13 July 2018

Deputy Chair, Karen Chester
Australian Government Productivity Commission
Email: super@pc.gov.au

Dear Ms Chester

RE: Submission on Productivity Commission draft report "Superannuation: Assessing Efficiency and Competitiveness"

BT Financial Group (BTFG), part of the Westpac Group, welcomes the opportunity to provide feedback on the draft report *"Superannuation: Assessing Efficiency and Competeveness"* released by the Productivity Commission (PC) for public consultation on 29 May 2018.

BTFG is supportive of the recommendations proposed within the draft report, which are intended to strengthen the efficiency and competitiveness of the superannuation industry.

While the detailed design work is yet to be undertaken, BTFG particularly supports the PC's key draft recommendation that the Government establish an expert panel to select the 10 'best in show' funds to help guide consumer choice and that this panel should sit outside of the industrial system.

BTFG also supports the measure to ensure consumers default once, and then take that fund with them between jobs until they choose otherwise, as well as Government reforms to facilitate fund mergers to address small and underperforming funds that should no longer be in the market.

Overall, we believe the recommendations proposed in the draft report are in the best interests of consumers. Any superannuation fund that believes it performs strongly, is well governed and consistently delivers good member outcomes should embrace competition and the PC's proposals.

Embracing the proposed recommendations brings the opportunity to significantly lift retirement incomes for all Australians.

BTFG shares the concerns of our industry associations, the Association of Superannuation Funds of Australia and the Financial Services Council, in relation to the methodology used by the PC to analyse investment performance. We support the submissions of our associations on this issue.

BTFG provides comments and recommendations on key areas of the draft report and the proposed recommendations in Attachment A.

Further to the representation we made at the Public Hearing we have responded to questions we took on notice regarding new entrants to the market in Attachment B.

Yours sincerely

Matt Englund
Acting General Manager, Superannuation
BT Financial Group

Attachment A: BTFG comments on the recommendation in the PC's draft report

Draft PC Recommendation 1: Defaulting only once for new workforce entrants

BTFG supports the PC's recommendation that default super accounts should only be created for members who are new to the workforce or do not already have a superannuation account able to accept contributions.

Further we support the ability for funds to utilise the existing functionality of myGov and Single Touch Payroll (STP) to allow members to register online their choice to open, close or consolidate accounts when they are submitting their Tax File Number at the time of starting a new job.

Ensuring that consumers carry over their existing accounts when they change jobs will immediately halt the proliferation of multiple accounts and help ensure members do not unnecessarily pay fees for multiple accounts or duplicate insurance policies.

We also believe that this recommendation will support increased engagement in superannuation as the link between the employer and the super fund would be replaced by an enhanced engagement between the employee and their super fund.

In our view, this is the single biggest change required to improve the operation of the system.

BTFG recommendation 1

BTFG recommends that Australians are defaulted only once, if they do not choose their own fund, and that the super framework encourages Australians to make an active choice to ensure their superannuation benefits are invested in the most appropriate fund to meet their needs.

Draft PC Recommendation 2: 'Best in show' shortlist for new members

BTFG supports the PC recommendation for a short list of approximately 10 funds to be presented to all employees who are new to the workforce (or do not already have a superannuation account), from which they can choose a fund.

We also agree with the recommendation that Australians are presented with clear and comparable information on the key features of the shortlisted products and that they should not be prevented from choosing any other fund (including an SMSF) if they wish to do so.

Default funds are provided advantages not afforded to other funds, including illiquidity benefits derived from:

- Guaranteed and predictable default contributions and rollovers;
- A flow of younger members in accumulation phase with a longer investment horizon; and
- Traditionally more disengaged members who therefore are less likely to switch investment options or redeem their interest in the fund.

These advantages allow default funds to access different asset classes and provide funds with the option to invest with different investment horizons.

Default funds also benefit from lower cost structures, derived from the:

- Higher proportion of disengaged members that interact with their fund less frequently;
- A broader membership base delivering economies of scale; and
- Guaranteed flow of fund members and contributions.

