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To whom it may concern

Productivity Commission Issues Paper: Alternative Default Models

As one of Australia's leading professional services firms, we believe we are well placed to share our perspectives on the important issue of superannuation. Our firm's national superannuation practice has deep experience in the superannuation industry and across the financial services sector more broadly.

Our firm takes its role in the community seriously. We are committed to positively contributing to the Australian community and supporting and enabling initiatives that will strengthen the future prosperity of our country.

Our high level feedback is overleaf.

In summary, our concerns are for the potential outcomes depending on which allocation model is used.

- The allocation model could well determine what the industry will look like in the longer term.
    - For example, if it is the view that there should only be a limited number of large, largely uniform superannuation funds (such as 5) versus also having a number of specific niche superannuation funds that are highly targeted to specific industries, then the particular model chosen may well determine this outcome.
    - How would a niche superannuation fund highly targeted to a specific group of employees have a future if not a default fund?
    - Will the specified default funds (if they are relatively few in number) end up becoming the only MySuper funds in Australia, given the implicit credibility given to them by the process?
- The more you try to select a fewer number of "best on offer" superannuation funds as the default/s, the greater the credibility you are giving these funds in the eyes of the public and this may in fact result in less competition and higher barriers to entry for any other superannuation fund.
- Also, you significantly increase the responsibility for the Government should one of these carefully selected funds fail.

- Similar comments apply to the process of segmenting employees.
    - If you segment by any one parameter such as age could be counter to other more important factors such as their level of savings or insurance needs etc.
    - Default funds designed for specific groups of employees could potentially be moving further away from the goal of encouraging employees to become engaged and encouraging competition through appropriate engagement.

You have already specified that the option of having one default fund will not be countenanced as this does not meet the requirement in the terms of reference for alternative models to be competitive. However, it is possible that this might have the opposite effect and in fact encourage competition.

- For example, if there was just one default fund which was considered the most basic, lowest cost, no frills and possibly a government–run fund, designed to catch the least number of default employees as possible, then it may just encourage more people to actively select a more suitable default fund. This is especially the case if this fund was mandated to essentially be a temporary holding account only and "effectively do themselves out of a job" by reminding and encouraging its members to roll over as soon as possible into another fund that would better suit their needs.
- In other words, if you consider that your base line and most optimal scenario is having "no default" then having a government safety net default holding account may in fact be the closest model to your preferred scenario.

We would welcome the opportunity to participate in any further workshops or consultative meetings to further discuss our views. Please contact me or Catherine Nance

Kind regards

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QUESTIONS ASKED BY PRODUCTIVITY COMMISSION ISSUES PAPER

1) Criteria for assessing alternative models

- How should the principles and considerations in the terms of reference be operationalised? Are the Commission's proposed criteria suitable? What trade-offs might arise between criteria and how should these be handled?
- What regulatory impediments to optimal competition might be relevant?

a) The five criteria of members' best interests, competition, integrity, stability and system-wide costs (page 7) appear both reasonable and comprehensive as is the proposal to assess the alternative models against a baseline case of no defaults. The difficulty will be operationalising the criteria.

b) In practice the alternative models could encompass a range from having all MySuper funds at one end to a limited number of MySuper funds to having just one MySuper fund at the other end. Given the current requirement to use MySuper funds for default contributions, we have assumed this would continue as we believe any default should at least satisfy the minimum requirements of MySuper.

c) We note that you have already specified that the option of having one "government run" default fund will not be countenanced as this does not meet the requirement in the terms of reference for alternative models to be competitive. By extension we assume that having just one MySuper fund would also not meet the competitive requirement. So in practice, this would indicate that the expected outcome would be all or a limited number of MySuper funds. (Please note we have some further comments on the use of a government-run fund in Section 0.

d) There is no doubt that there will be trade-offs when assessing these alternative models against the five criteria. For example, some funds are specifically geared to their industries or employees, particularly in regards to having appropriate insurance covers. The health based funds, emergency service funds and some mining company funds are examples of where tailored insurance covers have been specifically sought from the market and which are more appropriate than the standard covers typically available through other public offer funds. In these cases, the criteria of members' best interests would be easily met but how criteria should then be weighed against the other criteria is not easy to determine.

e) In regards to regulatory impediments, we simply note that there are some groups of employees where State or Federal legislation determines their superannuation fund. Often these are public sector employees and more specifically emergency services employees, where certain insurance covers are required to be provided.

