sunsuper

Sunsuper submission to the Productivity Commission's 'Draft report – Superannuation: Alternative Default Models'

April 2017

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Superannuation
Productivity Commission

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Dear Sir/Madam

SUBJECT: 'DRAFT REPORT – SUPERANNUATION: ALTERNATIVE DEFAULT MODELS'

Thank you for the opportunity to make a submission on the Productivity Commission's draft report on Superannuation: Alternative Default Models.

Sunsuper is one of Australia's largest and fastest growing superannuation funds, with more than 1 million members, 90,000 participating employers and $40 billion of funds under management as at February 2017.

We are the largest fund in Queensland by number of members and the ninth largest public offer fund in Australia. Established in 1987, our profit for members philosophy means our members can take advantage of low fees and a broad range of services designed to enhance their retirement benefit outcomes.

Should you wish to contact us about our submission, please contact Lachlan East, Chief Risk Officer,

Yours sincerely

Scott Hartley
Chief Executive Officer

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Strengthened criteria can be developed during future consultations with the superannuation industry.

Recommendation 2: Given the unique nature of any superannuation fund merger, Sunsuper does not support the implementation of a formal framework (including public disclosure) of fund merger (successful or unsuccessful) information.

Recommendation 3: We support Draft Recommendation 3.1 which proposes assigning a default product to a member only once when joining the workforce to avoid perpetuating the legacy problems the industry faces today.

Recommendation 4: Group insurance within superannuation should be retained to maintain the high value and relatively inexpensive risk protection which is afforded to members.

About the Commission's four alternative default models:

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Recommendation 6: We support model two. Model two maintains strong consumer protections (after applying the high quality filter) while boosting competition. It should be adopted along with complementary reforms to drive market efficiency.

Recommendation 7: We are supportive of the forward looking assessment in model three. However, we do not support the government sequential allocation to products and believe this decision should be made through employee/employer choice.

Recommendation 8: Model four should not be considered. This represents extraordinary market intervention which risks the stability and strong performance of the superannuation system and should not be considered further. It would result in a 'race to the bottom', a poor service offering and sub-optimal returns. It would preclude investment in historically strong performing illiquid assets.

2. Overview

Australia was an early mover on establishing a defined contribution mandatory savings system in 1992 to manage the costs of an aging population and promote independence and dignity in retirement. For most Australians, superannuation has become the second biggest asset after the family home.

At the most basic level, superannuation should provide dignified living standards for retirees and ease the fiscal burden of the aging population. Sunsuper supports the 2014 Financial System Inquiry's recommendation to clearly define the purpose of superannuation along these lines. We are pleased the Government has accepted the FSI recommendation and a Bill is currently before Parliament.

Once legislated, it is appropriate to test whether the superannuation system is delivering against these objectives. The framing and structure of the default superannuation market, which is the subject of this phase of the review, heavily determines the returns enjoyed by individuals and the Commonwealth.

Accordingly, we welcome the inquiry's focus on the efficiency of the system at this juncture.

We note that the draft report does not specifically address existing workers (in the turnover pool) that have multiple accounts and how the industry would determine which account becomes their future default account and, hence, does not address a reduction of multiple accounts for existing workers. This would result in a long tail of legacy practices in the system.

We would support further consultation from the Commission with the industry in relation to how a reduction of multiple accounts for the 'turnover pool' could be addressed.

Furthermore, the ATO's proposed Single Touch Payroll regime that is due to commence (for employers with 20 or more employees) aims to reduce the proliferation of multiple member accounts from 1 July 2018, i.e. well before any of the four proposed alternative default models would commence.

We caution that the transition of the industry to the successful model is as important as the choice of the model itself. A disorderly transition would significantly impact the trust in the industry and this is the case for all four models.

Products that are not included on any approved shortlist would likely be significantly impacted (through impact on cash flows) which would not necessarily be in employees best interest given likely impacts to product and service offering, investment strategy etc.

Hence we recommend an orderly transition to any product shortlist that starts with at least 20-30 products and is reduced over time.

It is also important that whatever the outcome of this inquiry, it ought to be consistent with the work on providing a clear purpose for superannuation. If superannuation is to deliver its longer term objectives of reducing age pension costs, the market structure must promote the attainment of strong investment returns.

If, for example, an outcome of this inquiry was a fee-based tender, in our view, the market structure would work against the objective of the superannuation system.

A race to the bottom with an obsessive focus on fees, rather than value, would be counterproductive and entrench a structural inconsistency in the superannuation scheme.

A sound and efficient default superannuation system makes a significant contribution to better retirement outcomes by ensuring Australians' retirement savings are not eroded by unnecessary charges while providing strong investment returns.

The design of the default superannuation market is critical as it is estimated that up to two-thirds of Australians do not select a superannuation fund.

