NAB MLC WEALTH SUBMISSION

Productivity Commission Draft Report: Assessing the Competitiveness and Efficiency of the Superannuation System

July 2018

About NAB and MLC[1]

National Australia Bank Limited (NAB) is a diversified financial services organisation, headquartered in Australia, with a subsidiary bank in New Zealand and branches in Asia, the United Kingdom and United States.

NAB and/or its subsidiaries provide superannuation services, advice, insurance and investment solutions to retail, corporate and institutional clients, supported by a number of brands including MLC1, JBWere, Plum and NAB Asset Management.

Excluding the Pooled Superannuation Trust, there are 4 Registrable Superannuation Entities overseen by NULIS Nominees (Australia) Limited (the Trustee) providing superannuation and retirement solutions to over 1.2 million members.

NAB has one of the largest financial planning networks in Australia providing quality financial advice, insights and expertise.

For ease of reference, unless specifically referencing a product or registered superannuation entity by name, this submission refers to the combination of our superannuation entities and service providers under the banner of MLC Wealth.

---

[1] MLC Limited (the life insurance company) uses the MLC brand under licence from NAB. MLC Limited is part of the Nippon Life Insurance Group and not a part of the NAB Group of Companies. NAB has notified the ASX of its intention to divest the wealth management business MLC via arrange of exit options including demerger and IPO or trade sale.

Contents

1 Introduction ... 1
1.1 Approach to the draft report ... 1
2 Executive summary ... 2
3 Draft Recommendation 1: Defaulting new employees once ... 4
3.1 Preliminary ... 4
3.2 Is there a role for employers? ... 4
3.2.1 Insurance – workplace designs ... 5
3.2.2 Investment options as part of corporate sub-plans ... 5
4 Draft Recommendation 2: 'Best in show' for new employees ... 8
4.1 Preliminary ... 8
4.2 Specific comments - shortlist of 10 ... 8
4.3 Hybrid alternative for default allocation ... 10
4.4 Comparability for members (pending next system assessment) ... 11
5 Draft Recommendation 3: Independent expert panel ... 13
6 Draft Recommendation 4 MySuper authorisation ... 14
7 Draft Recommendation 8 Cleaning up lost accounts ... 16
8 Draft Recommendations 9 and 10 - Member-friendly dashboards ... 17
9 Draft Recommendation 11 Guidance for pre-retirees ... 18
10 Draft Recommendation 12 Exit fees at cost-recovery levels ... 18
11 Draft Recommendation 13 Disclosure of trailing commissions ... 18
12 Draft Recommendations 14 – 17 ... 19
13 Information request 2.1 – Benchmark portfolio assumptions ... 20
13.1 All-of-fund performance ... 20
13.2 Assumptions and missing data: ... 25
13.2.1 Data assumptions – asset classes, hedging, infrastructure ... 25
13.2.2 Data assumptions – MySuper ... 28
13.2.3 Extrapolations – past returns ... 29

13.2.4 Transparency of benchmark portfolios 31

14 Information request 2.2 – factors explaining differences in investment performance 32

15 Information request 4.1 – allow lifecycle for MySuper? 34

16 DRAFT FINDING 4.2 – choice proliferation should be reduced through default benchmark 35

17 MLC Wealth citation – higher cost investments 37

1 Introduction

The Wealth division of National Australia Bank (MLC Wealth) appreciates the opportunity to respond to the Draft Report of the Productivity Commission (the Commission) into the Competitiveness and Efficiency of the Superannuation System.

This review provides valuable analyses on the current state and, with refinement, will deliver strategic insights for a broad range of stakeholders. It is a seminal work which will play a major role in the development of future studies and assessments.

The Commission has, in a short time, undertaken extensive research and has identified gaps and areas for improvement which we will continue to study.

As a long-term participant in the system we acknowledge there is potential for ingrained behaviours and practices to contribute to inertia or obsolescence. Hence, we support these examinations but also view competition as a critical driver of modernisation and continual improvement. Competition is crucial for a healthy sector combined with stable, strong funds resourced to continually develop contemporary products and services which comply with evolving regulatory requirements.

We note the focus is predominantly (and appropriately) on investment performance and mitigating erosion of balances through unnecessary fees, as the main drivers for building wealth and wellbeing in retirement. Two general questions we have in terms of the insights related to fund governance were whether the Commission had, through its extensive analysis:

- Identified strengths or gaps in administrative efficiency including for example, timeliness of processing contributions, actual attribution of returns and methods for attributing returns, liquidity profiles, and management of operational risk reserves?
- Considered possible future models to assist with policy change analyses and the types of transition frameworks that may be needed for both stability and the avoidance of adverse impacts?

The above may be secondary but can affect the efficiency of the system and costs. It may be a matter for a future assessment.

1.1 Approach to the draft report

We provide comment based upon practical experience (from asset management to administration) intended to assist the Commission with verdicts for the final report, and potential recommendations for future assessments. Given the timeframe for responses and the breadth of the report, we have focused this submission on:

- Information requests, methodology and findings related to investment performance (including lifecycle) and benchmark portfolio approaches.
- Duplicative accounts within the default system and defaulting an entrant to the workforce once.
- ‘Best in show’ shortlists for new entrants and default allocation.
- Choice options, performance, and comparability.

2 Executive summary

A competitive, transparent and well-regulated superannuation system is critical for generating improved, or self-funded, retirement incomes for Australians. It is also a crucial contributor to the security and functioning of the Australian economy with a ratio of assets in excess of 125% to GDP[2].

As a mandated retirement savings system, MLC Wealth supports the Commission's recommendation that the 'default' MySuper standards for authorisation be elevated in the interests of members with appropriate measures and regulatory action where warranted.

We agree with the Commission's assessment of the negative consequences associated with multiple accounts and duplicative fees and charges in the default (MySuper) structure. Recent and in-train initiatives, such as the combined interfaces of Single Touch Payroll (STP) and the online choice form (once rolled out widely) will see a significant reduction in duplication and also increased awareness of superannuation on entry to the workforce.

The Commission's concept of automatically 'defaulting' a person into super only once would further mitigate the potential for account duplication. MLC Wealth believes that with a strengthening of authorisation conditions for MySuper, there is and should remain a role for engaged (usually larger) employers to arrange corporate superannuation plans with features, and often additional benefits, suited to the workforce they employ.

With a strengthened MySuper authorisation regime, new entrants (or employers) can make a 'safe' choice (potentially from an objectively ranked listing based on regulator reporting).

MLC Wealth supports the fundamental principle of choice for individuals in determining the most suitable arrangements (and providers) to manage their superannuation and retirement outcomes.

A 'best in show' of 10 products in the Australian system has the potential to suppress competition potentially increasing homogeneity of designs and settings.

Diversity in types and styles of providers and in the types of products and options available affords Australians a competitive system. Participants are driven to improve their offers and remain contemporary while affording consumers a framework which gives them the potential to optimise their own outcomes (taking into account idiosyncratic needs).

[2] Willis Towers Watson, *Global Pension Assets Study 2017*

The Commission's proposed reference portfolios (BP1 and BP2) developed using aggregated whole-of-fund asset class data for the system assessment do not mirror the outcomes or performance delivered to members. As such, there is the potential for outcomes to be inaccurately reflected in the choice environment.

While benchmarks have limitations, if reference portfolios are to be used for the system assessment, multi-portfolio benchmarks could be created to provide members a basis against which to assess their specific strategy. These portfolios would be based on consistent asset class exposures and risk profiles for 6-8 sector diversified options using common labelling/classifications (such as, conservative, balanced, growth, high growth).

The Commission's surveys and analysis highlight the need to devise new and innovative approaches that allow members, be they 'choice active' or 'default', to compare their outcomes with other options. MLC Wealth believes the multi-portfolio benchmarks would support this aim.

From a performance perspective, a focus on the assessment of "inputs", in addition to outcomes (based on past returns), would provide a more holistic view of future capability and strength. As noted in our Stage 1 submission, this could include for example, assessing the appropriateness of governance structures particularly related to investment decision-making, looking at the size, experience and investment credentials of Investment Committees and Trustee Boards.

3 Draft Recommendation 1: Defaulting new employees once

3.1 Preliminary

In a mandated system, MLC Wealth agrees that unintended multiple accounts with replication of fees and insurances results in poor member outcomes and undermines retirement savings - a core objective of the superannuation system.

As the Commission has documented, this duplication has occurred through the design structure for mandatory contributions developed in a time with different workforce dynamics. It was a model of the 1980s and early 1990s when there was more job stability and progression pathways tended to be vertical and horizontal within an entity or, when job movements occurred, frequently did so within the same industry.

This contrasts with a significantly greater diversity of arrangements today including a growing 'gig economy' resulting in more individuals having multiple employers (simultaneously or sequentially) within and across industries. The effect has been that superannuation product has been attached to a job or employer rather than to the person with some individuals having accounts established in several funds.

Over time, measures have been developed in an attempt to mitigate this duplication. The most recent of these measures includes the Government's Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018. The substantive aims of the legislation are to:

- Protect member accounts with small balances from unnecessary and inappropriate erosion by fees and insurance premiums,
- Reduce the timeframe in which inactive accounts are to be designated as lost with a transfer to the ATO,
- Enhanced capability to enable the ATO to consolidate amounts where the ATO can identify an active account.

As a principle, MLC Wealth supports measures reducing the potential for replication or creation of multiple accounts particularly for disengaged entrants to the system.