Default funds therefore have both an investment and cost advantage over other superannuation funds.

BTFG submits that allowing all MySuper licensed funds to compete for a 'best in show' listing through the 'best in show process' proposed by the PC will enable all industry participants to take into account these advantages when designing their superannuation products, including new entrants to the market.

BTFG anticipates that, should all superannuation providers be able to take into account the benefits of default status when they design their default products, consumers will benefit from new, competitively priced products with superior investment strategies.

BTFG does see merit in further consideration of the impact of the 'best in show' process on the sustainability of those funds outside those selected for listing, including whether a larger number of shortlisted funds would be desirable from a competition and risk concentration perspective.

Additionally, BTFG recommends that the PC consider variations to ensure the tender process remains competitive over time. For example, there may be benefit to having a pool of 20 or 30 funds, with information provided on those products listed outside the 'shortlist', but with notable design features, such as special insurance suited to high risk occupations for employees who would not receive cover under standard insurance policies.

The Commission could also give consideration to tailoring the short list for different cohorts of members using key demographic features.

BTFG recommendation 2

BTFG recommends that a 'best in show' shortlist is presented to employees where they do not nominate a fund and do not have an existing superannuation account.

We also recommend that consideration is given to tailoring the short list for members based on demographic questions to allow the inclusion of funds that serve specific purposes.

Consideration may also be given to whether a larger number of shortlisted funds would be desirable from a competition and risk concentration perspective.

Draft PC Recommendation 3: Independent expert panel for 'best in show' selection

3(a). Establishment of expert panel

BTFG supports the recommendation for the Government to establish an independent expert panel to run a competitive process for selecting superannuation products for the 'best in show' list.

We agree with the recommendation that the panel should be comprised of independent experts who are appointed through a robust selection process and be held accountable to the Government. There is a range of examples where independent panels of experts can be convened to make commercial decisions where there are robust processes in place to ensure that conflicts of interest are disclosed or effectively managed, such as the Foreign Investment Review Board, Takeovers Panel and the Board of Guardians of the Future Fund.

We believe the skill set and interests of the panel members should be published in a skills matrix and the appointment process transparent to all Australians.

The process for managing actual, perceived and potential conflicts must also be clear and enforceable, and the legal framework should extend beyond disclosure obligations to provide the capacity for conflicted experts to be stood down or to stand down voluntarily to remove themselves from the actual, or perceived conflict.

3(b). Establishment of a set of criteria

BTFG supports the establishment of criteria to form the basis of the selection of the 'best in show' funds.

We do not however believe the criteria should be set by the expert panel, and instead recommend the criteria be established by the Parliament with the opportunity for consumers, regulators and the industry to provide feedback and input. The criteria should be extensive and include both qualitative and quantitative factors.

In our view, the criteria should include:

Objective/Quantitative measures:
1. Performance – expected ability of the fund to deliver on the product's risk adjusted return target on a prospective basis. This would take into account both backward-looking measures of performance over the MySuper period (where relevant for a product) and forward-looking measures to allow for changes in investment strategy and new market entrants.
2. Fees and costs, given the product's stated long-term investment return target and risk profile.
3. Cost and quality of insurance – i.e. insurance affordability/appropriateness given the profile of the members, including the strength of terms and conditions and the ability to offer a fee guarantee for the life of the review period.
4. Compliance with the Insurance in Super Working Group (ISWG) Code requirements.

Subjective/Qualitative measures:
5. Consistency between the product's long-term investment return target and risk profile for the types of members who typically default.
6. The fund's governance practices, including mechanisms to deal with conflicts of interest and appointment of a majority of independent directors and an independent chair to trustee boards.
7. Overall customer satisfaction – based on feedback from members using standard surveys.
8. The fund's education, engagement and advice capability, including the provision of education, the program of member engagement tools and activities and the provision of advice.
9. Sustainable investing – including a clear ESG framework applied to investment decisions.
10. The fund's track record on identifying and meeting member needs (including design of superannuation products).

