



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION

MR P HARRIS, Presiding Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

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5 **MR HARRIS:** Good morning, and welcome to the second of our hearings into default superannuation, the second phase of a three phase inquiry into general superannuation issues commissioned by the Federal Government. I'm Peter Harris, I'm Chairman of the Productivity Commission. With me is Karen Chester, who is Deputy Chairman of the Productivity Commission. The purpose of the hearings today are for parties who provided us with submissions to offer comments on those submissions and for us to get a better understanding of the positions and concerns that they might have had around our draft report.

10 The conduct of the hearings is pretty straightforward, we allow the use of social media in these hearings, but if you want to take any film or photographs you need to seek permission in advance for doing so. For people who might have attended this inquiry and are not submitting but would like to make a comment, if you have the persistence to last through right till the bitter end, which is sometime early this afternoon, we do allow comments from people who would have participated throughout the inquiry but haven't chosen to formally put in a submission or otherwise answer questions.

20 Health and safety regulations; so there's a nice green exit sign over the door there and, as I understand it, there will be people to advise you where to go in the event of an emergency, alarms will sound and all that sort of standard stuff. Advise that the assembly point is Westpac Plaza on the corner of Clarence and Market Streets; let's hope we can find space on that corner.

25 So I think we have our first participants here, could you please identify yourselves for the sake of the record?

30 **MR RICE:** It's Michael Rice, Rice Warner.

MR BONARIUS: Nathan Bonarius, Rice Warner.

35 **MR HARRIS:** Do you have a few opening comments to make of any kind?

MR RICE: I do.

40 **MR HARRIS:** Please.

MR RICE: So to start off, we believed that the Australian superannuation system has been very successful over the 25 years since the introduction of mandatory super. In that time there's been a lot of innovation in areas such as with life insurance, investment strategies and

intra-fund advice. Choice of fund has led to the growth of very large SMSF segment, and because the Baby Boomers retire we can expect the emergency of a large pension system as well.

5 So whenever a system has such rapid change and impact, it's sensible to reflect on whether it could be improved. Consequently we have considered the relative merit of your four alternate default models, as well as assessing which might be superior to the others, we need to review the practical difficulties of changing a system when so much is already
10 embedded.

 So we first consider the criteria set for assessing the models, the underlying criteria, member benefits, competition, integrity, stability and costs are all valid and we support them. However, we make two points:
15 so while life insurance for young members is ancillary and often of low value, there's a danger in omitting it from our superannuation system where it is a valuable benefit. If it is to be excluded for young entrants, we suggest it should be reinstated at an agreed age, say age 25, to prevent coverage falling away. We would also look at providing some life
20 coverage for new entrants who have already attained age 25, such as migrants.

 The second point is we agree that nett investment returns are the most valuable feature, but also note the difficulty in forecasting them. Rather
25 than using past performance, as is commonly put forward as a guide, except perhaps to eliminate poor funds from consideration, we consider that a better metric is to measure the fund's investment strategy and governance. This will be a better indicator of future performance. But we do agree that the nett return is by far the best measure of success of a
30 system.

 So when we look at the four models we considered potential operation and likely outcomes of each. The assisted employee choice model, it has many attractions, however, the fact that these changes are aimed at
35 disengaged, generally younger employees makes this model problematic. This is the group of consumers who are least likely to make sensible decisions in relation to their superannuation, so building a system around helping them to make decisions is fraught with some problems.

40 On the fee-based option, we're not comfortable with that. It will probably result in lower fees initially but could well lead to reduced services over time, as fees will dominate the equation rather than improvement in efficiency of the system. Over time this may well lead to a significant reduction in providers, especially not-for-profit mutual

providers, and there could be increased systemic risk if you end up with too small a pool of providers.

5 We're not attracted to the multi-criteria tender. While there would be less likelihood of systemic risk from the elimination of providers, the focus on fees is likely still to dominate. If that happens, services would be reduced to support ever lower fees and there could be the potential elimination of insurance which we would think would be a bad thing. And also not-for-profit providers might find it difficult to compete in this environment through lack of capital and they might be progressively eliminated over time. We're also worried about the likely increase of marketing of choice products by providers who lose out of default membership, and that could complicate the system and might even lead to higher fees for some segments of the market.

15 So the four models, we lean towards the assisted employer choice, it's closest to the current system so we think it would have the less disruptive change, because we have got quite a maturing in parts system and change may need considerable transitional review, and we think this system would still need some thought about protection of members. Again, the growth of choice funds which are less regulated than default funds could lead to members being attracted by matters other than value for money.

25 That's basically our comment.

MR HARRIS: That's great, thank you, Michael. I've got a couple of specific questions; you've probably got an entire book of questions. Can I do my specifics?

30 So you mentioned it in your presentation and it's evident from your submission as well, on the multi criteria tender, if I read it correctly and if I understand your brief mention of it then, your logic is that the multi criteria tender will see a discussion of fees dominate regardless of the fact they may be only one factor there, and that suggests that you don't have a lot of confidence in weighting systems and the like which are often used in tenders to make sure that that outcome doesn't happen. In other words, if there was a conscious choice not to have a fee-based option, which is one of the models, instead to have a multi criteria tender, one would assume you wouldn't use the one you chose as a means of delivering something you chose not to do, as in focus on fees.

40 So weighting is going to be quite a normal way of going about that and it seems to be allied to your, if anything, your larger concern which is if there is an obsession with fees then, as I think you've said, you think not-for-profit funds will be roughly eliminated because they can't afford

to remain in the business because fees have been driven down. Now, am I understanding your logic correctly there?

5 **MR RICE:** Yes. So although you're right, fees would be only one factor, some of the other factors are subjective, so that fees are the things which are most easy to measure. So they may well have another disproportionate impact. We see this when we run tenders, people tend to say, "Yes, we've looked at all the investment strategies, they're all fairly similar, they all do, we'll take the cheapest one".

10 **MR HARRIS:** Yes. But nevertheless, you could surely envisage a circumstance, I mean, we've done it ourselves in privatisations of assets that I've participated in from the Commonwealth Government's perspective, where we constantly have weightings and we stick rigidly to them and we have to publish the results or have the results available for
15 the participants afterwards to scrutinise how we arrived at our decision.

 So because it's quite a damaging criticism in its own way and it also suggests that where these models do work in other places, I won't
20 necessarily name countries which have run models like this, but where you would say, "Well, they're at risk of this outcome as well". So it's quite a serious criticism, it seems to me, and that's why I'm interested in getting a better understanding of whether you think it's genuinely valid or it's more of a sort of possibility you have to guard against, or exactly
25 what.

MR BONARIUS: I think it's probably something that you have to guard against. A multi criteria tender, I think our key concern with it was that the weighting would be more focused towards the fees and the past
30 investment performance to select that list of funds. As Michael said, when you run a tender, which we run many of them, there are a number of subjective factors. So the other point then too is to make sure that the group were appointed to run that tender are appropriately independent and qualified to make those assessments.

35 Because of that risk of interference or focus on what we see as potentially the wrong factors to look at, that's why our preference was more for the assisted employer choice.

40 **MR HARRIS:** No, I understand your preference, it wasn't the criticism. My other question is around insurance. So you have a novel proposition, and an interesting one, which says well perhaps insurance should cut in at an age where you're more likely to potentially receive a benefit from it. Had you given any consideration to making insurance optional?
45

5 **MR RICE:** We know that people don't insure unless they see a financial planner, as a rule. If you go back 20, 30 years, people – they always used to say, you used to get people to sell insurance, people wouldn't buy it naturally, and that's largely still the case. The fact that most people in the industry don't even know how much insurance they've got indicates that they haven't made a buying decision. But that doesn't mean that it's necessarily bad for them. But if you took an environment where people had to buy insurance by making a decision, we think that the coverage would go back to very low levels.

10 **MR HARRIS:** My final question is relating to that too then, so as you know, we have made recommendations around a once only default choice, what we call a first timer pool, and in part that was driven by our understanding that where you do end up with multiple accounts you often
15 end up with multiple insurance products, and you can't claim more than one of them, that would be fraud, for the particular incidents. Maybe you can claim in specific incidents but, generally speaking, you're not going to be able to claim more than one of them and, yet, you end up with a passive account, still paying for the insurance fee.

20 So it does rather seem to be a problem that's endemically created by the structure of the default system. In other words, we've received other submissions which say, "Well, you can get around this by the various matching mechanisms that are going on and more activity in that area".
25 But the bottom line seems to be the system is currently set up such that you're forced to create multiple accounts and, unless you're active, and as you've just pointed out, you tend not to be, you're forced to take multiple insurance products.

30 **MR RICE:** Yes. We agree that young people having several accounts, all with insurance, will mean that the premiums will take away from their retirement benefit. It's not efficient at all. The life insurance of a single person without dependents does not need to be a great deal, really, enough to cover a funeral and any debt. But as people mature, marry, have
35 families, their needs increase, so you can certainly argue that funds should do more to tailor benefits to needs of members, or they have to take a punt because they don't know the status of all their memberships. But the very large funds can have very educated guesses.

40 The issue of insurance is really, you know, if somebody young without dependents dies and they've got three lots of life insurance, it would probably go to their non-dependent mother, she'll pay 30 per cent tax on the benefit, it's just not efficient for the system. The benefit that you mentioned that we counted more than one, it was the disability
45 income protection.

MR HARRIS: Yes.

5 **MR RICE:** Which is usually limited to 70 or 80 per cent of the salaries if they're covered twice, and they might have workers' comp as well, you start getting off-sets against the cover as well.

10 **MR HARRIS:** I had a policy like that myself and it just said that you can't claim this from anybody – any other without telling us and then again, we won't pay.