We note the terms of reference for the Commission's review mean the emphasis for any future default regime is to be moved from default *"funds"* to default *"products"*.

As noted in the draft report, this shift has come about because of the introduction of the MySuper regime where, since October 2013, funds have been required to pay 'default contributions' (i.e. where a new employee has not chosen a *fund*) into a MySuper *product* (i.e. to a fund that offers a MySuper product).

The default superannuation regime which existed in legislation prior to January 2010 centred on the former Australian Industrial Relations Commission or state predecessor bodies selecting or agreeing on "funds" for default purposes.

We now refer to products as MySuper is the first detailed, legislated superannuation "product".

It has been our long term view that MySuper, as a superannuation "product" designed in legislation should not encourage apathy.

Every current and future policy lever in superannuation should be designed to encourage further member engagement as the system matures in coming decades. Member engagement in superannuation will be critical in achieving adequate retirement outcomes for many Australians.

We welcome the opportunity to make a submission on the four alternative default models as presented in the Commission's draft report.

Sunsuper's fundamental criteria for assessing the four alternative default models can be found throughout the submission and include:

1. Individual empowerment should always be promoted with engaged members more likely to become self-sufficient or largely self-sufficient in retirement. We do not support policy

changes which drive apathy and disengagement;
2. There exists significant scope for efficiency gains in the existing superannuation system which should be explored without delay (catalogued in part two);
3. We note the longer term focus of this review. We are open-minded about alternative models which seek to balance risk and return, transparency, promote efficiency and reduce unnecessary charges. However it is difficult to assess each of the four proposed alternative default models against the current operation of the system given the MySuper reforms will only be fully implemented from 1 July 2017;
4. Complementary policy action which is outside the scope of this review's time horizon will be necessary to deliver any of the longer-term reforms (as the draft report notes). We support, in the short and long term, reforms to promote:
    a. "genuine member choice of fund" (Draft Finding 1.1);
    b. strengthening prohibitions against inducements and ensuring member best interests are always paramount (Draft Finding 1.2); and
    c. enforcement of the ban on cross subsidisation in the MySuper laws through enforcement of s29VB(5) of Superannuation Industry (Supervision) Act (SIS) 1993, to ensure fees charged to employees of an employer-sponsor are to be "at least equal to an amount that reasonably relates to the costs incurred in the administration and operation of the fund in relation to those members'.

Simplification and comparability of superannuation products should remain core reform principles (consistent with the thrust of the Cooper Review into the superannuation system). Accordingly there ought to be one single set of default superannuation criteria in Australian law. On the following pages, we present our views and responses for the following:

Section 3: Driving efficiency
Section 4: The four alternative default models
Section 5: The Commission's 'information requests'

3. Driving efficiency

In this section, we outline our views on market and regulatory dynamics which in our view are reducing the efficiency of the default superannuation system. The issues outlined in this section can be dealt with in the immediate term as the MySuper reforms are concluded (effective 1 July 2017).

