MLC NAB WEALTH SUBMISSION

Productivity Commission Issues Paper: Assessing the Competitiveness and Efficiency of the Superannuation System

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National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

About NAB and MLC[1]

National Australia Bank Limited and/or its subsidiaries provide superannuation, advice, investment and insurance solutions to retail, corporate and institutional clients, supported by a number of brands including MLC, JBWere, JANA, Plum and investment brands under NAB Asset Management (collectively NAB Wealth Products – NAB Wealth).

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 Wealth 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 fund by brand name, this submission refers to the combination of our superannuation entities and service providers under the banner of NAB 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.

Abbreviation	Definition
AFCA	Australian Financial Complaints Authority
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
BAU	Business as usual
CIPR	Comprehensive Income Product for Retirement
Corporations Act and Regulations 2001	Corporations laws
DHS	Department of Human Services
FSCOD Act	Financial Sector (Collection of Data) Act 2001
FWA	Fair Work Act 2009
FWC	Fair Work Commission
PC	Productivity Commission
RIS	Regulation Impact Statement
RSE	Registrable Superannuation Entity (fund)
SCT	Superannuation Complaints Tribunal
SISA	Superannuation Industry (Supervision) Act 1993
SISR	Superannuation Industry (Supervision) Regulations 1994
SMSF	Self-managed superannuation fund
SRF	Superannuation Reporting Form (APRA)
SRS	Superannuation Reporting Standard (APRA)
SFT	Successor Fund Transfer

TABLE OF CONTENTS

1. Overview 1

2. Material policy / regulatory impediments to the competitiveness and efficiency of the system 2

2.1 Regulatory impediments to efficiency 3

2.2 Member behaviour and knowledge 5

2.2.1 Wrap platform "products" (choice) 5

2.3 Insurance 6

2.3.1 Whether policy changes are needed to ensure that insurance is not a barrier to account consolidation 8

2.3.2 Opting out – ease 8

2.3.3 Funds' use of member information to provide default insurance cover 9

2.4 Contestability 9

2.4.1 Changes improving contestability – distribution channels 9

2.5 Fund behaviour 10

2.5.1 Changes in products and services 11

2.5.2 Levers (nudges) 11

2.6 Effect of regulation 12

2.6.1 ATO & DHS: 12

2.6.2 APRA and ASIC 14

2.6.3 For APRA: 15

3. Mitigation Of Defaulting A member to a (long-term) underperforming product 16

3.1 What is the evidence of long-term underperforming default product providers exiting the default market? 17

3.2 How do the existing default arrangements create incentives for funds to maximise long-term net returns and allocate members to products that meet their needs? 18

3.3 What evidence exists of default arrangements encouraging open participation (contestability) and rivalry between funds for the default market? 18

4. Evidence Of Competitive Pressure Driving Cost Reductions And More Efficient Long-Term Outcomes For Members 19

5. How do existing default arrangements promote accountability and integrity in the selection and delivery of default products? 20

5.1.1 How could the existing arrangements be improved to achieve this goal? 20

5.2 Do existing default arrangements create concerns about stability that could lead to significant systemic risks? 20

5.3 Do the existing default arrangements minimise overall system-wide costs, taking into account costs on members, employers, funds and governments? 21

6. Stage 2 - The 4 Alternative Default Allocation Models 22

6.1 How could the process for constituting the body for selecting default products be designed to deliver accountability while mitigating the risks of politicisation and bias? 24

6.2 How could the 'first timer' mechanism be designed to mitigate against the risks of entrenching member disengagement and the risk of members remaining in inferior products? 24

6.3 Centralised clearing house 24

7. Merger Transparency – retrospective disclosure 25

8. System level benchmarking 25

8.1.1 In the context of the approach set out in the stage 1 Study to compare long-term net investment returns to a set of passive, liquid reference portfolios, which reference portfolios would most meaningfully inform the analysis? 25

8.1.2 What is the best way to ensure that equivalent taxes are netted out of returns to a reference portfolio? 26

8.1.3 What are the most appropriate listed asset class benchmarks to use to calculate the returns to these reference portfolios? 26

8.2 Asset class benchmarking 27

8.2.1 How can the Commission best assess the investment performance of unlisted investments? 27

9. Costs, fees and net returns 27

9.1.1 Whether disclosure practices are resulting in a consistent and comparable basis for meaningful comparisons to be made between products 27

9.1.2 Whether additional disclosure would improve outcomes for members 28

9.1.3 Whether the system is minimising costs and fees (including, but not limited to exit fees) for given returns; 28

1. OVERVIEW

NAB Wealth welcomes the Productivity Commission's review and the opportunity to respond to its consideration of Competitiveness and Efficiency of the Superannuation System.

We endorse the Productivity Commission's approach to using 'no default' as a baseline for alternative default allocation models, given choice decisions can deliver more suitable outcomes for individuals and can drive competitive behaviour through improved engagement. However, we acknowledge there are potential issues to be managed with both structures (choice and default) as the Productivity Commission has identified.[2]

NAB Wealth supports superannuation frameworks which:

- are open to competition (neutral in terms of laws and imposts);
- enable active and engaged consumers to exert control over their own outcomes;
- provide support and options (defaults) for those who need, or prefer, to 'outsource' their retirement savings decisions;
- accommodate savings to provide an adequate income in retirement; and
- provide automatic group insurance for 'default' members to protect and pay benefits in the event of premature death or disablement.

Registered Superannuation Entities (RSEs) need resources (directly or through servicing entities) to build engagement and transform offers and services to meet customer needs over time and in changing environments (economic, cultural, regulatory and operational).

While 'default' or pre-designed products are important for those who are disengaged or, for those who prefer decision support, capacity to choose from a range of structures and products is imperative to meet idiosyncratic needs for customers seeking to manage their personal circumstances. This is especially the case in early pre-retirement and post retirement and for people balancing exposures within and external to super (including personal businesses and housing).

Our view is that a diverse range of options, including member services (e.g. education, online advice capability, call centres) and choices, affords the broadest range of consumers the capacity to optimise their own outcomes over a lifetime given needs vary (sometimes unpredictably). We do not subscribe to the view that super fund trustees will know more and provide better outcomes than informed individuals making independent assessments and decisions (particularly with advice).

Efficiency in the system must be predicated on facilitating the best or most appropriate outcomes taking into account all participants, current and future, in a range of scenarios and over the longer term.

Stable and strong funds with appropriate governance and management capability will be more effective than those that produce riskier or more erratic returns, do not have sufficient or adaptive capability in infrastructure as the environment changes, or are insufficiently resourced to meet and respond to the increasing regulatory burden.

Overall, Australia's three pillar retirement system is robust but there are aspects where all stakeholders could benefit from:

- more stability in regulatory settings;
- less apprehension about ability to participate and compete on a neutral regulatory footing;
- reduction in red tape; and

[2] Productivity Commission Draft Report, Superannuation: Alternative Default Models, p5

- ongoing development and facilitative approaches to innovation in member disclosure and engagement.

NAB Wealth submits that a wholesale change to the allocation of default members through quota based models (including the untested and un-costed Fair Work Act model) or mandatory tenders is not warranted at this point.

We recommend that all public offer RSE licensees with authorised MySuper products be able to compete to provide default superannuation for any employee group or industry.

Given proposed enhancements to APRA's powers and trustee's obligations to test member outcomes, the quality of MySuper offers will, we believe, be sufficiently robust to protect default members' interests.

We also note that over time, segmentation by occupational industry type in the union fund sector, which was originally structured along industry or occupational lines, has diminished markedly. For example, Australian Super has over 70 listings (approaching 80) of the 122 modern awards. This fund is catering to a heterogeneous group of members.

In terms of arguments that there are too many MySuper products from which to choose, we refer to our prior submission noting that the options publicly on offer are, realistically, less than 70.

To put this in further context, one of our major conglomerate employers is subject to 13 modern awards across its workforce, in addition to several enterprise agreements. On average, there are 5 superannuation funds listed in each award. Whilst there will be some funds common across some awards the diversity of this employer means that they could potentially have to review 65 listings and be subject to between 5- 10 default MySuper products. It would be simpler to be able to select one from a single list of authorised products (all of which are prudentially regulated).

The effects of the substantial Stronger Super changes (including MySuper and SuperStream) are still to be realised, with implementation only recently completed (or, in the case of SuperStream, ongoing) with costs not yet amortised.

Further, proposed enhancements to both the regulator's powers and RSE assessment of MySuper offers in the recent exposure draft Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 suggest that, at least for the shorter term, changes should be facilitative of competition and improved efficiency including consolidation (i.e. incremental in nature rather than a forced overhaul).

2. MATERIAL POLICY / REGULATORY IMPEDIMENTS TO THE COMPETITIVENESS AND EFFICIENCY OF THE SYSTEM

As identified in previous submissions, there are legislative barriers to entry and exit of funds and withdrawal of products including:

- Regulatory impediments, together with significant complexity, which hinder fund and/or product mergers and consolidation.
- An arbitrary restriction of up to 15 named funds under the Fair Work Act (FWA) provisions (the Modern Award framework) in respect of mandatory contributions payable for an award employee where the employee does not make their own choice stifles competition (and can exclude capable, effective and efficient funds).

Further, a major contributor to costs and a drag on efficiency and ongoing innovation has been the constant, significant, and frequently iterative legislative changes, regulatory guides or prudential standards introduced (particularly since 2012). We have addressed this in prior submissions but provide some additional material below (in the section on 'Effect of regulation').

Many funds will have experienced situations where laws, standards or guidance are made without sufficient regard to implementation complexity and resource allocation over a given timeframe.

In addition, from a competitive perspective, pushes to conduct comparisons of default options with choice options may lead to distortions in outcomes and efficiency assessment.

