Due Governance

Investment Governance Solutions

Due Governance is a group of experts that specialise in developing governance related solutions for the fiduciaries of institutional investment organisations

# Due Governance Productivity Commission Submission:

# Reply to the Draft Report 'Superannuation: Assessing Efficiency and Competitiveness'

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# SUBMISSION TO THE PRODUCTIVITY COMMISSION

## REVIEW OF THE EFFICIENCY AND COMPETITIVENESS OF THE SUPERANNUATION SYSTEM

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## About the authors

Due Governance is a group of experts that specialise in developing governance related solutions for the fiduciaries of institutional investment organisations such as superannuation funds. Our team includes experts with backgrounds across:

- Institutional investments
- Corporate governance
- Investment operations
- Regulatory compliance
- Public affairs
- Investment technology

Specially, this paper was prepared by:

### James Dick

James has an institutional investment background, having deployed over $10 billion in capital with the Queensland Investment Corporation (QIC) over 12 years.

James has a background in economics and has previously served on the Central Council of the Economic Society of Australia and as President of the Society in Queensland. He has also served as a director on numerous corporate and charity boards. Among other qualifications, James is a Fellow of FinSIA and Graduate of the Australian Institute of Company Directors.

### The Hon. Bernie Ripoll

Bernie has served in the Australian Commonwealth Parliament from 1998-2016 as the Member for Oxley and has worked in both government and opposition roles and many Joint Parliamentary Committees as the Chair or Deputy Chair. In Government Bernie served as Parliamentary Secretary to the Treasurer and had responsibility for ASIC.

Bernie is now a Director with Government and Public Affairs firm, SAS Group. He also has significant governance experience including as a director of Inala Primary Care, Map My Plan, Utilitas Bioenergy Company, the Finance and Energy Exchange, Crohn's and Colitis Australia and is a member of the SMSFA Public Policy Committee. Bernie is also a member of the Australian Institute of Company Directors.

## Preamble

We commend the Productivity Commission's review of the superannuation system for its comprehensive and detailed analysis in its paper 'Superannuation: Assessing Efficiency and Competitiveness – Draft report'. While we agree with much of the analysis, we also feel there are some elements that are missing. Without proper consideration of these, the unintended consequences of applying the current draft recommendations could be worse that the current problems that the Productivity Commission is attempting to solve. The purpose of this paper is therefore to furnish the Productivity Commission with what see as the missing elements of the draft paper. We have provided references and justifications for these views where practically possible.

## Systems theory

Before we detail the components we think are missing from the report we first contextualise where the superannuation industry sits in terms of systems theory.

Systems theory suggests that there are broadly four (4) categories in which we can define an individual system. These four systems (and brief examples) are detailed below[i]:

1. **Simple**: The average height of all the members of a superannuation fund
2. **Complicated:** The calculation of the date of the highest King tide for a specific point on the coastline
3. **Complex:** A biological ecosystem, social network, economics[ii] or financial system
4. **Chaos:** A system where all levels of control and influence have broken down (eg Rwanda in the 1990's)

It is non-controversial today that financial markets are regarded as complex adaptive systems[iii]. This is largely because the system has evolved and continues to evolve at the hands of its participants who are each attempting to extract value from the system, sometimes at the expense of others. Although there are top down influences (such as regulations and regulators), these do not systematically control the outcomes of market participants. Like biological systems and other social networks, outcomes are determined by the complex interactions of the participants and other complex systems (in particular the real economy).

It is important to differentiate a complex system from a complicated system. In a complicated system, top down 'laws' control the outcome of the system. So long as observers are able to obtain a sufficiently detailed knowledge of how the system works, and they are able to gather sufficient information or data about its current state, accurate predictions about its future state can be made. This cannot be done for a complex adaptive system, because market participants are not just observers but are actually involved in causing system adaptations on an ongoing basis. Even if

you could perfectly understand the structure of the system at 1 July 2018, the system will evolve and change significantly by 1st July 2028 and could be expected to change even more dramatically over the period of a typical working-life.

As the superannuation industry largely achieves its outcomes by investing in financial markets, by extension the outcomes of the superannuation system are complex. Furthermore, as participants in the industry are humans within various social networks, the behaviours of the industry participants are also complex and are likely to adapt to changing circumstances.

## Superannuation investment professionals

Mention of financial markets, hedge funds, forex rates and stock markets would probably place in the mind of non-participants the image of an arrogant self-confident trader taking risks and winning or losing large sums of capital[iv].