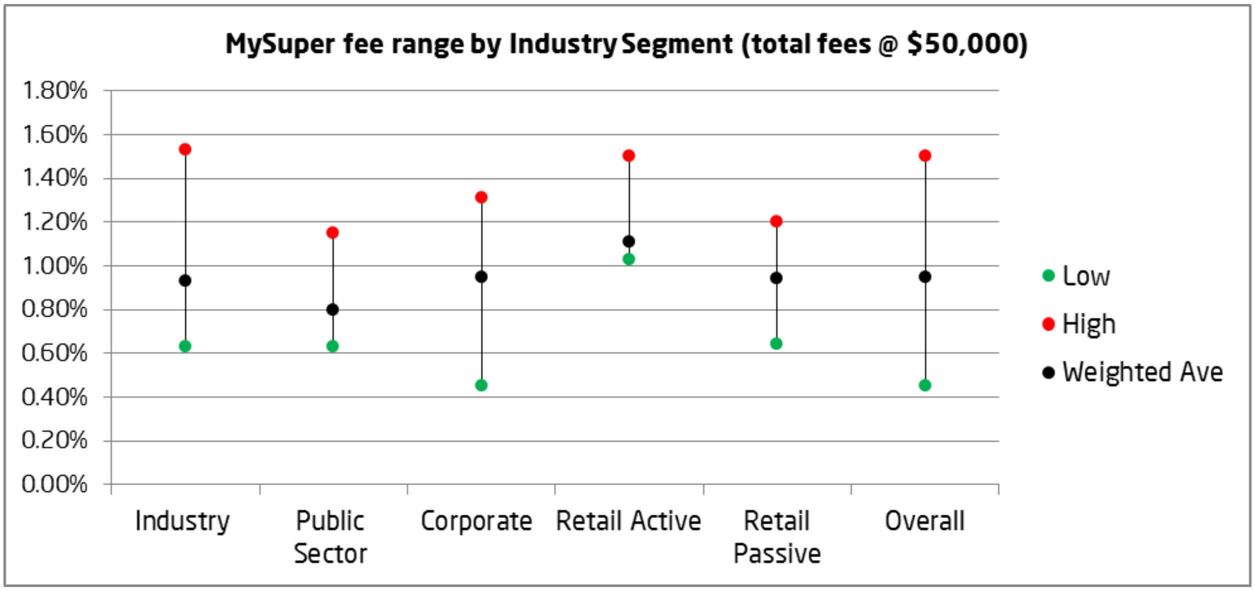
MySuper authorisation

The MySuper reforms were designed to standardise and simplify superannuation products for members who do not select a fund. Since its introduction in 2013, MySuper has been successful in reducing system wide costs to members without any evident impinging of investment performance.

Yet the accreditation process for which APRA is responsible has delivered a large variation in fees between MySuper products in the past four years. The MySuper governing legislation which has remained largely intact since 2013 provides a broad scope for APRA to evaluate MySuper products. To date, APRA has authorised MySuper products for most complying funds.

Evidence of the variation in fees can be found in the table below.

Table 1: Weighted average MySuper fees by sector (Chant West – December 2016)



"Source: Chant West Pty Limited (www.chantwest.com.au)." [1]

While the superannuation subsectors presented in this table are not homogenous, it provides a good example of the headline fee variance which ranges from 40 basis points to 1.50 in the MySuper sector.

As the table above demonstrates, MySuper is a very wide "gate" for legal determination of a default superannuation product. The very large divergence drives complexity, confusion and duplication. The MySuper criteria, as prescribed in legislation, should be the "one stop shop" for superannuation criteria in Australian law. Fees are observable but it should be noted that net returns and features also differ. These can also be measured in their own way.

Recommendation 1:

MySuper criteria that are applied by APRA should be tightened and used by a future selection panel such as envisaged in Draft Finding 3.5

A tighter "gate" should be applied as a suitable basis for a mandatory minimum standards filter as proposed under model two, "Assisted employer choice (with employee protections)"

[1] Disclaimer:
"The Chant West data is based on information provided by third parties that is believed accurate at December 2016. Your objectives, financial situation and needs have not been taken into account by Chant West and you should consider the appropriateness of this information having regard to your objectives, financial situation and needs, and read the relevant Product Disclosure Statement, before making any decisions. Chant West's Financial Services Guide is available at www.chantwest.com.au."

Strengthened criteria can be developed during future consultations with the superannuation industry.

Industry fragmentation

The superannuation industry today remains considerably fragmented.

The high level of fragmentation leads to costs which are too high. Only AMP and AustralianSuper have over 5% of system assets.

To compound this, approximately half the industry is in outflow, i.e. where funds receive less in contributions income than they pay out in benefits. Industry maturity – growth is decelerating rapidly and consolidation is becoming more important.

According to Tria Partners, in 2012, there was five per cent net inflow growth. By 2020, we expect that system growth (as measured by net inflows) will be negligible. Given a number of superannuation funds are already in outflow, this is likely impacting investment decisions they are taking today. Put simply, a small fund in outflow has less opportunity to invest widely – including in illiquid assets.

Size of fund and profile of membership is one of the biggest drivers of investment performance. While we are careful to use past performance as an indicator of future performance, large funds with strong inflows tend to outperform.

The basis for the historical outperformance by large funds is, in our view, in part linked to higher levels of investment in illiquid assets.

Other factors have driven higher performance levels for larger not for profit funds which include the absence of a profit margin and less motivation to use related parties.

In addition, industry statistics support the view that fund size also contributes to operational efficiencies and ultimately lower fees for members.

However, consolidation should not be sought for consolidation's sake. There are good and bad reasons to pursue consolidation bearing in mind the demographic profile of the funds. There is a place for large and small funds.

The Commission should be aware the barriers to funds seeking consolidation are varied and complex across the spectrum of cultural, structural and legal frameworks in which the industry operates.

We believe opportunities for mergers should be encouraged where it makes sense to do so, bearing fund values, vision, structure and demographic profile in mind.

Furthermore, loss/gain rollover relief should be extended indefinitely so as (Div 310 under the Tax Act) to remove any barriers trustee directors might identify such as future impediments to fund mergers such as the loss of a tax asset.

However, we believe a formal framework with public disclosure could be counterintuitive to encouraging consolidation in the industry.

Recommendation 2:

Given the unique nature of any superannuation fund merger, Sunsuper does not support the implementation of a formal framework (including public disclosure) of fund merger (successful or unsuccessful) information.

Legacy products

The existence of a significant pool of savings locked into high-fee legacy products such as "accrued default amounts" and older-style personal and corporate superannuation plans leads to higher fees for members than is necessary.