Comparison of products, indeed of separate investment options (including single assets such as a listed security) with very different investment and/or risk objectives, will likely lead members to make investment choices with potentially poor outcomes. For example, we develop Indexed Investment options which focus on outperforming an index benchmark. This has a vastly different objective to a balanced default MySuper product which would not be an appropriate option for comparison purposes, as the objectives and suitability differ.

Within Wrap products, members receive the full benefit of their own portfolio construction and strategy. Less than 10% of our Wrap customers hold one investment or portfolio only) and between 40%-50% of our Wrap customers hold more than 10 different investment options but they vary due to their own circumstances. Those in the Separately Managed Account framework have circa 16 sub-options (including top 20 Blue Chips).

The intent of a wrap solution is to enable investor directed portfolio construction, and therefore there is a low probability of cohorts of members with similar portfolios. The members with the most diverse exposure hold 50-100 investment options (including single assets such as listed securities) with a small number holding over 100. Those with exposures of over 20 options have average account balances in excess of $500,000.

It is incongruous to suggest that each option and single asset be separately comparable to say, a MySuper portfolio or trustee designed portfolio. See also section 2.2 *Member behaviour and knowledge.* Current dashboards are not delivering value for the investment made.

2.1 Regulatory impediments to efficiency

Please refer to our confidential submissions of May and September 2016 which included an outline of both the complexity associated with fund mergers (successor fund transfers) and recent regulatory imposts which have yet to be amortised. Further data on increasing regulatory costs (and a member attribution) is provided in the confidential appendix.

NAB has made significant investment in implementing regulatory change related to superannuation which will continue through 2018 and beyond. Since 2012 investment in Regulatory change has increased by more than tenfold (refer to the confidential appendix for a summary). We anticipate that with additional proposals to improve accountability and member outcomes[3], these costs will increase substantially from 2017 (particularly for the proposed 'Annual Member Meetings').

While member numbers and fees have changed over time we estimate that the average annual regulatory cost over the last 3 years is greater than 15% (that is, greater than the tax rate applying to super fund income) of the annual average total management fee.[#]

[#] based on YTD Jun-2017. Includes admin fees and other management fees such as platform investment fees, surrender/exit fees and Insurance Service Fee

This is a serious diversion of investment that could have been applied to improving fund products, services and efficiency.

While we support a strong prudential regime, it is our view that at least a proportion of these costs arise from duplication, ill-timed effective dates, iterative interpretation leading to re-working systems and processes for the same 'core' requirements (see as an example material related to ASIC RG97 below).

It is also important to note that levies are paid to fund the operations of the regulators (APRA, ATO and DHS) and a new 'user pays' levy for ASIC will come into effect from 2017-18.

[3] Refer Exposure Draft, Treasury Legislation Amendment (Improving Accountability And Member Outcomes In Superannuation) Bill 2017, 26 July 2017

In addition, industry will be required to fund the new disputes resolution body - the Australian Financial Complaints Authority (AFCA) – as well as the Superannuation Complaints Tribunal (SCT) as its processes are transitioned to AFCA. This would add to the per member cost associated with change, but it was excluded as this is, in general terms, a static cost.

It is important that there are laws or a charter to ensure legislators, advisory policy departments and, in particular, regulators adhere to a set of key principles and practices in making, interpreting or enforcing laws. Critical aspects include:

- clearly documented imperative and purpose of changes;
- robust cost and benefit analyses;
- minimising duplication (of regulatory oversight and revision of standards or guidance in short sequence);
- speed of issue of interpretative guidance or standards to accompany primary legislation;
- consistency of approach for intersecting regulators and/or portfolios; and
- minimising 'early spend' to comply with unsettled laws due to proposed timeframes/effective dates.

Additional impediments to fund mergers/consolidation

NAB Wealth recently completed a consolidation of 5 super funds to 1 at significant cost (see appendix). This cost was driven by a number of factors that are common across the industry (albeit a substantive part of the costs were also associated with the excision of the life company).

The common factors include:

- Successor Fund Transfers (SFT) legal tests that are complex, ambiguous and/or difficult to apply;
- complex superannuation and tax regulations;
- in some situations, onerous and complex disclosure requirements; and
- onerous regulatory engagement required to achieve relevant relief.

Those factors often result in:

- significant assurance steps are required including by independent third parties;
- technology becomes legacy as the barriers to consolidation exist; and
- increased cost of change.

<u>Experience from recent internal fund consolidation</u>

As part of the recent internal SFTs, there were a number of repeated relief requests submitted to APRA which were duplicative of existing relief already in place i.e. previously granted to one of our existing RSE Licensees.

We were required to re-apply for multiple existing relief items. That was indicative of overly prescriptive requirements particularly given the Trustee's existing fiduciary obligations to act in the best interests for the benefit of members.

Much of the repetitive process could have been avoided or reduced if APRA had the ability to recognise the movement from one internal fund to another in cases where there were no fundamental changes to the terms and arrangements, nor to the underlying assets of the arrangements – they were being taken on by the same Board of directors with the same capabilities albeit under a different RSE License name (and notably also, the same administrator).

We believe APRA would also benefit from additional refinements particularly to the 'equivalent rights' tests including with regard to trustee or regulator initiated MySuper SFTs.

2.2 Member behaviour and knowledge

There are iterative new regulatory initiatives increasing super fund disclosures to members with the purpose of improving understanding, awareness and engagement across the community.[4]

Those initiatives come at a cost but there is little evidence the recent statutory approaches have enhanced understanding or engagement.

NAB 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.

Disclosure requirements are set out in the Corporations laws, overseen by ASIC from a consumer perspective, and also APRA via the standards making powers affecting RSEs (under provisions in the FSCOD Act). They include requirements affecting PDS', periodic statements and product dashboards.

MySuper Product dashboards were introduced as part of the Stronger Super reforms in 2013, and intended to provide members with key information about their default superannuation product. The aim was to provide members and employers with the capability to make better informed decisions, however we have observed low levels of members accessing this information.

The below table and figures demonstrate less than 1% of our member's access their product dashboards. This is for the product that has the largest number of members and the group that is less engaged and less likely to investigate or interrogate alternatives.

This reveals, we believe, a costly but ineffective tool for the majority of the membership and shows the difficulties with prescriptive solutions which do little to enhance existing disclosure or mitigate perceptions of dense complexity (a function of many laws and frequent change).[5]

We do believe that further development of more interactive online tools, with landing pages, and ability to self-direct can improve access and understanding.

Industry needs the time and the resources to focus on these approaches. Our previous submission in September 2016 provided some data around increased responses through alternate mechanisms.

	2015		**2016**		**2017* (1/1/17 – 21/5/17)**	
	Total Instances	**Unique Instances**	**Total Instances**	**Unique Instances**	**Total Instances**	**Unique Instances**
MLC MySuper Product dashboards	1,352	1,284	6708	6112	2207	2043
TOTAL MySuper Members 640,000						

* Jan 1st 2017 - May 21st 2017

2.2.1 Wrap platform "products" (choice)

As outlined in our previous submission, Wrap platforms are predominantly an 'administration service' comprising a broad array of investment products and options with a tax management capability at the individual level.

[4] Explanatory Memorandum: Superannuation Legislation Amendment (Transparency Measures) Bill 2016

[5] This was predictable based on the consumer research undertaken by ASIC in 2013 and 2015 respectively. 2015 link: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-378mr-asic-releases-results-of-consumer-testing-for-the-choice-product-dashboard-and-further-detail-about-super-estimators/
2013 link: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-378-consumer-testing-of-the-mysuper-product-dashboard/

These platform services and the underlying offers differ markedly from 'collated' trustee-designed MySuper products.

While the majority of MySuper product holders are invested in a single investment portfolio comprising trustee-blended investment options (which may be lifestage or single diversified), Wrap platforms and 'Separately Managed Accounts' (SMAs) (hereinafter Wraps) provide a broad **menu** and variety of assets which include Managed Funds (both single sector and multi sector), Listed Equities, Stapled Securities, Listed Investment Companies (LICs), Exchange Traded Funds ETFs), Term Deposits (TDs), Real Estate Investment Trusts (REITs) amongst other options.

This allows the member to expressly tailor their suite of options to suit their circumstances (taking into account both internal fund exposures and external holdings).

Wraps are, in effect, similar to a form of Self-Managed Super Fund enabling greater self-direction and bespoke capability but with a separate, unrelated APRA-licensed trustee (rather than the members themselves).

Wraps are traditionally the tools of advisers and are often only available via an adviser or require higher minimum balances to open an account. While Wraps may offer portfolios designed by the Trustee (similar to the composite MySuper) they are predominantly used by advisers/members that wish to customise or maintain a specifically formulated portfolio rather than to utilise more generic portfolios. By design and demand Wrap members (directly or through an adviser) involve greater engagement.

Wrap platforms provide the underlying PDS' of each investment to members and advisers for the comparison of different options. Given how comprehensive the menus are and with such a large offering of externally managed funds, it is not feasible for a Wrap to have one PDS, which encompasses all of the options, that is up to date and not confusing.

Similarly, if choice dashboards were to be introduced, these should be produced only in respect of multi-asset type ('collated') portfolios/options and produced, if applicable, by the product issuer rather than a platform. If platforms were to provide choice dashboards it would inevitably lead to differences between platforms for widely held assets and arguably create further confusion for members when comparing investment options across the different platforms.

Product Dashboards for [all] choice Options, would add a large administrative burden with associated costs and very limited benefit to members that create customised or self-constructed portfolios. We would estimate that, depending upon scope, the build costs could be well in excess of $1.5 million for any given platform.

It is this type of regulatory change that, despite evidence, hampers efficiency and actually acts against improving outcomes for members.

