28 April 2017

Productivity Commission
Public Inquiry Superannuation: Alternative Default Models

ONLINE SUBMISSION

Dear Commissioners

Public Inquiry Superannuation: Alternative Default Models

National Australia Bank Limited (NAB) provides superannuation, advice, investment and insurance solutions to retail, corporate and institutional clients, supported by a number of brands including MLC (Super and Investments), JBWere, JANA, Plum and investment brands under NAB Asset Management (collectively NAB Wealth Products – NAB Wealth). NAB also operates one of the largest networks of financial advisers in Australia.

NAB Wealth appreciates the opportunity to provide feedback on the draft report into Alternative Default Models released on 29 March 2017 by the Productivity Commission. Our submission is brief.

The draft report reflects a comprehensive assessment of the current system and clearly enunciates the Commission's aims in designing potential alternate models.

The analysis provides four possible options which can inform potential future policy direction from the perspective of a broad customer base and also useful insights for our industry and business from an external perspective.

NAB Wealth values the Commission's extensive efforts in this regard and anticipates learning more from the detailed material over time. It is particularly noteworthy that the Commission identifies some of the significant systemic and sustainability issues that arise from models or approaches which unilaterally override existing arrangements. Prospective application of potential changes will minimise significant dislocation and allow more controlled and considered restructures to occur where warranted, or pursued by the regulator, with regard to member outcomes.

Inevitably in a mandated system predominantly managed privately under a significant prudential structure, there will be tensions in determining settings that suit all participants over time. NAB Wealth supports frameworks which are competitively neutral, ensure active and engaged consumers are able to exert control over their own outcomes while also providing support and options (defaults) for those who need, or prefer, to 'outsource' such decisions. In all cases, building engagement and transforming offers and services to meet customer needs over time and in changing environments (economic, cultural, regulatory and operational) is a core objective.

While 'default' or pre-designed products are an important feature for those who are disengaged or prefer decision support, capacity to choose from a range of structures and products is important to meet idiosyncratic risks particularly in retirement and particularly with the system operating as a 'pay as you go' model (defined contribution). This can and will deliver improved outcomes for individuals whose circumstances do not 'fit the average' particularly with professional advice.

In terms of the models identified, the key points NAB Wealth would request the Commission and Government consider are:

- Quotas - Issues with quotas (particularly hard quotas) from a cost and competition perspective;
- Duplication - Duplicative structures/costs for providers in applying for default status;
- Insurance -The value of insurance in the default superannuation context;
- Sequencing - in light of the changing regulatory environment; in particular the implementation of MySuper, SuperStream and other technology initiatives which are yet to mature.

Quotas

Based on our reading, with the exception of option 2 "assisted employer choice" each of the models has either a specific, or effective, quota. While it is possible to choose 'outside' the options with restricted numbers of funds, NAB submits that specific regulatory concentration of markets be avoided. The prudential framework operates to apply criteria and standards to operators and providers which would, and does, act as a control on entrants.

If it is identified that there are participants in the market which should exit, then actions should be targeted at those entities and providers, including necessary legislative support to remove barriers to exit [1]or, enhance regulator capability to facilitate exits. A quota can operate to exclude equally effective, efficient, valuable products and providers for no reason other than an arbitrary cut off number.

While there are arguments that choice can overwhelm consumers, in the superannuation context, this is mitigated by having any number of defaults where the consumer does not have to choose. In this context, if an employer is a consumer and the issue is whether funds providing defaults are sufficiently well managed and resourced to serve and protect the employer, NAB submits that the licensing and authorisation regime can be refined to moderate these risks.

In the context of the report, the Commission identified a 'daunting' number of MySuper products greater than 110. NAB submits that the actual range of options that are available to the private sector generally is far less. The source document we use for this purpose is the APRA quarterly MySuper statistics (December 2016 edition - published 21 February 2017): This actually shows 109 MySuper products. We note the number was 123 when MySuper products were first summarised in the APRA statistics, so there has already been consolidation. However, not all of these products are available to any employer or consumer (public offer). MySuper laws have catered for employer arrangements which are specific to their workplaces and employees. These products are generally not publicly available.

Employer-specific offers fall into two types:

- "Tailored" MySuper offers which meet certain criteria and are managed within a master trust/industry fund (e.g. Wesfarmers within the Mercer Super Trust);
- Stand-alone corporate and public sector plans that are only open to employees of that employer to join.

Based on our analysis (which we can share) NAB estimates there are only around 50 MySuper products available to consumers to choose openly.

The Commission analysis suggests that "models with mandatory minimum standards or product accreditation (assisted employer choice (with employee protections) and assisted employee choice) have relatively higher costs because these models require ongoing regulatory oversight of a potentially large number of products".