MR RICE: Yes.

15 **MR HARRIS:** So it's just that you end up with this structured outcome and whilst, as I said, some submissions have suggested you can deal with it via these various matching mechanisms and things like that. The system appears still to be rather passive in those areas, including by the funds themselves.

20 **MR RICE:** Yes.

MR HARRIS: Who do have information but tend to see it as a problem for somebody else to solve.

25 **MR RICE:** So we see insurance as being valuable, although not necessarily of good value for many young people. Our argument is if you don't have a criteria of insurance, it's quite likely that people will enter the system and never bother to take it up later. So that was really the - - -

30 **MR BONARIUS:** Also to add to that, sorry. With the Insurance Council, the death and total and permanent disability usually would be added in. Another point though is we have a large sample of superannuation accounts that we do a study on over the 10 million, and there are some kind of stop gaps that start to come into play with the
35 insurance cover. So most policies, the cover will actually lapse if your balance is below a certain threshold, maybe \$2000 sort of premiums weren't there would be paid.

40 So we see in our sample that the average percentage of accounts with cover is about 75 per cent as a result of either people opting out or cover lapsing. If you look at just active members it's 85 per cent. So what that tells you is that there are quite a few of those small accounts that exist where they would have had cover but the cover has lapsed and the
45 premium is no longer being charged.

MS CHESTER: I just want to say, because I've been on this journey a bit longer than my chairman has, the study stage 1, and this is our first public hearings with Rice Warner, to thank you, because you've been with us on this journey with workshops and submissions and very thoughtful and considered submissions. So for that the Commission is very grateful.

In your submission there's a bit of a watermark you've established around the age of 25, and I'm thinking back to your pre-draft report submission where you were sort of trying to get to the issue of where do we have multiple accounts that are problematic and where do we have insurance policies that would be grossly inappropriate. And so I'm sort of wondering is it insurance that's driving the 25 year old or is there something that you think – so my reading of your current submission, and correct me if I'm wrong, is that you're comfortable with model 2 with some refinements.

The refinements would be that we would only limit it to the new job entrant pool for those under 25, which would knock about 40 per cent off our new job entrant pool in terms of the numbers that we know. So we would go from 400,000 a year, giving us \$800 million initially - -

MR RICE: No, we were quite happy with all new entrants.

MS CHESTER: Okay.

MR RICE: We were just saying that if a new migrant comes in and they're 35, 40, then if you exclude insurance that might be a valuable benefit for them.

MS CHESTER: So it's just the under 25 year olds for the insurance, from that perspective?

MR RICE: Yes. We thought there's a very high correlation between being single and not needing life insurance. So age is a good barometer, if you like.

MS CHESTER: I think on insurance, and you'll know from our draft report and from our earlier discussions that it's kind of like the trustee's a bit damned if they do and damned if they don't. They don't have all the data, they have to meet these obligations, but they don't want premiums to detract from the retirement income balances from the super contributions.

MR RICE: Yes.

MS CHESTER: So at the end of the day we kind of viewed it as it's in there, people want it, most people want it to stay in there, what's the best way to do it in a competitive, allocative process. So we kind of put it into the realms of it's regulated, so let's just make it a pre-eligibility criteria.
5 So we do consider it, but we don't do it through a competitive lens. The way we consider it I think we say something like, "Insurance, as part of a default product, must meet the minimum regulatory standards" - so we know that there is some work amongst the industry at the moment to lift those standards - "and details" - and this is the hook - "must be clearly
10 and accessibly disclosed".

So that's kind of the minimum. If you're not doing that, and doing that reasonably well, you don't get into the competitive process. But did you have something more in mind for how we should be viewing - - -
15

MR RICE: Well, only that if people are going to be judged on other factors, they might well downplay insurance and just provide the minimum on the grounds of why incur any more costs, if it might get us out of the auction, or whatever the case is used for selecting a small number.
20

MS CHESTER: So in saying that, Michael, do you have a view that the current requirements of a super fund trustee with respect to appropriate insurance products for their membership, is that a sufficient sort of threshold to be met? Because that's really all we're imposing.
25

MR RICE: But most funds actually provide far more insurance than they need, because they use it as a competitive tool themselves. So that's the only argument, is whether you feel that insurance under a system when there's a bit of competition, and it's delivered fairly cheaply for members, is desirable or not.
30

MS CHESTER: With some of your commentary around models 3 and 4 in terms of some of the risks that you've identified, we tried to put a few more belts and braces in there to make sure the auction wasn't a race to the bottom and to stop them from going to poor investment strategies by prescribing a minimum investment strategy. We also put in place some monitoring arrangements as another protection and, indeed, it was partly informed by an earlier submission of yours about let's be a little more forward looking.
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So same to the multi-criteria tender, the winners would be going into a contract with the government of the day and they would be making forward-looking undertakings. Indeed, they would then be monitored by Government, and if they egregiously departed from those undertakings, by
45

going for a poorer investment strategy or dialling down services, they could be bumped off the list. Does that sort of protective mechanism address some of the concerns you have around model 3 and part model 4?

5 **MR RICE:** Yes. I think ironically the model that we favour is the one where you didn't limit the number of participants. Part of our reasoning was let's say we have any of the models and we have four or five first rate funds that get the flow of new entrants, they would have a marked advantage in other areas as well, like the fact that they've been chosen
10 therefore they're better. The funds that didn't get that flow, we believe, particularly the retail funds that try to protect profit margins, would shift towards the choice marked.

15 At the moment, people who choose probably don't pay a great deal more from an institution or a fund that has a MySuper product. So if it's a different investment strategy or even a different retail product that's open, the difference in fees and structure is probably not great, but there are a number of growing choice products for people that don't offer MySuper that appear to offer lower value, and the danger is that if you end up with
20 four or five that dominate the market, everybody else could shift and choice is less regulated.

25 So you've set up a system where you have to be good at fees, you've got to have a good structure because you've gone through some process to get on that favoured list, but everybody else can say, "Well, we're not on that list so we'll put our large (indistinct) into choice".

30 **MS CHESTER:** So that's your attraction to the twin lists, that we have the best in show, which might be four to 10, and then we might have a longer list, which could be a little bit different, but still meet those minimum accreditation standards.

MR RICE: Yes.

35 **MS CHESTER:** What's your sense of - - -

40 **MR BONARIUS:** Sorry, could I make one more comment? With the point on member services and holding them to account on their services, there is a distinction between existing services and improvements in those services. You can easily hold someone to account to make sure they're delivering to a standard, but what you might not get is that innovation or improvement or development of new services, which better help those members over time as well if you went down one of those paths with the tender.

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5 **MS CHESTER:** Yes. And indeed, that's one of the criteria in the multi criteria tender, which will be running every four years and it's something that we could still do in the best in show, models 1 and 2, to make sure that – and that's what the value of that refresh as opposed to it being a MySuper on steroids, like lifting that high bar and having a smaller group that are eligible.

10 What was your sense of how we've lifted the MySuper high bar? Have we lifted it high enough to make sure – because, it was interesting, one of the larger super funds gave us a submission – we had a couple of submissions from the larger super funds – one in particular said the biggest risk for a default member from their perspective was being defaulted into a poor product. Do you kind of agree that that's probably the biggest risk for a default member?

15 **MR RICE:** It is, and of course it's very subjective how you define a default product. I mean, what the industry has tended to do is look at fees and the past performance, and they may not be a good guide to what's going to happen in the future. They may be, if the fund has high fees or performance is subscale and doesn't seem to be able to get out of that position, that you could argue that those members are badly done by.

20 **MR HARRIS:** What about the reverse then? As Karen says, we've got this in a number of submissions, and it seems that, well, there's a general perception of a wall of opposition to utilising competitive processes to expose better information to members, different rationales for why that wall is appropriate, but it's still a wall in view.

25 **MR HARRIS:** What about the reverse then? As Karen says, we've got this in a number of submissions, and it seems that, well, there's a general perception of a wall of opposition to utilising competitive processes to expose better information to members, different rationales for why that wall is appropriate, but it's still a wall in view.

30 Nevertheless, some of the larger individual funds have accepted that there is a risk, and the risk that Karen outlined, and I think you've agreed that it is the primary one, which says under the current default system you have the risk of being defaulted into a poorly performing fund, one that we know is poorly performing, APRA has probably a good understanding of, but no one's actually forced it to either merge or, alternatively, lose status.

35 So here's a hypothetical, what about we turn the process around from picking the best four to 10 funds to running a tender for competitive purposes which says at the end we'll determine the worst. You might see in employer assisted choice we're actually proposing APRA lift, as Karen alluded, to the MySuper standards and give us the outer boundary which might be, for illustrative purposes, say 80 rather than 120 kind of MySuper product. And that says 40 just lost status, but the status is unclear, what did they lose? Well, in that case, that model, they've lost default status.

45

Just stick with that alone, would you have great reservations about that as a process? Because there doesn't seem to be a mechanism at the moment by which we trigger this. In other words, we all know these things exist, and yet - - -

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MR RICE: True. Well, that could be done by just setting a higher standard for the MySuper.

10 **MR HARRIS:** I quite like the transparency of an auction process versus the opacity of the regulator behind the scenes, as it were, nudging. That appears to be today's mechanism, doesn't it?

MR RICE: Nudging slowly, yes.

15 **MR HARRIS:** Nudging slowly. So just the clarity, the sheer clarity that says you only retain default status, which after all is a gift, a regulatory gift, you only retain default status if you succeed in the every four yearly, I'll call it tender-based check-up.

20 **MR RICE:** That's true. Some of the difficulties are what do you do about nett returns which need to be measured over 10 or more years in the four year period? You could well have all funds gravitating towards each other, and there's a bit of that today where no one wants to have an asset allocation too different from their peers.