3.2 Is there a role for employers?

The Commission's proposed approach, being a once-only automatic default on entering the workforce, would prevent many of the issues which these measures are attempting to moderate from occurring.

The antithetical aspect of the Commission's proposed approach is that designs and benefits negotiated by active, and usually larger employers, would potentially be lost. The main benefits, noted in prior submissions, include:

- Discounted fees to the member as a result of the employer being able to gain wholesale rates;
- Reductions in fees to the members in the cases where the employer pays either for insurance or superannuation fees or both;

- Insurance benefits such as: subsidies, additional employer-paid insurance cover, or bespoke insurance designs suited to the workplace demography;
- Continuing superannuation contributions for employees on parental or maternity leave;
- Workplace education and engagement;
- Differentiated investment options within the sub-plan for that employer;
- In some cases, defined benefit options (rarely offered to new employees).

3.2.1 Insurance – workplace designs

Engaged employers have been central to the development of the superannuation system and workplace designs. A core feature of many such designs is tailored insurance arrangements specific to the cohort of employee members with that employer, including their age and industry classification.

These arrangements are priced on a group basis which is more affordable for most of the members than a personal insurance policy and is particularly beneficial for higher risk occupations and industries.

All of the ~90 Plum corporate super division plans have tailored insurance arrangements. Around 6 of these plans (~39,000 members or ~32% of Plum corporate super members) have their insurance either fully or partly subsidised by their employers. In MasterKey Business Super there are 173 employers currently subsidising premiums (either fully subsidised or partially).

While there are less employer plans with tailored insurance designs in MasterKey Business Super, employers have the option, subject to review processes, to choose from different levels of Death, TPD and income protection cover as part of the default cover for their employees. Hence there are many variations of cover provided across the 20,000+ MasterKey Business Super plans.

3.2.2 Investment options as part of corporate sub-plans

Most of the corporate plans in both the 'large employer' and 'small- medium employer' segments include a number of diversified choice portfolios.

These choice portfolios are typically requested by employers to cater for the employer demography, and to provide additional choices for engaged employees.

It is acknowledged that, based on recent history, some industry super funds have outperformed in the MySuper arrangements. However, MySuper (mandatory from 1 January 2014) has only been in operation for ~4 years. This is a short time horizon in the context of superannuation and investment performance.

The Commission has adopted a 12 year past performance horizon but as noted in section 13.2.2 our MySuper products (and many in the retail sector) only commenced from January 2014. The Commission's analysis incorporates pre-FOFA and pre-MySuper data. This exacerbates the issues with past performance comparisons. Not only is past performance, in shorter timeframes, a poor predictor of future outcomes, the extrapolation of data prior to the existence of MySuper in the retail context is not an accurate reflection of the product construct.

In contrast to some of the findings that 'choice products' uniformly underperform the, mainly industry fund MySuper options, we note this is not the case for the most popular diversified options in the Plum corporate and MasterKey Business products as described in the table below.

Summary:

- Pre-mixed Assertive and Horizon 5 are the most popular 'choice' diversified options on the Plum and MLC Business Super menu with a similar growth asset allocation^ as other major industry funds;
- Pre-mixed Assertive has outperformed the median Industry Funds' Balanced Option and the median fund in the SuperRatings MySuper Index over all time periods to end December 2017;
- Horizon 5 has outperformed the median Industry Funds' Balanced Option and the median fund in the SuperRatings MySuper Index over 1, 3, 5 and 7 year time periods;
- Both Pre-mixed Assertive and Horizon 5 have performed broadly in-line with major Industry Funds (Australian Super, Cbus, First State Super, HESTA, HOSTPLUS and MTAA).

Returns (net of investment fees and taxes) as of December 2017:

Option	1 Year (%)	3 Years (%)	5 Years (%)	7 Years (%)	10 Years (%)
Plum Pre-mixed Assertive	11.40	8.41	11.15	9.29	5.34
MLC MasterKey Horizon 5	11.18	8.37	10.95	8.87	4.59
SuperRatings Industry Funds Balanced Option Median	10.84	8.31	9.92	8.65	5.45
SuperRatings MySuper Index Median	10.80	8.26	10.06	8.77	5.51
Australian Super - MySuper Balanced	13.59	9.80	11.11	9.52	5.95
Cbus - Growth (Cbus MySuper)	12.15	9.76	11.12	9.67	6.06
First State Super MySuper - Life Cycle Growth	12.62	8.39	10.35	8.84	5.73
HESTA MySuper - Core Pool	10.84	8.57	10.13	8.85	5.70
HOSTPLUS MySuper - Balanced	13.40	10.13	11.33	9.82	6.08
MTAA Super - My AutoSuper	10.72	9.35	10.15	7.95	2.71

^ Source: SuperRatings Asset Allocation survey as of December 2017, using NAB Asset Management asset class classification.

While the Commission's approach will assist in reducing multiple accounts, we do believe there are some features of the existing employer-based model that should be retained. In this regard, we have suggested a hybrid below in section 4.3.

We note the Commission's comments and concerns regarding inducements to employers to the detriment of employees and members. There has been no evidence produced, or any clear fact base, which supports the commentary (despite investigation). As long term participants in the system, which have acted to exert competitive pressure in favour of employee-members, employers as a class should not be overlooked. To the extent that there are concerns the existing provisions are not sufficiently robust, consideration could be given to controls which would mitigate the potential for such activity.

4 Draft Recommendation 2: ‘Best in show’ for new employees

4.1 Preliminary

MLC Wealth acknowledges the plethora of choices available in the superannuation market may be confounding for many consumers. This can create, rather than ameliorate, apathy and disengagement. As an entity we have recognised that there is a need to undertake some rationalisation and simplification of our product offers.

However, we do believe that variety in both structures and offers are and will remain important in the choice arena. For those who are engaged and active in seeking to optimise their overall financial situation, a range of options is important. This helps enable self-determining individuals, particularly with advice, to create their own best solution taking into account risk profile, liquidity needs, personal situation and other assets.

In the choice environment, a member invests in a particular investment portfolio(s), which may be tailored expressly for them (particularly in the Wrap space). Their options are not based on a comingling of every asset that is held in the different portfolios offered across the entire fund. The combination of all options and portfolios provides an average return which is unrelated to the actual outcome for individual members.

The Commission’s surveys and analysis highlights the need to devise new and innovative approaches that allow members, ‘choice active’ or ‘default’, to compare their outcomes with other options, as well as to build awareness and engagement. The multi-portfolio benchmarks, suggested in section 13.1, with the associated risk profiles would, we believe, assist in this regard. It would also allow investors in Wrap (or IDPS-style) options to review their individual or combined allocations against these benchmarks.

4.2 Specific comments - shortlist of 10

Given the changing workforce structures, the Commission’s approach to centring the default enrolment mechanic on the member, to assist them to make their own selection, is an interesting modernisation.

We agree that building and enhancing the retirement savings of Australians is compromised by unintended duplication and potentially by the imprudent automatic consolidation of accounts (other than those clearly identified as lost or unclaimed). Engaging new entrants (or job changers) when commencing new employment via an online process should build awareness and allow them to either specifically, or by default, direct contributions to an existing arrangement.

The roll out of the STP and pre-populated online choice forms via a centralised ATO system will provide:

- Stimulus for individuals to consider their existing arrangement, or their employer’s default if applicable, and
- Determine when and how to consolidate other accounts that may exist.

There are some significant interfaces and associated costs to navigate with the Commission's suggested approach including major enhancements to the functionality of both the MyGov site and the ATO STP with interfaces to funds.

A better first step would be to require employers and payroll providers to adopt the in-train STP and prepopulated online choice form. This would identify existing fund details for new employees as a selection option during the on boarding process.

While we can see that a 'best in 10' approach could drive consolidation and limit workforce entrants defaulting, at least initially, into poorly performing or managed products, it has the potential to constrain real competitive friction for incumbents (clustering around similar objectives/performance/asset mixes), and, given a 4-year only review cycle, impedes new entrants.

MLC Wealth's concerns with a 'list of 10' especially in the short term are:

- A best-in-show shortlist could divert new super contributions to a very small sub-set of super funds or products within the market, and away from other comparable or equally market competitive products – there is not a great gap in the difference from the 10th (or all of the 'top 10') and the next best or equally best next 10 or more. Ranking can change reasonably quickly depending upon markets and exposures;
- It is likely a 'best in 10' will cluster around similar features/outcomes and track the benchmark (herding) with little to no incentive to innovate, or adopt alternative strategies;
- Longer term, the industry may experience a significant reduction of the availability of super products in the market, creating a concentration of wealth in the hands of a limited number of industry participants and depriving super investors of the benefits of a competitive market;
- It has the potential to drive more frequent switching in the pursuit of the 'best' at a particular time (short term focus). This can have the effect of realising losses and/or forgoing returns from portfolios with longer time horizons and different risk profiles (even for simper options such as breaking a term deposit).
- The creation and composition of another 'regulative' structure with the associated framework, constitution, and governance requirements is expensive (see our prior submissions).
- Assembling an independent panel of sufficiently qualified experts is potentially difficult in the Australian context.

Before embarking on a regulatory-driven market construct which will potentially limit competition, it is worth:

- Allowing time to assess the results from the current set of in-train reforms including the STP changes and online choice forms (mitigating multiple accounts) and enhanced APRA standards for trustees aimed at strengthening member outcomes;
- Allowing further time to assess the outcomes of MySuper given that it only commenced on 1 July 2013 (mandatory from 1 January 2014);
- Elevating the MySuper authorisation (de-authorisation) criteria;

- Adapting and implementing a number of the Commission's proposals focusing on governance, disclosure and comparability.