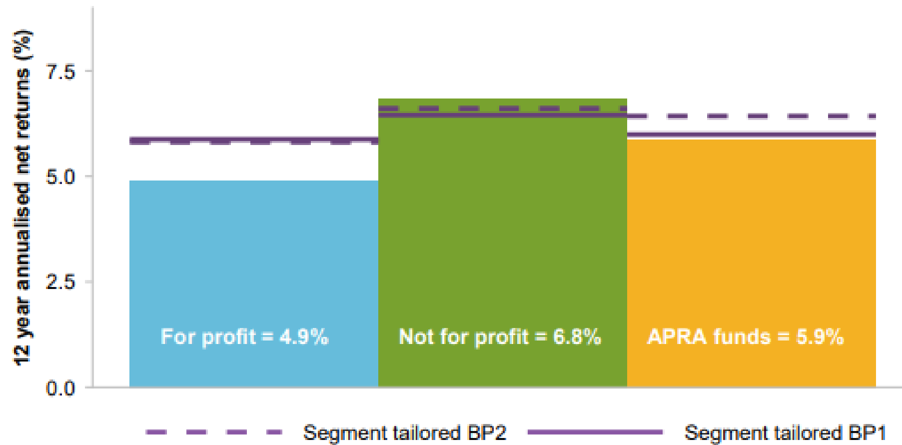
As the authors of this paper have deep experience working with the superannuation system we are quite familiar with the mindset and behavioural norms of our past and present peers across the sector, especially in relation to investment professionals within the not-for-profit sector.

Instead of the archetypal fast-twitching trader, our experience has been that the investment professionals who gravitate towards the superannuation system sit at the more prudent end of the spectrum, preferring to leave the higher-risk-higher-return work for those in the Australia equivalent of 'Wall Street' or working as hedge fund managers. This is despite there being the potential for significantly higher remuneration levels for investment professionals outside of the superannuation system[v].

Although it is difficult to evidence a difference in behavioural inputs to those in the institutional superannuation system, the outperformance of industry funds detailed in the Draft report Figure 2.7 reprinted below[vi] appear to justify our view that not-for-profit investment professionals have successfully produced enviable long run returns despite the influences of short-termism that exist elsewhere.

Figure 2.7 **Fund-type segments: not-for-profit funds outperform their benchmarks on average**

Benchmark adjusted for asset allocation, 2005–2016




| | | | |
|---|---|---|---|
| **Sources** | PC analysis of APRA confidential data and financial market index data (various providers). | | |
| **Benchmark** | Segment BP1 and BP2. | | |
| **Coverage** | All APRA-regulated funds. Excludes exempt public sector superannuation schemes, eligible rollover funds and insurance-only superannuation funds. | | |
| **Survivor Bias** | No. | **Selection Bias** | No. |

## Prudent versus maverick risk management

Draft Finding 9.4 of the Draft report noted that:

> Many funds mimic (at least to some degree) the strategy of rival funds for fear they will otherwise exhibit poor short-term performance relative to their peers ('peer risk'). This short-termism is likely to be at the expense of long-term returns to members.

This is a draft finding we would like the Productivity Commission to reconsider. In particular, it seems the Productivity Commission is of the view that larger scale funds are expected to generate higher returns than smaller scale funds:

> If many funds have not been able to achieve scale benefits by reducing their average costs — and few have achieved this through delivering higher returns through higher-cost investment strategies — this could be a sign of a lack of competitive pressure in the system[vii].

However, we propose an alternative view. Rather than a lack of healthy competition driving peer tracking, we believe that the industry as a whole has settled more or less on a broadly prudent asset allocation (for a given level of risk tolerance). In his book, Pension Fund Excellence[viii], Keith Ambachtsheer states:

> That is why maverick risk tends to be so important in practice. If there is no obvious way to tell whether you should be more or less aggressive than your competitors, why not match them? It eliminates maverick risk
> – Keith Ambachtsheer

In other words, Funds that don't consciously 'match' their peer group are liable to suffer what Ambachtsheer refers to as maverick risk.

To take this one step further, it would be our fear that if a regime changed occurred that encouraged funds to take on more peer risk than they currently do, this would shift today's funds from taking prudent levels of risk to taking on maverick levels of risk.

Before the Productivity Commission recommends any regime change to increase the level of risk taken by funds, it needs to be certain that its assumption that there is a lack of competitive pressure in the system is driving asset allocation 'matching' rather than some other rational reason.