2.3 Insurance

Please refer to our prior submissions. In summary:

- Insurance through superannuation, particularly group insurance, provides a safety net to millions of Australians who would have otherwise not chosen or been unable to take out life and disability insurance individually.
- It is a mechanism where the impacts of unexpected premature death (in respect of dependants' economically relying on the member) or pre-retirement disablement can be ameliorated because insurance proceeds have an important role in financial wellness, and make up for unanticipated lost income and/or retirement savings.
- In general, trustees offering MySuper products must provide minimum death and permanent incapacity (disability) benefits to employees working full or part time which can be on an opt-out basis. The trustee may also allow temporary disablement or income replacement benefits.
- A fundamental premise behind low cost, easily accessible group insurance cover for employees is that most employees in the group (generally subject only to an 'at work' test) are insured thereby eliminating the need for individual underwriting.

- The default approach minimises anti-selection risks thus reducing the likelihood that only those with a high probability of claiming will retain insurance which in turn increases premium rates and makes cover less affordable, or unaffordable. However, it is also recognised that for various reasons, for example having cover elsewhere, members should be able to opt out.

APRA statistics indicate that more than $4bn was paid as insurance claims to superannuation fund members in the year to 30 June 2016[6]. Most of these payments will have been from group arrangements.

We have provided some statistics from our funds in the confidential appendix along with a case study but refer again to our prior submission in September 2016 for a further example which is reflective of many employer based arrangements.

Could policy changes improve default cover?

NAB has previously made submissions to the Commission highlighting the value of insurance through superannuation, particularly default. We believe opt-out insurance should remain a part of the default superannuation offer.

The value of default insurance provided for those with admitted claims can be observed by noting the claims paid to superannuation fund members. For example, for NAB's default superannuation offering for small, medium and larger sized employers, MLC MasterKey Business and Personal Super, in the year to 30 June 2016, 974 members were paid insurance benefits totalling $132 million.

We receive many stories of the value of these payments to members and their beneficiaries, most of who would not have had cover were it not for the default group insurance.

This is not to say that aspects of default insurance designs couldn't be improved to maximise value for-money for members. Affordability and needs can conflict, and so insurance default designs can be enhanced and the number of duplicate or multiple accounts reduced to address inappropriate erosion of account balances.

When re-designing the default 'trustee chosen' insurance levels (ahead of MySuper reforms), we considered average member needs combined with an overlay of affordability, and adopted a 'life-stage' approach. This provides cover that varies with age to provide affordable financial protection during the years when it is most needed. The design provides:

- a higher level of cover when expected mortgage and level of support required for dependants is highest;
- a higher level of permanent disablement cover than death cover at younger ages where, if disabled, the need for this type of benefit is at its greatest (and where there has been little time to build assets);
- a reducing level of cover as a member ages to reflect declining average levels of debt and dependency support and to help manage the impact of rising insurance costs on retirement incomes;
- death but not permanent disablement cover to members over age 65, resulting in substantially lower premiums; and
- premiums that vary by age, gender and occupation to enable more equitable charging of premiums to underlying members and to minimise the impact of cross subsidisation.

We have recently reviewed this design, and believe it remains largely fit-for-purpose. In this context, we note the work of the Insurance in Super Working Group looking at approaches to mitigate duplication of insurance (and premiums), loss of insurance cover, modern design/definition concepts, and better approaches to explaining cover to members.

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[6] APRA, Annual Superannuation Bulletin June 2016 (issued 01 February 2017)

NAB Wealth supports these initiatives, and believes the resultant Code of Practice and Good Practice Guide for superannuation funds will improve default cover through superannuation and ensure it represents value-for-money.

2.3.1 Whether policy changes are needed to ensure that insurance is not a barrier to account consolidation

NAB Wealth does not believe that insurance has been a material barrier to account consolidation. Whilst it is true that some members retain a duplicate account to maintain insurance cover (e.g. if the member has his/her own SMSF and cannot otherwise take advantage of group insurance), in many instances insurance cover can be transferred to another superannuation fund without the need for underwriting, thereby not presenting a barrier to account consolidation.

Efforts are being made to improve member awareness of the benefits of account consolidation. This is important as duplicate accounts are a reason for many members' accounts being inappropriately eroded by administration fees and insurance premiums. Whilst multiple insurance arrangements may be deliberate, it is often inadvertent and provides cover in excess of the levels the member can afford, or wants.

Individuals are starting to consolidate their superannuation, with the number of members with only one single superannuation account increasing on the back of a number of the Stronger Super reforms.

Further, many government initiatives are underway which will further reduce the number of multiple accounts (e.g. utilisation of myGov and SuperMatch). The number of members with multiple accounts will further decrease should the default allocation models being contemplated by the Productivity Commission be introduced. If implemented, the effect is that a member is only potentially defaulted on joining the workforce, and then retains that default fund on moving employment.

Insurance Case Study

As a CEO of a large listed company stated, "Insurance in super is the single greatest gift most Australians don't know they have, until they need it. I would echo this sentiment!"

This case, with another, is included in the confidential appendix. These are indicative examples only.

2.3.2 Opting out – ease

As part of the review processes, it is intended that the funds administered by NAB Wealth make it easier for members to opt-out of insurance cover. As systems are enhanced, NAB will aim to build suitable online opt out facilities. Analysis on the viability of rolling this capability out more widely will also be undertaken. However, we believe it is currently reasonably easy for a member to opt out of group insurance under existing arrangements.

Options include:

- Phone call to call centres, including capability to conduct an identity check at the time.
- Email message to fund subject to identity check.
- Signed document mailed or otherwise sent

It is important to note that in the group context, where employees are enrolled by default by their employer, they do not complete or sign an application form. Welcome kits are provided on joining with information about the insurance (and other features) via a PDS and links to additional information on the website.

While we do not have explicit records of opt out statistics, the insurance data provided in the confidential appendix reflects approximately 20% of 'group members' are not insured. This would be reasonably indicative of an opt-out rate.

2.3.3 Funds' use of member information to provide default insurance cover

Generally, there is more flexibility of insurance design in professional retail funds taking into account, where appropriate, the nature of the employer and employment.

The levels of insurance cover and premiums may vary from plan to plan, and larger employer plans often even have tailored premium rates reflecting the employer group's risk profile. This flexibility is possible provided the data points required (typically salary and employment status) can be collected accurately as they are not collected as part of the standard SuperStream fields.

Most professional retail funds have insurance designs where employers can select a default design suitable for their employees, albeit Trustee default designs are becoming more common due to the commoditisation introduced with MySuper (particularly for small to medium enterprises).

In the division of the segment of the MLC Super Fund focused on larger employers with custom needs (85 primary employers with a number of subsidiaries) the insurance designs are all tailored. In the small to medium segment, the default lifestages is adopted by the majority (97% of employers, translating to over 21,500 employer MySuper plans).

In addition, most professional retail funds such as those managed and administered by NAB Wealth allow members to readily increase or change cover if desired (subject to underwriting requirements as set by the insurer). While we do not track this as a matter of course, indicative rates suggest that 5% of the group insured membership choose different levels of cover from the default level (data for the SME based corporate superannuation offer is in the confidential appendix).

2.4 Contestability

Height of barriers to entry arising from default rules and market impediments to funds accessing distribution channels[10].

Please refer our previous submission of September 2016, and the confidential costs provided in the Appendix to our submission of April 2017 in relation to the MySuper authorisation process and the potential impacts of the modern award default member allocation process.

It is highly unlikely any dually regulated prudential approach, particularly with a quota, would meet the aims of reduced red tape, reduced regulatory burden, or facilitate greater competition over time.

Embedded participants operating under quota based systems would potentially become apathetic and unresponsive to broader environmental change over time, thus diminishing member outcomes.

In terms of accessing distribution channels, rapid technological developments and extensive adoption of innovative digital tools has enabled newer entrants to move into the superannuation system.

Such entrants are arguably more able to disrupt and displace incumbents who need to modify infrastructure and processes with concomitant risk management and regression testing. Below are some illustrative data points:

2.4.1 Changes improving contestability – distribution channels

Forecasts estimate digital and limited advice is expected to grow by 567% and 417% respectively over the next 5 years. In this same time, traditional advice will fall by 31%[7].

Intra-fund (super fund) advice will reduce in both face to face and phone based arenas, but increase by 275% in digital.[7]

[7] Comparator, Market Pulse, Financial Advice,

While clearly more 'choice oriented', the exponential rate of growth in the SMSF sector (with currently circa 600,000 funds and more than 1 million members) is an indicator of the effects of competition, when not impeded, and evidence that new players can enter the system.

In terms of servicing the default sector, digital channels will mean more expensive and entrenched traditional workforce-based servicing, utilised by long-lived life companies and professional retail funds, will decline. This will allow redirection of resources and deployment to activities which can advance these channels and improve product designs and targeting.

Using a hypothetical case study of a 45 year old with $100,000 to invest, it was estimated that in 5 years' time, super funds and robo-advised would become the most likely source of advice. The rate of growth in these channels over 5 years would be 1900%[7].

These changes reflect a dynamic change in workforce participation. In contrast to the decade when union affiliated industry funds were established, today the national average tenure in a job is 3.3 years (3 years and 4 months), based on voluntary turnover of around 15% per annum[8]. But further change and disruption will expand this gulf exponentially.

"*The forces of disruption are not just being driven by start-ups and felt by business leaders – they're driving change in the workforce and labour market. Two-thirds of those with less than five years' experience (early-career Australians) expect that their job will not exist, or will fundamentally change, in the next 15 years...... Of those who will pursue a new job in the next ten years, three in five are looking to change to a different industry, a different role, or both.*[9]"

Whilst prudential licensing and authorisation processes act as barriers, they do so in a manner that is intended to ensure participants are capable of operating in a market with a statutory flow of money. This is a reasonable barrier as opposed to a barrier based upon archaic divisions of industry and occupations which are traversed by many of the original union affiliated industry funds that have since become public offer.