MLC Wealth believes specific regulatory measures which lead to concentration of markets should be avoided until current and prospective prudentially focused measures are settled. It can destabilise competition and artificially limit participants both in absolute terms (numbers) but also in terms of diversity (which seems to have been an issue identified in the broader review of Competition in the Australian Financial System[3]). We believe that viewed collectively the above initiatives will result in significant enhancements for members and achieve desired outcomes over a 'best in show short list'.

In this context, the prudential protections become even more important. The framework needs to operate to apply criteria and standards to funds offering MySuper as a default. The framework should reinforce, highlight and enhance the duties and responsibilities of trustees for those who are disengaged or wish to rely upon professional trustee judgement to manage their financial retirement outcomes.

4.3 Hybrid alternative for default allocation

At this stage, MLC Wealth proposes consideration of an interim or hybrid model which reflects the main principles of the Commission's recommendation – keeping the member at the centre of the process combined with the role of the 'active' employer, the functionality of the new STP and online choice form.

For those individuals first entering the workforce, the default would be the employer's corporate MySuper product, or in the absence of this, the MySuper option to which the employer directs most of its mandatory contributions. This could be identified by the employer, or in time, via the STP process with ATO records translating it to the online form.

The passage of Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017 and the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 combined with the STP could achieve much of what the Commission intends. As part of the on-boarding process with a new employer, employees would have line of sight to any existing active account which would be their default (much as MySuper was intended to operate) but, could elect to join the employer offered 'default' if an employer provides a corporate superannuation sponsored plan.

This hybrid model would still promote the Commission's once-only 'default' approach whilst capitalising on the positive additional benefits provided in some employment arrangements.

---

[3] Productivity Commission, January 2018, Competition in the Australian Financial System, Draft Report

In terms of member engagement and potential ability to assess and compare outcomes (new or existing) we believe a set of multi-portfolio benchmarks would offer members the opportunity to consider investment options with differing risk profiles and how these compare to their situation (see section 13.1).

Should a 'best in show' listing be progressed for automatic allocation where the employer does not have a default available (or for new employers), it should be based the public offer MySuper products which could be ranked by objective criteria reported to the regulator annually (see section 6, MySuper authorisation).

While we understand the Commission's limit of 10 is derived from behavioural economics analysis, it is a significant diminution in the number and potential variety of the MySuper arrangements on offer. In looking at a similar default allocation model such as KiwiSaver in NZ, we see that the number of 'defaults' is 9. The Australian system is much larger and has been in operation for a significantly longer time period.

Acknowledging the Commission's twin aim of ensuring members are not defaulted to underperforming funds, an elevated MySuper authorisation along with stricter regulator standards will offer protection from deficient products. In effect, substandard, underperforming MySuper products would be closed, through regulator action, to new entrants.

Apart from the potential to change market concentration, the risk in moving too quickly to a shortlist, particularly a very short shortlist is that products which are only relatively new are locked in based on a limited track record. We support the regulator being afforded more powers to interrogate and deal to outcomes assessments that are definitively inferior or deficient. We also support strengthening the objective criteria for gaining and retaining MySuper authorisation. These are initiatives which we believe should be prioritised.

4.4 Comparability for members (pending next system assessment)

Leveraging the effort of the Commission, and taking into account investment performance issues (discussed in section 13.1) MLC Wealth posits an alternative that may operate more effectively at member level (rather that at an aggregated system approach).

This alternative, which needs developing, relies upon the Commission's concept of utilising benchmarks. While there are likely to be concerns about 'herding' behaviour with any benchmark approach (potentially putting the brakes on differentiation within class) the Commission's research suggests the need for the system to better aid individuals in assessing their outcomes.

To this end, MLC Wealth submits using benchmarks for a defined set of sector or diversified portfolios based on common designs and labels (ensuring that the composition by asset class is consistent). It should be possible to construct an approach for lifecycle options (based potentially on age brackets) – it would necessitate some research into designs, asset allocation benchmarks and risk profiles of and performance from current models.

Each portfolio (option) would have a 'risk' profile related to performance outcome, liquidity, and volatility.

This better allows an individual to match their risk profile and situation to a portfolio or even a single asset or sector option as well as to assess the effectiveness of their current arrangement. It would assist advisers, and also clients of advisers, to determine whether they are getting the outcome anticipated (whether in a default or choice arrangement).

The ASIC MoneySmart website already has features which allow some comparisons of products (including fees). Adding the benchmark portfolios to the calculators and applications (here or within the MyGov site) would enable members to compare relative outcomes (both for like 'labelled' options and others).

5 Draft Recommendation 3: Independent expert panel

We have reservations about a 'best in show' selection shortlist as noted in our response above to Recommendation 2.

If a 'best in show' shortlist regime is introduced, we believe it should be expanded to accommodate authorised public offer MySuper products operating under elevated criteria against which funds report to the regulator – this could be based on the elements identified in Table 13.1 subject to clarification as discussed below in section 6.

In addition, we believe the criteria should include:

- Reporting on number and type of choice options (including those that would be part of the multi-portfolio benchmark proposed in section 13.1). For funds that offer single asset or sector options, it could simply be the total number of these additional options;
- Number (and type) of retirement income options;
- Adequacy of the fund's operational and investment risk and governance frameworks.

The regulator should regularly monitor the performance of the 'best in show' shortlist products (at least annually) as compared to other super products and update the shortlist more frequently than 4 yearly and revise the shortlist where:

- Another product demonstrates superior outcomes to the products listed on the 'best in show' shortlist; or
- A product in the 'best in show' shortlist delivers substantially less returns in the 1st, 2nd or 3rd year after the list is constructed.

6 Draft Recommendation 4 MySuper authorisation

MLC Wealth supports proposals and measures which would raise the regulatory bar for the issue and retention of MySuper authorisation.

This approach would operate to ensure that trustees with MySuper products that are underperforming across a set of key criteria over time would act, or be required to act, to improve the outcomes or cease the offer (and/0r lose authorisation).

An objective assessment undertaken through reporting to the regulator would be preferable to Government-appointed panels which would create 'best in show' lists where costs would be duplicative and conflicts potentially difficult to manage given the size of the market and availability of expertise. That is, we believe it would be less duplicative and less costly to enhance the filters and criteria of the licensing regulator.

In principle, and with an exception discussed below, the criteria in the Draft Report Table 13.1 (combined with those suggested in section 5) are a reasonable basis for this purpose although some clarification or confirmation is required. This includes:

- Confirmation that the investment benchmark is tailored to the fund's investment return target and risk target i.e. this is the measure against which the assessment is performed.
- That the benchmark is not regulator devised, rather the fund be required to report its benchmark and this reporting be done annually as it can change from year to year.

We note there will be differences between an investment strategy and investment benchmark driven by the portfolio management approach and experience of the Investment Manager – trying to benchmark this through a benchmark imposed by the regulator would appear to replicate existing requirements established through the investment governance framework.

The determination of what margin of underperformance triggers revocation requires a process rather than being just automatic. For example, there needs to be clarity around what is deemed a material margin and consideration for situations where a fund has performed within benchmark for 4 of 5 years and then have a bad year meaning it was out of benchmark over the 5 years.

That is, it is not practical to have an automatic rule that authorisation be revoked on underperformance of a benchmark, as there can be many legitimate reasons why a fund underperforms its benchmark and many of these might be quite reasonable at any given point (e.g. investment style out of favour, market conditions unfavourable but changing to favourable). If a benchmark performance model is to be used, it is best used as a trigger to review the fund's authorisation with opportunity for fund to substantiate and justify its position rather than as an automatic revocation.

The construction of these benchmarks would require standards, or provisions to establish appropriate asset class mixes and ranges ensuring consistency in designation and assessments. This is similar to what we propose as multi-portfolio benchmarks above (and in section 13.1).

Exception:

We question the proposal to report to the regulator members electing to switch to (higher fee) choice products. In this regard there are existing requirements under APRA's SRF 610.1 to report switches. This reporting includes switches between both MySuper and choice products. Accordingly, the regulator can currently interrogate trustees about switching patterns and we question the utility of a further cost impost.

Further clarification is sought as follows:

- The additional requirement to report will increase costs and thus fees. Is this intended? Given existing reporting, is it more efficient and less costly to presume that choice products are, generally, higher fee?
- What is meant to be captured by a 'higher fee' product? Is this investment fees? In some cases whether a product was "higher-fee" would depend on an individual member's account balance, activity and investment choices. What occurs where members have a combination of the MySuper product or investment options and other choice options?
- How does the proposal relate to those members moving into pension products?
- Could the Commission provide the basis for this recommendation? As noted above, there may be in place reporting which would address the concerns.

7 Draft Recommendation 8 Cleaning up lost accounts

Whilst we have no concern with the draft recommendation to auto-consolidate 'lost accounts', we do see some issues around:

- Practicality and defining 'lost accounts'; and
- 'Explicit member signals' (not to auto-consolidate).

We believe that any legislation needs to consider member's interests and be flexible enough to account for valid reasons why a member may not be contributing for a period of time.

We believe that by using the new Lost member reporting (funds have already invested materially to deliver for a 1 October 2018 obligation date) the member would be better off with a direct consolidation to their active account and staying in the market rather than the proposed two-step process (send to the ATO to then find an active account and move money again). This would limit unnecessary industry cost overhead for better outcome.