It is our strongly held view that it is the desire to avoid maverick risk and a prudent long-termism that has meant that not-for-profit funds have both outperformed other sectors in the market while simultaneously avoiding highly volatile asset allocations.

## Prudent risk management vs low volatility

Although it is common to differentiate risk (which due to uncertainty can be difficult to properly define or measure) from volatility[ix], which on an *ex post* (historical) basis is easily defined and measured. Despite the recognition of the difference between risk and volatility, how these differences impact risk management are rarely discussed. In this section we aim to differentiate between the two using an example that the authors are familiar with. For confidentiality reasons we are not able to name the fund(s) that this example relates to, and will use the term 'Fund X' instead.

As a result of the Global Financial Crisis (GFC), central banks around the world dramatically cut interest rates and introduced quantitative easing. Without an economic downturn these economic measures in isolation would have likely caused significant levels of inflation. However, given the deteriorating real economy around the world from the year 2008, there was uncertainty in the minds of investment professionals whether the GFC policy responses would be sufficient to bring the global economy out of recession or on the other hand whether it would create excess levels of stimulus leading to inflation. Given the global economy had never been through a great recession of this size simultaneously combined with expansionary fiscal and monetary policy measures, the future outcome of economic variables such as growth and inflation rates was uncertain, and was actually unknowable in advance.

Nonetheless, investment professionals around the world in 2008 needed to make a decision about how to set asset allocations. The option that Fund X ultimately elected was to:

- increase allocations to real asset such as real estate and infrastructure as these can be expected to have better inflation protection characteristics than listed asset such as equities and bonds
- introduce a material allocation to global commodities as these can be expected to be super-sensitive to changes in expected inflation levels and therefore hedge a significant proportion of the overall portfolio to unexpected inflation increases
- retain significant exposures to listed equities (in lieu of bonds) in order to generate returns from potential recovery in the real economy

The investment professionals who recommended and implemented this strategy believed it to be the most prudent manner in which to balance the risks and uncertainties of recovering growth against potential rising inflation. At no stage was it designed to represent the portfolio with the best outcome under either a high growth or high inflation scenario – but rather as a 'middle-of-the-road' option. More precisely, it deliberately aimed to produce returns somewhere in between the best and worst possibilities regardless of the economic outcomes.

As events transpired, consumer price inflation (cf asset price inflation) did not rise dramatically after the GFC. As a consequence, *ex post* volatility data will not show any evidence of which funds were conscious of potential inflation risks and took those off the table. This prudent investment management would have only been visible *ex post* (after the event) in scenarios which included much higher levels of inflation.

To be clear, in a complex system such as financial markets, it is not actually possible to know in advance whether or not a certain policy action will work, especially when dealing with one that had not been tried on a global basis before. By extension, it is therefore impossible for investment professionals to know in advance whether or not a single investment view will be the best performing or not.

## Should super be commoditised?

Operating within a complex system means that there is no one right answer[x]. Although we have noted that superannuation funds have gravitated towards a relatively common prudent asset allocation in order to minimise maverick risk, there are other significant variations (such as the level of overall risk tolerance set by the default fund, the suite of available investment options, the insurance arrangements negotiated and what additional services provided by each Fund). These are likely to differ depending on how the fiduciaries and management of the Fund's believe they can best meet the needs of their members.

For instance, construction workers are more likely to understand and feel comfortable with an above average exposure to investments in real estate and infrastructure. Given the high-risk nature of construction work, they may appreciate the benefits of insurance coverage that they may not be able to obtain as individuals outside of the superannuation system – or with the same level and type of benefits offered by a more generic fund.

Another example would be a cohort of workers of religious institutions that may have a preference for investments that are made sympathetic to their ethical views rather than accessing a generic fund that attempts to generate higher returns but at the 'cost' of not meeting the ethical standards of this cohort.

We would argue that funds that tailor their investment, insurance and ancillary services to meet the specific needs of a cohort they understand well are more likely to deliver an outcome nuanced to the expectations of this cohort than would likely be captured by APRA data.

We also question whether delivering non-tailored or commoditised services would do anything to improve levels of member engagement. Engagement is a form of communication and good communication is usually considered a two-way street. If the only available product is generic, we wonder if this actually reduces the reasons for members to engage. Legal Super for instance note that they have tailored their investment options to suit a member base that is interested in Self Managed Super Funds (SMSF) and given that a very high proportion of their members are invested in non-default options is a sign of the high level of their member engagement[xi].