25

MR HARRIS: But if your one, three, five, seven and 10 year performance are all below average, surely at that point we're at the stage of saying, "You should no longer retain default status", because we are actually crystallising the very risk that you and Karen earlier agreed is the primary risk and one of the largest things you told us is a primary risk, which is being defaulted into a poorly performing fund. Why would we continue to give you the gift of default status if your one, three, five, seven and 10 are all rotten?

35 **MR RICE:** I'd agree.

MS CHESTER: Mergers. We benefited from your suggestions and we've had some interesting feedback in our post-draft report submissions on how we best deal with the world of folk getting to the altar and then getting shy at the 11th hour and moving back away from the altar. Similar to yourselves, we have had some other thoughtful submissions, and one from PWC, and I'm not sure if you had a chance to have a look at that. I think we sent out a little message if you could, we'd appreciate it.

45 **MR RICE:** Yes.

5 **MS CHESTER:** They had a couple of suggestions around effectively – we were attracted to your idea, we like transparency when we’re looking for accountability from trustees, so we were attracted to that. But we were also very mindful that it could result in some perverse disincentives for folk to even get close to the altar if they had to do it in a more transparent manner. I guess what we’re struggling with is how does a member know today that a merger didn’t occur and was that in or not in their best interests? That’s where we were kind of attracted to the transparency idea.

10 The other idea that’s now being suggested is we go from a much more elevated role of the regulator, with three component parts. So disclosure to APRA once you get to a post-MOU stage re the outcome of merger due diligence and, if not proceeding, why for the key reasons. A real kick the tyres on whether the scale test is effective and working, and then better guidance on managing conflicts for trustee board directors. For example, not racing to decisions around who the CEO and the board position should be of a merged entity until after you’ve done your due diligence and you’ve established what’s actually in the members’ best interests.

20 So it would be good just to see where your thinking has evolved around how we best deal with mergers, given you were the guys that headed us off in this good direction.

25 **MR RICE:** Yes, I think what you want to avoid is the fact that you – particularly with a not-for-profit fund where there’s no – you know, if it was a listed company and you want to buy it you just end up paying more and more until the shareholders give up and let you take it over. But with a not-for-profit fund, if you do nothing, no one can force you to do it.

30 So what you want to do is you want those trustees to consider any merger proposition sensibly and act in the best interests of members. Now, they all tell you that they do, but how would you know that? They could just say, “No, we’re not interested”, they don’t have to give a reason. So I can understand that you’d want a lot of the discussions to be confidential, and perhaps they should be at the level of only disclosing to APRA for some time.

35 But I think if you were a member of a small fund, particularly if it wasn’t performing well, and a big successful fund offered to take you over effectively, rather than merge perhaps, and your prospects were then better, you’d want to know that the trustees had rejected that with good intent. At the moment they don’t have to tell you, they don’t even have to disclose that they had an offer.

5 **MS CHESTER:** So would one hybrid be effectively a merger of your idea and PWC's idea, where during the immediate live time it's APRA-elevated role there, but then sometime after the event, after APRA's received all of the documentation about why it did or did not proceed and for what reasons, that's then ultimately disclosed. So at the end of the day, the member does know, "They looked at a merger, it didn't go ahead, but that was in my best interests".

10 **MR RICE:** Yes, I think member should know that and you could argue that they're mostly disengaged and wouldn't do anything about it. But that's not a valid enough reason not to show them.

15 **MS CHESTER:** I've only got one more question and it's a simple yes or no question and I'm asking every participant this question and now some colleagues can now write down what it is and think of what their yes or no answer will be when we ask it. Do you believe that over the long term poor performing funds should be compelled to exit the default market, and do you believe that new entrants, high performing new entrants, should be
20 allowed to enter the default market?

MR RICE: Yes.

25 **MS CHESTER:** Thank you.

MR HARRIS: I wanted to offer a bit of clarification for your sub, towards the end you commented on negative impacts on model 4, and I think it's inherent for one of the other models as well. You say, "What happens to existing members, is there mass disruption if a successful fund
30 is not reappointed at the end of the four year period?" I didn't got back last night and look through all the detail of what we did write up, but I'm pretty sure we have a proposition in there which says, and we recognise this, that merely losing status in one of those models at the end of the four year period does not say you're a bad fund, it just says you weren't the
35 very best, you weren't the fourth or fifth best in the show.

Our proposition was that members would be informed but not – no other action would be taken. The area where we had in mind under one of the model was of actual loss. The only area where there might be loss of
40 members is if you actually did not deliver something that you contracted to deliver at the time of one of these processes. But even then we recognise the somewhat problematic nature of that kind of event. We do know a country that operates a system of this kind and we've asked them that very question and while they say that they would indeed deprive the
45 gift of default status from someone who failed to deliver their contracted

obligations, I think they too recognise it's a little problematic how you'd actually enforce that.

MR RICE: Yes.

5

MR HARRIS: So in terms of the query in your submission, "What happens to existing members merely at the end of a four period if they've not a winner, they may be the sixth best performing fund, but we're only going for five, then the answer is the members would be informed, but no other action will be taken, that says your fund is no longer one of the four or five preferred ones.

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MR RICE: Although the market might then decide to target those members.

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MR HARRIS: Quite. We realise that there's all kinds of competitive outcomes that can come from the applications of any of these systems. So that's worth noting. Okay, thank you very much for your time and effort, and as Karen said, for your participation throughout this. And we have a phase to go, so we're still hoping you'll stay with us through phase 3.

20

MS CHESTER: The marathon.

MR HARRIS: Thanks very much.

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MR RICE: Thank you very much.

MR HARRIS: So I think now we have the Financial Services Council. Once you're settled and have done the water exchange.

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MS CHESTER: Sorry for the wine glasses, we managed to get some sensible jugs.

MR HARRIS: Yes. Doesn't look good on TV, but I've banned TV presence, so they won't get you having a sip at 9.30 in the morning. Once you're settled can you guys identify yourselves for the record please?

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MS LOANE: Thank you, my name is Sally Loane, I'm the Chief Executive Officer of the Financial Services Council.

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MR BRIGGS: Blake Briggs, I'm senior policy manager for superannuation at the Financial Services Council. And you'll have to excuse me, I have a little bit of a cold, so I may be a bit messy through this.

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MR HARRIS: No problems.

MR PREMÉTIS: My name's Spiro Premetis, I'm the senior policy manager for tax and economics at the Financial Services Council.

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MR HARRIS: Sally, do you have anything to say by way of opening comments?

MS LOANE: Yes, opening comments, thank you. I'd like to thank the Productivity Commission for the opportunity to provide evidence in addition to our recent submissions on the interim report. The overarching theme in our submission, the FSC's submission on competition in the superannuation market, is that the Commission and the Government should prefer a competitive model that facilitates increasing levels of consumer engagement.

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Whilst the default superannuation inquiry relates to consumers who, by definition, are currently disengaged because they default to a MySuper product, this does not mean that the Commission and the industry should assume that this cohort of consumers will always default or that they are better off defaulting.

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Our default superannuation system today fosters and we would argue even promotes ambivalence. No one gives employers or unions carte blanche to choose their bank accounts, so why do so many allow them to choose their super funds? It's our view that too many people in some parts of the super system assume that young people can't or won't make decisions about their long-term future, that they're chronically disengaged, that they need decisions made for them by a third party who may or may not have their best interests at heart.

25

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We do not believe for a minute that this is true. If you give people information, importantly if you give them choice and innovative products, they will engage. More importantly, this paternalistic attitude is not sustainable, if we generally want our superannuation system to deliver adequate retirement incomes for all Australians, including women who take career breaks or our increasingly Uberised millennial workforce.

35

The competitive model that the FSC has proposed, which we have been calling for quite a long time "Super 2.0", offers consumers choice between funds, is competitive, flexible and fit for purpose, particularly for those young Australians entering the workforce. The FSC's model can be contrasted to the status quo, our current industrial model that encourages disengagement.

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The industrial model is predicated on the average white male working from 9 am to 5 pm in the same occupation in the same industry for 40-plus years who's disengaged from responsibility for his retirement savings and is prepared to leave its management to his union and employer.

5

We say that this view of superannuation has no place in a modern financial service industry or, indeed, a modern economy, where in any other product category consumers can manage their financial affairs at the touch of the iPhone. It has no place in a modern society where we're trying to find solutions to ensure women can save at least as much for their retirements as men.

Competitive markets work best when engaged, informed consumers discern between products to choose an offering that best suits their personal needs. This principle holds true for superannuation, as it does with any other product or service in our economy. Engaged consumers in the superannuation market not only choose a product that's best suited to their needs but their engagement also increases pressures on funds, and those funds' trustees, to raise the standard of their products and reduce their costs to attract and retain members. Opening up super's default system to competition and choice will kick start an arms race in innovation and, we argue, engagement.

The FSC recognises that the Commission has put forward four options, each of which are intended to increase competition between trustees. The FSC has submitted, however, that the Commission should focus its final report on identifying the policy objectives that a default superannuation model is intended to achieve and compare their recommended model, or models, against these objectives.

30

The FSC's position on the objectives are clear: they should (1) promote consumer engagement; (2) facilitate the consolidation of the industry by putting sub-scale funds under competitive pressure; and (3) ensure that competitive pressures are retained on an ongoing basis to keep funds honest. These objectives are achieved to varying degrees by each of the models the Commission has proposed, however, none is, by itself, perfect.

The FSC argues that the best model to achieve these objectives is a hybrid of options 1 and 2, where every consumer can choose their own fund with an enhanced APRA approval process for MySuper accreditation, and where a consumer does not make a choice, their employer can choose a default fund for their workplace.