8 Draft Recommendations 9 and 10 - Member-friendly dashboards

MLC Wealth supports the concept of quick, simple summary disclosure that can be digested by consumers as a first port of call when considering their superannuation options. There have been many attempts within industry and also by the regulator to design simpler consumer-friendly material to enhance the understanding of product. This continues with the proposed "Design and Distribution Obligations' which have been the subject of recent consultation.

Single page "key features" dashboards to assist consumers to make 'like for like' comparisons of the features attached to the 'product' may prove more effective than current designs. These could be designed in a similar format to the Key Features Statement which formed part of the Customer Information Brochure regime (which existed prior to the introduction of the Product Disclosure Document regime).

We caution against Product Dashboards under current designs for [all] choice options (including single assets such as exchange listed options) given the associated costs and very limited benefit to members. Where members are advised and are selecting from a menu (basically an Investor Directed Portfolio Service (IDPS)- like vehicle) they will use the menu and suite of options (including single assets) to create 'their product' – that is, customised or self-constructed portfolios. In this regard, our proposed multi-portfolio benchmarks (see section 13.1) would provide a reasonable basis against which members could assess their own particular outcomes and risk profile settings.

We would welcome engagement with the regulator and wider industry to genuinely work to design appropriate and useful product dashboard(s).

The Commission's recommendation to deliver dashboards on a centralised online service may make it easier for members to identify the providers of superannuation products and to compare key features of these respective products.

Choice dashboards should be produced and uploaded only in respect of multi-asset ('collated') portfolios/options.

9 Draft Recommendation 11 Guidance for pre-retirees

MLC Wealth supports measures that seek to educate retiring Australian's about their financial options and encourages them to actively manage their retirement savings.

In the development phase, consideration will need to be given to the interaction with advice and, if applicable, CIPRs.

10 Draft Recommendation 12 Exit fees at cost-recovery levels

As a key strategic activity, we are actively working to remove our legacy exit fee arrangements.

We support the proposal to place a ban on exit fees which act as a barrier to members moving their retirement savings to a product which better suits their individual needs and circumstances and note this is a key measure in the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018, currently before the Parliament.

11 Draft Recommendation 13 Disclosure of trailing commissions

As a general principle, we support measures designed to improve the transparency of fees and costs to members. Accordingly, we have disclosed adviser remuneration schedules in product disclosure statements and readily provide this information to members upon request.

If considered helpful, we could publish adviser remuneration schedules on the Trustee's website.

However, as these costs are already incorporated in the administration fee, we would not separately disclose trailing commissions in periodic statements. Apart from potential confusion, the large operational expense of implementing the change would produce little benefit to members and add further cost. To accommodate the core intent of the Commission's proposal, enhanced disclosure on annual member statements could include a specific notice that:

- The administration fee for your current product covers the operational charges of running the product as well as commissions paid to financial advisers.
- Newer products accommodate specific and separate deductions for Adviser Service Fees agreed between you and your financial adviser (and do not allow commission).

As a key strategic activity, we will encourage financial advisers and assist them t to transition their businesses into fee for service models. We support Government initiatives that further progress the financial service industry's transition to non-commission based structures, noting the difficulty of navigating pre-existing grandfathered contractual obligations.

12 Draft Recommendations 14 – 17

We note that provisions in Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 deal to the matters in Draft recommendations 14 – 17.

In general:

- We support the principle of reducing and/or removing opt-out death insurance cover for younger members without dependants or financial commitments (i.e. mortgage, HECS debt etc.). However, we also believe there is a strong case for the retention of opt-out TPD cover, given the need for financial support in the event of disability is likely to be the same for a member regardless of age.
- The current proposed arrangements will create an issue of eligibility requirements as members move from the opt-in arrangement to opt out (default) after age 25. The current proposed arrangement will introduce a potential selection impact but also potentially individual underwriting. Further work and engagement with insurers will be required to determine the appropriate eligibility criteria on reaching age 25 (e.g. requiring members to satisfy alternative 'at work' requirements).
- As a general rule, we believe it is reasonable to cease insurance on accounts without contributions. We support an appropriate balance between premium costs and erosion of retirement benefits. However, we note that there are multiple reasons why a member's account may be 'inactive' where insurance cover remains important. Examples include members on extended sick leave that may be more likely to claim in future (even if not yet eligible), or members on maternity or other forms of leave without pay that plan to return to work and require continuity of cover. There are also some groups of members that should be excluded from this requirement in a similar way as applies to defined benefit members. These include members with insurance only retail polices and those where the employer pays for the premium
- We support an appropriate balance between insurance premium costs and generation of retirement benefits. The Trustee's Insurance Management Framework contains an existing control framework specifically designed to monitor any inappropriate erosion of member balances and address accordingly.
- The Trustee has resolved to adopt the Voluntary Insurance in Super Code of Practice and we support the Code being a mandatory requirement.

13 Information request 2.1 – Benchmark portfolio assumptions

MLC Wealth acknowledges the Commission was tasked with developing a system level assessment.

We have some concerns with the architecture of the model since, without sufficient caveats and a purpose, or use classification, consumers or members may be misinformed. This is due to the assumptions and methodology used in constructing the benchmark portfolios intended to assess the system. It is particularly problematic if the data is used to assess or compare outcomes at either a fund or individual member level.

Averaged performance derived from the past performance of aggregated (and comingled) asset classes does not, and cannot, have regard to the number or rate of separate member-driven decisions within the options offered in a fund, or to a particular option in which a member is invested.

Below we have outlined our concerns and suggest that additional benchmarks which may assist in addressing differences in asset allocations and in risk profiles across portfolios.

13.1 All-of-fund performance

Attempting to calculate an all-of-fund performance net return [4] based on comingled 'all-of-funds' asset allocations leads to highly inconsistent results across funds. The fund-level data combines all products and options sitting under the umbrella of a super fund. All options from cash, diversified funds, geared equity portfolios, amongst a variety of others, are combined together to produce the fund-level returns.

For example, these combined numbers lose meaning for different portfolios. The aggregate return numbers derived will not be representative of returns that any one member receives and will be distorted by the distribution of assets across options which reflects the individual decisions of investors, not the investment strategy adopted by the investment managers (by mandate from the trustee).

Drawing conclusions about the efficiency of the system based on results of such a comparison of long term net returns of the system may be difficult. Most funds have some allocation to unlisted assets and hence comparisons will be impacted by the performance of unlisted assets relative to other liquid assets. We note this might not reflect efficiency of the system but rather the cycles of relative performance of unlisted assets versus listed assets.

[4] If this is to be adopted as a measure for future and ongoing assessment, the definition of net return and how it should be derived is also a matter requiring clarification to ensure consistency across the sector.

Given the distribution of assets will differ across funds (due to different objectives) returns are not comparable. This problem is particularly exaggerated for funds with large numbers of vastly different options.

Table 1 below is extracted from the APRA data base and lists the number of investment options for all APRA-regulated funds with total FUM > $10bl. From this, it can be seen that even the largest industry funds have not more than ~20 options whereas retail funds' options are in the hundreds (and sometimes well over a thousand).

While the Commission has expressed concerns about the array of options offered, the breadth of the offers is intended to enable informed and advised members (particularly in the Wrap-type structures) to craft their own bespoke portfolio solutions suited to their circumstances.

Please refer to section 16 regarding the purpose and intent behind the range of options offered although we note the Draft Report does recognise the emergence of these structures as competitive alternatives to SMSFs where demand has been growing since their inception.

Table 1: Range of choice options

Fund name	**Total assets ($'000)**	**Number of investment options**	**Fund type**
AMP Retirement Trust	17,427,275	204	Retail
AMP Superannuation Savings Trust	55,329,525	244	Retail
ASGARD Independence Plan Division Two	22,437,182	1,933	Retail
Australian Super	123,183,652	13	Industry
Care Super	16,118,643	25	Industry
Colonial First State FirstChoice Superannuation Trust	72,074,739	743	Retail
Commonwealth Bank Group Super	11,061,177	10	Corporate
Construction & Building Unions Superannuation	40,275,274	10	Industry
CSS Fund	65,239,578	2	Public Sector
First State Superannuation Scheme	65,919,428	25	Public Sector
Health Employees Superannuation Trust Australia	42,064,051	20	Industry
HOSTPLUS Superannuation Fund	25,412,966	21	Industry
IOOF Portfolio Service Superannuation Fund	25,754,519	2,559	Retail

Fund name	Total assets ($'000)	Number of investment options	Fund type
LGIA Super	11,030,169	14	Public Sector
Local Government Super	10,547,168	8	Public Sector
Macquarie Superannuation Plan	17,594,186	2,413	Retail
Mercer Super Trust	22,584,091	174	Retail
Military Superannuation & Benefits Fund No 1	43,573,487	4	Public Sector
Mine Wealth and Wellbeing Superannuation Fund	10,769,273	30	Industry
MLC Super Fund	77,335,327	725	Retail
MLC Superannuation Fund	18,681,563	1,816	Retail
MTAA Superannuation Fund	10,665,207	16	Industry
OnePath Masterfund	36,194,686	141	Retail
Public Sector Superannuation Accumulation Plan	10,764,628	9	Public Sector
Public Sector Superannuation Scheme	75,734,856	2	Public Sector
QSuper	95,238,627	13	Public Sector
Retail Employees Superannuation Trust	47,832,145	26	Industry
Retirement Wrap	61,686,369	2,661	Retail
StatePlus Retirement Fund	17,735,353	10	Retail
Sunsuper Superannuation Fund	47,856,434	42	Industry
Telstra Superannuation Scheme	19,990,676	14	Corporate
Unisuper	63,096,958	16	Industry
Victorian Superannuation Fund	19,349,506	10	Public Sector
Wealth Personal Superannuation and Pension Fund	34,870,087	1,413	Retail

Source: APRA Annual Fund-level Superannuation Statistics June 2017 (Issued 28 March 2018)

The PC report itself notes that "*Some participants contest the usability of fund-level data. A fund-level return represents an amalgamation of different products and investment options offered by a fund, and is therefore not necessarily reflective of the member experience in a particular product (such as a balanced or growth option)*".