NAB Wealth postulates that the numbers are not as significant as potentially identified, as there is necessarily a natural overlap and resulting synergy with regulators' oversight of this highly prudentially regulated sector. That is, the additional costs of, in particular, a lightly filtered 'employer assisted' model would not necessarily be as costly as alternative options such as a government run multi-criteria tender or auction (both of which it is suggested are undertaken only once every 4 to 8 years which have implications for contestability, innovation, and incumbent dynamism until a 'race to the bottom' trigger of review is imminent).

Duplication

NAB has concerns with industry based or Government-appointed panels (or members) where costs will be duplicative and conflicts potentially difficult to manage given the size of the market and availability of expertise. We don't discount this approach, but would submit that, it would be less duplicative and costly to enhance the filters and criteria of the licensing regulator.

NAB Wealth acknowledges the benefits of current tender processes in the superannuation context (also identified by the Financial System Inquiry and the Commission). Our main concerns with Model 3, the multi-criteria tender (not dominated by a fee metric which would drive a race to the bottom), are outlined below.

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[1] Discussed in response to the Productivity Commission Issues Paper: Superannuation Efficiency and Competitiveness, September 2016

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- The cost of the process: a. new body/panel, associated infrastructure, likely duplication of [several] processes involved in current licensing/authorisation applications, potentially a replication of core reporting and enforcement activity, establishment of a new intermediated approach that can allocate consumers to 'sequentially' to 'winning' funds.
- Potential conflicts between prudential and tender standards/protocols.
- Potential conflicts within the process and appointments to the (which equally applies to any model where a government body is charged with overseeing the selection process)

Our analysis of, and drafted applications, for the first part of the current Fair Work process involved a duplication of effort which could be avoided. An objective filter, potentially enhanced MySuper criteria, could operate to reduce the costs of additional infrastructure including constituting panels and governance processes as well as removing the potential for conflict in a divided sector.

We have provided a summary of the estimated costs of our applications in a confidential appendix.

We acknowledge the difficulty in creating objective criteria and weighting for qualitative features but believe it is worth exploring from an efficiency and cost mitigation perspective.

NAB does not support an auction process for a number of reasons (some apply to other models but not all) including:

- Regulatory processes concentrating providers in the market.
- Timeframes for review and ability to compete.
- Fees as a dominant metric due to concerns with a race to the bottom, the potential for investment structures being designed with an overwhelming focus on cost of manufacture rather than optimised net return to members, capacity to respond to and prepare for differing economic and market conditions – buffers and reserves would suffer which could create significant risk particularly in a very narrow and concentrated market.

Insurance

NAB has previously made submissions to the Commission highlighting the value of insurance through superannuation, particularly default.

Insurance is a valuable feature in the superannuation environment. Particularly for those not in defined benefits arrangements, it is a mechanism where the impacts of unexpected premature death (in respect of dependants' economically relying on the member) or pre-retirement disablement can be ameliorated in the short and potentially longer term. That is, insurance proceeds have an important role in financial wellness, and make up for unanticipated lost income and/or retirement savings. This was a large driver behind the framing of the prudential laws dealing with the purpose of super and the specific inclusion of death and disablement cover as ancillary benefits.

A major advantage is the capability of the system to provide broad coverage to a large component of the working population through automatic 'default' group insurance. Unlike private health cover which utilises a 'carrot and stick' approach to promote self-provision, there is no legal requirement for individuals to take out life and/or disability insurance which could otherwise come at a significant cost to the taxpaying public through increased pressures on the social security system.

Unless someone has had a close experience, or knows their risks, their contemplation of the necessity or desirability of life / disability insurance, with no immediate or tangible benefit, just does not occur. This is why it generally involves advice (retail acquisition of preferred insurance which is subject to health underwriting) or, is delivered through automatic 'default' group insurance for employees. It is particularly valuable for younger workers with mortgages and/or young families because they have had little time to build assets.

In this context, we also note the work of a cross-industry working group looking at approaches to mitigate duplication of insurance (and premiums), loss of insurance cover on changes, modern design/definition concepts, and better approaches to explaining cover to members.

For these reasons, NAB encourages the Commission and policy makers to include the insurance offer and capability as component of a default offer.

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Sequencing

As identified in the Terms of Reference to which the Commission refers in the draft report, an assessment of the system will precede any new default model allocation framework.

MySuper will not be fully implemented until mid- 2017. Similarly, SuperStream initiatives (and newer technology processes) are still in development, all of which are intended to enhance system capability. There are also some barriers to exit (merger) which, if mitigated by changes in law, could improve system efficiencies.

NAB Wealth submits that, in the interim, MySuper operate unfettered by the Fair Work Act process (which was not subject to a sufficient impact assessment process). This would require the Government to pursue changes to the laws enabling genuine competition as an appropriate precursor to testing how effective the system is in delivering outcomes for consumers and prior to determining a default allocation model.

Yours sincerely

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