40

We welcome any questions the Commission may have in regard to our submission, and of course, Blake and Spiro will be providing the technical answers to this. Thank you, Commissioners.

5 **MR HARRIS:** Do you want to start?

10 **MS CHESTER:** I'd love to, thank you. Competition means different things to different people, as we've learnt during the course of this inquiry, and for some people it means access to the default market and for others, like ourselves, it means competing for the default market. From your introductory remarks and from your submission I think one of the key areas where you would like to depart from our thinking is the twin lists. So you're comfortable with the long list, but not comfortable with the short list.

15 So it would be good to better understand why the discomfort with the short list, because the short list is the only way we truly inject, from our viewpoint, competition for the default market.

20 **MR BRIGGS:** So first of all I'd like to take a step back in that you're right, the Commission's focus appears to have been competition within the default market, that is getting different providers to compete with one another for that market.

25 But one of our concerns I think we'd just like to reiterate through our submission on the interim report is that it's actually competition in the superannuation industry that's suffering more broadly as a result of the current settings in the default market. So if you get the default settings right, not only do you engender competition between providers in the default market, but you also engender competition in the broader superannuation market through enhanced consumer engagement and informed decision making. So I think that's a very important point to make from the outset.

35 Then once you sort of delve beneath that into, okay, if there are – if you assume that there will be a degree of consumers who through every effort of the Commission and the industry to promote engagement will remain disengaged and therefore default, and that would certainly be the case at the start, but we shouldn't assume it would always be the case in the future, then how do you engender competition between those, between providers within that market?

40 Our quite strong view is you do that by still enabling providers to push consumer engagement as their way of improving their products, lowering their fees, innovating, redesigning, and that creates the

competitive environment that the Commission would hope to see and that we would hope to see, that you do not need to have a short list to drive that sort of provider behaviour.

5 **MR PREMÉTIS:** If I could just add to that. I think it kind of goes to part of the question that you're asking everyone around here today, and it's about entry to the market. So I think our main concern with the short list would be the impact a short list would have on the providers to enter the market, should they not be on that short list. So I think that's how we
10 view that, that would be a significant barrier to competition.

MR HARRIS: Sorry to interrupt, just on Spiro's point. Would you continue to hold that even though the short list is preferred, it's not mandatory? So under our employer assisted model, the short list was just
15 a preferred thing. So I'm not sure how, if I was a new fund entrant, I would feel necessarily prevented from entering. I can see that maybe you wouldn't necessarily have the status, but that's pretty true of every new entrant. No new entrant starts out equivalent to any rather large firm that's an incumbent, does it?

20 **MR PREMÉTIS:** Yes, I think that if we're going to be conscious of a behavioural economics approach, I think they recognise it's pretty clear what that type of nudge would do. It's a pretty strong nudge. So I think that it would create a substantial barrier beyond and above what new entrants already face.
25

MR HARRIS: Okay.

MR BRIGGS: I think the proof of that is the Commission looked at, I
30 think it was the UK model, where the government scheme was set as the default option or one of the default options, and it basically gobbled up the market. It's unsurprising that if you, in that instance, if you allowed a government player and there was a nudge for that cohort, that not only would it create a new barrier to a new entrant and being able to gain
35 meaningful market share, but it would actually more or less turn the tables on how the industry works completely.

MR PREMÉTIS: I think it's also worth noting that when you think about the actual providers we're talking about, I think Blake knows the statistics better than me, but MySuper products, we think it's about 61
40 actual MySuper product providers.

MS CHESTER: So it's 67 that are open, but at the end of the day 67 is still like choosing ham at a New York deli, or as we've heard from young

people, toothpaste in a toothpaste aisle of Australia, there's just too many to choose from and they can't tell the difference.

5 I guess let's stay with the twin lists a little bit longer. So the best in show, the four to 10, so it may not be four, it could be 10, would be refreshed every four years. Then you've got your longer list, which I like to call "MySuper on steroids", those that have cleared a much higher threshold. So you've got competition for the default market between those providers, those wanting to stay on the MySuper on steroids list and 10 then those trying every four years to get to the top four, including new entrants.

15 Indeed, behavioural economics has informed us about having the best in show list as we transition to a world of trying to nudge disengaged default members into a world of choice. We know that the number from all the experimental survey work that's been done and behavioural economics is you've got to have a list under 10, it's got to be small. So they can look at the metrics, they can feel like they're making an informed decision, and as they get older they might make an even better informed 20 decision, feel comfortable moving into the longer list.

25 So it's not just looking at creating the dynamics of competition between the providers, which we think we do through the twins lists, otherwise you're just getting onto the longer list and then you kind of sit there by not breaching anything, as opposed to competing every time to get the best in show, to get that badge of honour. But also thinking of the consumer, if we really want them to be engaged, I'm not sure what it is that's going to help them be engaged if it's not under 10, based on what behavioural economics tells us.

30

So I guess we're struggling to see the danger of the best in show list.

MR BRIGGS: So we ran some data to try and discern on the dispersion of performed nett returns both since when MySuper started and over 10 35 years to understand the dispersion and performance between the top 20 funds. Compared to the full suite of 60-odd publicly available, 120 marginal products in total, the dispersion was incredibly small. So the nett result of what the Commission appears to be suggesting is that in order to get down from the top 20, and this is only current performance 40 figures, let alone how it would compress if there was a MySuper on steroids, but in order to discern between those, you're going to have to try to effectively split hairs in terms of nett returns.

45 But the implications for the businesses that don't make the top four or the top 10 are enormous. And the implications for their ability to come

back in three, five years' time and compete again, particularly in the industry fund sector, where they don't have capital to sustain them, is enormous as well.

5 So first of all what you're asking a fair and equitable panel to do to
create this short list is distinguish between two products that, for all
intents and purposes, might be effectively identical, you know, number 9,
number 10, or number 10 and 11. Then what you're also saying is, "And
10 if you just happen to miss out, please hang around for four years because
we need you to in order to make this meaningful beyond 10 to 1".

 Then what you're also saying is, "Oh, but we're doing this to protect
consumers or to help them engage by having a short list to choose from",
but at the end of the day it would be no significant different in the
15 consumer outcome because there's no real difference between number 10
who made it and number 11 who didn't.

 So I guess my proposal is that it's got a lot of blemishes on it, it
certainly would engender competition, at least in the first tender, but then
20 what are the ramifications of that and do we really want to go down that
path, if there are significant hazards.

MR HARRIS: So this dispersion analysis you've done, would you be
able to let us see that, perhaps just - - -
25

MR PREMÉTIS: Page 17 of our submission.

MR HARRIS: That one, okay.

30 **MR BRIGGS:** We can provide the data also if you want.

MR HARRIS: No, sorry, I thought you were – when you say "split
hairs" and I thought, "Is it really that narrow".

35 **MR BRIGGS:** Well, a great example, over the 10 year return, between
the 25th and 75th of the top 20 funds, we're talking about half a
percentage point in nett returns. And we compared that to – that should be
compared to a similar chart we did in our first round submission, where
the dispersion of the MySuper population was significant, I think three or
40 four percentage points.

MS CHESTER: So I think we'd need to be careful to know that best in
show is not just solely based on past performance, there are other areas
that we'd be looking at, not dissimilar to the multi criteria tender, that
45 would inform it. So I don't think it would ever be a matter of splitting

hairs, for me it would be if it was the 20 that's on the MySuper on steroids, be good to get your suggestion on who you think might clear that threshold, in a number sense not a name sense.

5 That would then create – that's the only thing that's going to create the drive for those providers in default to go above the minimum standards that are being set. So I'm just trying to struggle with, you're pro-competition and pro-consumer, but you don't want the ongoing competitive tension within the default market. You want access to a
10 minimum standard but then you don't want competition beyond that.

MR BRIGGS: So what we'd actually pose is something that looks like the PC's MySuper on steroids. We quite strongly support that where it appears through various models. So we call it the hybrid model, but what
15 we do is we actually propose enhancing APRA's MySuper approval process, so an administrative filter, in order to raise the overall quality. So it's still a minimum, but it's a high minimum.

20 We would expect that would cause further compression and consolidation in the industry and, what's quite important out of that is you end up with a much smaller population of MySuper products as a result of doing just that.

MR PREMÉTIS: I think if I also could add, what you're saying is –
25 you're not really saying we're not pro-competition, we're saying that your form of enhancing competition also creates barriers and we think that the barriers that that creates have costs and we believe in our assessment those costs outweigh the benefits that you're raining on them. So that's kind of where we're coming from. There's different types of competitive
30 markets, you're kind of highlighting competition - - -

MR HARRIS: Competition for the right to be a default option.

MR PREMÉTIS: And we're saying that - - -
35

MR HARRIS: So you're saying there are many, many funds who compete individually on different performances, and we agree. You favour APRA being used for this purpose. Now, I know we shouldn't be backward-looking on performance necessarily, but you must therefore
40 have some enhanced APRA activity in mind here. I mean, you are really asking the regulator to make quite serious decisions because presumably the consequence of what you're talking about is that 10 to 20 funds may be – of the public offer ones, maybe more than that, don't retain status as a default fund, and that's quite a shift from where we are today.
45

I'm not trying to be critical of anybody, it's just it is quite a shift, there is minimal activity self-evidently going on for the purposes of addressing this. So do you have criteria in mind? I don't mean lists and things I just mean, conceptually, how would you see a regulator going about taking such a step?

MR BRIGGS: So the main point I make is that we envisage it still being an administrative filter. So it's not a quality filter that APRA would be taking on that risk of being a – selecting products as opposed to just vetting their capacity to enter the market. The other point I would make is that – sorry, I've drawn a blank.