The criteria would need to take into account the advantages that incumbent default funds are likely to gain during their time as a shortlisted fund, to ensure the process is competitive and equitable going forward. Otherwise there is a risk that the benefits that have accrued to incumbent default funds could unfairly disadvantage funds trying to break into the shortlist in future tenders.

For example, the criteria would need to recognise, and adjust for, the fact that incumbent default funds would have received the benefit of an illiquidity premium.

As discussed in the section below headed "Additional questions posed to BTFG at the Public Hearing on 22 June 2018", our view is that the only barrier to entry into the system should be the ability to meet an enhanced MySuper threshold (as relevant) and all of the associated relevant legislative and regulatory requirements. For this reason, the measures need to reflect a forward-looking bias to enable new entrants and new products (including potential foreign entrants) to have the ability to enter the market and potentially vie for the shortlist.

Of the objective/quantitative measures listed above therefore, criteria 1 is particularly important. Trustees should have the ability to modify existing products, or establish a new product, so that it is tailored to the default consumers that are derived from a shortlisting in a manner consistent with satisfying their obligations to act in the best interests of members.

Compliance with the ISWG Code requirements (criteria 4) is also extremely important. As a founding member of the Insurance in Superannuation Working Group (ISWG), we believe the Code strikes the right balance between ensuring members have an appropriate level of insurance cover while protecting their level of retirement savings. For this reason we continue to support the implementation of the ISWG Code to be made compulsory.

Of the subjective/qualitative measures, the fund's governance practices (criteria 6) is in our view critical. The Cooper Review, the Financial System Inquiry and the PC have all recognised the importance of a high minimum standard of governance with a 'critical mass' of independent directors.

BTFG submits that a minimum standard of governance should be an essential requirement for any fund competing for shortlisting. BTFG believes recommends that the criteria require funds to appoint a majority of independent directors and an independent chair to their trustee boards.

BTFG recommendation 3

BTFG recommends an independent panel be appointed to oversee the process for establishing a 'best in show' shortlist of funds. We believe the criteria for 'best in show' should be prescribed in regulations with weightings varying according to the member's demographics.

Draft PC Recommendation 4: MySuper authorisation

BTFG supports the recommendation for the Government to legislate to allow APRA to apply the member outcomes test as a key criterion for MySuper authorisation and retention of such authorisation.

We also support that the rules for MySuper to be strengthened to raise the overall quality of the funds that are authorised as MySuper funds.

BTFG is concerned, however, that Commission's recommendation pre-supposes that Choice options are necessarily higher fee. A range of choice options, offered by BTFG and other providers, especially including passive investments options, are lower cost than MySuper products. BTFG suggests that the Commission revisit the assumptions that underpin its recommendation in this regard.

BTFG recommendation 4

BTFG recommends that the MySuper authorisation process be strengthened so that there is a requirement for trustees to satisfy an ongoing member outcomes test to retain their MySuper authorisation.

Draft PC Recommendation 5: Regulation of Trustee Board Directors

BTFG supports the recommendation for the Government to legislate to require trustees to assess at least annually their board's performance and require all trustees to maintain a skills matrix and annually publish a consolidated summary along with the skills of each trustee director.

In addition we strongly support the removal of legislative restrictions on the ability of trustee boards to appoint independent directors. We believe this will ensure that the directors with the most suitable skill set and experience are appointed.

BTFG recommendation 5

BTFG recommends increased transparency around trustee boards' skills and experience. Further, we strongly support the removal of legal impediments to allow appointment of independent directors to boards.

Draft PC Recommendations 6 and 7: Reporting on merger activity and CGT relief for mergers

BTFG supports the recommendation for the Government to require trustee boards of all APRA-regulated funds to disclose to APRA when they enter a memorandum of understanding with another fund in relation to a merger attempt, and for full disclosure to be provided where these mergers do not proceed.