Although the transition period for higher fee pre-MySuper products closes on 30 June 2017, we believe there is further scope to reduce cost and inefficiency. A large driver of legacy product proliferation in the wealth management sector is the absence of a mechanism for rationalising largely pre-compulsory superannuation, whole of life products.

We believe a product rationalisation mechanism which applies across the financial services industry is overdue and should be swiftly implemented in accordance with the recommendations of the Financial System Inquiry of 2014.

Cross-subsidisation within MySuper Products and Corporate Super Practices

We support the administration fee exemption for employees of an employer-sponsor, as provided under SIS (1993) S29VA(8) and S29VB. This provision is a sensible exemption that reflects economies of scale derived from large employer sponsorships, and it encourages competition and better outcomes for members.

Our concern is that it appears that some market participants are taking advantage of this exemption in that the level of discounting apparent in practice goes well beyond a level that is justifiable based on the reasonable costs that are incurred by trustees (or their service providers, in most cases a related party) in administration and operation derived from employer sponsorship arrangements.

Discounts of this magnitude mean that members of the same fund pay vastly different MySuper administration fees, with a similar level of account balance, services and features.

We support enforcement of s29VB(5) of SIS to ensure fees charged to employees of an employer-sponsor are to be 'at least equal to an amount that reasonably relates to the costs incurred in the administration and operation of the fund in relation to those members'.

Recommendation 3: We are supportive of Draft Recommendation 3.1 which proposes assigning a default product to a member only once when joining the workforce to avoid perpetuating the legacy problems the industry faces today.

Multiple accounts and centralised online service

The intent of Single Touch Payroll (STP) is to "*Improve the efficiency of the superannuation system (reducing the proliferation of the multiple accounts & fees, better engagement in the choice process)".*

It is likely that a centralised reporting service for data will be implemented. This will capture member default fund and associate it with TFN and allow funds to consume the service via APIs. This is logical role for the government to play and the intent of STP.

The ATO is producing technical documents to support this intent with the view of myGov being the one centralised point for a member to easily consolidate superannuation accounts. This is further supported by SuperMatch2, already implemented by Sunsuper, to streamline this process with automated transfers from ATO held monies.

The employee on-boarding process will further support a member's ability to view active Superannuation accounts through myGov when commencing with a new employer to allow the member to make informed an Superannuation choice. This will be further extended to pre-filled TFN and Choice forms also available through myGov.

It's important to note that the automated on-boarding process with the ATO is not mandatory and relies on payroll providers offering an automated process with the ATO.

In terms of the concept of a centralised clearing house, the level of infrastructure and complexity required to centralise clearing across Australian superannuation is growing. As workforces are increasingly portable and the 'gig economy' influences work behaviours, employers are paying super more and more frequently and to more and more destinations.

This complexity and the need to still resolve exception management and human error will be insurmountable for the government. The government has already seen low success with the Medicare based central clearing house for small businesses. Employers simply do not want to deal with them. This option is only viable after a stance is made for options 1-4 above and maturity is developed.

Insurance

It is Sunsuper's view that insurance in superannuation is critical in ensuring members are protected if something unfortunate was to happen to them and they could not work until retirement. Last year the industry paid out over $4 billion in claims, Sunsuper over $280 million, many of those members would not have had insurance anywhere else if it was not part of their superannuation offering.

Currently the Insurance in Super Working Group (ISWG) are looking at insurance and ways to make it more efficient inside of superannuation.

The vision is to make insurance in super easier for members to understand and access with topics such as member communications, claims handling, retirement erosion and standard terms and definitions being reviewed, discussed and changes recommended that all superannuation funds will be required to adhere to.

Sunsuper are actively participating on all of the working streams of the ISWG, leading two of the streams and also intends to put in a submission on every discussion paper that is published for consultation.

Sunsuper believes it is important to influence and lead insurance changes that will lead to a better member experience, and believes the changes recommended by the ISWG will make the process more efficient for all parties involved.

Sunsuper are consistently looking for opportunities to improve efficiencies in both product design and in our service offering and work closely with our insurers to ensure members are receiving the best possible service solution.

Recommendation 4:

Group insurance within superannuation should be retained to maintain the high value and relatively inexpensive risk protection which is afforded to members.

Attrition

Consistent with the need to tighten MySuper criteria in legislation, the number of eligible default products should also reduce over time as was originally envisioned by the Cooper Review into superannuation.

Ideally, over time the number of eligible default products (MySuper options) should reduce from hundreds to dozens.

4. Our feedback on the four models

We note that the four models countenanced in the paper would only be considered sometime after the full implementation of the MySuper reforms.

Accordingly, our comments are designed to assist the Commission assess these options in abstract and before the MySuper reforms are concluded on 30 June 2017.