MS CHESTER: Well, maybe if we go back to the threshold, because it's interesting, in our report we sort of detail in one box in one chapter what the current MySuper thresholds are, and then we've got what we've suggested, which is what I like to call MySuper on steroids, and then I had a look at what was in your submission, and I'm not sure your submission actually gets us. Unless you have a detail that you think you've got in mind, it doesn't even kind of in some areas get us to the MySuper threshold. So there's nothing on exit and switching fee, there's nothing on commissions - - -

MR BRIGGS: In addition to what is currently under law was the closing statement. Yes.

MS CHESTER: Okay, all right. So - - -

MR HARRIS: But it's that catalytic effect that's confusing us I think.

MS CHESTER: Yes.

MR HARRIS: We can't see how, from what you've described, the regulator would have the ability to – in other words, it's a bit like the criticisms of some of our models that have been made, where the criteria are clearly objective, those are considered to be quite harsh, where they're subjective they're considered to be uncertain and therefore how can the panel come to a view, blah, blah, blah.

Or I guess I'm putting back the same proposition to you in regard to the regulator. How can the regulator act in such a manner as to, equivalently, shut down a number of funds?

MR BRIGGS: The regulator already does that analysis. I mean, APRA has an extraordinary amount of data about performance and other metrics of individual funds. It uses that to inform its discussions with trustee

boards about their performance and their policies and procedures, and to have difficult decisions about whether or not they should continue to stay in the market. What we're suggesting is not only should APRA collect and use that information as part of its prudential regulation, but also use that information it already has in order to be able to refuse to give someone MySuper authorisation, or take it away from them if it already has it. We're also suggesting it should have enhanced powers around mergers, and it could use that information for the same purpose.

10 There's a lot of analysis that APRA does as a prudential regulator that never makes publicly available in relation to institutions, which is quite appropriate, but it could make more use of that information.

15 **MS CHESTER:** So I think we have more common ground. We've all agreed that APRA can do MySuper on steroids, and I think our MySuper on steroids is still a bit higher than your MySuper.

MR BRIGGS: There were some differences, yes.

20 **MS CHESTER:** Yes. And they're important differences, ones that wouldn't have the high bar as high as we would like to see it. So we're comfortable with APRA doing that.

25 **MR HARRIS:** The outer edge, but it's to get down to - - -

MS CHESTER: The best in show is where we struggle. But you're saying that's moot because you don't want the best in show. If we were to get the best in show up, how would you see APRA making those calls about - - -

30 **MR BRIGGS:** So this is the short list, the 4 to 10?

MS CHESTER: Yes.

35 **MR BRIGGS:** So we struggle with this. The honest answer is the only bodies that would have the capacity, governed or had the capacity to choose which funds should be the default funds in the same way if the Fair Work Commission currently does, are those organisations with a sufficiently strong culture to be able to resist political interference. The two bodies that come to mind are APRA and the RBA.

40 It's unlikely that either of those would actually want to have that role of vetting it, but that's the sort of safeguard you need to have because evidence has shown this body that is proposed, wherever it sits, would be highly politicised and has been politicised in the past. And so we talked

about having APRA, APRA having an enhanced role at the administrative filter stage because that is as independent as you can get it, but we do not support having a body created shortlist because those bodies qualified to do it wouldn't want to do it for the reasons, and those bodies who could be created to do it or given it to, wouldn't be sufficiently robust to prevent political interference.

So what we've argued is that the power to make the decision should be vested in each individual consumer because that's the only way to avoid politicisation, if you disaggregated the power amongst the broader population of consumers.

MS CHESTER: But we're still dealing with a default market so we've got a bunch of people that are disengaged and aren't making choice, we've got Government mandating that they say, at the end of the day, the Government is the one that has to ensure that they don't realise what we've been told by industry participants to be the greatest risk, then defaulting into a poor product or a relatively poor product.

MR BRIGGS: Which is why you raise the minimum to this enhanced MySuper on steroids.

MS CHESTER: Yes.

MR BRIGGS: Yes.

MS CHESTER: But the competitive dynamic of the best in show ensures that the minimum standards don't become a lowest common denominator over time, given they will be administered by the regulator.

MR BRIGGS: But the current market doesn't achieve that, I'm not quite sure why you'd be concerned that that would be the case. So at the moment you have a range of outstanding superannuation products and over time they would rise to the top and build up the largest market share whilst the sub-standard MySupers and the sub-scale ones are slowly going out backwards but very, very slowly.

By bringing MySuper on steroids you accelerate that process, in tandem we're doing other reforms like requiring independent directors on boards, so that they sit and look at their organisation and say, "Okay, we're the ones that are falling behind, we need to do something about this". So these reforms are intended to slot together, but that drives the consolidation quicker, it rewards the high performing MySuper products quicker, and as a result you achieve the sort of consumer protections and

funnelling of the market towards the better products in the sort of timeframes that PC's talking about.

5 **MS CHESTER:** So at the end of the day we're still dealing with default and agree that if we got the MySuper on steroids and had APRA do the job properly there we would get rid of a lot of underperforming funds, they go into nett outflow territory much more quickly and exit.

10 **MR BRIGGS:** Yes.

10 **MS CHESTER:** But at the end of the day, we're still dealing with default. You've then got 20 on the list, how do you keep the 20 on their toes, how do you inject competition into that default market?

15 **MR BRIGGS:** I would expect that - - -

15 **MS CHESTER:** And deliver the innovation and things that you're talking about.

20 **MR PREMÉTIS:** Well, what is say is I think – you're calling it a default market, but say it's the employee choice model. Yes, they're getting defaulted but they're picking a product. There's got to be stuff like a comparison website - - -

25 **MS CHESTER:** With under 10 providers that they can look to and be engaged and make a choice based on behavioural economics.

30 **MR PREMÉTIS:** No, but there's already a number of metrics out there and they're going to look at those metrics and hopefully make an informed decision. But common rules of thumb easily develop and are easily communicated to consumers, net returns is going to be that, funds are always going to compete over net returns. So you're going to see that ranking, whether you have a list of 10 or 20 or 50.

35 **MS LOANE:** Yes. And over time you would expect that default market to not be the massive proportion it is today. I mean, that would be the best end game, is to have that default market really get down to a very minimal proportion.

40 **MR PREMÉTIS:** And the behavioural change of consumers where say they actually have to pick their default fund out of the list of appropriate default funds, well, gee, that's a pretty big decision, I would – you could see behaviour responses where actually – and it would be great – where you get 20 year olds going and getting financial advice on which super

fund should I pick up. You see that when people go to brokers when they go and get a loan, so why wouldn't they go and see a financial advisor?

5 **MR BRIGGS:** And the other thing to point out in relation to that question as well is at the moment engaging is a function of your age and your balance mostly. So your concern appears to be that for those who default you'll have aggregation of performance around some sort of mean or some sort of baseline, and then for those who default in perpetuity, they will always be defaulting into this kind of lowest common denominator.

10 But what I think asserts that idea is that as people are aging, as they have larger balances, they get engaged with their superannuation. So those consumers who were defaulted in their 20s start getting engaged in their 30s and 40s, and that is why, but they're still in a default fund at that point, but those default funds will be having to compete to help them get engaged and make better decisions and start structuring their financial affairs.

20 So that competition will continue because there are always people turning 30s and 40s and people are contributing their balances against that threshold that they start to notice, and that will be a continuous process, hence, creating that competition in the default market, even though these people haven't yet become engaged.

25 **MS CHESTER:** We might move on from the concept of competition, I think we've hit diminishing marginal returns. But it has been helpful to get a better understanding of your thinking. Turning to the expert panel, so let's broadly assume that we do have a best in show, everyone seems to – so the one thing we've united the entire industry on, apart from two very large super funds who actually support the independent expert panel, and a couple of thoughtful submissions from some other experts - - -

MR HARRIS: But we're not naming them, just in case.

35 **MS CHESTER:** No, we're not naming anybody. They can name themselves, one of them is in the audience today, but anyway. PWC did provide us with a thoughtful submission, they were comfortable with the idea of the expert panel, indeed, given all their transaction work, they've seen expert panels make very large decisions on behalf of Governments without fear or conflict.

40 They talked about the role of the Australian Government acting in a technical sense supporting them with the evidence base, but they also talked about holding them publicly accountable, including through disclosure of the decision making following the selection, which to me

sounded like some good belts and braces around the appointment of the selection panel. Be good to get your thoughts and feedback on those.

5 **MR BRIGGS:** Yes, so we took a look through PWC's submission after
you requested that we do so. The first point I make in relation to the
actuaries is that whatever panel is doing this process will have an
enormous amount of information at its disposal. So the actuary can
provide expert advice and forecasts and the like, but it's within the bigger
population. But what's more is the – if it is to become politicised, that
10 information just goes into the mix and can be downplayed or ignored or
whatever.

 So you would hope that a big panel would take it into account and
make decisions based on it, but there's no way I guess for the Productivity
15 Commission to guarantee that would be the case. And like the Fair Work
Commission panel at the moment, all the funds lined up and then you
show us that one of the process in front of the experts, but then the experts
drew up a master list and the normal condition is those that don't have any
experience in financial services or superannuation, then chose them off the
20 expert list, then whatever information was fed into the process at the
beginning was effectively null and void.

 So that by no means would be a sufficient safe way. The second part
is, well, let's make them report against the criteria that are listed so it's
25 transparent and we come out the other side knowing why they made the
decision they did. And the Fair Work Commission makes a decision and
writes up a few judgments, doesn't necessarily meant it wasn't politicised
or that there weren't other reasons that would include the judgment. And
what's more, do you want to create a body where it may make a decision,
30 it may explain the reasons for its decision, which would have varying
degrees of merit, it may be politicised – and I know this is outrageous, but
four or five years later, the issue's died away because the political
debate's moved on and we're back to where we started four years later.