2) Designing the models

- Is this framework suitable for designing alternative models? What other steps might be necessary?
- What lessons arise from models used in other countries and sectors? How applicable are these to Australia's superannuation system?

a) We agree that there needs to be considerable research done into the impact of each of the possible models for determining:

   i) the default employees

   ii) the default superannuation funds, and

   iii) the method of allocating the default employees.

b) One further consideration could be to consider what the longer term view is of the superannuation industry is in Australia. For example, if it is the view that there should only be a limited number of large, largely uniform superannuation funds (such as 5) versus also having a number of specific niche superannuation funds that are highly targeted to specific industries, then the particular model chosen may well determine the outcome.

   i) How would a niche superannuation fund highly targeted to a specific group of employees have a future if not a default fund?

   ii) Will the specified default funds (if they are relatively few in number) end up becoming the only MySuper funds in Australia, given the implicit credibility given to them by the process?

3) Step 1: Identifying employees

- Which employees should be covered by the new default allocation model? Should any employee groups be exempt?
- Should there be any flow-on effects for existing default members from any new default allocation model?

a) In our view, if this model is to be applied it would need to be applied to everyone that is entitled to SG contributions with the exception of employees that come under State or Federal laws in regards to their superannuation.

b) The model should only apply to new default members not existing default members. Forcibly changing superannuation funds for existing default members would potentially incur unnecessary costs and detrimental impact on existing insurance covers.

4) Step 2: Specifying a competitive process to determine default products

- What key services (or features) should be provided by default superannuation products? Should they all have to be MySuper products?
- What are the advantages and disadvantages of allocating insurance through a separate competitive process? What should be the key features of this default insurance product?
- What other considerations are relevant to specifying a competitive process?

a) Given the likelihood that a significant number of new employees will end up in the default fund/s, it would seem appropriate that these funds meet the basic requirements of MySuper.

b) In addition, a basic level of automatic insurance should be provided with the ability to opt out.

c) If the default funds are required to provide the same terms and conditions to their other members, then we do not see how a separate competitive process for insurance would work and how this would be efficient.

d) Also, if you end up with only a small number of default funds, it is difficult to see how you would determine the default insurance covers that would be appropriate for what would be most new employees in Australia.

   i) For example, should death cover be mandatory when most new employees entering the workforce would be too young to have dependants?

   ii) Would income protection be mandatory when their income earning ability is probably their key asset?

   iii) Should all insurance definitions use an industry standard?

5) Step 3: Allocating employees to eligible default products

- Within a particular allocative model, should employees be segmented into groups for the purposes of allocating them to default products? If so, how should they be segmented? What are the benefits and costs of this approach?
- Who should decide on which employees are allocated to which products, where multiple default products are chosen by the new allocative model?

a) We are concerned that any segmentation of employees by one parameter such as age could be counter to other more important factors such as their level of savings or insurance needs etc. Also, if you start to have default funds designed for specific groups of employees, you are implicitly recommending these funds for these employees and could potentially be moving further away from the goal of encouraging employees to become engaged and encouraging competition through appropriate engagement.

6) Some options for an allocation model

- What other types of model, in addition to the three identified here, should the Commission consider in this inquiry?

a) You have already specified that the option of having one default fund will not be countenanced as this does not meet the requirement in the terms of reference for alternative models to be competitive. However, it is possible that this might have the opposite effect and in fact encourage competition.

b) For example, if there was just one default fund which was considered the most basic, lowest cost, no frills and possibly government–run fund, designed to catch the least number of default employees as possible, then it may just encourage more people to actively select a more suitable default fund. Especially if this fund was mandated to "effectively do themselves out of a job" by reminding and encouraging its members to roll over as soon as possible into another fund that would better suit their needs.

c) In other words, if you consider that your base line and most optimal scenario is having "no default" then having a government safety net default may in fact be the closest model to your preferred scenario.

d) The more you try to select a fewer number of "best on offer" superannuation funds as the default, the greater the credibility you are giving these funds in the eyes of the public and this may in fact result in less competition and higher barriers to entry for any other superannuation fund.

e) We encourage you to consider all possible options for alternative models.