Given the scale of the changes reflected in the Commission's draft report, the issues that we outlined in section three would need to be addressed before further changes are considered and a reasonable transition period would be essential. At least, we would expect the efficiency dividends which exist in section three to accompany any structural reform (adoption of one of the alternative models).

In assessing the four alternative default models suggested by the Commission, the principles we would apply to any possible market structures include:

1. Engagement and individual interest in superannuation should always be encouraged, market design should not encourage apathy;
2. Ideally, an initial workplace default by a member would be the only default assigned to a member in their career;
3. The true measurement of value to members and the Commonwealth is long term sustainable net returns – not fees;
4. Fees and costs are an input which should be systemically minimised but not focused on obsessively;
5. A properly designed market will deliver the best outcome for members. Only market competition drives innovation, competitive fee pressure and better member services;
6. Recognising that sovereign risk cannot be totally eliminated in a mandatory pension scheme, sovereign distortion and risk should be minimised wherever possible;
7. Insurance in superannuation delivers essential risk protection to millions of Australians in a cost effective manner which has only been possible because of the group policy pricing and conditions.

MODEL ONE: Assisted employee choice

This model leverages the competition benefits that arise when members exercise choice, but with information and nudges to assist members to make informed choices.

Consistent with our desire to boost community engagement, Sunsuper accepts there are positive elements of an assisted employee choice model, including a designated shortlist of approved funds.

Requiring employees to select an approved, shortlisted superannuation fund is a reasonable proposition. For this model to be implemented, the Financial System Inquiry's recommendation to guarantee most Australians the right to select a superannuation fund by extending this to enterprise agreements was accepted by the Government.

Accordingly, a Bill was introduced last year to give effect to this recommendation – although the Bill lapsed when the 2016 Federal election was called and has not yet been re-introduced.

Aside from driving individual engagement from the start of employment, there are downsides which need to be considered. More choice entails the risk of promoting systemic costs which would be borne by members.

The model also does not appear to cater to employee industry specific product requirements (see also comments in relation to model three) and assumes that employees will be equipped to select a fund from the short list relevant to their needs when this may not be the case.

Costs

Excessive marketing costs would likely emerge as funds look to attract retail members which had previously been assured or a high level of assurance through either enterprise agreements or modern award listings. The aim to be the number one brand in the market will be a significant driver of costs.

A breakdown of the costs of acquiring a new member can be found below. On average, marketing costs for each member are $30 which would increase dramatically if model one was implemented.

Ultimately members would bear these costs further eroding retirement savings. It would also increase the risk a decision based on brand awareness rather than features and member needs.

Table 2 – Activity Costs (CEM Benchmarking Report (2013 and 2015))

Marketing Strategy, Advertising and PR costs	$ per member (p.a.)		
	2013	**2015**	**% change**
In-house Average	$9.63	$10.28	7%
Out-sourced Average	$8.01	$9.57	19%
Overall Average			**13%**

Source: CEM Benchmarking Report (2013 & 2015)

Another possible consequence of model one is further market fragmentation. At one level, more individuals exercising choice of fund will reduce the ability for trustees to deliver scale benefits through lower costs and better products in investment, administration and insurance components. Historically, the lowest fee superannuation schemes have been industry funds and large employer retail master trusts. The table below unpacks this in detail.

Table 3: Superannuation fees by segment – Rice Warner

Fees by superannuation segment – Year to 30 June 2014						
Sector	Segment	Operating	Investment management	Operating & investment management[1]	Advice	Total fees[1]
		(%)				
Wholesale	Corporate	0.16	0.46	0.62	0.02	0.64
	Corporate Super Master Trust (large)	0.28	0.53	0.81	0.04	0.86
	Industry	0.29	0.63	0.92	0.04	0.96
	Public Sector	0.17	0.59	0.76	0.04	0.80
Retail	Corporate Super Master Trust (medium)	0.66	0.62	1.28	0.10	1.38
	Corporate Super Master Trust (small)	0.79	0.64	1.43	0.11	1.54
	Personal Superannuation	0.87	0.49	1.36	0.29	1.64
	Retail Retirement Income	0.78	0.40	1.18	0.43	1.61
	Retirement Savings Accounts	0.60	0.40	1.00	-	1.00
	Eligible Rollover Funds	0.68	1.51	2.18	-	2.18
Small funds	Self-Managed Super Funds	0.21	0.68	0.89	0.15	1.04
Total		**0.37**	**0.59**	**0.96**	**0.14**	**1.10**

1 Components may not add up to totals due to rounding.

The table above compares the blunt comparison of fees. Investment performance needs to be looked at separately as does the insurance component.

The fee offering has been made possible because of the scale and certainty of servicing large employer bases.

Future Fund

We do not support any form of Commonwealth intervention into investment management or superannuation administration. Large financial institutions operated by Australian governments have historically not served the community in a sustainable manner.