This is accurate. As a simple example, the table below shows the very different results of individual portfolio option performance separately to the result when aggregated[5].

Over 5 years, Horizon 4 (H4) Super and Inflation Plus Moderate Super (both diversified portfolios) have each outperformed their objectives. However, if we combine the portfolios (simply 50/50) then that combined portfolio underperforms the H4 benchmark (proxy for an asset allocation weighted benchmark used by the PC) by over 25bps.

25bps is the cut off for what the Commission's model would classify as underperformance. Therefore we can see that 2 outperforming portfolio options would be represented as underperforming.

	5 Yr Return (p.a)
H4 Super	9.44%
Inflation Plus Moderate	6.95%
Combined portfolio (50/50)	8.20%
Asset weighted Benchmark	8.50%
Combined portfolio excess return	-0.29%

As noted in the Commission's report (citing APRA and Chant West): "*Fund-level data also do not accommodate separate consideration of investment performance in the accumulation and retirement segments, which have very different characteristics.*"[6]

This is a very important point given the variability in choices (and increasing conservatism of choices in post-retirement) can affect asset allocations markedly.

Depending upon the constituency of a fund, the overall outcome is reported as an aggregated return i.e. the average return of combined portfolios is erroneously perceived as comparatively lower for those in accumulation phase relative to other funds with fewer retirees.

The report goes on to note that "*While the Commission has assessed the member-level experience using more granular data, fund-level data is certainly useful when undertaking a system-wide assessment, as the Commission is.*"

[5] The table is calculated by using unit prices before fees and taxes are deducted. The benchmark is an asset-weighted return of the Horizon 4 strategic asset allocation multiplied by the relevant asset class indices..
[6] Productivity Commission Draft Report, Superannuation: Assessing Efficiency and Competitiveness, p102

Depending upon the manner in which the data is published, and accompanying warnings, information constructed on this basis has the potential to mislead investors and distort decision making.

In light of these issues, we would suggest the Commission consider producing performance analysis for single investment options in addition to aggregate fund level data, or that additional reference portfolio benchmarks be developed for use and for comparison purposes. That is, MLC Wealth believes there is a need to develop architecture below the system level assessment in order to more accurately reflect the actual state of outcomes for members at investment option level.

Another option that could be considered, to address the challenge of assessing system wide efficiency, is assessing the success rate of individual investment options, for example by observing the percentage of options exceeding their respective benchmarks or their defined investment objectives.

We have previously made recommendations regarding benchmarking options and believe this might be further advanced by establishing a framework for a set of common reference portfolios using current 'portfolio/investment option labelling' language (for example, conservative, balanced, growth, high growth etc. – see section 13.1).

Below is an extract of our previous recommendation – as suggested this could be moderated to incorporate 'labels' which innately incorporate an inference regarding risk profile.

"*.... separate reference portfolios should be selected for different risk categories of portfolios and that these reference portfolios should be constructed based on the average asset allocation of funds within each risk category. ...the broadest possible universe of funds should be used so as to avoid any particular biases that might emerge from using smaller or select universe of funds, but that the funds within each risk category universe should be comparable in terms of risk profile and total exposure to growth assets.*

...We would propose that the following risk categories should be used and defined in terms of funds benchmark exposure to growth assets:

Risk Categories Definitions - Growth asset allocations:

- *0%-19%*
- *20%-39%*
- *40%-59%*
- *60%-76%*
- *77% - 90%*
- *91% - 100%"*

The benefit of this approach is that it accommodates a risk profile for each of the labelled portfolios. However, we note that any benchmarking exercise has imperfections - it can influence investment manager behaviours, it is backward looking which is not an accurate predictor of future outcomes (see below) and may encourage 'short termism'.

While our previous submissions have proposed assessment of individual options against their specific investment objectives and benchmarks, this proposed multi-portfolio benchmark alternate may, despite its imperfections, provide a manageable suite of

options against which individuals can compare their outcomes (taking into account their risk profile) and also encourages the industry to provide more consistent disclosure.

13.2 Assumptions and missing data:

We understand the Commission has identified a lack of the data it has determined is required to calculate the benchmark portfolios as devised[7]. The reference benchmarks rely upon collated data for returns and expenses aggregated across all asset classes in a fund (which contrasts with the way funds typically hold and interrogate performance outcomes based on the options, and objectives of those options, as offered to members).

As a result, for the Draft Report, the Commission has needed to make multiple assumptions which we believe have led to inaccuracies in representations of underlying portfolios' performance outcomes (see below).

MLC Wealth would be pleased to collaborate with the Commission for this purpose and, if adopted, assist in developing a set of reference portfolio benchmarks (as discussed above).

In the interim and in light of the recognised gaps and the breadth of assumptions in the underlying data/methodology for aggregated benchmark portfolios, it is suggested the Commission consider widening the underperformance assessment basis from a differential of 0.25% to, say, 0.50% relative to the benchmarks.

The analysis of performance of H4 and Inflation Plus portfolios presented above supports this suggestion as their combined performance is between 25 and 30bps under their asset weighted benchmark despite both options outperforming their individual respective benchmarks.

13.2.1 Data assumptions – asset classes, hedging, infrastructure

There are questions, in particular with the following assumptions, which lead us to be concerned about the accuracy of representations as to performance:

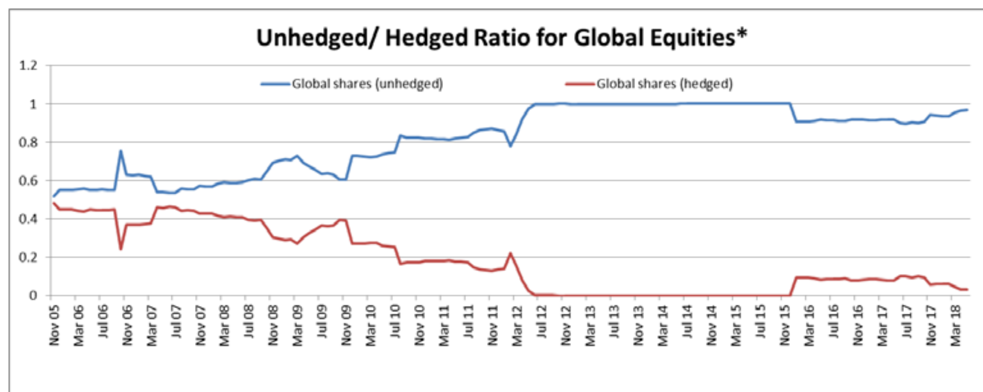
- The commission constructed a benchmark for the "other" category asset class using 50 per cent S&P / ASX 300 and 50 per cent 30/70 hedged/unhedged MSCI International equities index. This is unlikely to be representative of the characteristics of this "other" asset class as it incorporates all assets that do not fall into the traditional asset class categories including equities. This would include Alternative Investments, many which aim to have a minimal correlation with equities or have defensive qualities. Using an equities index to benchmark this category

---

[7] In this regard NAB Wealth has identified to the Commission that it does not hold certain data in the form or at the level the benchmarks devised require. Efforts have been made to accommodate the approach to enable the system level assessment. As discussed we have concerns with the utility (or accuracy) of a system assessment at fund and member investment option level.

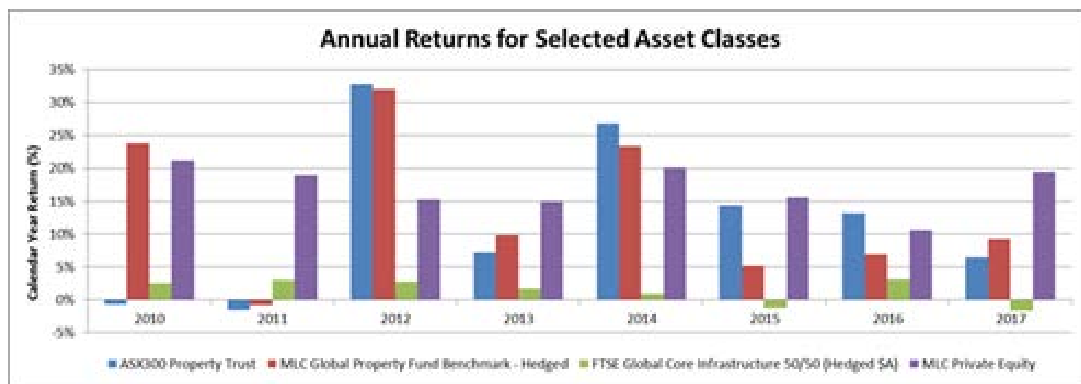
would not result in a meaningful comparison as the investments may not aim to outperform or even have any exposure to equities.