System participants need to be nimble with effective engagement. As the environment changes, exclusionary practices should be curtailed to allow capable and competent participants to enter or adapt (and others to leave).

2.5 Fund behaviour

"Funds' use of member information and behavioural finance lessons in product design, development and take-up of tailored products, member services and retirement income products[10]*"*

Please refer to our last submission in 2016. This submission identifies some of the historical factors which created lags in funds' understanding of and responses to members. These still exist to some extent but funds are embracing technological advances and innovation to better engage with members in order to provide products and services.

At a very high level, we can build engagement by boosting **confidence** and **literacy**. Simple explanations, personalised experience and a way to make it less "scary" is important and digital advances are making this easier to do.

Below we have provided some further background on previous changes driven from within the system and observations about current policy settings that impact retirement behaviour (fund and individual).

[8] McCrindle Research: Australia in 2020 ... "By 2020 average job tenure will be around 3 years (4 years today) with voluntary annual turnover approaching 20%. More than 1 in 3 workers will be employed on a casual basis"

[9] Deloitte Access Economics, Chartered Accountants Australia and New Zealand, The Future Of Work: How Can We Adapt To Survive And Thrive?, February 2016

[10] Productivity Commission, Superannuation: Assessing the Competitiveness and Efficiency of the Superannuation System, July 2017, p16

2.5.1 Changes in products and services

Wrap platforms (and indeed SMSFs) are the result of wider community demand: member and adviser (including accountants).

Their development and expansion was driven by a range of factors including technological capability and increased self-direction from higher income and wealth individuals (evidenced particularly by a growing SMSF sector).

The development of account based pensions in the early 1990s ('allocated pensions' and subsequently 'term allocated pensions' (now largely defunct)) resulted from professional retail fund advocacy to build out options for post-retirement products. This followed the transition from defined benefit to defined contribution arrangements. These 'pensions' were conceived as an alternate to restrictive, often costly and inflexible traditional guaranteed pensions or annuities.

Guaranteed pensions or annuities involve an exchange of a capital lump sum for an annuity income. In general, long term or lifetime pensions have NOT been popular in the Australian market. Some of the reasons include:

- restrictions on access to capital when needed;
- lack of transparency in rates/costs and how the capital is managed and returned as income;
- no, or reduced, capital access on 'early' death (estate planning issues);
- lack of capacity to change provider and/or perceived provider (counter party) risks; and
- for those in the lower income brackets, the likelihood that they subsidise higher income earners due to higher mortality rates of those in lower socio-economic groups.

Allocated pensions grew rapidly in volume and remain a preferred post-retirement option due to their transparency, relative simplicity, flexibility, the ability to generate growth and, for some, the ability to leave a bequest. However, the positives can have countervailing negative effects with unpredictable markets and hence unpredictable income and, depending upon balances, difficulty in smoothing and managing longevity risks.

There are, in broad terms, four key objectives to generating income in retirement:

- Growth: the majority of wealth is actually generated through market returns following retirement (unless there are atypical market events such as the GFC).
- Liquidity: because people inherently don't like being locked in to anything, and they may have unforeseen expenses.
- Capital certainty: because individuals don't like losing money, either temporarily and certainly not permanently.
- Longevity: because there's a chance of living a very long time.

Most of us will want to pursue all four concurrently, but we cannot maximise all four concurrently. There are trade-offs. Trustees are more cognisant of the risks that need to be managed as are individuals following the GFC. However, it is not simple to create solutions 'for' individuals especially in highly heterogeneous funds. Advice is critical as is engagement. Different approaches to managing risk will depend very much upon individual circumstances.

2.5.2 Levers (nudges)

In the past, levers to nudge people toward guaranteed income and longevity protection products involved both tax and social security concessions.

These generally don't assist the very wealthy or those in the lowest socio-economic bracket but can influence those in the middle to upper middle wealth brackets – arguably the group policy makers should most encourage to become more self-sufficient for longer.

Such levers can overcome some of the aversion factors in adopting annuity/annuity-like products – i.e. a more balanced approach to generating at least a portion of income needs from a more stable and guaranteed long-lasting income (to death or estimated life expectancy).

Social security is the main remaining lever that would tend to encourage people toward more restrictive products which lock up capital (and to an extent risk the bet on who dies first for mortality credits).

Not all members will benefit from being in such products, particularly those with lower balances who will rely substantively on the age pension (because current and potential income will not be sufficient to enable adequate deferral of consumption in pre-retirement).

The FSI recommendation, and ongoing Treasury consultation, proposes that Trustees pre-select a Comprehensive Income Product for Retirement (CIPR) but that individuals need to opt in to this upon retirement; there are currently no incentives.

Without it being mandatory, or without some incentives, providers face risks in bringing certain products, with longevity protection, to market without some ability to reasonably anticipate volumes (scale) – this is particularly the case for products reliant on pooling and mortality credits. However, even products such as 'variable annuities' face resistance as the underlying tools for management are reasonably complex and the 'protection features' come at a cost[11].

There are a range of issues to be addressed (and a number of submissions raise these). However, for this purpose we note the following;

- Australia is somewhat unique in having a means tested age pension that lasts for life and is indexed, and will be relied upon by 70% of the population for some time to come.[12] This is the lifetime annuity that will be the primary longevity and stable income product for the 'boomer population' and much of GenX (as the superannuation system is not mature).
- Equally, this creates a disincentive to invest in private annuities even for those with more means (although not the very wealthy).
- When lifetime annuities (and certain long term annuities) were fully or partly exempt from the assets and income test, they accounted for one third of retirement income sales. The voluntary take up of annuities in Australia deteriorated (tanked) following removal of exemptions from the social security assets tests between 2004 and 2007[13].
- CIPRs will create an option that individuals need to consider, but do not change the incentive structure (on current settings).
- The means tested age pension can, without other drivers, act as a material disincentive to buying private annuities and CIPRs will not materially change this without incentive.

To the extent that levers are used, it is important that qualifying criteria are principles-focused to ensure neutrality as to structure, are product agnostic and are flexible enough to allow reasonable ability to adapt to environmental changes.

2.6 Effect of regulation

2.6.1 ATO & DHS:

"- overall member experience
- regulator monitoring and enforcement activity on inducements
- ongoing and predicted effect of RG97 on transparency of fee disclosure"[10]

Recent superannuation reforms include the introduction of low cost default products (MySuper introduction), increasing transparency to fund members around fee and cost disclosure (RG97), and streamlining of fund data transactions between employers, superfunds and the ATO (SuperStream initiatives).

These reforms overall have had a positive impact on fund members, delivering improved transparency and enhanced efficiencies.

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[11] Refer Confidential Appendix for a summary of the various income stream type products with a comparison of features.
[12] Intergenerational Report Australia in 2055, 2015, p65
[13] Piggot J, Too Much Risk to Insure? The Australian (non)Market for Annuities, refer Table 3, p17

For example, as a result of the SuperStream reforms, fund transfers are legally required to be conducted at reduced timeframes of 3 days, compared to the prior obligation of 30 days. Clearing houses and improved contribution remittances have also ensured faster allocation and exposure to the market.

However, the industry has been faced with many challenges with implementing the broad ranging reforms with others occurring concurrently such as recent Federal Government budget initiatives which require implementation by the same superannuation business resources (both from within the industry and within the relevant Regulatory and Government departments). It is challenging to manage the lack of co-ordination between the regulators in the deployment of their reforms in addition to limited capacity for the subject matter or system experts on these topics.

Limited appreciation of the time required to implement change across the industry has, in our experience, often resulted in insufficient consultation or development timeframe in the laws. That leads, in some circumstances, to a number of deferrals or the need for interim/transitional measures to enable industry to meet requirements in very tight timeframes.

An example of this occurring was in the recent Federal Budget 2016 Superannuation Measures, where a number of instances such as Transition-To-Retirement (TTR) and Death Benefit changes have required the industry, in conjunction with APRA, to agree upon transitional or interim arrangements. We appreciate that some measures, particularly those that are tax based, require appropriate deadlines to minimise arbitrage. However, those impacts can be mitigated with early engagement on options and relief where relevant. This will alleviate the unnecessary diversion of resources; potential for duplicative builds (tactical then definitive) and/or formal 'breach' management where it is inevitable due to timeframes.

Interim or tactical solutions will, in most cases, be temporary and often have higher risks attached to them. Subsequent investment in sustainable solutions will also be required with interim solutions being rationalised, with most of the investment thrown away.

Recent examples where industry has been faced with challenges to implement reforms or duplication include:

- **Superannuation Budget 2016:** The 2016 Superannuation Budget Measures involved the introduction of significant changes to Pensions and Transition-To-Retirement (TTR) Products impacting core systems, advice, and disclosure and reporting.

  The legislation only passed in November 2016 and had an implementation date of July 2017 which gave Super Funds less than 12 months to implement the changes. The tight deadlines meant that, in some cases, funds were forced to implement temporary solutions to comply, thus increasing overall costs and risks.

  This also gave funds a short period of time to assess, design solutions and complete communication to ensure financial advisers and customers could assess the impacts and options, to determine how best to manage their impacted retirement savings.

  We acknowledge that some measures need shorter timeframes to manage arbitrage, but submit that solutions and reliefs in an administrative sense should be part of a standard protocol.

- **DHS Reporting duplication**: The Department of Human Services (DHS) has requested additional information from funds regarding pension payments from January 2019. The majority of this information is currently provided to the ATO via the new Member Account Transaction Service (MATS) which is to commence from July 2018. DHS has requested duplicated reporting from funds.

