusts as options and, in our experience, the services offered by the leading providers in both categories are extremely competitive and comparable in terms of insurance offerings, investment choice, fees, investment performance, client servicing and ancillary services.

In the case of many corporate tenders we find pre-existing attitudes to the way in which industry funds operate and their differences with master trusts change considerably once a comparison is made on a fair and balanced basis.

Large industry funds such as Sunsuper and REST, as two examples, offer a corporate product that is specifically geared to meet the needs of a corporate transfer in areas such as employer servicing and insurance benefits.

There is no question, in our opinion, that there is consistent and healthy competition both:

a. Between industry funds; and

b. Between industry funds and retail funds.

In our experience of recent tenders there is definitely rivalry amongst providers which would not have existed 10-15 years ago. Subject to them being able to meet the benefit design requirements of the tender (some providers decline on the basis that they cannot, for example, administer defined benefit funds or categories within a fund or cannot offer the range of investment or insurance options for a successor fund transfer to occur) we find that it is extremely rare for a provider, either industry fund or master trust, to decline to tender for a corporate fund, especially where assets exceed, say, $50 million.

This competition produces competitive tenders which ultimately benefit superannuation fund members in improved net returns and superior insured benefits. This competition may not have occurred if both unions and employers had not taken a sensible and pragmatic view to the enforcement of Modern Awards. In my experience I have yet to see action taken by unions or the Fair Work Commission against employers who have inadvertently or otherwise breached a Modern Award by selecting a default fund which is not listed in the Modern Award.

On this basis, if the Modern Awards are not going to be enforced then one has to question whether superannuation should be included in these Awards. In our opinion a sensible outcome, which would ensure a competitive environment between funds would include:

a. Superannuation being removed from Modern Awards

b. Employers being allowed to select any superannuation fund as the default fund which has a complying MySuper option as the default investment option. We believe that the oversight provided by APRA for all MySuper regulated funds provides a strong safety net for fund members.

c. All employees should be allowed Choice of Fund. Currently some Enterprise Bargaining Agreements (EBA) and legislation specify a fund into which all employees of the employer or employers that are parties to an EBA or legislation being members of the specified fund. This does not allow these employees choice and could be interpreted, in some cases, as third parties not necessarily acting in the best interests of employees.

d. All employers must notify an appropriate regulator or the Fair Work Commission of the default fund chosen by the employer prior to any employees being transferred to this fund. This would ensure only MySuper funds could receive default Superannuation Guarantee contributions unless the employee makes an active choice to have the contributions paid to another fund, with or without a MySuper option. This level of protection does not currently exist which means there will be some employees in the work-force who have not been placed in appropriate products.

There is, however, a barrier for new entrants to the market which could be said to limit the competition. Administration, in particular, has become increasingly complex with relatively low margins. If we were to exclude self-administration arrangements an industry fund has a very limited range of options: primarily Link/AAS, Mercer and Pillar. These three organisations, all of whom provide high quality services, have taken over smaller competitors (for example over the years Mercer has acquired firms such as Sedgwick Noble Lowndes and Buck Consulting which previously provided administration services to corporate funds). In addition the NSW Government has publicly put Pillar up for sale which, depending on the purchaser, could even further reduce the number of providers in this area. When we

add the reporting and benefit design complexity to the equation Deloitte has formed a view that critical mass for an outsourced administration provider is approximately 500,000 accounts. This clearly is a major barrier to any new provider successful entering the market.

Likewise a new master trust provider, that doesn't opt for self-administration has the same limited range of options and, in order to become profitable, needs to very quickly grow its market share in order to meet with the fee structures the large administrators require. There is no suggestion of anti-competitive behaviour by any of the major administrators, simply an acknowledgement that they need clients of a certain minimum size in order to retain profitability and any new player to the Australian market would, in our opinion, face the same challenges.

In summary we strongly support the concept of a competitive superannuation system which will drive superior outcomes for members. The current barriers to competition from a fund perspective, which are rarely enforced, grew out of a period of commissioned products and a relatively low level of oversight by both APRA and ASIC. A question needs to be asked as to whether these barriers are justified in this current regulatory environment. For service providers we believe there is competition however in areas such as administration it is far more limited and there are significant cost and critical mass barriers for new providers to join the market.

Should further commentary be needed I can be contacted

Yours sincerely,

Russell Mason
Partner
Deloitte Touche Tohmatsu