- The commission notes that the Benchmark Portfolios (BPs) are quite sensitive to the hedging ratio assumed. An assumption of 70% hedged and 30% unhedged for international asset was based on a 2015 survey. This hedge ratio will have changed materially over time as is reflected below for one of our flagship funds, the MLC Horizon 4 Balanced Fund:



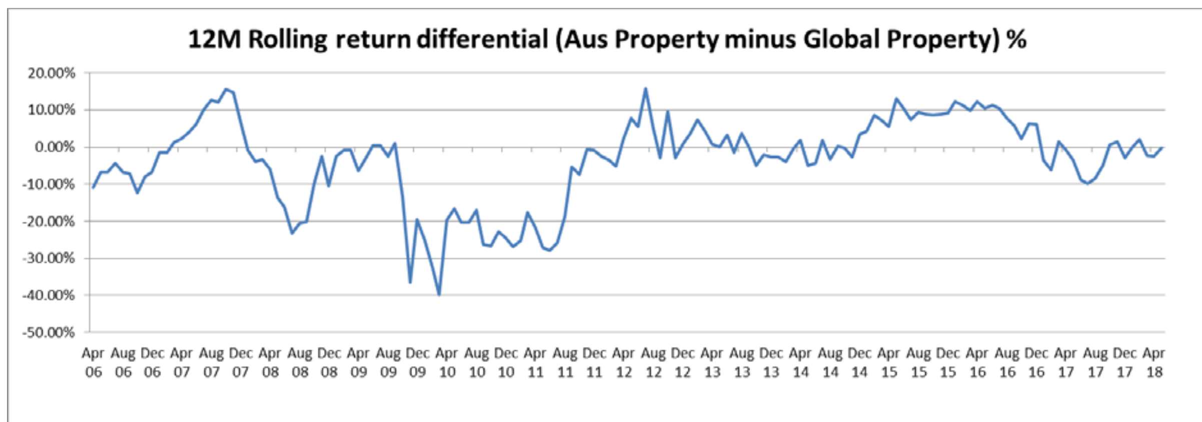
Source: NAB Asset Management Services Ltd

- APRA asset allocation data does not contain separate categories for private equity or infrastructure. Further, listed property is not split between domestic or international property. These sub-asset classes have very different return experiences. For example, Australian listed property delivered a very different return in 2010 to global listed property, as shown in the chart below:



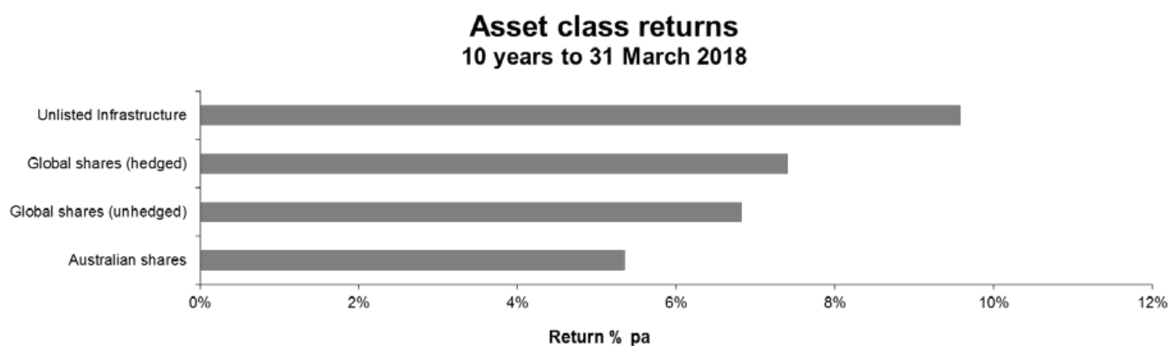
Source: FactSet Data Extract, NAB Asset Management, July 2018

The return differential for the same sub asset classes has also varied significantly over time:



Source: FactSet Data Extract, NAB Asset Management, July 2018

- Infrastructure allocations are only reported from 2011 onwards. This means that prior to 2011, any infrastructure asset will still be included in the 'other' asset. This will not be an accurate representation of the return experience of infrastructure. Furthermore, given the strong historical performance of infrastructure, funds with an allocation to this asset class will receive a significant (and artificial) benchmark-relative performance tailwind when measured against the 'other' asset benchmark which is comprised of a combination of equity market indices. The strong performance of unlisted infrastructure over the past 10 years relative to these indices is shown below:



Source: NAB Asset Management Services Ltd
Index data source: Australian shares - S&P/ASX 200 Accumulation Index; Global shares (hedged) - MSCI All Countries World (A$ hedged); Global shares (unhedged) - MSCI All Countries World; Unlisted Infrastructure - JANA Unlisted Infrastructure Fund Index.

- It is also not clear whether the data includes legacy (off market) products which, if combined with all on-market contemporary products, would create an inaccurate representation of the performance of the latter (see also below regarding MySuper).

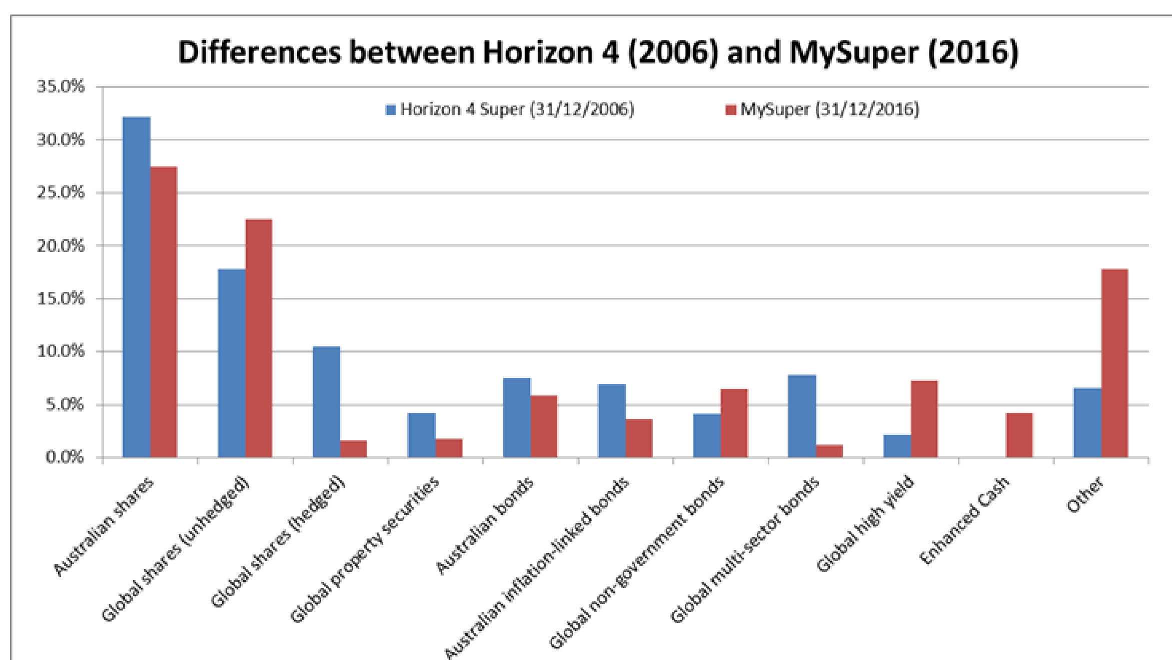
Any of the assumptions listed above could have a material impact on the end performance of the benchmark. We believe the assumptions involved in calculating these benchmark returns, without important refinements (and caveats as to system versus individual use) may compromise conclusions drawn.

13.2.2 Data assumptions – MySuper

To address the gaps in APRA asset allocation reporting prior to 2014, the Commission has assumed the asset allocation of MySuper products in later years are broadly representative of the default investment options of the funds.

This is unlikely to be representative given asset allocations have changed materially over the 12 year period covered. While our MySuper option has a short history, comparison of its asset allocation with that of the longer history MLC Horizon 4 Balanced option, which has the same risk profile and same benchmark growth/defensive asset allocation as MySuper, shows significant differences in asset allocation prior to 2014. This is illustrated in the table below which shows comparison of asset allocations in 2016 and 2006.

Asset allocation differences are particularly pronounced in the ‘other’ asset class category as well as the ‘hedged/unhedged global shares’, ‘Australian shares’ and ‘high yield bond’ categories.



Source: NAB Asset Management Services Ltd

When the MySuper regime commenced, the respective Plum MySuper (in Plum Superannuation Fund) and MLC MySuper (in The Universal Super Scheme - TUSS[8]) commenced as new options. They started from a zero balance, being built only with the contributions of the identified default members. No employer default options, or products, were merged to start the respective public offer MySuper products.

[8] Note both the Plum and TUSS schemes have been subject to an internal Successor Fund Transfer to the MLC Super Fund.

This means that performance history explicitly related to MySuper is only available from commencement and can't be compared to the long term performance against other MySuper products (particularly in relation to those which were simply rebranded from an existing option).