  Successive governments and regulators have pursued policy settings aimed at reducing the red-tape burden on the industry. Member information should only be reported to one Government agency and the same data should not be reported to each regulator individually.

  To date the actions demonstrate poor communication and alignment between these regulators.

- **Death Benefit Rollovers (consultation and preparation)**: The 2016 Budget reforms introduced a new measure which required death benefit rollovers to be identified as part of fund reporting to the ATO. However, without prior consultation or warning the ATO implemented changes to the paper based rollover benefit statements and provided industry with only a short period to implement before 1 July 2017. Over the preceding 5+ years all APRA Funds have implemented the SuperStream electronic rollovers and this new ATO requirement contravened the ATO's SuperStream data standard.

  After months of workshops the change was deferred until a full solution through SuperStream can be implemented. In the interim a manual transitional process has been implemented increasing the costs to processes and the risk or errors occurring.

- **ATO Reporting (changing frameworks)**: As part of the Stronger Super reforms, funds were required to implement a new ATO service (Member Information Exchange - MiX) by November 2017 to provide the ATO with changes to a member's attributes in a fund. With the introduction of the 2016 Budget Superannuation reforms, together with the Single Touch Payroll requirements, the ATO ceased work on the MiX report opting to replace the requirements with two new ATO services (Member Account Attributes Service – MAAS and Member Account Transaction Services – MATS).

  Funds had invested significant resources in developing plans and solutions for the original MiX requirements that were no longer required. For NAB this was approx. 6 months of effort. To compound this a new interim report (Transfer Balance Account Report – TBAR) was required to be developed as a short term solution until the new MATS report could be fully scoped by the ATO and developed by Funds.

If there is insufficient direct engagement between regulators and the superannuation industry, the industry will be reliant on industry groups to communicate the prevailing technical issues to the relevant regulators. With coordination across a large group of stakeholders, this often results in additional requests for deferrals due to differing levels of readiness across the industry.

This could be remedied if regulators changed their engagement models and allowed sufficient expansive consultation on the implementation of new reforms before setting hard compliance dates. Alternatively, where it is necessary to manage legislative arbitrage through tight timeframes, regulators can provide reasonable 'administrative' exemptions/proxy approaches (and/or reliefs for a transition period). This would mitigate errors of rushed development and allow a more stable and efficient approach to managing changes.

2.6.2 APRA and ASIC

Regulator (APRA/ASIC) monitoring and enforcement activity on inducements

NAB Wealth abides by the laws in conducting and managing the superannuation business. Where we identify errors or issues we act to mitigate future instances and remediate events as appropriate. We have not identified any breaches of the law with regard to the provisions in the SIS laws banning inducements to employers.

It would seem that part of the activity and speculation has been driven by competitively motivated research and media campaigning. However, we are supportive of the regulators undertaking investigations of all public offer entities in determining whether illegal incentives or inducements have been used to obtain an unlawful advantage.

Investigations conducted by regulators which are limited in scope or repeated for the same entities do create a resource diversion and cost drag for those entities.

It is important, we believe, that neutrality be observed in activities undertaken with regulator reviews and engagements.

Ongoing and predicted effect of RG97 on transparency of fee disclosure

Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements, was issued by ASIC in November 2015 to provide ASIC's view of both the existing regulations and the class order changes introduced by ASIC Class Order 14/1252.

We support transparency and also note ASIC has sought to address concerns of under-disclosure of fees and costs in superannuation and Managed Investment Scheme (MIS) products.

As a result of new requirements introduced by RG97, we generally expect there will be an increase in the level of disclosed indirect costs and additional disclosures of transaction and borrowing costs in PDSs and Periodic statements.

However, the expanded disclosure obligations are still within a transition period until 30 Sep 2017, making it difficult to assess the impact of the changed policy on fee transparency at this point.

ASIC continues to update the requirements and issue new legislative instruments amending the Class Order and Regulatory guide, adding complexity to the implementation of this policy.

ASIC deferred the compliance date for PDSs from 1 Feb 2017 to 30 September 2017, following an industry-wide application due to the difficulty in interpreting RG97.

The following is a timeline of changes and amendments made to the new RG97 regime;

Timeline of Changes to RG97 requirements	
Date of occurrence	Change Event
July 2014	ASIC Report 398
Dec 2014	ASIC CO 14/1252
November 2015	ASIC Regulatory Guide 97 – Disclosing Fees and Costs'
November 2015	ASIC Instrument amended [CO 14/1252]
October 2016	ASIC issued 22 FAQ's on RG97
December 2016	New ASIC Corporations Instrument which further amended [CO 14/1252]
17 February 2017	ASIC updated the October FAQs
23 February 2017	ASIC issued an updated RG97
29 March 2017	ASIC issued an updated RG97
26 May 2017	Additional FAQs
22 June 2017	Additional FAQs
July/Aug 2017	Imminent release of a new ASIC Instrument which further amends [CO 14/1252], as indicated by ASIC

It has been challenging for the industry to interpret the requirements and collect the required downstream data for the new reporting elements.

With every change made to the approach, this expands the initial scope and adds to implementation and project costs. It will often require a reassessment of prior positions, in light of the new and revised requirements. This creates significant rework for Legal and IT resources.

There are further impacts to fund members due to an inability for the Trustee to explain the detailed requirements in a meaningful way as the requirements continue to change.

We understand and appreciate the complexity that the regulator needs to navigate given the different industry structures. It would help if detailed and early consultation could be undertaken before building and setting implementation dates in complex scenarios to help mitigate the need for substantive revisions.

We have provided indicative costs of the changes in the confidential appendix.

2.6.3 For APRA:

- *effect of current successor fund transfer rules and likely effect of proposed guidelines on fund mergers*
- *regulator activity in ensuring that trustees discharge their obligations under the scale test*
- *regulator activity in ensuring that trustees discharge their obligations on bundled insurance*

Regarding successor fund transfers or fund consolidation, please refer to our prior submissions and section 2.1 above.

The recent extension of the CGT relief (for 3 years) as well as additional guidance from APRA is welcome. However, we believe there remain complexities in tax law (eg an inability to 'transfer' losses or deferred liabilities) and also the approach to managing 'equivalent rights' (as opposed to an overall best interest' approach) which may impede decisions to merge all or parts of a fund or affect the timing of mergers.

We acknowledge that these issues are not universal and, with planning, could be managed in many instances. That is, such complexities are not, in their own right, a sufficient basis for not considering mergers or transfers where other factors may indicate it would be desirable to build scale and/or to access more modern systems and processes for the overall benefit of members.

Proposed provisions in the Exposure Draft 'Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017' refine the regulator's approach to the scale test as well as their powers to encourage trustees to ensure they are delivering for their default member.

These amendments, if passed, will have the effect of focusing trustees on fund viability, in particular the MySuper offering for 'default' members. Such a focus could result in further appropriate merger activity (or strategies which improve efficiency for members).

3. MITIGATION OF DEFAULTING A MEMBER TO A (LONG-TERM) UNDERPERFORMING PRODUCT

MySuper has only been fully implemented from mid-2017. SuperStream initiatives (and newer technology processes) are still in development, all of which are intended to enhance system capability (and have done so based on data released recently by the ATO)[14].

NAB Wealth has previously posited that competition, with the substantive prudential overlay in place through SIS provisions and regulatory oversight, will deliver overall strong outcomes for individuals who cede their decision to manage their default superannuation to the trustee of an employer-chosen fund. This is a main driver of our concern with any model which adopts an arbitrary quota given imposed limits can lock out efficient, effective funds and block adaptive and innovative change.

As part of the prudential overlay, MySuper trustees must make an annual determination as to whether MySuper beneficiaries are disadvantaged by the fund having inadequate scale (as noted above, further refinement of this approach is being proposed). In addition, MySuper trustees must:

- Promote the financial interests of MySuper members; and
- (in common with trustees of choice products) maintain and implement an appropriate investment strategy, and consider the cost of any insurance offered through the product to ensure it does not inappropriately erode member retirement incomes.

Trustees must also publish and maintain a MySuper product dashboard which enables members to compare the historical performance of their MySuper with other MySuper products as well as reporting to APRA, which publishes core attributes of these products including fees and performance.

These obligations and the publication of key data can serve as an incentive to trustees and their service providers to review strategy and to 'lift their competitive game'.

In addition, and as noted above, APRA has indicated that it is taking an increased interest in MySuper performance and trustees' management of these obligations.

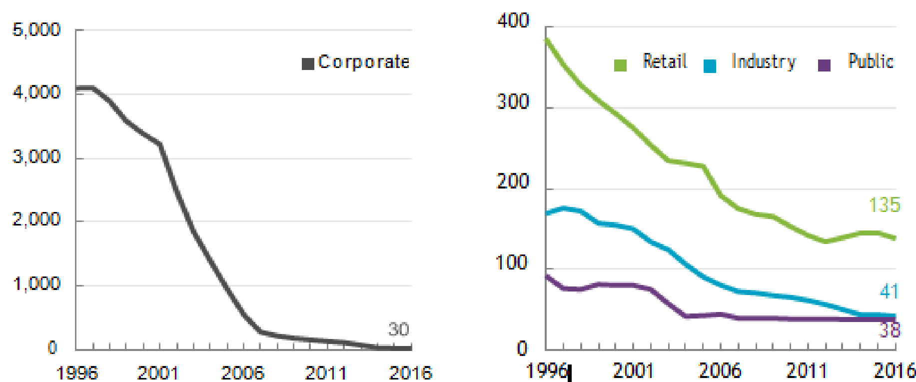
[14] ATO Media Release, SuperStream benefits support the superannuation industry and its members, 29 August 2017

3.1 What is the evidence of long-term underperforming default product providers exiting the default market?

While not necessarily underperforming, a significant amount of consolidation occurred within the corporate superannuation sector through the 1990s and 2000s.