## How small is too small?

One of the worrying trends we have noticed recently is for the language used by observers of the superannuation system in Australia to refer to any fund with less than say $5 billion as 'small'.

In our work as investment governance advisors, we see many fiduciaries that are responsible for the oversight of pools of capital held by charities and other institutions. These fiduciaries may be responsible for overseeing a pool of say $1 million, $10 million or in rarer circumstances $500 million[xii]. In an institutional investment setting, we would consider pools of this size as 'small'. We would not consider a fund that has over 6,000 members and around $2 billion of assets (equating to $300,000 per member) as 'small' – as is the case for the AvSuper Fund. Nor would we consider a fund that has around 84,000 members and around $5 billion of assets (equating to around $60,000 per member) as 'small' – as is the case for Media Super[xiii].

On face value you might think that doubling the asset size of a fund will *ceteris paribus* halve fixed administration costs (as a percentage of funds under management). It will usually do very little to reduce variable costs – which includes

the typical outsourced investment management expenses which are already charged as a percentage of funds under management. We also believe that larger organisations are likely to have additional layers of overheads that are required to manage larger teams or to manage asset with an in-house investment capability.

According to our analysis of the APRA data, the median operating cost of the all super funds between $1 billion and $5 billion is only 0.1% lower than the operating costs of funds between $5 billion and $10 billion. There was no difference in the median operating costs of this $5 billion to $10 billion group than the $10 billion to $20 billion funds[xiv].

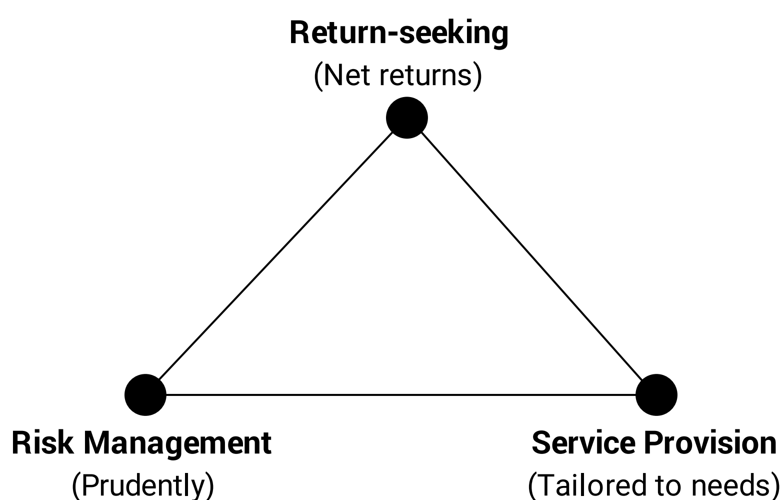
We therefore question the underlying desire of the Productivity Commission to see fund mergers and increase the funds under management of Funds in the system once they have reached a level that allows them to maintain an institutional investment capability.

## Three core characteristics to manage

By definition, complex systems are difficult to understand and even harder to manage. In reality there are a multitude of factors that need to be managed. If we just look at some of the core characteristics required for a well-functioning financial system, they would include[xv]:

- Operational efficiency
- Capital allocation efficiency
- Dynamic efficiency
- Resilience to shocks
- Resilience to normal change and cycles
- Fair treatment by participants to each other
- Confidence in the system
- Transparency

The 2014 Financial System Inquiry (FSI)[xvi] noted the importance of financial firms acting in the interests of their legal beneficiaries. For superannuation funds, this means their members. If we place ourselves in the minds of those members for a moment, most of the core characteristics of a well-functioning financial system are nebulous, and indeed, probably taken for granted. Instead, we believe the three most tangible characteristics the average member would expect to be managed over the duration of their accumulation of their financial assets are 1/ returns (after costs), 2/ financial losses and volatility no greater than what they personally feel appropriate and 3/ a set of services tailored to meet their needs.




At Due Governance, we understand that the characteristics raised by the FSI are of vital importance in maintaining the integrity of Australia's financial system, including the superannuation sector. Our focus in this paper is to encourage the Productivity Commission to take care in the relationship between the legislative framework that ultimately set the rules as to which entities are 'rewarded' and the behaviour of entities who in a competitive system are naturally attempting to generate the highest rewards.