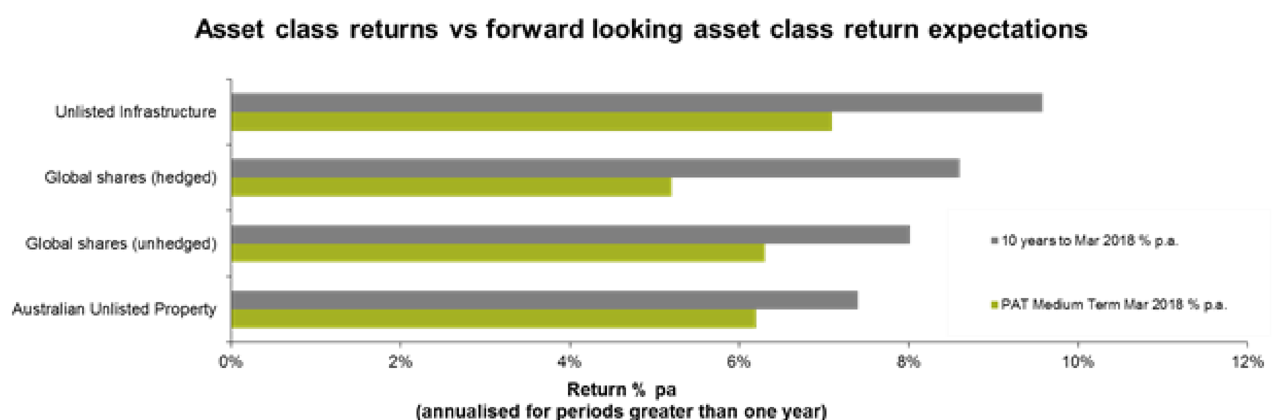
The previous Trustee-approved defaults were either selected from the standard Investment Menus or, in the case of Plum, were a tailored employer-specific option. We have had to identify each default member in each of 40 options in The Universal Superannuation (TUSS) options and 24 Plum options. It is therefore difficult to accept that the performance analysis prior to the commencement of MySuper in respect of defaults can be reasonably taken as a long term history of default performance.

We also have concerns with taking the performance of MySuper options for a short period of 3 years (notwithstanding this is currently the only available data) as an indicator of future performance or as a key criteria for designating the product non-performing and removing authorisation (discussed further below).

13.2.3 Extrapolations – past returns

The benchmarks are based on historical investment performance which isn't a strong predictor of future outcomes particularly over relatively short timeframes. The report takes the available data – at most about 10-12 years and sometimes less than 5 - to extrapolate the results to periods of 46 years of experience of a typical 21 year old person entering the workforce. This extrapolation applies at two levels:

- First, that the returns of the past 10 years are indicative of future returns – since average market returns over this period are well in excess of longer term averages this seems unlikely. The below table shows the returns experience for a selection of asset classes which have been the key drivers behind superannuation fund returns over the last 10 years. We have also included our forward looking forecast return assumptions (medium term - 7 year) for those same asset classes. As can be seen, our future return expectations for these asset classes are well below those returns experienced by investors over the last 10 years:



Source: NAB Asset Management Services Ltd

Index data source: Global shares (hedged) - MSCI All Countries World (A$ hedged); Global shares (unhedged) - MSCI All Countries World; Unlisted Infrastructure - JANA Unlisted Infrastructure Fund

Index; Australian Unlisted Property - Mercer/IPD (MUPFI/PPFI) Property Index. PAT Assumptions are our forward looking assumptions on various asset classes.

- Second, the strongest performing managers will persist – in practice we observe that it is not uncommon that past strong performers become relatively weak future performers. Our analysis shows that switching into the best performing super fund based past performance tends to deliver sub-optimal outcomes for investors. For example, an investor who switches into the 'Past Winner' (defined as the best performing Balanced Fund based on 3 year past performance) every 3 years, delivered that investor a fourth quartile performance outcome over the last 10 years:

		Annualised 10 yr Return
'Past winner' strategy		**3.56%**
SuperRatings Balanced	Top quartile	5.26%
	Median	4.77%
	Bottom quartile	4.01%

(*Analysis uses fund performance data from the SuperRatings Accumulation Fund Crediting Rate Survey, 'Balanced' category for the periods from June 2007 to June 2017. Annualised returns over 10 years to June 2017)

The same detrimental outcome for investors can apply if investors chose a fund with an even longer history of strong relative outperformance of peers. For example, an investor choosing the best performing 'Balanced' Fund over 10 years from the SuperRatings Balanced Fund survey in March 2008 would have experienced a very different peer relative return in the subsequent 10 year period to March 2018.

As an example, in March 2008 Fund A[9] was ranked 1 (out of 25 surveyed funds), with a 10 year annualised return of 10.23% pa. In the subsequent 10 year period to end March 2018 they were ranked last (124/124) with a 10 year annualised return of 3.3% pa. This is reflected in the table below:

10 year period to:	Fund	Return (% pa)	Median (% pa)	Top quartile (% pa)	Bottom quartile (% pa)	Rank vs peers
1) end March 2008	Fund A	10.23%	7.33%	8.90%	6.33%	**1/25**
2) end March 2018	Fund A	3.30%	5.99%	6.49%	5.32%	**124/124**

Source: SuperRatings Accumulation Fund Crediting Rate Survey, 'Balanced' category (March 2008, March 2018)

[9] Refer to the Confidential Appendix for fund identification.

The approach taken implies that past performance of, say, the best super funds versus the worst super funds will continue for 46 years[10] and also that the markets – including listed and unlisted asset classes - will perform the same way they performed over the particular 12-year long period.

This approach could lead to future behaviours which undermine the intended outcomes as trustees and managers seek to emulate or adjust to these findings (particularly if competing for 'best in class' listing).

The 12-year period analysis coincided with a period of unprecedented and aggressive monetary policy intervention which supressed interest rates to historically low levels which was a major tailwind for all asset classes, and most particularly unlisted assets.

Unlisted property and unlisted infrastructure assets enjoyed a period of significant out-performance relative to other assets. This environment (of declining interest rates) has come to an end (and monetary policy is starting to reverse. As such extrapolating a period which was materially advantageous for such assets and suggesting that funds which held such assets would likely deliver such superior results over a 46 year period is a dubious and potentially detrimental conclusion.

Moreover some funds have categorised such assets as 'defensive'. We regard this as inappropriate – there is no fundamental difference in the underlying investment risks of listed versus equivalent unlisted assets. While there is some short term smoothing of returns, this can disguise a higher level of underlying risk.

13.2.4 Transparency of benchmark portfolios

The Draft Report does not provide transparency on the asset allocation composition of the benchmark portfolios. It would be constructive for participants to have the tables with details of the asset allocations of BP1 and BP2 to allow review and identification of key reasons for differences in performance.

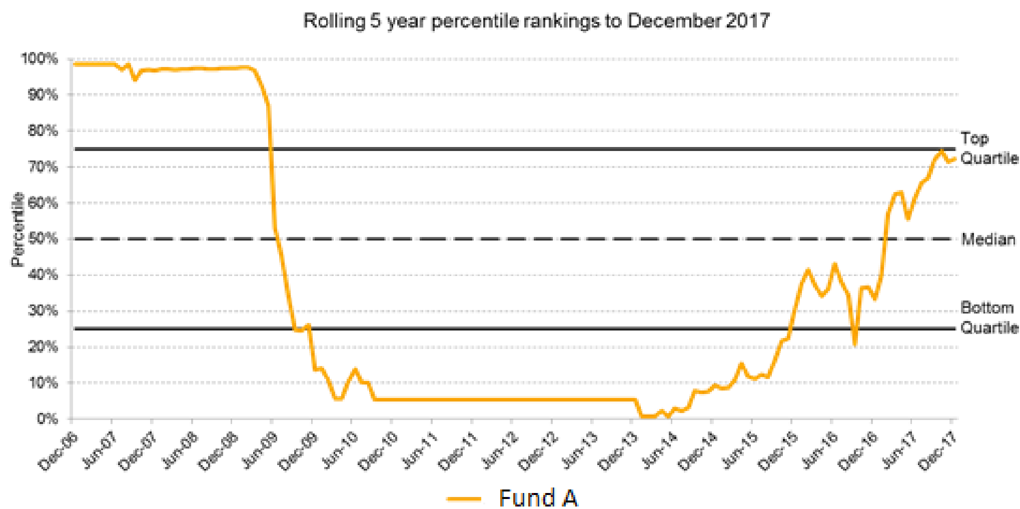
---

[10] Based on a 21-year-old entering the workforce and staying in the system for around 46 years until retirement at 67-68 years old.

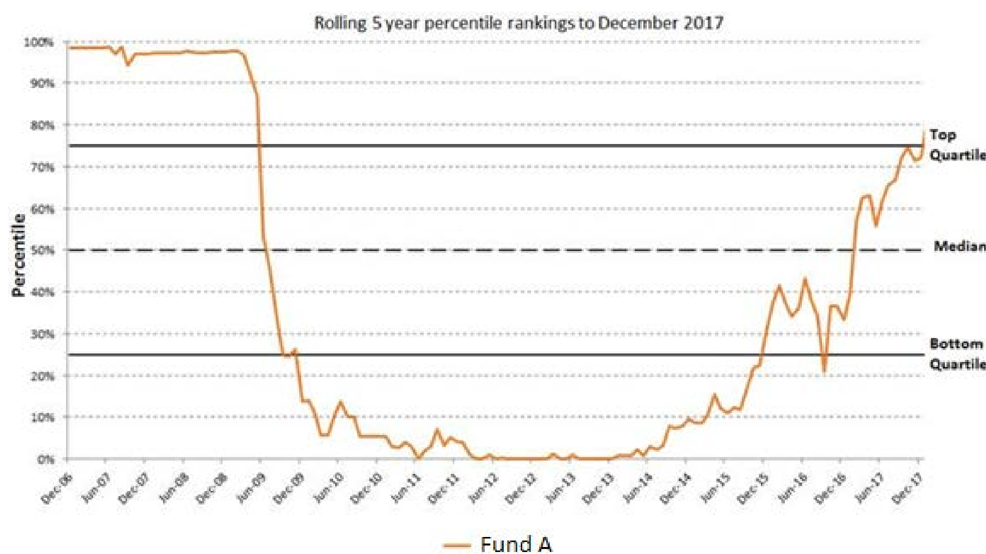
14 Information request 2.2 – factors explaining differences in investment performance

Across the industry there has been inconsistent classification of assets into either growth or defensive categories. This has influenced the classification of funds in surveys resulting in funds with very different risk profiles being compared against each other.