35 So there is no sufficient safeguard, in our view, to prevent that from
occurring, in spite of potentially attaching a range of different bells and
whistles to try to protect it. I remember one of the discussions we had at a
previous meeting was around having overseas experts appointed as well.
But we can't see how a combination of those would adequately achieve a
40 goal of ensuring the integrity of anybody, except, as I said, if it was an
organisation with such a strong culture that politicisation is just not
possible.

45 **MS LOANE:** And I don't think we can ignore massive politicisation of
superannuation, it's incredibly partisan and I think we have to look at

ways to reduce that, instead of just going forward with Government bodies each time the Government changed – their rules would change. And I think that would be extremely disruptive and would keep that partisan nature of super going. I think one of the things that we'd like to see is that partisan nature of superannuation disappears, because it's not in the consumer's best interests.

MR BRIGGS: Actually that's a really good point. You almost create a price that a future incoming government gets to determine, like the US Supreme Court. Who's in government gets to choose who's going to be on this panel and direct it towards one side or the other. You don't want to change the trajectory of the industry to go down that path, and our submission has been the only way you really protect against that is by vesting the power with the individual consumer.

MS CHESTER: That's the goal.

MR HARRIS: Well, as you say, it's a widely held perspective amongst some of the protagonists, or many of the protagonists, that don't otherwise agree on anything, but do agree that they don't want a panel that any side of politics could interfere with.

MS CHESTER: Well, I think both sides conceded (indistinct).

MR PREMÉTIS: But I guess the only reason you would need a panel per se is because of the short list approach. Again, that comes back to your early questioning on the relative merits of different types of competition. And I think all kind of perspectives will put forward the point that they don't believe that the type of competition that you might be entitled to engender outweighs the benefits from existing competition and a higher filter.

MR HARRIS: Yes, I think we can observe that the experts think that. We also observe that the members don't. So members give up the disengagement issue, and there are multiple versions of survey for this purpose and I think radio was trying to characterise it in a simple fashion, it is this New York deli problem, there are just so many choices, it's just impossible, and I abandon all thought of this, particularly if I'm young and asked to do so, and moreover, I've got a system that asks me to do it every time I change a job.

So you almost couldn't design a system better to confuse and discourage people, yet, I know, been done, otherwise for some other purposes, nominally in members' interest. But I think one of the submissions at least called it quite paternalistic, the system is designed for

that purpose, to be paternalistic. But that enhances disengagement. So we can see why the experts think what they think, and we can see why members own behaviour, a probable cause for why they act in the way they do, and we are looking for a solution and that's what it comes down to.

There may be no solutions at all, and I think you lean towards this idea which says don't expect competition to encourage member engagement. But we're interested in this because that's what the Terms of Reference asked us to do, how can competition address the default market which is, after all the characterisation is, disengagement, I defaulted, I didn't make a decision.

MR PREMÉTIS: I think our underlying what we're saying is the member actually having to make a choice, even for the first default product, which is not currently the case because they actually have to just default from there, they can just non-elect, would be an appropriate nudge. So it's a different world you're envisioning.

MS LOANE: I also think that – and looking around the market at the moment, looking at the things that do engage young people, they are innovative new products in superannuation, there's one or two that I won't mention, but everybody's probably seen them on social media, it's got massive engagement with young people and it just shows what innovation can do in an open market. There's no reason why default products can't do that. But at the moment, the business model suits disinterested, disengaged, so there's no innovation. And it suits the current business model.

MS CHESTER: I've got two final quick questions. One, my yes no question. Can you remember what it was so I don't have to repeat it?

MR BRIGGS: I remember our answer.

MS CHESTER: Okay. That's not bad, because someone evil journalist will get our transcripts in a couple of days' time and they can quote us. So if you accept the concept that the biggest risk is defaulting a member into a poor performing product, do you agree then that it is a good objective to ensure that poor performing products over time exit and new entrants with high performing products, competing for the high performing short listed products, are allowed entry?

MR BRIGGS: I think when you put it to the large group, you were a bit stronger in terms of do they have to exit, it was something like, "Must they exit" or "Should we force them to exit". I think the answer to that is

no, because competition takes care of it. If you have a competitive framework they will exit, but you shouldn't have a regulator forcing them out. And the second one, yes, we should be having new entrants and the barriers to entry are too high.

5

MS CHESTER: You've broken the golden rule then, straying from yesterday, but I probably allowed that to happen by not sticking with a simple question.

10 **MR PREMÉTIS:** You did vary the question from the last time.

MS CHESTER: I just confessed my sins. I guess the issue, Blake, with respect to compelling the exit or wanting to see them exit, that's the role of the regulator, given the current arrangements we have. The other
15 question is one that - - -

MR PREMÉTIS: Just going back to the last question, if I could take liberty for Blake, I'd say the answer is yes for us.

20 **MS CHESTER:** Thank you for the simple answer and we'll apply it to the earlier version of the simple question.

MS LOANE: Yes.

25 **MS CHESTER:** We've had a couple of the large super funds indicate to us that for the best in show competition, whether it be model 1, model 2, model 3 or model 4, the 400,000 new job entrants which initially represent about \$800 million per annum, is enough to get the supermodel to come out and do the catwalk. We've only heard that from a couple, you
30 represent a large number of large super fund providers, what's your sense from the feedback that you've had from them to date on our draft report as to whether or not the new job entrant size of the market for our competitive processes would be enough for them to enter the competition?

35 **MR BRIGGS:** So we haven't put that question directly to them, so I can't say with any degree of certainty. The point that I'll make is that most of our members are unable to compete in the default market at the moment but still have MySuper products. So you could probably infer from that that they would at least, in the first one, turn up. But there is no
40 guarantee, we haven't asked them that yet.

MS CHESTER: Is that something you could put to them and get back to us on? It's just we want to get a sense of – we have to make a judgment call not to go with the total churn market, we've gone with the new job

entrants for stability reasons, so you can transition out poor performing funds over time.

5 **MR BRIGGS:** The observation I think it quite relevant is that the Chilean model, the catwalk was set up because there were very few providers in the market and they needed to try to bring in new providers. They established this catwalk with a large prize, and one new provider came to the market. Now, it's very different from the Australian market where we've got lots of providers and we're trying to whittle it down, so
10 the comparisons that Grattan(?) has done between Chile and Australia are almost meaningless in a lot of ways. But the reality is it failed to attract many new entrants in the Chilean system and we have the reverse problem, we're trying to get people out and not get them to show up.

15 **MR HARRIS:** Just Karen's question and your response triggered a recollection of mine from when we were generating these models. One of the problems that, because we envisaged that if you were a winner in this small – in the short list, you would pass on the benefit that you offered to your future stream of default members to your existing default member.

20 We thought, you know, there's a value in that, it means the utterly dominant firms, the very largest, might not compete, simply because they have to pass it on to their – in other words they've got very large banks of default member, they might not compete in it, and might actually be –
25 well, you can make the argument both ways, it might be pro-competitive for new entrants. In other words, it's an opportunity and I don't have any incumbent default members, so I don't have to pass anything backwards and I've now got a share in the market going forward.

30 **MR BRIGGS:** That is exactly what happened in Chile.

MR HARRIS: We thought we would get responses from both yourselves and from others which said, you know, this is a significant factor, that you may not get a lot of spread, as it were, of the benefit because everyone
35 who's got a large bank of default members won't bit. Curiously almost no one's made that comment.

MR BRIGGS: So we put in a submission in the first round which modelled the experience in Chile to try to understand that. I think the
40 current provider, the one with a significantly lower cost bid, was it Movida, from memory?

MR HARRIS: Yes.

5 **MR BRIGGS:** Its return on equity is almost zero, it extended its (indistinct) forecast, as it was required to do, it hasn't made any money from slashing costs, and it is actually the lowest performing provider in terms of nett returns in Chile now, whilst the other providers have significantly higher cost base, charge higher fees, are higher performing, and I think everything that was intended to be achieved through the option model in Chile that Grattan talked about, hasn't come to pass.

10 **MS CHESTER:** I think you're - - -

MR HARRIS: We've got our own criticisms of the Chilean model, but it's my question, when is the fund itself - - -

15 **MR PREMÉTIS:** I think it's an astute observation.

MR HARRIS: It's a curious thing that no one's alighted upon it, and yet – in other words, it could cut both ways, it could actually be pro-entrant because I don't have any – as you called backward, I think you called it.

20 **MR BRIGGS:** Yes.

MR HARRIS: But it could equally be, gee, this is a radical way of getting something innovative, rapidly – anyway, we were just interested because we thought it was one of the kinds of - - -

25 **MS CHESTER:** So your stable's going to be able to tell us the people that are trying to get access to the default market.

30 **MS LOANE:** Yes.

MS CHESTER: Will that be enough for them to get out of bed? I guess we've put it to Industry Super Australia as well, for their stable. But from those that are in neither of those stables, we have heard back from a couple of the larger ones that they will. Which is - - -

35 **MR HARRIS:** We wonder if that isn't the distinction that's actually occurring here, that if you like – I think that analysis could have been conducted by some of the funds individually and they've probably come to their own conclusions, but they're actually not displaying that. And of course we're always interested in everyone's conclusions because we'll learn more from that than we will from our own analysis internally. So
40 thank you very much for this.

45 **MS CHESTER:** Thank you.

5 **MR HARRIS:** And we've got phase 3 to go, stick with us through phase 3 in the end, there will be, for those who are frustrated by the fact that we've kept this to default and we're going a particular way, there will be the opportunity to go right out into all the other interesting and fascinating aspects of superannuation in phase 3. Thank you very much.