We also support the recommendation for the Government to legislate to make permanent the "temporary loss relief and asset rollover provisions" that provide relief from Capital Gains Tax (CGT) liabilities to super funds in the event of fund mergers and transfer events.

The complexity of individual financial products and the range of different features and characteristics make the current "equivalent rights and benefits test" for successor fund transfers impractical. The test does not adequately have regard to the overall benefits that will accrue to members from product rationalisation.

We recommend that principles-based legislation be introduced, comprising a single test based on an evaluation that the proposed product rationalisation will result in at least equivalent benefits to the class of members as a whole. In addition we recommend that a Regulatory Guidance be prepared, in consultation with industry bodies on the application of the principles underpinning product rationalisation.

Overall these measures should help support consolidation across the industry and provide benefits of economies of scale, which should flow through to members in the form of more competitive net returns and better product offerings to consumers.

BTFG recommendation 6 and 7

BTFG recommends the implementation of measures to promote consolidation across the industry, including the permanency of CGT relief, transparency and accountability of the discussions around mergers, and the simplification of the current 'equivalent benefits test' to a more flexible principles-based test.

Draft PC Recommendation 8: Cleaning up lost accounts

BTFG strongly supports measures to 'clean up lost accounts'. In our view, the PC's recommendations would result in significant changes that would ensure this does not remain an issue going forward.

We do not believe (in most cases) it is in the members' best interests for their super balance to be moved to the ATO as they forego potential returns and insurance cover because their fund no longer has their current contact details. We believe a better outcome would be for the ATO in the first instance to provide the most up to date contact details to the fund and at a later point auto-consolidate the "lost" member's superannuation balance to their active fund (where they have one) if the fund is still unable to contact the member.

New super fund accounts should only be established where a Tax File Number has been provided. This will ensure that the member's details can always be matched with the most up to date information the ATO has for the member.

BTFG recommendation 8

BTFG recommends that the ATO is given the ability to provide super funds with members' current contact details and that, failing this as a means of connecting with members with their super, the secondary (or inactive) accounts are automatically consolidated to members' active account.

Draft PC Recommendations 9 and 10: A member-friendly dashboard for all products and delivering dashboards to members

BTFG broadly supports the recommendation for funds to publish a simple, single-page product dashboard for all superannuation products that is consumer friendly and widely available on a single website.

We support any appropriate measures to enhance transparency and simplicity as we believe it will make it easier for members to compare funds and ensure they are with the fund that best meets their priorities and needs. The process should ensure that the member is presented with this information at the time of their entry into the workforce.

However, we believe that wrap and platform products should be excluded from the product dashboard requirements based on the bespoke nature of these products, and the fact that members of such products are choice members.

BTFG recommendation 9 and 10

BTFG broadly supports the recommendation that all funds deliver member-friendly dashboards for all products to simplify the task of comparing super funds for members.

However, we believe that wrap and platform products should be excluded from the product dashboard requirements.

Draft PC Recommendation 11: Guidance for pre-retirees

BTFG supports the recommendation for the Government to guide all superannuation members when they reach age 55 to website links and materials that will assist in their preparation for retirement.

We would also recommend the Government look to provide this guidance to all superannuation members and consider funding additional financial literacy initiatives to help more Australians take an active interest in their retirement savings at an earlier age.

BTFG recommendation 11

BTFG recommends that the Government pro-actively assist superannuation members who reach 55 to access information to assist their retirement planning.

Draft PC Recommendation 12: Exit fees at cost-recovery levels

BTFG supports the recommendation proposed by the Government in the recent Federal Budget to ban exit fees on all superannuation accounts.

We also support the recommendation by the PC to limit switching fees to cost-recovery levels for all new members and new accumulation and retirement products.

BTFG recommendation 12

BTFG recommends that exit fees on all super funds are removed and switching fees are limited to cost-recovery levels.

Draft PC Recommendation 13: Disclosure of trailing commissions

BTFG supports the recommendation for the Government to require all superannuation funds to clearly disclose, on an annual basis, to all members who are subject to trailing commissions the amount of commissions paid.