In particular a system that only rewards one of these three outcomes is likely to only see the management of one of these three outcomes[xvii]. Given that two of these factors are personal to the individual members' views (risk management and service provision) – we strongly believe are one sized fits all approach is not appropriate.

## Good competition vs combative competition in a complex system

In a perfect world, we would define good competition as one in which the winner(s) are determined on merit. In a tractable complex competitive system, such as *Pope particles* in a thermodynamic process, the winning particles are those those that dominate other particles on a relevant metric[xviii]. However, in complex adaptive systems such as financial markets and the superannuation system, we have noted that there are multiple characteristics that are mutually relevant to meeting member expectations.

A system that encourages 'good competition' would be one that ensured that the winner(s) are those are able to balance multiple attributes not just one. We would define poor or combative competition as one in which produced a winner from either a single but relevant factor (such as net-returns without regard for risks or services) or worse from an irrelevant attribute (such as marketing/sales ability).

We can also express this concept algebraically.

In a single factor complex competitive system, good competition is where particle p dominates when it has better characteristics than particle q:

$$y_p > y_q$$

In a multiple attribute complex system, good competition is where those that have better n(net returns), r(risk management) and s(services) dominate:

$$y_{nrs} > y_q$$

One form of a poor combative system is where the winner may only offer a single characteristic that dominates a more balanced mix of multiple attributes:

$$y_{n*} > y_{nrs}$$

An even more undesirable form of competition is where an irrelevant or undesirable characteristic such as m(marketing/sales) dominates:

$$y_m > y_{nrs}$$

## Unintended Consequences of 'Best in Show'

Complicated systems, such as the laws of physics are usually not prone to 'unintended consequences' when observers alter the manner in which they interact with these laws. So long as those interacting with these laws (say engineers designing a bridge) are conscious of the laws of physics, they will be able to take appropriate account of them in their designs.

Complex systems (such as the superannuation system) on the other hand are highly susceptible to the unintended consequences of changes by well-meaning changes by participants such as legislators and regulators.

Although we are unable to foresee all the consequences of the Productivity Commission's 'Best in Show' recommendation, we believe we are able to see a line of sight to one significant unintended outcome that it would create.

Earlier in this paper we have illustrated the importance of good competition rewarding providers that can balance three characteristics that we believe members desire over time, namely:

- Maximising net-returns
- Doing so with prudent risk management practices
- Ancillary services tailored to meet member needs and expectations

We believe an unintended consequence of the Productivity Commissions Draft Recommendation No.2 ('Best in show') that supports new members flowing only to ten (10) funds is that only one of these three factors would be managed – net

returns.  To be clear, we feel this would mean that in order for funds to feel that they could make the top 10 list, they would no longer be able to take a prudent 'middle-of-the-road' position with any uncertain risk decisions they needed to make – but instead take more extreme positions or 'swing for the fences' by taking a single minded position on a likely outcome, and position the portfolio(s) so that it would maximise net-returns in the event that the forecast economic outcome eventuate. The downside naturally would be worse investment outcomes during periods where actual economic outcomes do not match previously forecasts outcomes.

We are disappointed that the Commission has not taken prudent investment risk management into account in its review to date.

We believe the current 'best in show' recommendation would encourage the introduction of maverick risk.  While we feel that it is the intention of the Productivity Commission to end the peer matching approach of many superannuation funds, we feel this will be achieved at the cost of the unintended and undesired consequence of encouraging high levels of maverick risk.

## Best in show governance

Let us consider a future where a 'best in show' system is in place, and the Productivity Commission's recommendation of increasing the number of non-employee non-employer representative Trustees is also a reality.

In this scenario, a Fund would be conscious that it needs to outcompete other funds on a narrow range of outcomes (the first of which is net-returns).  If we think about the kind of non-representative fiduciaries that would suit this scenario, superannuation funds may look for individuals from the hedge fund and investment banking industries in order to 'best' manage aggressive 'winner takes all' investment management processes.

Whist this would assist a small number of funds rotate in and out of a 'Best in Show' format, we do not believe this would be in member's best interests long term, due to the significant level of short term risks that would need to be taken.

# Good governance

We believe that the role of governance is to provide appropriate challenge and review independent of the management team that reports to the board and its committees. This is sympathetic to the view expressed by APRA in their thematic review of superannuation governance.