7) Administrative model

- What are the advantages and disadvantages of using some form of administrative filter to determine which products are eligible to be used as defaults?
- What metrics should be used and how prescriptively should they be specified? Should the metrics be quantitative, qualitative or a mixture?
- Should there be a cap and/or floor on the number of qualifying products?
- How frequently should the process be run?
- Who should administer the selection and subsequent monitoring of products?
- What might be the role of MySuper in the long term under this approach?
- What would be the likely effects of an administrative filter on competition between successful funds and in the superannuation system more broadly? What would be the implications for product innovation and system stability?

a) As a general statement, whatever metrics you set will be what drives the future development of superannuation funds, so care would need to be taken as what you measure is what you will get.

b) One other consideration is the responsibility that will sit with the Government for the performance of the default funds as a results of the selection mechanism.

c) If you apply an administrative model, you are basically saying that any fund that meets this bar is open to being a default fund. For example, this could simply be any MySuper fund as they have already met a certain minimum standard.

d) This will likely result in less responsibility for the Government should one of these funds fail, then if you actively try to select a fewer number of "best" on offer through a mixture of quantitative and qualitative tests and one of these funds fail.

8) Administrative model - How would employees be allocated to products?

- What are the relative merits of using a single filter that covers the entire system versus a more segmented approach? What are the key practical considerations and challenges in implementing each approach?
- In what ways could employees be allocated to eligible products in an administrative model? What are the advantages and disadvantages of each approach? What costs and responsibilities would fall on employees, employers, regulators and superannuation funds under each approach?
- What should happen to default members in products that lose their approval under the filter?

a) As noted above, we are concerned that any segmentation of employees by any one parameter such as age could be counter to other more important factors such as their level of savings or insurance needs etc.

b) Also, if you start to have default funds designed for specific groups of employees, you are implicitly recommending these funds for these employees and could potentially be moving further away from the gaol of encouraging employees to become engaged and encouraging competition through appropriate engagement.

9) Market based models - How would eligible products be determined?

- What would be the likely effects of a tender on competition between successful funds and in the superannuation system more broadly? What would be the implications for product innovation and system stability? What would be the likely effects on long-term member outcomes?
- What metric(s) would be most appropriate to include in a tender, and why?
- How should the bids be assessed against the metric(s)?
- Where there are multiple metrics, how should trade-offs among them be assessed?
- What scope might there be for funds to manipulate a tender process, and how can this be minimised? How might trials or experiments help in refining the design?
- How frequently should a tender process be run? Who should administer the selection and subsequent monitoring of products?

Market based models - How would employees be allocated to products?

- What are the relative merits of using a single tender that covers the entire system versus a more segmented approach? What are the key practical considerations and challenges in implementing each approach?
- In what ways could employees be allocated to eligible products in a market-based model (including through single winner and multiple winner tenders)? What are the advantages and disadvantages of each approach? What costs and responsibilities would fall on employees, employers, regulators and superannuation funds under each approach?
- What are the merits of using the MySuper requirements as an entry threshold to the tender process? What are the potential problems with this kind of approach?

a) See above comments for administrative models, namely:

   i) The more you try to select a fewer number of “best on offer” superannuation funds (through a market based model) as the default, the greater the credibility you are giving these funds in the eyes of the public and this may in fact result in less competition and higher barriers to entry for any other superannuation fund.

ii) Also, you potentially increase the responsibility for the Government should one of these carefully selected funds fail.

iii) Segmentation of employees by any one parameter such as age could be counter to other more important factors such as their level of savings or insurance needs etc.

iv) Default funds designed for specific groups of employees could potentially be moving further away from the goal of encouraging employees to become engaged and encouraging competition through appropriate engagement.

10) Active choice model by employees

- What are the advantages and disadvantages of an active choice model? How can these costs and benefits be assessed and measured?
- What safeguard mechanisms might need to be put in place to deal with some of the potential pitfalls of an active choice model?
- Would an active choice model benefit from a filter to ensure good quality products are chosen? What are the costs and benefits of government involvement in specifying a recommended list of products, compared to private sector provision of such information?
- How can behavioural finance inform the development and refinement of an active choice model? What experiments would need to be formulated and conducted to provide relevant evidence?

a) You are already indicated that an active choice model is the goal. If it is the goal then this implies the least intervention in determining the default fund. In fact, the default fund should be almost a last resort fund only.