We also support the recommendation that all funds publicly disclose the extent of trailing commissions and the number of affected members in their annual reports and provide this information to ASIC.

During our appearance at the Public Hearing on 22 June 2018 we confirmed that 140,000 BT Advised customer accounts will have their grandfathering arrangements switched off effective 1 October 2018, benefiting these customers through either higher investment returns or lower fees.

BTFG recommendation 13

BTFG recommends that all superannuation funds disclose any trailing commissions paid.

Draft PC Recommendation 14: Opt-in insurance for members under age 25

BTFG acknowledges and supports the Government's desire to protect the retirement savings of young members, as well as those with low account balances and inactive accounts from undue erosion.

However the removal of automatic insurance cover for under 25s may disadvantage certain young Australians that are unable to access who may not otherwise be able to get TPD cover where it is provided on an individually underwritten basis. Certain members may not get cover at all, exclusions may apply, or they may have cover offered to them at a much higher price than a group arrangement would allow. This will present significant problems for members with health issues, as well as workers in blue collar, high risk and manual occupations.

Unlike Death cover, which younger people who do not have a spouse or dependents may not need, TPD is a particularly valuable benefit for younger people. Importantly, younger members have a longer timeframe against which they need to be protected in the event they are permanently unable to work – i.e. the balance of their working lives. Younger people are also more likely to participate in riskier pursuits, and consequently may find individual cover expensive or unavailable.

Behavioural economic research suggests that most young members will not take up insurance if it is offered on an opt-in basis (ASFA expects less than 10% of under 25s to opt in to insurance). This means most young people will slip through the safety net and will not have insurance cover if they are injured, at least until they reach 25 or their account balance reaches $6,000.

This is likely to exacerbate the impact of Australia's underinsurance problem, as those who experience injuries which prevent them working long term will fall back on the National Disability Insurance Scheme (NDIS) once their workers compensation has expired after 2 years, thus increasing the cost to Government.[1]

Consistent with the ISWG Code, we believe limiting premiums to a level that does not exceed 1% of individual members' salary would achieve the desired policy outcome of providing insurance cover that does not inappropriately erode retirement income, and in a way that does not place certain (especially younger) members at risk of being entirely uninsured. This would also require funds to regularly obtain information on members' salaries.

[1] The current level of underinsurance across the community negatively impacts individuals and families, as well as being a drain on government expenditure. According to Rice Warner's Underinsurance Report 2015, underinsurance for disability represents the greatest cost to government – estimated to be $1,258 million per year for total and permanent disablement (TPD) cover alone.

BTFG recommendation 14

BTFG recommends the retention of the current opt-out insurance model, coupled with hard limits being placed on the level of premiums that can be deducted from individual members' accounts (to say 1% of salary), as an effective means of achieving the Government's desired policy outcome of protecting members' retirement savings and ensuring their balances are not inappropriately eroded by insurance premiums.

Draft PC Recommendation 15: Cease insurance on accounts without contributions

In our view, contributions and rollovers alone do not reflect a member's engagement with their superannuation, nor do they alone form a sensible basis against which decisions about the retention of cover should be made. We believe that, in addition to contributions and rollovers, consumer decisions about the level or type of insurance cover they hold, as well as which investments or investment options they hold, are equally valid indicators of their engagement.

Many members specifically choose to have multiple superannuation accounts with different providers – one to receive their Superannuation Guarantee (SG) and other contributions and another specifically established to provide insurance cover, often over and above the default amounts and without exclusions for pre-existing conditions. These accounts are generally established/maintained with a sufficient balance to cover the insurance premiums for a number of years, without the need for further contributions. We call these "choice insurance accounts".

We therefore recommend that the meaning of 'inactivity', for the purposes of ceasing insurance on accounts, be expanded such that a person is only deemed to be inactive where no contributions and rollovers are received *and* they have not made a decision regarding their insurance cover or their investments in the fund. In other words, choice insurance accounts should not be treated as inactive.