MR PREMETIS: Thank you.

10 **MS LOANE:** Thanks.

MR HARRIS: Now we're going to have morning tea, I think, people get a free cup of tea. I don't know, once upon a time there was jam scones here. I remember that with – it stands out as it's not a public service stale biscuit, but outside there might be jam scones, or otherwise just tea. We'll
15 come back in about 10 or 15 minutes.

ADJOURNED

[10.19 am]

20

RESUMED

[10.34 am]

MR HARRIS: We have a submission and some representatives from
25 CHOICE I think. Can you guys identify yourselves please for the record?

MR KIRKLAND: Allan Kirkland, CEO CHOICE.

MR O'HALLORAN: And Xavier O'Halloran, policy and campaigns
30 advisor at CHOICE.

MR HARRIS: Do you have any opening comments you'd like to make?

MR KIRKLAND: Just a few brief comments thank you, Chair. In
35 opening, we would say that I think it's a given for this inquiry, but just to restate our position, we think the defaults are very important as a feature of any complex market, particularly where that market is more or less universal or there's a degree of compulsion, and that's because they obviously provide a basic level of protection for people who might
40 struggle to navigate through that market or might fail to exercise choice. So we take that as a given, but figure it's worth restating.

At the same time it's worth acknowledging that defaults also create
45 challenges, as acknowledged in the draft report. They can discourage engagement, meaning that many people can end up with products that

5 don't meet their best needs. With two-thirds of people, based on survey evidence, sticking with a default fund, there are signs that we're seeing those sorts of problems with disengagement in super, which is mirrored in some of the findings of CHOICE research with superannuation consumers.

10 The other sign the system's not working, the default system's not working effectively for consumers at the moment, is the proliferation of superannuation accounts, which is well-documented in the draft report. It's for this reason that we strongly welcome the Commission's proposal that default models only apply to people who don't already have a super account, effectively stopping a new default account being opened every time a person changes jobs without exercising choice.

15 This is particularly important for younger people who are a key area of interest for CHOICE, given the compounding effect of duplicated fees and insurance premiums over time and the impact that then will have on retirement income. We also note that for young people those problems are exacerbated by inappropriate insurance products, which is a point that we made in some of our other submissions to current inquiries.

20 We do welcome the finding that there are grounds for requiring that where a fund secures default status it should extend the same fees and terms to members of its existing default product. And we also welcome the focus in the draft report on the sorts of systems that are required at the Government level to support better consumer outcomes regardless of what the default model is, in particular allowing members to choose, close or consolidate accounts on line, building upon current MyGov functionality.

30 In terms of models proposed, as will be clear from our submission, our clear preference through this process has been for a model of assisted employee choice and the model proposed by the Commission blends a default system focused on nett long-term returns with nudges that encourage engagement, which we think is the ideal mix to be aiming for.

35 Just as a final point by way of introduction, we do think, as raised in our submission, that it's important to think about the boundaries between the default and the choice market. So unless we enable – in any system, unless we enable easy comparison between default and choice products, there is the risk in the context of what is a complex market that consumers are lured into poor quality high cost choice products. And while we can't absolutely prevent that, we do need to make sure we're designing a system that makes it easier for consumers to compare all products and to make decisions in their best interests.

45

MR HARRIS: If I could start off, I've got a couple of almost like threshold kind of questions. We have regulators active in this field, do you feel that the regulatory system is set up sufficiently oriented towards members rather than towards funds? I know that's quite a provocative sort of way of looking at things, but – and we are in the default space here, so I'm primarily thinking of the default space, but it appeared from so many of the submissions we've received that, although members are recognised in passing, it seems to be relatively rare that a proposition is put to us that the regulatory system itself has taken any ownership of members. Rather, it's a lot easier I guess to regulate the institute the institutions and, indeed, therefore the structures that are set up for that purpose. Do you have any view of that or does it ring a bell with you?

MR KIRKLAND: It's a very interesting question. We wouldn't want to criticise any of the regulators, because I think they're doing the job they've been asked to do, but I think it would be probably be fair to say that if you look at where is the weight of regulatory effort at the moment, it's at the prudential end, which is predominantly focused on the funds rather than the members.

Obviously they have benefits for members of time, but there's not a lot of regulatory effort that goes into understanding how consumers are engaging with the system or thinking about how the system needs to evolve in order to better meet member needs. I would say most of the focus in regulation is on prudential regulation.

MR O'HALLORAN: Yes, and I guess one example of that is the kind of data that's available comparing different default products that APRA releases, it's not in a format or even a context that would ever be decipherable by any member, and I think a lot more could be done to translate that information into useful information for members.

MR HARRIS: Because we looked at information provision because of this problem of default is sort of a function of disengagement. What could be done to address disengagement? Some things potentially could be done through competition to make the choice smaller but clearer and a basis for that. Although, as you've heard, there are criticisms of that.

But there's also this proposition that somehow better information could and should be provided. So you ask yourself who would provide the information. Funds themselves say we tell our members things, and I guess you can accept that that's a reasonable thing to do, but it's like it would be self-serving by – and that's not meant to be an insult, it's just likely to be self-serving, isn't it? They don't fill a wider public interest to the broader questions.

5 So then you would think of regulators, and you look at the regulators' function, I think you mentioned ASIC is, for example, might undertake some activities in this area. We've equally discussed in this hearing and the previous one, APRA. But it doesn't appear that there's a sort of member oriented information provision sort of structure. We had thought about the ATO itself in the sense that it would when it receives a tax file number identification, have a potential ability to provide information back. For example, on a preferred list or – but it's just another way of thinking, well, who else could do the job. I'm just wondering if you had any thoughts at all about who else could do the job for the members.

15 **MR KIRKLAND:** I think there are potentially two levels at which you could answer that question. One is I guess who is gathering information on things like how funds are performing over time and publishing that information, and we think that that process could be improved. It probably is a situation where the information, looking at other sectors, is best gathered by APRA and published by ASIC. That sort of information needs to be published in a way that's consumer friendly, for people who access it at the primary source, in terms of whether a regulator publishes it, but it also needs to be published in a machine readable way, that means that third parties can help consumers to make product comparisons.

25 The other level to look at it, which I think is potentially where your question was more going, was around how do we provide information directly to consumers that might trigger further engagement in the system. I think funds do also – they do that, but I don't think we can rely solely on funds doing that, because obviously they only know part of the picture and particular interests that they're looking out for.

30 I think it probably makes most sense to link that information provision to other points of contact with the system. So the two key agencies that large numbers of consumers have access to, probably in order of importance are the ATO and Centrelink. So to the extent that we can actually be providing information in a way that's timely and relevant, and probably the tax system is the one that is more relevant for most super interactions, the ATO is probably the best agency to do it, for individual information provision.

40 **MR HARRIS:** Because as you can see with our first time, people have gone down this thing saying, well, there's a level of knowledge that's pretty much 100 per cent, you put in your tax file number when you join an employer, it's easily trigger, "Does this tax file number have a superannuation account linked to it or not". If there's no account linked to it, fine, there's a choice to be made or a default will occur. If it does, that

information could rapidly be provided back. So it effectively becomes an advice to the employer, this is this party's super fund, obviously they have the right to exercise choice, but otherwise that's where the money goes.

5 In other words, we almost have a system that's set up for this, but it's not designed to deliver such an outcome. Then you think, well, but if information provision is the problem, then could we actually utilise that as well for information provision. I know these are not functions that the ATO would necessarily throw its hat in the air and say, "Gee, we'd be
10 really happy to deliver this".

 But when you've set up the structure, and SuperStream does have this communications facility and quite a substantive nature now. The question is, couldn't you better use it.

15 Anyway, I wanted to raise it primarily because it's going to be an ongoing area of interest and I suspect in phase 3 we'll come further to this, not just on default, but to this whole question of information provision.

20 **MR KIRKLAND:** Just briefly, we think there are a number of opportunities for triggered engagements that are being missed at the moment, where there's data there but we're not taking advantage of. So for example, where insurance premiums cease to be paid, that's potentially a trigger that somebody has ceased employment or changed jobs or,
25 indeed, that they think the premiums are being paid but they're not. But there's no information provision that's being triggered by that at the moment. So we think are a range of opportunities that are being missed across the system.

30 **MS CHESTER:** So just on that strain then. So I guess if there was one overriding theme that's emerged from stage 1 and stage 2, is the lack of member in the equation. So in data there's two ways we're looking at it, one way is in terms of what data is currently collected by the ATO, APRA and others that can inform good policy development and design and,
35 indeed, the team really struggled, we had to do a lot of our data work, because it's collected through the lens of the employer or the fund, not the member.

 The other side of the equation then is how, when we're developing the
40 models to better allocate default in a competitive way, can we have information that's member reader-friendly, and at the right times? So partly the way we've designed the model is to inject competition for the market, but while at the same time thinking of how do we nudge engagement? And that's where the twin lists kind of come in.

45

And then reflecting on earlier feedback we've had on the twin lists, it now makes me realise that the fear of the short list was a fear for the fund, not a fear for the member. So maybe if we talk a little bit about that, because your submission was terrific, I think it's one of the only submissions where on page 18 there was a refreshing understanding of the mechanisms that are already in place to help the member, the mechanisms we tried to put in place with two of our models, model 1 and model 2, to protect the consumer, the member. But then you talk about other additional things that might be required, ASIC new powers around inappropriate products.

PWC's submission to us have identified a couple of other strands of protection, and it would be good – I don't know if you've had a change, Allan or Xavier, to have a look at those.

MR O'HALLORAN: Yes, we have.