We believe good governance has many analogies to the due diligence process used by investment management teams.   The elements that we feel are most important to a good governance function are:

- A common, or mutual purpose by members, management and fiduciaries. This may be best enunciated through a set of investment and corporate objectives.
- Layers of accountability such that management are accountable to fiduciaries and the fiduciaries are in turn accountable to members.
- Maintaining an appropriate oversight of the composition of the management team and ensuring that its skills and capabilities develop in line with need over time
- Monitoring of the processes and outcomes of investment and other corporate operations against a set a previously established objectives

We see the last bullet point as fiduciaries providing an appropriate review function, while an appropriate challenge role can be established by asking questions that cover both forward and backward looking factors with both outward facing and inward facing perspectives.  This is commonly described as the 'Tricker Model', illustrated below[xix]:

Governance experts such as the Australian Institute of Company Directors generally recommend that this function is undertaken by asking probing questions, rather than by telling or directing management how to do their jobs.  Outside of the United States of America, it is generally considered more appropriate for the members of the fiduciary board to be independent of the management team.

We do not see any reason to think that fiduciaries who are aligned to either employer clients or employee representative organisations would not be independent from the management teams they oversee. Indeed, we are seeing increased pressures on corporate boards globally to include representatives from customers and other stakeholders[xx].

## Moving forward: Rewarding a prudent superannuation/investment industry

Our recommendation to the Productivity Commission, legislators and to regulators is that there are better options that can be taken to improve the superannuation industry by encouraging an industry that rewards funds that meet a particular 'gold' standard rather than rewarding only a very small number of funds that for a period of time out-compete their peers on a small number of metrics such as net-returns.

We intend to establish in this section an example of one alternative that we believe would have many similar characteristics to the 'best in show' but without the obvious unintended consequence of encouraging a small but dominant group of funds to 'swing for the fences' with a winner takes all risk management attitude.

### Expectations of an alternative to 'best in show'

Given that the Productivity Commission agrees that the majority of not-for-profit funds are achieving satisfying return outcomes for members, we believe it would be counterproductive to dramatically alter the system and risk the kind of unintended consequences that we have already raised.

That doesn't mean that the system can't be enhanced. Specifically, we think one that deals with the need for 'default' funds directly and uses technology could lead to simple but powerful improvements.

Our expectations of any changes to the system are that:

- We would want to ensure that any revision did not exclude prudently performing funds from the system and if possible for these funds to have a competitive advantage
- That the issue of multiple member balances is solved via use of technology and oversight at the federal level
- We feel any revision of the system would ensure that we do *not* see construction workers becoming members of a fund tailored to suit the needs of commercial pilots, or more broadly, that employees are more likely than not to find a find that is tailored to meeting their needs

## Automated member account portability

Given the superannuation system in Australia currently allows member account portability between most funds, and the ATO holds the fund contribution records for almost all members via the Tax File Number (TFN) we believe it is only a question of technology and funding to allow the ATO to manage an automated member account portability system that (unless a member opt out was selected) would ensure that there was only one superannuation account per individual.

In the next section we discuss the process for determining which Fund each worker becomes a member of.

## Three-tiered system

Rather than a panel selecting a set number of funds (say 10) based on metrics such as net-returns, an independent panel establishes a set of prudent criteria that determines the definition of a 'gold' standard. This 'Tier 1' represents funds that have been able to demonstrate prudent funds management, governance, compliance, and ability to provide appropriate member services. If only 10 Funds meet this standard, then there will be 10 Tier 1 funds. On the other hand, if 50 or 100 Funds meet this standard, that is the number of Tier 1 Funds.

Tier 3 Funds would be defined as those that the regulator deems to be failing to meet their licensee or other necessary obligations.

Tier 2 Funds would be all remaining funds.

## Tackling the need for default funds

The majority of superannuation members take advantage of a default fund. We believe this is in part due to a lack of financial expertise and interest from workers when they are new to the workforce. This is a fundamental problem that cannot be legislated away.

However, each PAYE taxpayer (ie most workers and superannuation members) receive a tax return from the ATO. It should be technologically feasible for the ATO to include an additional page and decision box for every taxpayer to complete when the ATO system recognises that they have multiple superannuation accounts.

Our recommendation would be that the ATO furnish the taxpayer with simple to understand information about each of their multiple accounts and offer a decision box about which fund they wish to retain going forward.

The information the taxpayer would be furnished with could be limited to the name of the employer that sponsored the contributions to each fund (ie to determine whether it was a current or past employer) and whether the Funds are ranked Tier 1, Tier 2 or Tier 3 and what these tiers mean.