Further, based on analysis conducted by the Association of Superannuation Funds of Australia (ASFA) it is evident there has been significant ongoing change over the past two decades in consolidation across the corporate, professional retail and union-affiliated industry funds. The charts below illustrate the changes.

Charts 2 and 3: Number of institutional fund entities*



Source: ASFA, The Australian superannuation industry, March 2017 [APRA Quarterly Superannuation Performance, December 2016, APRA Annual Superannuation Bulletin, June 2016 and other APRA data.

** Figures in the charts refer to the number of funds as at the end of the December quarter 2016.*

The APRA quarterly MySuper statistics (December 2016 edition) published 21 February 2017 shows 109 MySuper products. We note the number was 123 when MySuper products were first summarised in the statistics, so there has been some consolidation in this 'new' default arena.

It should also be noted that in the professional retail segment there are arrangements that represent long term legacy (some of which relates to traditional life insurance products acquired through mergers some decades ago)[15]. Due to constraints with the 'equivalent rights tests' as well as the design of some of these products, it can be difficult to upgrade or transfer members to more modern options. Consideration could be given to approaches which allow trustees more options to manage such legacy including through, for example, 'balance' guarantees (without leading to 'defined benefit' designation with associated costly and complex certifications).

As noted, NAB Wealth has consolidated 5 separate funds (the master trusts) into 1. We have not consolidated our Wrap funds (3) with these other funds as they are fundamentally different products. A merger of such service based platforms with the master trust funds would, overall, significantly impact (and maybe make it impossible) to achieve what 2 different product types set out to achieve (for example, taxed at pool level vs taxed at the member level). However, we would consider future consolidation if systems and/or other administrative initiatives suggest it would be feasible.

While there has been some slowing in merger and consolidation activity, there are initiatives that are being undertaken via the regulators and proposed new laws which may drive further mergers.

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[15] http://www.ricewarner.com/why-we-need-super-fund-mergers/

At June 2016, there were 105 products sold by commercial businesses (the Retail segment under APRA's segmentation). This seems far too many but it also includes many legacy products that will be swept up in coming years. The funds which don't make profits for shareholders are company, industry and public sector funds. There were 139 of those funds.

3.2 Default arrangement incentives to maximise long-term net returns and allocation of members to products that meet their needs

As noted above, competition, publication of outcomes and prudential oversight does drive participants to improve offers and to review settings.

The focus of many stakeholders, including members and employers when selecting default funds appears overwhelmingly, in the current environment, to be based on past performance and level of fees.

Academic research has shown over many years that past performance is a poor indicator of future performance and practice shows the tendency of investment performance to move in cycles.

The focus on past performance as a differentiator in selecting default funds heightens the risk that members and employers will be selecting and investing in funds at the wrong time in their performance cycles.

Greater attention should be focussed on qualitative assessment of fund capabilities with a view to assessing future return potential rather than historical performance records. Stability of returns and risk profile (see further below) are significant in this context.

Furthermore, the intense focus on fees is creating incentives and pressures for funds to move to lower cost investment strategies which in many instances is reducing future return potential and increasing the risk characteristic of fund's investment portfolios. We believe that higher investment costs, and active management, can in many cases support better net return outcomes for members.

The assessment and selection of default funds appears not to place much emphasis on the liquidity profile and illiquidity risk of funds.

Many funds have substantial exposures to unlisted and illiquid assets. Where these exposures are high, members and employers should be made aware of the risks and vulnerabilities of member accounts to potential liquidity crisis.

The sharp fall in the value of the Motor Trades Association of Australia Superfund (MTAA) following the GFC is an important reference point in consideration of these risks given its high allocation to unlisted assets going into the GFC.

This is particularly relevant in the current environment given the high level of valuations currently placed on many unlisted property and infrastructure assets.

3.3 Evidence of default arrangements encouraging open participation (contestability) and rivalry between funds

There are contestability constraints that in law including provisions introduced through the Fair Work Act as part of the Stronger Super reforms. Due to conflict issues these Fair Work processes are dormant.

Under 'grandfathering' provisions which operated under the previous industrial relations regime many funds that have been operating for many years, such as those in the MLC/NAB Wealth stable are able to continue to compete to service corporate superannuation arrangements.

In our experience, there is:

- significant competition to win default funds (medium - larger funds) – see appendix for data regarding our participation in medium - large fund tenders;
- significant member choice funds available and marketed to members; and
- SuperStream has made it easier and more seamless for members to consolidate.

However, more could be done to make it easier for funds to consolidate, be administered and allow new entrants.

4. EVIDENCE OF COMPETITIVE PRESSURE DRIVING COST REDUCTIONS AND MORE EFFICIENT LONG-TERM OUTCOMES FOR MEMBERS

There have been significant and dramatic changes to products and services in the last 20 years to the point where most modern products are not comparable with past products.

As noted above (section 2), the development of Wrap platforms and innovation in the retirement product market has been driven by competition (as well as trustees acting in the best interests of members).

Distribution and advice channels are opening up with digital capability (section 2) which is providing members with more support and for many, affordable and 'time-right' advice relative to more traditional face to face models.

Digital channels open up markets to new entrants who challenge existing thinking and engagement protocols. As in many industries, innovation is changing the nature of financial services, including superannuation and how customers interact or want to interact with the system.

An increase in smart phones and internet access has led to better accessibility which can empower customers in comparing products and, in some cases, changing providers. While still evident, duplication of accounts is reducing through recent SuperStream based changes enabling customers to consolidate their accounts (including through myGov) and fund driven exercises many based on more facilitative online tools.

As new and established market participants respond to shifting customer demand, innovations and digital service offerings will increase competitive differentiation. Emerging online oriented partnerships, often adopting white labelled products and back office support, are indicative of a market that is responding to support digital-savvy customers (particularly Millenials)[16].

Blockchain technology (as well as Single Touch Payroll) will challenge traditional transaction models and superannuation service providers (such as clearing houses). This is one of the reasons why we would not endorse the creation of a single central clearing house (see further below).

In our prior submission we provided information on our developing digital disclosure and engagement processes which have been facilitated with some refinement of the regulator's (ASIC) position with regard to online disclosure approaches[17].

In the confidential appendix we have provided some additional headline statistics on the growth in digital interactions.

Costs

Rice Warner has undertaken analysis of fees in the superannuation system for more than a decade. The analysis indicates that overall fees have reduced from 1.30% in 2004 to 1.03% in 2016[18]. This is in an environment of significant and relentless regulatory change.

Research conducted by Tria Partners for the FSC shows that the past five years of reform have cost approximately $105 per superannuation account.

Our data (included in the confidential appendix) is based on averages but would support these findings.

Funds have reasonably significant costs attributable to managing regulatory change which must be considered in any analysis of system efficiency.

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[16] Examples include WealthFront, Betterment, Atlassian and Spaceship, and Grow Super. Citation is not indicative of support, ratification or endorsement. These are merely examples of newer entrants with technology/digital footprint.

[17] ASIC, RG 221 - Facilitating digital financial services disclosures, March 2016

[18] Rice Warner, Superannuation Fees Analysis 2017

It is important to note that savings from digitisation and competitive pressures may not result in reduced fees as funds and their service providers:

- Must respond to regulatory change;
- Upgrade systems and processes to meet emerging trends and demands (such as digitisation); and
- Invest in providing better services to members.

5. HOW DO EXISTING DEFAULT ARRANGEMENTS PROMOTE ACCOUNTABILITY AND INTEGRITY IN THE SELECTION AND DELIVERY OF DEFAULT PRODUCTS?

The combination of the APRA licensing regime, the trustee obligations referred to above, and other trustee obligations in the SIS legislation mean that, regardless of how a default superannuation product is selected, that superannuation product can reasonably be expected to be a fair and judicious product run by a licensed trustee.

Proposed additional provisions will also focus trustees on the default MySuper offer and its relative fitness compared to others in the market.

Under SIS legislation, trustees must give priority to member interests in the event of a related party transaction or other transaction creating a potential conflict. This gives some additional comfort, at least as far as the conduct of a trustee and related parties is concerned, that the conduct of the trustee and related parties in relation to the trustee's selection as default product provider, is not prejudicial to members.

SIS legislation also prohibits the giving of inducements to employers for putting their employees into a superannuation product.

5.1.1 How could the existing arrangements be improved to achieve this goal?

APRA has recently announced proposals for greater prescription over trustee operational governance and this should result in improved understanding of APRA's expectations and clearer minimum standards.

5.2 Do existing default arrangements create concerns about stability that could lead to significant systemic risks?

From 1 January 2015, the Fair Work Act (FWA) provides that the Fair Work Commission (FWC) select at least two, but no more than fifteen, default MySuper products for each modern award[19] (of which there are 122)[20]. That is, there is a legislated barrier to entry and a legislated flow of monies to specifically named, but limited funds, in the private sector determined by a workplace industrial relations tribunal.

The framework operates in addition to the APRA MySuper authorisation process.

Any default MySuper products used by an employer that are not named would cease to receive mandated contributions although balances would remain in those funds unless members exercised choice to transfer them. That is, as the Commission has identified, it is a model which would, amongst other things, increase account duplication with associated consequences.

[19] There is potential for: transition arrangements, but these are not yet specified; or a higher number if the FWC determines it is warranted based upon the range of occupations in the modern award.
[20] At present, due to conflicts within the process at the FWC this restrictive process is in abeyance (refer to the submission from the Financial Services Council – FSC).