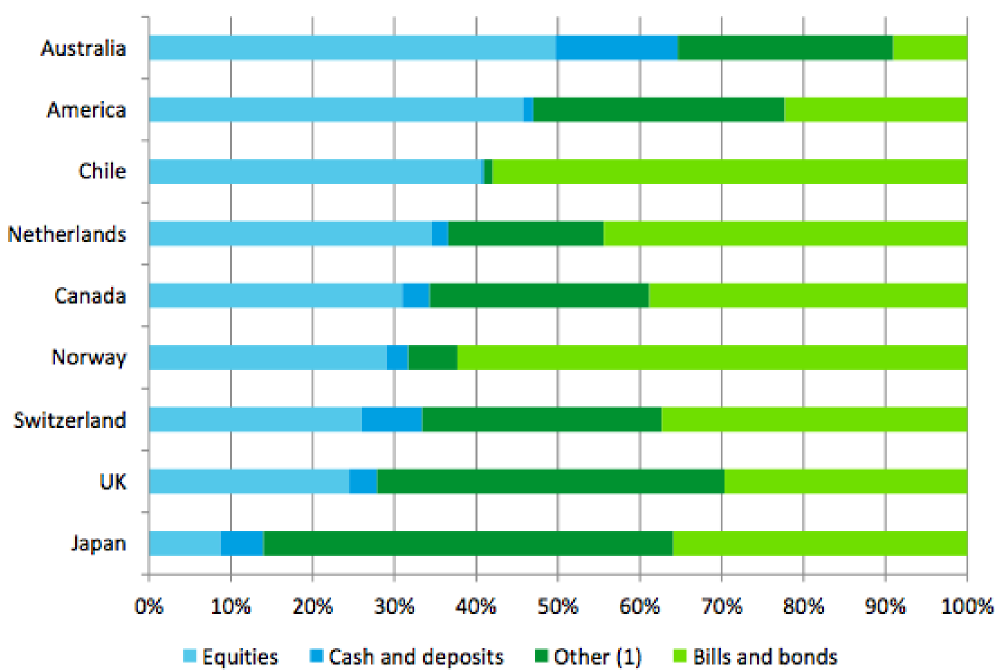
There is no case for any form of Commonwealth intervention into investment management or fund administration.

For any member that does not exercise choice, we support allocating that member to an approved (non-government) default fund using a prescribed formula (for example each fund gets allocated a new member in turn).

On a global comparison basis, Australia's superannuation industry delivers relatively low fees whilst providing solid returns over the first 25 years of the scheme's history.

As Deloitte Access Economics found in a report for the Financial System Inquiry, Australia's higher allocation to growth assets, as seen below, is a distinguishing factor of our scheme.

Table 4: Asset allocation by country – Deloitte Access Economics



As Deloitte also found, the higher allocation to growth assets had not put Australia at the top of the pack for costs. We remain a middle of the pack on a cost basis.

Commonwealth intervention would only reduce investment flexibility, competition and innovation in the market. This is a different function to designing the market structure.

<u>Recommendation 5:</u>

We are concerned model one would not strike the optimal regulatory balance. This is particularly the case in the event where employees do not make a choice default into a government fund. Model one delivers considerable cost and sovereign risk into the market and will result in excessive marketing costs from competing funds.

MODEL TWO: Assisted employer choice (with employee protections)

This model injects competition by giving employers choice in selecting a default product for their employees, as long as the default product meets some minimum standards, while also simplifying choices for small and medium sized businesses.

In Sunsuper's view, model two is the preferred option which has been put forward by the Commission.

At the core of this model is a Commonwealth agency selecting 4-10 default superannuation products (i.e. through the application of a 'heavy filter'). This model is not dissimilar to the Fair Work Commission selection process for each modern award which allows for '2 to 15' default funds to be listed in a modern award (s156H).

The primary difference is the selection of a small number of products (application of a 'heavy filter') for the Australian economy rather than a small list for 122 sectors of the economy as reflected by the 122 modern awards.

Requiring default products to meet minimum standards could occur through the new agency or it could be achieved by tightening the MySuper authorisation legislation as canvassed in section one of this submission.

This model envisages a Commonwealth agency to select the superannuation funds and conduct the regular reviews. We agree with the intent of the Commission's design features as envisaged in Draft Finding 3.5.

This function could not be fulfilled by a regulator as it could give rise to a conflict for either the prudential (APRA) or market (ASIC) regulator.

Given the myriad government bodies the superannuation industry is required to engage with today, we would not support the creation of an additional agency.

Accordingly, we believe the best agency to house a selection panel would be the Commonwealth Treasury.

The superannuation panel could be created in a similar manner to the Tax Practitioners Board or the former iteration of the Foreign Investment Review Board which were largely housed within the Treasury or Australian Tax Office.