## Refined default fund process

This way the current system could be refined to work as follows:

1. When a person enters the workforce they can either choose their own fund, or default into the fund selected by their employer or award (ie no change to the current system)
2. When this person moves employers, the auto-account portability system kicks in:
    a. Unless they make their own superannuation selection, the contributions from their new employer are forwarded to the new default superannuation provider (with a temporary account, but otherwise similar to the current system)
    b. At the time they prepare their next tax return the employee is given a decision box to select either their old fund or move to the new fund. The ATO ensures all existing balances and future contributions are allocated to this fund
    c. In the event that the employee does not utilise the decision box in their tax return, an algorithm at the ATO selects between the Funds based on which fund is ranked in the higher Tier. If they are both ranked equally, then the default could be to move the old fund into the new fund (as we could assume the current Fund is more likely to understand how to tailor services to members of a similar cohort).

We believe this system would ensure that Australian workers:

- Have one super fund
- That it is one specifically of their choosing or aligned to the industry they have had something to do with, either now or in the past,
- There is increased competition between funds to meet an independently determined 'gold standard'
- The number of workers who don't consciously participate in their superannuation management diminishes
- Prudent investment management and governance is promoted rather than diminished

## Legislation and regulation

So far in this paper we have made the case for the prudent management of superannuation tailored to the need of members. In this section we deal with the importance and impact of legislation and regulation on the industry, as this also affects member outcomes, both positively and negatively.

For the sake of system stability, it is important for participants in the financial sector to not just do the right thing, but to be seen to be doing the right thing. Good legislation and regulation encourages this. We commend Parliament, the Productivity Commission and the relevant regulators for each playing their part in this process.

However, it is also true that there is a cost to increased legislative and regulatory needs. For instance, in Britian, we have seen that increased regulation and oversight in (retail) financial services has caused a reduction in service delivery which is now being referred to as the 'Advice Gap' and the Financial Conduct Authority (FCA) is looking at further reforms to actually reduce this[xxi].

More broadly, we fear that an increased legislative burden in the superannuation sector would make it difficult for smaller players to participate in the market – not just reducing competition, but also limiting the number of tailored services that boutique entities typically perform. In other industries we see the co-existence of both large players as well as boutiques that know how to service a particular market niche. We recommend the Productivity Commission considers the importance of retaining boutique service providers in any industry under review.

While it would be comforting to believe that institutions can continue with existing productive development programs at the same time as dealing with additional legislative requirements – this is rarely the case in reality.

The superannuation industry has unfortunately been subject to a continual stream of legislative and regulatory changes. While many of these are sensible and appropriate, it should be recognised that the onboarding of these changes from outside the industry can push out the ability of funds to undertake (non-compulsory) but nonetheless productive changes driven from within the industry. The Australian Institute of Superannuation Trustees (AIST) led initiative to help super funds better manage their operational due diligence requirements is a contemporary example.

Although it has been said by many others, many times before, we would encourage the Productivity Commission to consider the benefits of a consistent legislative and regulatory regime. We feel that the desire for regular change is a symptom of misinterpreting the superannuation system as complicated rather than the complex system that it actually is.

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[xi] https://www.morningstar.com.au/smsf/article/industry-fund-reacts/5822

[xii] Salvation Army net assets. See 2017 Annual Report

[xiii] APRA Annual Fund-level Superannuation Statistics June 2017

[xiv] Ibid

[xv] See for instance the 2014 Financial System Inquiry: http://fsi.gov.au/publications/final-report/

[xvi] Ibid

[xvii] Eisenberger, R., Aselage, J. (2008), Incremental effects of reward on experienced performance pressure: positive outcomes for intrinsic interest and creativity, *Journal of Organizational Behavior*

[xviii] Klimenko, K.Y., (2012), Complex competitive systems and competitive thermodynamics, *Philosophical Transactions of the Royal Society A*, Volume 371

[xix] Original source: Tricker, R. (2009) *Corporate Governance, Principles, Practices and Policies.,* Oxford University Press - Image from https://en.wikipedia.org/wiki/Robert_Ian_Tricker

[xx] See for instance AFR 21 May 2018 "Call for customer representatives on boards"

[xxi] See for instance the Financial Times 14 March 2016 "FCA proposes reforms to close 'advice gap'" and for more background see https://moneyobserver.com/our-analysis/how-new-adviser-regime-has-created-advice-gap