The current legislated process is inactive due to a Federal Court ruling that conflicts existed in relation to appointed members of the Expert Panel which was intended to assess and create a list of funds from which a smaller selection could be made. As a result, the panel has not been re-constituted.

Issues identified with the Fair Work process have been enunciated in analysis conducted for the FSC by Rafe Consulting[21].

It is noteworthy the Commission in its previous inquiry identified some of the significant systemic and sustainability issues that arise from the existing legislative Fair Work model framework (which, as noted above, is inactive). It is a model which can unilaterally override existing arrangements and does not involve engagement with the employer or employees (as would a market based model).

While we have reservations with other substantive changes to the default allocation of members (including through the Fair Work process), the potential options proposed by the Productivity Commission would minimise some of the significant dislocation inherent in the Fair Work model and allow more controlled and considered restructures to occur where warranted, or pursued by the regulator. However, these models (in at least 3 of the 4 alternatives devised) also would not come without reasonably significant cost and disruption, some of which we discuss below.

5.3 Do the existing default arrangements minimise overall system-wide costs, taking into account costs on members, employers, funds and governments?

Please refer to earlier comments regarding the regulatory cost imposts and timing for implementation which, without due consideration, can have serious implications for efficiency, cost minimisation and overall fund services.

Many smaller employers would prefer that their employees managed their superannuation directly. However, the ATO does provide a 'free' clearing house for small employers to help them manage remittance of mandatory contributions to default and choice funds. In addition, SuperStream measures introduced to improve administrative efficiencies are beginning to bear fruit. As more transactions are completed electronically costs will be reduced.[14]

The Government, through the ATO, has expended money in building infrastructure to support Australia's superannuation system however much of the expense is borne by industry (and members) through levies imposed to recover these costs (as well as to support the twin peak regulators – ASIC and APRA).

NAB Wealth supports the public / private partnership that has been created on the basis that it encourages competition which drives participants to continue renovating to maintain pace with new entrants and innovators.

These competitive forces are typically lacking in publicly funded monopoly systems which can become archaic and myopic. We believe this is exhibited by other OECD nations which were slow to identify and remediate underfunded defined benefit arrangements or to develop broad-based retirement savings policies to mitigate ageing population imposts[22].

While our system will not be mature for some years, superannuation is contributing to a lowering reliance on the age pension and improving outcomes for participants. In modelling conducted for the FSC by NATSEM in 2014, the age pension outlays were reduced by $5.7 billion per annum. Continuing to dedicate the superannuation system to providing retirement incomes will further reduce age pension outlays by $11.1 billion per annum by 2030[23].

[21] Rafe Consulting, Impact Of Changes To The Fair Work Act On The Australian Superannuation Sector, Employers And Their Employees, 16 June 2014

[22] Australian Centre for Financial Studies, Melbourne Mercer Global Pension Index, October 2016. In this system, Australia ranks third in a comparison of 27 countries' retirement income systems.

[23] FSC, Response to the Financial System Inquiry, March 2015

6. STAGE 2 - THE 4 ALTERNATIVE DEFAULT ALLOCATION MODELS

We support the Productivity Commission's approach to enabling choice for any individual who is engaged and active in deciding the fund (and products) to which their superannuation (deferred salary and wages) should be directed.

We are concerned with options that significantly and precipitously reduce the number of default funds through a legislatively driven model. That will have a very significant cost, and/or create legacy issues resulting in waste across the industry and higher costs for members. This is particularly the case currently given the sunk costs from recent investment in complying with MySuper standards and SuperStream initiatives.

It is NAB Wealth's view that it is preferable to let the forces of competition and prudential regulation enforcing minimum standards to more naturally lead to consolidation of the industry rather than forcing a major dislocation across multiple providers in the short term.

The Stage 2 proposed models would each introduce new costs into the industry to meet the requirements of a shortlist (or quota) although less so in respect of the 'employer assisted choice' model based upon a 'light filter' (presuming a quota or short list is not intended in this model).

As noted in our previous submission on default models, and based on our reading, with the exception of option 2 "assisted employer choice" each of the models has either a specific, or effective, quota.

While it is possible to choose 'outside' the options with restricted numbers of funds, NAB Wealth has concerns with regulatory concentration of markets.

The prudential framework operates to apply criteria and standards to operators and providers which would, and does, act as a control on entrants.

If it is identified that there are participants in the market which should exit, then actions should be targeted at those entities and providers, including necessary legislative support to remove barriers to exit[24] or, enhance regulator capability to facilitate exits.

We broadly support the policy intent behind amendments in the Exposure Draft legislation to improve accountability and member outcomes[4] for this reason.

A quota can operate to exclude equally effective, efficient, valuable products and providers for no reason other than an arbitrary cut off number.

Below we have provided a limited and basic assessment of the impacts. We would, however, endorse the articulation of the issues with the models as identified by ASFA in the submission to the second phase of the inquiry[25].

Fund impacts

- Risks for Options 1 (employee assisted choice including 'last resort' future fund), 3 (multiple criteria tender), and 4 (fee based auction):
  - Non-shortlisted funds with default MySuper products will effectively have externally imposed product legacy suddenly and without engagement of the sponsoring employers or existing members.
  - These products will face decreased flows and benefits will start to erode (potentially for all members in the fund as investment scale will be lost with the additional potential for under-investment in systems and administrative capability).
- Auction/tender models – Provide no guarantee of ongoing retention of default status. This will lead to fewer funds willing to participate, as has occurred in Chile.

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

[25] ASFA, Productivity Commission – Superannuation: Alternative Default Models, October 2016

- Those funds that have missed out in the first determination may subsequently not have enough scale to make it into future default listings limiting the future competitor field and leading to incumbent apathy.
- Changing to any of these options will be driving efficiencies out of MySuper products but particularly those with an arbitrary quota – Industry has spent a considerable amount to comply with MySuper and a substantial re-set now will crystallise this expenditure; i.e. legislatively imposed waste including the costs to move to the new system (for both 'winners' and 'losers').
- The effect of the models is a 'front book' focus (shortlisted funds) – longer term strategy should be the focus, not only on fees. If fees become the main focus, there will be a trend toward cheaper options including investment strategy, which may lead to less ideal member outcomes (investments away from longer term/higher return assets).

Member impacts

- Depending upon the overall fund strategy, members of the non-shortlisted funds may be better to move to more viable funds with positive flows, services and capability. However experience shows that most default members are disengaged and not likely to move. This will likely require a forced transition into another fund.
- Non-shortlisted funds are likely to be more costly to run due to less growth and this would translate into fee increases (or fewer options and services), and the need for greater substantiation to APRA that they can continue to offer a MySuper product.

Implementation timing

- Employer choice model – arguably this is, in relative terms, more straight-forward for funds to address as it is not substantively different to current frameworks.
- In terms of the other 3 models - significantly more time is required in order to:
  - identify selection criteria (excluding the 'last resort option' for member directed choice);
  - assess and moderate impacts (including transition approaches, support for mergers, communication campaigns to members and employers, trustee due diligence;
  - determine need for enhanced 'wind up' or member and asset transfer powers; and
  - determine resource requirements and detailed cost / benefit analysis.

Estimate of Costs

Members – No additional immediate costs – indirect costs and potentially fee increases may apply for members left in a MySuper product that is in a non-shortlisted default fund.

Depending upon selection criteria and whether an 'additional' gatekeeper is appointed, costs for application may be passed on. Depending upon complexity, this may be particularly relevant for option 3 (the multiple-criteria tender).

Funds – All Shortlist/Auction/tender models will incur similar costs to meet shortlist requirements. We estimate the following (see confidential appendix for summary of approach):

Funds will incur approximate costs of $2M - $3M to qualify to meet requirements of additional product filters. This is based upon recent tender experiences and also the MySuper authorisation process.

In addition, there will be legacy costs associated with the change which cannot be quantified for funds that do not make the shortlist.

Employers- Refer to previous costing of the FWA approach under taken for the FSC by Rafe Consulting.[21] Costs are higher for employers if required to run two default systems over a transition period.

6.1 Process for constituting the body for selecting default products

If it is determined that there be an additional process to select default products we would submit that it be run and managed by APRA given the experience and systems that have been established both for licensing trustees and authorising MySuper products.

As we have noted throughout this submission, the industry is absorbing significant regulatory costs and is already paying substantive levies for the support of the key regulatory bodies and agencies involved in this sector (and it will be expanding to cover further funding for ASIC and a central complaints body – AFCA).

Estimates undertaken for the establishment of the Financial Adviser Standards and Ethics Authority Limited (FASEA) put the cost for establishment and initial 3 year funding needs close to $7.5million. This entity has a very different purpose but in terms of the constitution of a separate body with the imprimatur to establish standards governing the financial advice sector, it is a reasonable guide. We estimate however that the cost would be higher for a body analysing and selecting default products.

It is, in our view, duplicative to have a separate body and framework in place and would act as yet another drag on efficiency for participants and the wider member community.

6.2 Mitigating 'first timer' risks of entrenching member disengagement and the risk of members remaining in inferior products

Single Touch Payroll (STP) will change the on-boarding mechanism for employees as they join an employer. This includes a greater level of visibility to members of any existing superannuation funds in which they hold accounts with the option to consider the employer's default fund offering.

This will become a key trigger point for increasing member engagement. In effect, employees will move from the current environment where there is limited visibility of existing funds and simply being defaulted to their current employer's default fund to having full visibility of their own existing fund(s) and the ability to make simple choices.

This will lead to a new wave of account consolidations as members are made aware of any existing accounts but also drive increased engagement as some basic details of those funds will be visible. These include the member's balance, whether there is insurance and whether there have been recent contributions.

6.3 Centralised clearing house

The introduction of a centralised clearing house would create costs and risks for funds, employers and members.