A decision for this purpose should include all circumstances where the insurance cover has been individually underwritten.

BTFG recommendation 15

BTFG recommends that insurance cover should not cease where a member has made a decision regarding their insurance cover or their investments in the fund (i.e. it is a choice insurance account) or the member engages with their fund on at least an annual basis, subject to the limitations of the ISWG Code of Practice.

For this purpose, a decision to obtain insurance, including individually underwritten cover, should remain valid indefinitely regardless of when that decision was made.

Draft PC Recommendation 16: Insurance balance erosion trade-offs

As a founding member of the ISWG, BTFG played an instrumental role in the development of the Insurance in Superannuation Voluntary Code (ISWG Code). We have long been committed to ensuring insurance through super is a valuable benefit to members and that the value is balanced against the potential erosion of retirement benefits and the trustee's obligation to act in the best interests of its members.

We believe the reporting of the impact of the premiums made on a member's projected retirement balance is a great step towards ensuring more members have greater awareness of the effective insurance / balance erosion trade-off.

We strongly support the 1% premium cap set out in the ISWG Code and believe that this cap will be a great first step to ensuring the overall trade-off is mitigated. However we would like to see the cap applied at an individual member level to ensure outlier members (such as part time, low income workers) are protected. Applying the test at a member cohort level will not achieve this.

As a measure of the success of the premium cap, it is recommended that the current balance erosion (as at 30 June 2018) of premiums across the industry is compared with the balance erosions in four years' after implementation.

BTFG recommendation 16

BTFG recommends that the 1% insurance premium cap is legislated at an individual member level. We also recommend an evaluation of the impact of the 1% premium cap post implementation of the ISWG Code to review the impact it has had on the effective insurance / balance erosion trade off.

Draft PC Recommendation 17: Insurance code to be a MySuper condition

We strongly support the recommendation for compliance with the ISWG Code to be a MySuper condition. We believe this would be an effective way of overcoming the legal impediments to making the Code binding on trustees.

BTFG recommendation 17

BTFG recommends that compliance with the ISWG Code be adopted as a MySuper condition.

Draft PC Recommendation 18: Insurance code taskforce

The industry has proven the value of an industry-led ISWG Code in providing higher standards for the industry and consequent outcomes for members in the most efficient way. We believe the industry should be encouraged to continue with the progress of a 'stage two' version of the ISWG Code which would address the PC's concerns with issues like standard definitions.

We believe the requirement to make compliance with the ISWG Code a MySuper requirement will be sufficient to ensure universal take-up.

BTFG recommendation 18

BTFG recommends that the industry should be given the opportunity to refine any requirements of the ISWG Code.

Draft PC Recommendation 19: Independent review of insurance in super

BTFG welcomes an independent review of insurance in super to assess the costs and benefits of retaining the current opt-out model. We believe it is imperative that a four year period is allowed to pass, to ensure the benefits of the Code (which will come into play in stages over the next couple of years) are realised and reflected in the cost-benefit analysis.

BTFG recommendation 19

BTFG recommends an independent review of insurance in super in four years' time from the publication of the PC inquiry's final report.

BTFG response to Productivity Commission draft finding concerning life-stage products

BTFG acknowledges the commentary regarding life-stage fund products and agrees that further review of both life-stage and balanced funds as a default choice is warranted. BTFG also agrees with the spirit of Information request 4.1 "that the varying circumstances of members nearing retirement" (should be taken into account) but argue that that consideration applies equally to balanced funds and life-stages products.

BTFG has concerns, however, with the approach taken by the Commission in relation to modelling the outcomes for consumers of life-stage products and for the reasons outlined below we continue to hold the view that a life-stage product is appropriate for our consumers.

A summary of our views of life-stage products is outlined below:

1. Life-stage funds often hold higher risk allocations to growth assets, earlier in a members life, than both balanced funds and transition to retirement products pre-preservation age, because:
    a. Investor risk tolerance decreases as a function of age (see for example: Black, S, Rogers, L, Soultanaeva, A, (2012) and associated references).
    b. The impact of market corrections on retirement balance reduces the further from retirement the member is at the time of the correction.