Given we entrust Ministers to appoint the Governors of Reserve Bank and High Court Justices, the superannuation panel should also have Ministerial appointees. We believe there exists a deep reservoir of superannuation fund selection expertise within the industry which would be drawn upon for this purpose such as professional services firms, ratings agencies and/or tender consultants.

We support this model as it applies a two tiered filter to the selection of default products:

(i) An independent body with deep superannuation skills and expertise: and
(ii) Employer: an employer selects a product from a shortlist where the employer will have specific knowledge of the workforce and ultimately result in a more optimal outcome than random sequential allocation.

<u>Recommendation 6:</u>

We support model two. Model two maintains strong consumer protections (after applying the high quality filter) while boosting competition. It should be adopted along with complementary reforms to drive market efficiency.

MODEL THREE: A multi-criteria tender

This model incorporates a market-based mechanism into the selection of default products, with sequential allocation of members among winning products.

In our view, this appears to be a more forward looking model than options one and two as it involves an assessment as to the likelihood of future performance of tendering funds.

However, a government-run tender may not be appropriate for the superannuation industry as it is at risk of breaching the line between the Commonwealth designing a market and being involved in the marketplace.

Moving from a list of recommended funds to the Commonwealth involving itself in a semi-commercial process where it picks a mandatory product on a periodic basis introduces potential sovereign risk.

The model may also discourage member engagement as the Commonwealth assumes a larger ongoing role in the market where members can do nothing, ever. It is a very strong contrast to Model one which requires members to consider their options, what's important to them and their family.

We believe the model is also at risk of participants attempting to 'buy' market share and hence may not support a long-term view introducing risks related to sustainability.

We do not believe that sequential allocation of members to successful products is appropriate as employee/employer choice. Employees could be allocated to a product that is not appropriate for their industry (for example) and not provide services that are appropriate to their needs (for example insurance product offering, advice offering, education etc.)

<u>Recommendation no. 7</u>

We are supportive of the forward looking assessment in model three. However, we do not support the government sequential allocation to funds' and believe this decision should be made through employee/employer choice.

MODEL FOUR: A fee-based auction

This is the lowest common denominator option. Model four works against the engagement of members and will result in less investment in the industry, less innovation and less improvement of member experience.

Formalising a "set and forget" approach would not be in the interests of members and we do not support model four.

Premise

The very premise of a tender was based on incorrect global comparisons on superannuation fees. For example, the Grattan Institute's submissions to the Financial System Inquiry were materially incorrect in that their report compared Chile and Australian systems and failed to count both administration and investment fees.

Chant West, an independent consultancy, found the failure to accurately capture the Chilean pension fees meant the apparent benefits of the Chilean auction model were considerably overstated and Australia already had lower comparable fees.

Returns not fees

We also have concerns that this model may result in an obsessive focus on fees, not value. Value can only be measured by considering risk and return.

In Australia's system, historical outperformance of larger not for profit funds has been underwritten by high levels of exposure to unlisted and illiquid assets.

Any reform that compromises the ability of trustees to continue making investments which have a higher cost base with the potential of greater reward would be regressive.

Given the MySuper reforms are not yet fully implemented, moving to a tender process would be a cavalier approach given no interim steps have been attempted.

<u>Recommendation no. 8</u>

Model four should be not be considered. This represents extraordinary market intervention which risks the stability and strong performance of the superannuation system and should not be considered further. It would result in a 'race to the bottom', a poor service offering and sub-optimal returns. It would preclude investment in historically strong performing illiquid assets.

5. Information requests

In this section, we respond to a number of the Commission's requests for information where these relate directly to the four proposed models. In most cases, the substantive points have been made in sections two and three.

Model One: Assisted employee choice

INFORMATION REQUEST 5.1

In terms of a shortlist of superannuation products, what evidence is available on the size of the list that would best facilitate the majority of employees to choose a fund that meets their needs?

What specific information should be included alongside such a shortlist to help employees to choose between products? In what format should the information be presented? What evidence is there for how the metrics would assist employees to make decisions?

What institutional arrangements would best suit a last-resort fund? Should it be managed by existing eligible rollover funds or the Future Fund?

Under a system of active employee choice, what would be the costs and benefits of prohibiting funds or related parties from offering prospective members a short-term benefit that is unrelated to the superannuation product? What specific form should any such prohibitions take?

In relation to any shortlist, we are not aware of any empirical evidence that would demonstrate a specific shortlist size which would be optimal for new employees.

As outlined above, we do not believe the length of the list of eligible default funds will present material problems for employees or employers, although, as stated earlier, we recommend an initial shortlist of at least 20-30 products, to be reduced over time.