Risk profile is a significant differentiator of performance, as well as an issue of governance. Liquidity risk in particular has not been identified. Examples of funds with very high allocations to illiquid assets can be found showing volatile investment performance outcomes for members. As an example, the below table shows the change in Fund A's performance ranking versus peers over a prolonged period of time. An overexposure to illiquid assets during the GFC saw the fund's peer relative performance ranking drop for a sustained period.



Source: SuperRatings Crediting Rate Survey (Balanced Category) December 2017, NAB Asset Management.



Source: SuperRatings Crediting Rate Survey (Balanced Category) December 2017, NAB Asset Management (data analysis)

The draft report also does not appear to address the fact that performance tends to move in cycles and that “past performance is not a guide to future performance”. Some of the top performing funds today are very different to the top performing funds from five or six years ago (e.g. Fund B’s 5 year performance is ranked 2 out of 155 funds as at 31 March 2018. The same fund was ranked 100 out of 146 funds for the 5 years ending March 2014. A similar story can be seen for Fund C (ranked 6th today and 106th as at 31 March 2014; Fund D - 7th today and 84th in 2014 etc.)[11].

The analysis in the report appears to be based on one snapshot in time and while the Commission has attempted to use as long a period as practical (12 years) the results will still be very sensitive to the economic and market conditions of this period (as well as significant regulatory change particularly for MySuper which only became compulsory from 1 January 2014 - see above).

This “point-in-time analysis” is particularly problematic given, as noted above, this period coincided with an unprecedented and extreme level of monetary policy intervention which is now being rolled back. In short, the next 12 years is likely to look very different to the past 12 years and drawing conclusions based on the last 12 years will be particularly unrepresentative (hopefully, given the GFC is regarded as a black swan event). It is suggested that the Commission consider sub-period analyses (for example two independent 6 year sub-periods) and assessing whether there are any meaningful differences in results across the sub-periods.

The results of the report are at odds with results from other independent sources, such as the Chant West report, which estimated return differences between industry and retail funds to be around 0.9% pa[12]. And some of this difference is attributable to either or both different liquidity and risk tolerance profiles.

Trustees have a range of issues to consider in aiming to design and then meet the investment objectives looking forward – the future is uncertain and risk tolerances may vary particularly as there can be membership characteristics that dictate different approaches to, for example liquidity profile or defensive asset allocation. This could include the potential for members to exit an option through transfers to choice options, switches to another fund or, depending upon age profiles, transitions to retirement phase. Therefore, MLC Wealth requests that the Commission consider:

- Risk adjustments in benchmarking its analysis at the investment option level and grouping investment options by risk categories as outlined in section 13.1; or
- Grouping options by their stated investment return objectives and risk profiles (for example by their stated Standard Risk Measures).

  Such an analysis would contribute to more accurate comparability across funds.

---

[11] Please refer to the Appendix for fund identification.
[12] Chant West Multi-Manager Survey, March 2016

15 Information request 4.1 – allow lifecycle for MySuper?

The Draft Report argues against life-cycle funds:

"*The last few years of the accumulation phase are critical. Balances are high at this time. Reducing sequencing risk by switching to a conservative investment strategy at older ages could potentially reduce the retirement balance of a member by about $130 000, a significant sacrifice for a relatively small improvement in certainty*".

This statement is based on an extrapolation of the last 10 years of performance, and is premised on the absence of major corrections in growth assets. It concludes there is a sacrifice to retirement income of $130,000 which we are unable to replicate. We think it is important to create a hypothesis based on real conditions to demonstrate potential outcomes for clarity in how the outcome is derived.

Well-designed life-cycle funds represent a reasonable trade-off between potential returns and risk of losing capital at the worst possible time. Specifically, they sacrifice some potential upside under good market scenarios against some – partial – protection under negative scenarios.

MLC Wealth supports life-cycle products as an allowable investment design for MySuper providing they align to the demographic composition of the membership. This includes consideration of likely or trend contribution rates and balance growth as well as the potential rate of transition into retirement income phase. In this latter regard, some funds will have members accumulating quite small balances over long periods in which case, they may be more likely to draw lumps at earlier ages thus negating the potential benefits of lifecycle options.

We do note that some life-cycle approaches may result in 'de-risking' too early in the member's lifetime which can significantly impact retirement outcomes. Consequently, rather than excluding life-cycle products as viable default approach, trustees must be able to demonstrate how the investment strategy aligns to the profile of the relevant membership cohort and is in the best interests of the overall member group to which it applies. This approach to the trustee's obligations in developing and monitoring its MySuper option is consistent with the proposals in the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 and the proposed Design and Distribution Obligations policy (in consultation phase but emerging from recommendations made in the Financial System Inquiry).

A single diversified option assumes the strategy is and will be appropriate for the entire membership – age cohort from 18 to 65. This may be a valid way to approach a 'default' strategy for a diversified membership or a membership that accumulates relatively small balances. However, there are variations in the lifecycle which should be considered, including an ability to have a single diversified strategy until members reach ages nearing transition to retirement (i.e. 50+), which then sees the investment strategy switch to optimise a members income in retirement by balancing sequencing risk.

We have included some preliminary and commercially sensitive analysis in the Appendix and we would be pleased to discuss this with the Commission if desired.

16 DRAFT FINDING 4.2 – choice proliferation should be reduced through default benchmark

The superannuation industry caters to a multitude of different member segments and therefore it is appropriate that products offered in the system provide different features and benefits that cater to the particular needs, attributes and demands of their target market. A one-size-fits-all product is not suitable for members of different:

- life stages (new work entrants through to retirees)
- socio-economic spectrums
- financial pro-activeness
- levels of education & investment literacy
- risk appetites
- taxation requirements
- capital growth, income and capital liquidity requirements, and
- goals in retirement.

Whilst "no frills" product offerings may generally be suitable for default super members who are not proactive in managing their super investment and are unadvised, products which offer more sophisticated features, flexibility and control (including larger investment choice, tax reporting and online trading capability) allow the advised or engaged member to manage their superannuation finances with regard to their overall circumstances.

The popularity of retail products, and SMSFs[13], rely upon the active decision making by individuals and demonstrate that demand for wide-choice super products. We acknowledge the Commission's analysis suggesting performance outcomes may not replicate those of default options. However, this does not take into account their decision-making in the context of their overall finances nor personal situation.

A 'balanced' portfolio is not without risk given reasonably substantive exposures to equities particularly if they are dominated by the ASX. Active choice members could well be adjusting for transition to retirement, concentrated exposures in finances external to superannuation or with a preference for loss mitigation for a variety of reasons. Where a fund has a diverse membership, we believe that it is important that a range of products (including options within an employer sponsored product) are available to service the particular needs, risk profiles and preferences of engaged or advised individuals.

[13] There were 597,000 SMSFs holding $697 billion in assets, with more than 1.1 million SMSF members as at 30 June 2017.2. Over the five years to 30 June 2017, growth in the number of SMSFs averaged almost 5% annually. SMSF Segment Overview, ATO, Jan 2018.

We support measures which require super trustees to monitor and assess their performance against their stated investment objectives and performance indicators, and that super trustees take action in relation to investment options which are consistently underperforming (noting that this is a current requirement of Superannuation Prudential Standard530 – Investment Governance).

17 MLC Wealth citation – higher cost investments

In the Draft Report the Commission notes:

"National Australia Bank MLC Wealth (sub. 63) argued that 'in their experience' higher cost investments translate into higher net returns over the long term, and that a focus on minimising fees poses a risk of influencing investment decisions in ways that might compromise members' net returns".

Our submission perhaps could have been clearer. As we noted, a system with a primary focus or an intense focus on minimising costs or fees created potential risks with a 'flight to the bottom'. This had been a documented effect of the Chile model raised in the Financial System Inquiry.

The Grattan Institute analysis cited has also been the subject of multiple reviews identifying issues with a range of the assumptions that had been made and hence questioning the conclusions that had been drawn[14]. The other studies cited are based on much older data. We understand the Basu and Andrews study was based on pre-MySuper 'defaults' from 2004-2012 which were not readily identifiable as such in many retail funds (please refer to section 13.2.2).

We have experienced better net return outcomes from some higher cost investments particularly in the private equity space. As noted elsewhere in our prior submission, we do believe that higher investment costs, and active management, can in many cases support better net return outcomes. The converse also is that an intense focus simply on chasing the best returns has the potential to undermine member outcomes if fees and costs as well as risks (performance, liquidity, and volatility) are not considered.

Our intent was to indicate that beneficial performance outcomes are not always the cheapest, as has been evidenced in analysis of the Chilean model.

[14] As an example of the issues identified, see the Financial Services Council (FSC) submission to the FSI, Financial System Inquiry – Phase 2, Chapter 1, Superannuation, Investment Management and Retirement Policy.