



SUPERANNUATION: ALTERNATIVE DEFAULT MODELS SUBMISSION TO THE PRODUCTIVITY COMMISSION

24 November 2016

Introduction

NESS Super is a niche Industry Fund that has been servicing the electrotechnology industry since 1987. We currently have \$620 million in assets, 15,000 members and we provide a MySuper product. Our employers are predominantly small electrical contracting businesses.

We have noted the submission by RiceWarner dated 14 November 2016 in which they ascertain that size is important for MySuper and are calling for all superannuation funds with less than \$2 billion in assets to be forced into a merger protocol. It is our view that this protocol would only serve to be confusing to members, be expensive to implement and would potentially expose smaller well-run and efficient funds to predatory behaviour by larger funds. Most importantly we do not believe this suggestion of a merger protocol would be in the best interests of the members of these funds which is the principle that has driven the decision-making process of the Board of NESS Super since inception. It is important to note that mergers are expensive to implement, do not always provide benefits to members and can be detrimental to the interests of existing members.

Implicit in this proposal, is that the Industry and members, would be better served if we reduce the number of funds. There are currently 120 authorised MySuper products in Australia as published on the APRA website. The report lists 151 funds with assets less than \$2 billion. It is clear that the majority of these funds are not funds which provide a MySuper product and although may be APRA regulated, they do not come under the same APRA scrutiny as a fund which provides a MySuper product. The Boards of these funds are not required to annually examine the adequacy of their funds in relation to the Adequacy of Scale tests as does a MySuper fund such as NESS Super.

The Goal of Improving Efficiency

This concentration solely on the operation of small funds poses a significant distraction from the goals of the Productivity Commission as it seeks to improve the efficiency of the superannuation industry and to improve outcomes for members under the current default model.

By concentrating solely on small funds, it distracts from the real questions in relation to efficiency and distracts from the examination of real potential learnings from a considered analysis of the industry.

The more appropriate questions would be:

- What are the factors that have caused some funds to fail to deliver benefits to members through reduced fees even where they have been able to access significant scale? and
- What it is that some small funds do to enable them to be extremely efficient and competitive even without direct scale?

Ability of small Funds to be effective and efficient

In relation to the assertions by RiceWarner that the largest funds have significant advantages over small funds in the areas of:

- Lower fees for members due to the benefits of scales.
- Better governance structures.
- Access to unlisted investment opportunities.
- Better ranges of services for members, including provision of financial advice.

We would argue that there is sufficient contrary evidence to dispute these assertions as blanket statements. While a number of large funds have performed in line with these advantages, it is certainly not the case that good performance is only the domain of large funds nor that scale automatically provides an immunity to bad performance or to the poor financial management of members' funds. Small and mid-size funds can without significant scale also perform competitively in these areas.

Assertion	Contrary Evidence
<i>Lower fees for members due to the benefits of scales.</i>	<p>The MySuper regime has now been in operation for over 3 years. APRA now has access to considerable data regarding the relationship between scale and fees. Based on this actual data, APRA at the 2016 ASFA Conference, provided evidence against the myth that there is a direct relationship between increased scale and lower fees.</p> <p>We operate under a model where we seek to access scale through our outsourced providers. As a small fund, we must operate with a strong inherent discipline in the financial management of members' money in order to continue to be efficient. Marketing expenditure is closely controlled and targeted with the Board taking a strategic decision that it would not use members' money on expensive sponsorships or advertising campaigns.</p>
<i>Better governance structures.</i>	<p>To argue that larger funds have better governance structures would be similar to the argument that larger corporations, the big four banks and the very large retailers are more immune to issues of poor decision making than their smaller counterparts. Events over recent times in areas such as insurance and financial advice clearly show that this is not the case.</p> <p>It is also arguable that only APRA, which has intimate knowledge of each fund's governance framework, would be the only organisation that would be able to provide insight on the quality of the governance in an RSE and to provide a considered view of the advantages and challenges faced by both large and small funds.</p> <p>It is our view that effective governance is not a product of scale but a product of a highly functioning skilled Board free from the dysfunction caused by conflicts of interest, poor advice and lack of a clear strategic direction. The overriding consideration of the best interests of existing members should be the tenet which drives the decision making of all Boards of superannuation funds.</p> <p>APRA recently published an information paper on Risk Culture dated October 2016. On page 15, the following comments were noted:</p>

Assertion	Contrary Evidence
	<p>“Larger institutions noted that size and complexity introduced additional challenges, particularly regarding the greater prevalence of sub-cultures.”</p> <p>It is therefore worth considering whether in fact increased size, and associated complexity, makes achieving effective governance more challenging.</p> <p>It is not suggested that any particular large funds do have governance issues but simply being a smaller fund does not automatically result in governance problems and perhaps that a lack of complexity may assist in the process of governance.</p>
<p><i>Access to unlisted investment opportunities.</i></p>	<p>Unlisted investment opportunities have provided excellent value to members through the recent period of instability in equity markets and low interest rates. While smaller funds may not have the option of direct investment, there is no impediment to small funds accessing these markets through pooled arrangements.</p> <p>While small funds do not have direct scale, they can easily access this scale through strategic relationships not only in investment areas but also with outsourced providers in the areas of administration, insurance and financial planning.</p>
<p><i>Better ranges of services for members, including provision of financial advice</i></p>	<p>Contrary to RiceWarner’s view that: “Smaller funds can exist for Choice”, it is our view that it is in the area of MySuper that smaller funds are able to provide excellent service and value for their members.</p> <p>NESS Super has been able to provide efficiency and value to members through maintaining a specific focus on MySuper members. Unnecessary expenditure on products and services which provide little value to the vast majority of members are not pursued. While, the provision of services that only benefit a minority of members does add to the range of services for members, we would argue that it is not in the best interest of MySuper members. Should members seek these additional services, they can exercise Choice of Fund in order to move to a fund which provides these additional services. To date we, at NESS Super, have seen little evidence of such movements. We believe most members are rightly focussed on reasonable fees, insurance that is tailored specifically to their needs provided at a reasonable cost and good investment returns.</p>

Assertion	Contrary Evidence
	<p>This focus on providing a vast range of services for the benefit of only small segments of members without the interests of the majority being taken into account, is in our view a major source of inefficiency in provision of superannuation to MySuper members. As mentioned above, small funds must operate with an inherent discipline in the financial management of members' money in order to continue to be efficient. This does <u>not</u> mean that we do not provide intrafund advice to our members or that we do not pursue other services which we perceive, provides value to the majority of our members and also improves the effectiveness and efficiency of our service delivery.</p> <p>We would also argue that due to the small nature of our fund, we can have more direct contact with members and thus provide a more personalised service delivery.</p>

Conclusions and Recommendation

The emphasis on increased scale and mergers as the mechanism to deliver efficiency has been a significant distraction to the determination of what actually drives efficiency and inefficiency in both large and small funds. Smaller funds can be both efficient and competitive.

If it is not scale which drives efficiency, the real issue to be addressed is looking beyond scale to what factors actually drive efficiency and what are the practices that detract from providing value to members that should be stamped out.

If the goal of a superannuation fund is to be efficient, rather than subject only small funds to scrutiny, it is our recommendation that all funds be required to publish an efficiency ratio and where this ratio exceeds an Industry benchmark be required to justify their use of members' funds.

Angie Matrippolito
CEO/Fund Secretary
On behalf of the NESS Super Pty Ltd

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