In the past few years, a number of standardised regulatory measures have been created to help members compare products. Although we do not support Model One as a preferred option, if it were to be adopted we think it would be appropriate for any shortlist to contain at a minimum:

- The product dashboard for each MySuper product listed
- The standard risk measure rating for the product

A last resort fund is unnecessary if employees/members are required to provide superannuation fund details upon employment commencement. As discussed in section two, we would not support the Commonwealth intervening into investment management or fund administration.

Sunsuper supports the maintenance and expansion (if necessary of section 68A of the Superannuation (Industry) Supervision Act which prohibits inducements to be paid to employers considering a default fund.

While we support empowerment and individual choice, we believe marketing costs could significantly increase if the market was based on model one. On this basis, we prefer model two which maintains a stronger role for the employer in the marketplace.

Model Four: Fee-based auction

INFORMATION REQUEST 6.1

Is the format of a first-priced sealed bid with a best-and-final-offer stage and potentially multiple winners the best fit for a fee-based auction? Are there any risks associated with these design elements that have not been identified?

Regarding transparency, what would fall under the exemption of information that, if it were disclosed, could reasonably be expected to have commercially adverse consequences for the bidder?

Could a fee-based auction be designed to facilitate second-order competition between funds on non-fee aspects of performance, such as member services?

A fee based auction would be a lowest common denominator approach which would not be consistent with the objectives of the superannuation system as described above.

Model Three: Multi-criteria tender

INFORMATION REQUEST 7.1

Which aspects of member services should be included in the tender criteria? Do default members value the same services as choice members?

How should default members be allocated across the set of winning products? Are there problems with sequentially allocating members into products with different investment strategies, fees and services, as is implied by this model? What role could a best-and-final-offer stage play in providing a select number of funds the opportunity to improve their offer?

Regarding transparency, are there any problems with only withholding information that can reasonably be shown to be commercially sensitive? What information would fall under this exemption?

Although we do not support Model Three as a preferred option, if it were to be adopted we suggest the following aspects could be included in the tender criteria:

1. Organisation – Board, Management Team, Financials, Culture, Strategy;

2. Risk Management – Risk Management processes, IT and data security protocols, governance structures;
3. Operations – registry system and workflow systems used, and service standards;
4. Member Services – Engagement principles, and how you execute on those, demonstrable evidence on success of engagement, range of services (including multi-channel, digital offerings, contact centre, education and advice);
5. Investments – philosophy/beliefs, quality of people, governance model, asset mix (SAA), MySuper default design, range and mix of investment options; and performance (absolute and risk adjusted) against benchmark and peers over different time periods;
6. Insurance – design flexibility, competitiveness of premiums and terms and conditions, choice of insurer;
7. Fees – simple, transparent, value for money, peer competitive; and
8. Innovation/Continued Investment in Services – demonstration of plan, commitment and execution of continued innovation/enhancement in customer services.

Also, as stated in our Recommendation No. 7, we do not support the government sequential allocation to products and believe this decision should be made through employee/employer choice.

Model Two: Assisted employer choice

INFORMATION REQUEST 8.1

What are the main drivers of costs to employers in selecting default products on behalf of their employees? Would a shortlist of preferred default products make this task easier for employers? Is there an ideal minimum number of products that should be nominated on the preferred default list?

Are there other specific criteria in addition to those proposed under the minimum standards criteria that default products should meet to protect members and help to achieve better outcomes for them in the long term?

Would a dual-list approach, allowing employers to select a product from one of two lists, provide them with sufficient flexibility to select tailored default products that best meet the needs of their employees?

Which types of employers prefer to retain a role in default product selection? To what extent are default products or corporate fund offerings considered important benefits offered to prospective employees in competitive labour markets

As stated in section 3, we support the Commission's view that Model Two should be the preferred model.

There is a significant variance in the views of employers. Many small businesses (as evidenced by the Small Business Council) have suggested they do not want to be part of the superannuation system but if they are, they want to select their own providers.

The costs of selecting a default fund or product for a small business are generally modest.

The costs of selecting a default fund or product differs between small and large employers. Large employers who operate a competitive evaluation processes for their corporate superannuation fund can find the process expensive.

After application of a 'heavy filter', a simple list of no more than 20 products (in due course) would be appropriate in our view for small and medium enterprises (around half the labour market are employed in these businesses).

The same list can apply for larger businesses which may choose to put in place a different default fund having undertaken a competitive evaluation process. In most cases a large employer would formalise the outcome of the process by entrenching the default fund in an enterprise agreement or multiple agreements in conglomerate businesses.

Larger businesses have the resources to operate the competitive processes and are more likely to view a corporate superannuation offering as an employee benefit. Smaller businesses are more likely to see superannuation as a compliance burden and will want a seamless process of selection and administration.

We do not see a case for further complicated criteria to be applied in respect of either list.

As stated in section 2 and section 3, it is our view that the superannuation selection panel should use 'tightened' MySuper criteria to make judgements about funds that should be listed.