Over the last 5 – 6 years the industry has invested significantly in the SuperStream data standard. ASFA has reported that it has cost the industry over $900 million to implement the SuperStream data standard which included a $390 million levy for the ATO SuperStream Program.

The SuperStream journey for employers has not been a simple one and the impact of another significant change could negatively impact employers' confidence in the industry and the regulators.

It is unclear what the benefits of the proposed centralised clearing house are that could justify further costs to funds and employers.

As noted above, currently there is an ATO managed Clearing House solution available to a small employer through the small business superannuation clearing house solution which provides SuperStream compliant messages to funds.

Given the recent impacts on the industry caused by an almost constant series of outages of ATO services, the impacts of a centralised clearing house being offline for any period of time could be catastrophic. This is especially the case as the ATO has struggled to maintain services over the last few years during the chaotic end of financial year period. It is questionable how much more the ATO, fundamentally a revenue collector for the Commonwealth, can and should take on particularly with an even greater level of volume that would be placed on it.

Having a multi service provider solution generates a competitive environment and ensures that all service providers constantly review their services and offerings. This would most likely be lost under a single service provider model.

The proposal includes a reference to the centralised New Zealand model. This is quite a different superannuation market to the current Australian one which is more complex and diverse (including Defined Benefit, SMSF and volumes) than in New Zealand.

7. MERGER TRANSPARENCY – RETROSPECTIVE DISCLOSURE

We don't see that requiring some disclosure of potential mergers should materially discourage merger activity. But it is not clear what the level of disclosure would be and the purpose of the disclosure, and what APRA might then be required or expected to do in response to such disclosure.

In relation to retrospective disclosure to industry fund members of past industry fund merger discussions might mitigate risks of influence or bias. We do not see much benefit or use to members in relation to the professional retail sector funds.

8. SYSTEM LEVEL BENCHMARKING

8.1.1 In the context of the approach set out in the stage 1 Study to compare long-term net investment returns to a set of passive, liquid reference portfolios, which reference portfolios would most meaningfully inform the analysis?

We believe that 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. In selecting the group of funds in each risk category we believe that 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.

The average allocations of each reference portfolio will need to be determined on an ongoing basis, and we would propose that the calculation of average asset allocations should be based on annual data as a minimum, but ideally quarterly allocation data where available.

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 advantage of these categorisations is that they are consistent with select published surveys, such as the SuperRatings survey, and are sufficiently narrow to ensure comparable funds are grouped together.

We would highlight again concerns about drawing conclusions about the efficiency of the system based on results of such a comparison of long term net returns of the system. 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 that this might not reflect efficiency of the system but rather the cycles of relative performance of unlisted assets versus listed assets.

8.1.2 What is the best way to ensure that equivalent taxes are netted out of returns to a reference portfolio?

Returns of the reference portfolios can be netted for tax by adjusting the gross investment returns of each underlying asset class in the reference portfolios. We would suggest that these tax impacts at the asset class level be determined based on simplifying assumptions of:

1) average % of dividends that are franked;

2) average rate of capital gains tax (having regard to proportion of discounted capital gains tax);

3) average rate of turnover of portfolios; and

4) split of return between income and capital growth.

For 1) above we would suggest a franked dividend proportion of 70% be used as representative of the average franked dividend rate across the Australian equity market.

For 2) above we would suggest a capital gains tax rate of 10% be used as representative for passive portfolios given most gains will be long term.

For 3) above we suggest using an average turnover (i.e. proportion of capital growth that is realised gains) of 10% given generally low turnover rates of passive portfolios.

For the determination of the split of returns into income and growth we would suggest that income return be determined by reference to quoted dividend and coupon yields on respective benchmark indices for each asset class (see 2.17.4) and that the growth return is determined as the remainder of the total return less income return.

8.1.3 What are the most appropriate listed asset class benchmarks to use to calculate the returns to these reference portfolios?

We would propose that the following benchmarks be used for each asset class, as these are widely recognised in the market as representative benchmarks for each asset class.

Asset Class	Benchmark
Australian Shares	S&P ASX 300 Accumulation Index
Global Shares Unhedged	MSCI All Country World Index (Net)
Global Shares Hedged	MSCI All Country World Index Hedged (Net)
Global Listed & Unlisted Property Hedged	FTSE EPRA/NAREIT Global Developed Index Hedged
Australian Listed and Unlisted Property	S&P ASX200 AREIT Index
Private Equity	MSCI All Countries World Index Hedged (Net)
Listed & Unlisted Infrastructure	FTSE Global Core Infrastructure 50/50 Hedged (Net)
Hedge Funds	Bloomberg AusBond Bank Bill Index
Australian Bonds	Bloomberg AusBond Composite (0+Y) Index
Global Bonds	Bloomberg Barclays Global Aggregate Index Hedged
Cash	Bloomberg AusBond Bank Bill Index

8.2 Asset class benchmarking

Estimation of system wide net returns at the asset class level is very challenging due to the wide variety of products, strategies and approaches used within each asset class across funds. As an example within global equities, some funds use fully active approaches, some use fully passive approaches, some use combinations of active and passive management while others used semi-passive or enhanced index approaches.

Approaches that use passive management should arguably not be included in the estimation as these passive management approaches are not expected to deliver net returns materially above benchmark index returns. As such we would suggest that funds across the system be requested to submit returns for the active components of their asset class strategies, and that only these active component returns be used for the estimation of system wide returns.

Furthermore, the estimation exercise also needs to recognise that some funds don't offer the underlying active components of asset classes as standalone product strategies, and as such might not have fees set at the asset class level. Consideration should be given to assessing performance at the gross return level and comparing against gross returns of benchmarks.

We also believe that it will be difficult to draw conclusions about efficiency of the system based on results of performance at the asset class level due to the fact that the system represents the "average" fund which will always represent a mix of out-performing and under-performing funds. Consideration should be given to determining the proportion of funds out-performing the benchmark index for each asset class.

8.2.1 How can the Commission best assess the investment performance of unlisted investments?

It is very difficult to assess and draw conclusions on the investment performance of unlisted assets given the heterogeneity of these asset classes and the wide variety of types of assets within each category of unlisted assets.

In all cases, performance should be assessed over long periods of time, such as 10 years and beyond given the long term nature of the cash-flows of these assets.

While published benchmarks are available (such as Mercer/IPD Australian Property Fund Index for unlisted property), these benchmarks are typically un-investable and reflect average performance of a group of active funds. As such we would suggest that performance rather be assessed relative to long term absolute hurdles such as CPI + 6% pa.

Listed equity benchmarks for property, infrastructure and equity could also be used for assessing performance of unlisted property, unlisted infrastructure and private equity, but such comparisons are only meaningful over very long horizons (say 20 years and beyond) given the cyclical nature of relative performance of these listed versus unlisted assets.

Furthermore, investment performance is only one dimension of assessment of unlisted investments as the risk profile and liquidity profile of these assets differ markedly and return outcomes should differ to reflect these different risk and liquidity profiles.

9. COSTS, FEES AND NET RETURNS

9.1.1 Whether disclosure practices are resulting in a consistent and comparable basis for meaningful comparisons to be made between products

Current practice has funds self-classifying assets into growth and defensive categories. Many funds classify their unlisted property and infrastructure assets as entirely or partially defensive assets while those funds with listed exposure to these asset classes classify these assets as entirely growth assets.

This results in inconsistent classification of growth exposures across funds. As such many funds with unlisted assets are effectively "under-reporting" the true extent of growth asset exposure in their portfolios, and as a consequence are being grouped in the same risk categories as lower growth funds (as represented in public surveys). This is despite the fact that they have higher growth exposures as well as higher illiquidity risk.

Due to the diverse range of products available, and the differing services and insurance options available to fund members, this impacts on the ability to appropriately compare like-for-like superannuation products.

Existing disclosure initiatives such as MySuper Product Dashboards, Shorter PDSs and RG97 have had the potential to improve comparability between products.

ASIC Class Order 14/1252 and RG97 have introduced significant changes to the manner in which fees and costs will need to be treated and disclosed in PDSs and Periodic statements. The purpose of the changes is to provide further clarity and consistency in reporting across the industry, and also to address concerns of under-disclosure of fees and costs in Super and MIS products.

Due to this initiative still being within the transition period (transition to end 30 Sep 2017), it will take further time to review the effectiveness for transparency and product comparability.

9.1.2 Whether additional disclosure would improve outcomes for members

Further increasing the disclosure requirements particularly around fees and costs or using existing approaches may have the unintended consequence of restricting trustee access to some investment options particularly in the private equity arena.

A singular and 'non-nuanced' focus upon fees and costs, rather than net returns over time, might drive investments away from unlisted infrastructure/real property assets which generally have higher transaction costs although these can provide noteworthy higher returns than more liquid assets.

It is well known there is low member engagement within the context of superannuation, thus an emphasis on additional disclosure measures for a disengaged member base is unlikely to deliver any significant uplift in engagement or in member outcomes.

In addition to our earlier comments about dashboards, studies have also shown people are not looking for 'more information' about their super. This was noted in research conducted by CHOICE[26], exploring how superannuation fund members think and feel about super, how they currently engage, and what would prompt them to become more engaged.

9.1.3 Whether the system is minimising costs and fees (including, but not limited to exit fees) for given returns;

Without context, we are concerned with a primary focus on minimising costs and fees as it can be done at the expense of net investment return outcomes, or important services and capability renewal, for members.

Our experience is that higher investment costs do translate into higher net return outcomes over the long term, and that the intense focus on minimising fees poses a risk of influencing investment decisions (a flight to the bottom) which might compromise net return outcomes for members in the longer term.

[26] Project Superpower: Informing a strategy to engage people with their superannuation. CHOICE - October 2016