It appears the Life-stages fund considered by the Productivity Commission holds balanced fund growth allocations until 5 years prior to retirement whereupon it de-risks to 100% cash. BTFG agrees that this kind of product will likely underperform the balanced fund in all scenarios except a market shock occurring at retirement.

BTFG suggests that such a product is more representative of Transition to Retirement products than Life-stages funds. Therefore, the report conclusions are applicable to Transition to Retirement products rather than Life-stages funds, particularly Life-stages funds with an Income Replacement target as discussed below.

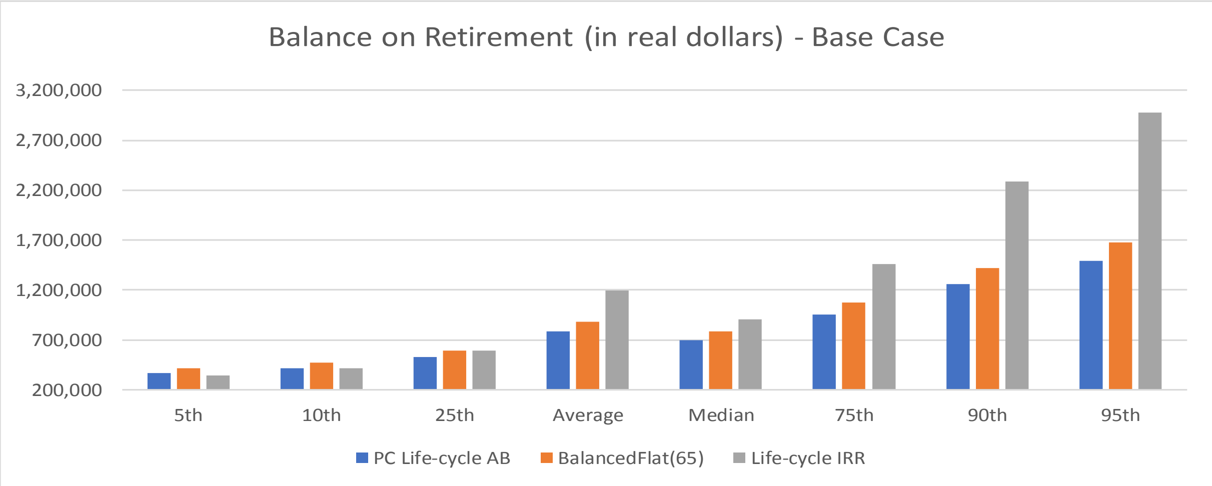
2. BTFG acknowledges the range of Life-stages products observed by Productivity Commission (Figure 4.7), but notes that Life-stages funds can be broadly decomposed into 2 groups based on fund target objective:
    a. **Balance-based targets**: The risk in this category relates to the risk that an account balance will fall as a result of short term market volatility. Acknowledging this perception

of risk aversion will tend to shift life-stage design toward mitigating short term market risk at the expense of growth.

b. **Income-replacement targets**: The risk in this category relates to the possibility that over the long-term the balance may not achieve its target and a consumer's consumption may have to fall after retirement occurs. Acknowledging this perception of risk aversion will tend to shift life-stage design toward maintaining a long-term standard of living by promoting growth over the course of the investment lifecycle, with less emphasis on mitigating short term market risk.

BTFG suggests that the Productivity Commission analysis only applies to the Balanced based target fund and therefore that the conclusions drawn by the PC report don't apply to Life-stages funds with an Income Replacement target.

To demonstrate this, BTFG used the Productivity Commission modelling approach, and found that a Life-stages fund with an income replacement target (Life-stages IRR), outperformed both a Balanced Fund and the Life-stages product modelled by the Productivity Commission (PC Life-stages AB) in all but the lowest decile of the wealth distribution.



The conclusion BTFG draws from this analysis is that the design and intent of the life-stage fund plays an important role in determining outcomes for members and should factor into any review of their suitability for members.

3. Balanced funds differ from Life-stages and Transition to Retirement products in that de-risking is via constant allocations to defensive products over the entire life-cycle vs the latter products which phase allocations to growth and defensive assets over the life-cycle. The 30-year data window analysed by the Productivity Commission is characterised by:
   a. Historical negative correlation between stock and bond price; and a
   b. 30-year bond bull market.

Negative correlation between stock and bond prices is an anomaly from a historical perspective (see for example: Illmanen, Antti (2003), 'Stock Bond Correlations', The Journal of Fixed Income 13(2), September 2003) and therefore the data set combined with the resampling technique used by the

Productivity Commission is likely to overstate the performance of balanced fund style (i.e. passive) traditional de-risking – “sell equities to buy bonds” – in future.

We are current in the lowest decile of rates, which implies an end to the bond bull market via rising rates and therefore increasingly diminished protection offered by bonds against equity shocks.

BTFG suggests that the further analysis of the likely future behaviour of passive derisking strategies in a rising rates environment may lead to different conclusions regarding the relative merits of Life-stage investing for a default member.

Attachment B: Additional questions posed to BTFG at the Public Hearing on 22 June 2018:

(a) Should international competition be allowed into the sector?

(b) How do you measure their performance?

In our view, the only barrier to entry into the system should be the ability to meet an enhanced MySuper threshold (as relevant) and all of the relevant legislative and regulatory requirements. Whether a fund is an overseas fund or an Australian fund, if they comply with all the relevant legislative and regulatory requirements of the superannuation system and provide excellent services to members and competitive after-fee returns, they should be allowed to compete for the 'best in show' funds list if they wish to do so.

That being said, comparing fees and after-fee returns between Australian superannuation funds and overseas pension funds is a complex issue and should be undertaken with caution. Deloitte Access Economics has noted that cross-country comparisons of fees (as well as returns) in superannuation can be challenging. Returns and fees are affected by a range of factors which vary significantly across jurisdictions, including:

- product proliferation and the level of choice;
- competition impeding economies of scale;
- flexibility and the regulatory environment;
- investment strategy;
- benefit design (defined benefits v defined contribution);
- average fund size in terms of assets and number of members;
- imbedded products and services such as life insurance and financial planning;
- bundling;
- tax; and
- the economic cycle.[2]

Australia's superannuation system tends to be more complex and flexible when compared to many overseas systems, especially those which are predominantly defined benefit. Australia's superannuation system is also characterised by heavy user services – i.e. superannuation funds are expected and required to provide a number of services to members. For example, they must provide standardised reporting of performance and fees, year-round engagement options (such as call centres), the ability to handle inter- and intra-fund transactions, investment choice options and opt-out life and disability insurance (and the ability to increase or decrease cover).

In contrast, many overseas pension systems do not require participants to provide the same level of services or flexibility to members. Fox example, defined benefit, government-run retirement funds such as Norway's funds are not required to provide member services or interactions and frequently have much of the operating costs embedded in the employer contribution rate.

There are also differences in the way Australian superannuation funds and international funds invest, or more specifically, are required to invest. Unlike many international funds, there is

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[2] Deloitte Access Economics, "Choice and competition in the Australian default superannuation system", report for the Financial Services Council, April 2017.

generally no minimum requirement for Australian superannuation funds to invest in government bonds or other similar assets. In contrast, a country like Israel for example requires funds to invest a minimum of 30% of assets in government bonds.

These types of investment restrictions or directions that some overseas jurisdictions place on their participants can make it difficult to draw meaningful conclusions when comparing investment fees between Australian and international funds.

Therefore, if international funds are allowed to compete in the Australian market, care must be taken to ensure a rigorous process is established to be able to compare their fees and returns on a like-for-like basis with those of Australian funds. For example, overseas funds will need to stipulate (in an accurate way) the fees they will charge if they were to operate in the Australian market and provide the services to members they would be required to provide under Australian law.