MS CHESTER: Which get to sort of the bait and switch risks that I think you were touching on before, Allan, where you've got people that might be default, but then moved back into choice in our new environment. Be good to get your feedback on that, because the choice – it was quite interesting, the CHOICE submission, out of all the submissions, was the one that realised that there weren't protections in the existing arrangements and we put more in with our models, and now we've got some ideas for some further ones.

MR KIRKLAND: So we think it is absolutely important to focus on some of the bait and switch issues, as raised by PWC. We think it's a key risk. And in a way it's similar to the risk that we were highlighting when we were talking about the need to allow comparability across the default and choice markets. I think the key thing there is I guess around – sorry, I just lost my train of thought.

MR O'HALLORAN: Yes, so we considered the PWC model and thought about other ways that we might achieve a similar outcome and looked to other sectors where they faced similar issues. And I think one that came to mind was in telecommunications. There's quite a difference between what a standard product can offer in terms of consumer protections and what a product outside of that can offer, and consumer protection that was brought in to make sure people weren't just switching between products without really realising what they might be losing from your standard product, which has kind of improved fault repairs and installation timeframes.

5 There was an insertion of a kind of active consent, which explained to the consumer what they'd be giving up if they moved away from the default, in a very simple language. Again, this kind of stuff would have to be user tested to make sure it did actually communicate appropriately and people understood what it meant.

10 But gaining that kind of active consent, so the people know exactly what they're doing, they're making quite an informed choice to move away from what is meant to be quite a solid product. So even we kind of thought about what kind of wording might go into that, and of course this would need to be tested, but it would be things like informing the consumer that the current option that you're invested in has been selected through a competitive process, it was targeted to highlight the best performing options that might suit you, and moving away from this option isn't necessarily covered by those same protections or it wouldn't be covered by those same protections.

20 Testing language like that and making sure people are making really active decision when they do choose to move away from what we think would be a strong default model is important.

25 **MR KIRKLAND:** Thanks, Xavier, that was the point I was trying to find in my thinking. I think the key thing is to test – to look at what are the key opportunities for engaging consumers due to some sign that they're taking an action or considering taking an action, or moving through a different life stage. So the possibility of them moving from a default product to a choice product is one of those key opportunities. I think one of the key things to test is what sort of – not just what language but what data you can put in front of them that might drive behavioural change in their own interests.

35 A parallel would be some of the ideas we've advanced inside the insurance market, the general insurance market, where we pointed out that currently, when consumers receive an insurance policy renewal they're not told – they're told the new premium but they're not told the old premium. And when in the UK they tested the impact of showing consumers the difference in premiums, it drove significantly higher rates of switching. So that's the sort of data that you want to put in front of people, based on testing, and see what's most effective.

40 But as a general point about data to try and encourage better engagement, the critical thing we would say is that we can't actually make a call on this at a point in time and say it's done. We actually need to be thinking about moving to a system where there's constant iteration and testing in how we encourage good engagement over time, which might

mean continuing to change the sorts of information that's presented. Which is a fundamental shift in the way in which government tends to think about regulating for choice.

5 **MS CHESTER:** Yes. Which comes back to the issue that Peter's raised, who's best placed to do that role going forward. And on the issue that you raise about further consumer testing, which we completely agree with, we have been doing some experimental survey work to make sure we refine models 1 and models 2, in terms of the best in show, how to present that
10 information in such a way that if we can get folk to make a semi-engaged decision, from a smaller list, what's the best way to present that information that results in an optimal outcome from their perspective?

15 So we will be sharing the results of those surveys with folk and it would be good to get more feedback on it once we've finalised it, it's not too far off now.

20 I guess it brings me back to the facts that we've got a lot of people that are happy for the elevated MySuper, which is kind of like a long list in assisted employee choice, but not so happy with the best in show. I guess where we were coming from with the best in show were just two simple thoughts, (1) it would ensure competition within that larger group over time to keep the funds on their toes, but secondly, we know from behavioural economics that for consumers to make a choice in such a
25 tough market, complex market, it's got to be under 10, the list's got to be under 10.

30 So just be good to get your thinking on what we'd be losing if we just had the longer list, I don't know whether it's 30, 40 or 50, versus the under 10, under assisted employee choice.

35 **MR KIRKLAND:** So I think the critical thing here is to make sure that the expectation around the cognitive load that we put on the consumer is realistic. I think there's plenty of data from behavioural economics to sort of say that if we're going to give people a list that's got 10 or 20 or more products on it, it's just going to be impossible for them to compare those products on that list. So I don't know what the perfect number is, I would say, based on the research I've read, it's got to be some way under 10.

40 I think it does go to that fundamental difference of perspective that you were pointing to earlier, which is are we designing a system for funds, we quite rightly want to make sure that they've got the best chance of appearing on a list, so they'd probably prefer to see a longer list, versus members. If you look at it from their perspective, it's got to be a list that
45 they can understand and choose between.

That's consistent with CHOICE's experience in user testing and product comparison across a range of markets, that there's a point at which, for the larger body of consumers, they actually want to reduce it or have it reduced for them to a smaller consideration set so they can realistically, within their mind, understand and compare that shorter list of products.

MS CHESTER: So if we have a best in show, somewhere under the 10, we then need someone to decide who the best in show is. I guess this is another area where your submission and probably a handful of others have strayed from the pack and actually think that there could be an expert panel in place to do that. I think we've singularly united both sides of the industry in opposition to having another independent expert panel.

But you do raise a different perspective on that. So I think it would be worthwhile just elaborating on that and what you have in mind, because I think if you look at the principles that we've identified, there could be a potential for your suggestion but I just want to get a better idea of what you've got in mind with consumer representation being on the expert panel, Allan.

MR KIRKLAND: Certainly. So at a high level, just on the general proposal, we think there has to be an expert panel. And to the extent there's criticism, I don't think – the way I read it, I don't think many of the commentators are saying the idea of an expert panel per se is a bad idea, they're saying there's a high risk that the appointments become politicised and therefore the decisions are politicised and subject to public debate.

So I think if that's the risk then let's talk about how we manage that risk, and you could do that by in terms of who actually makes the appointments, and potentially that doesn't necessarily have to be an appointment by government, or there could be a way of constraining the choice of government that seeks to minimise the degree of politicisation. But ultimately, we think there needs to be an expert panel, and we also think there's merit in some of the PWC proposals about trying to manage that risk through greater transparency about the reasons for decisions. We think that could actually be quite a useful intervention over time.

But in terms of our specific point, we think it does broadly accord with one of the principles that you've articulated around having – I think it's in terms of understanding the needs of members, in the draft report. When we talk about consumer representation, we're not talking about people who are appointed by consumer organisations or are there to

represent the interests of consumer organisations, it's more about having people who have expertise in understanding the needs of members or consumers and are able to bring that expertise to bear in the selection process.

5

MS CHESTER: I guess indeed that would be – to find that right sort of person who understands the importance of a member lens, member information and within the context of superannuation and finance, that sort of person wouldn't tend to be considered to be open to as much partisanship. I guess that in itself would probably inject a level of independence into the panel.

10

MR HARRIS: Yes, I think it just appears that the concern about this is driven entirely by the possibility of bad behaviour which exists in a regulatory system, it's just here magnified. So whenever you come up with a proposition which says somebody with wisdom should determine the matter, it's suggested that the person either won't act wisely or that the possibility exists that the system is so poorly constructed that they're unable to act wisely.

15

So we live with this, we're on the lookout for better propositions. It's occurred to us, but again, not to any participant, that there are a number of advisory entities which did publish their own rankings tables. It's curious again that no one is seeking to make this system work if they're concerned about the appointment, individuals have suggested, well, why don't we get the ATO every time a person changes job to just send information to that employee via their contact with the employer, with the top five, top 10 or whatever it is, named by three different ratings agencies.

20

Again, they're outside a politicised. In other words, it is somewhat notable here that no one's really tried to make the panel work, that they've pointed out how poor it could be and of course that's what we're used to in these systems, in our work we get people regularly saying what could be the very bad outcomes. The same has applied to the Fair Work Commission process too; it's just that we've consciously kept it at arm's length until phase 3. But that will come up again in phase 3.

25

30

It's equally open to appointments of a particular kind and so you get this concern that just – it contributes then to the fact that we can't provide better information to members, which is why I started out with my question, given that you are CHOICE, around members. Not too many people appear to have constructed their advice around a genuine concern for members. Members do appear in submissions, are named often. But the idea of providing better advice to them generically across the system, driven by the needs of members, is apparently unpopular.

35

40

5 **MR KIRKLAND:** It does seem to be unpopular. On the expert panel, I
just come back to that, I find – the proposition from the critics seems to be
that people who are appointed to a public role with clear responsibilities
10 are going to ignore those responsibilities in order to pursue some personal
political view. I think that’s a fairly strong proposition to put and I would
challenge it, and I think that to the extent that it might still be a risk, you
can mitigate it significantly through having very clear criteria, through
15 having transparency around how those criteria are applied and requiring
that to be published.

 I think that then puts anybody who is acting in, based on personal
views, under the spotlight and they’ll need to defend those views.
Obviously the more people you have on the panel, that also helps to –
20 within reason, that helps to mitigate risk as well, because it’s harder for an
individual to assert their views over the evidence.

MS CHESTER: One other issue that you thoughtfully raised in your
submission to us was around how – we focused very much on default and
25 accumulation, which is what our Terms of Reference asked us to do.
Indeed, when we get to stage 3 we’ll look more broadly through the entire
life cycle of retirement income products. We’re very conscious and
cognisant the Government’s got a parallel process underway, the CIPR,
Comprehensive Income Products in Retirement.

 You have raised some suggestions in your submission about how we
deal with CIPR, and I just want to make sure that we kind of understood
that. Because it’s interesting, once someone retires, we take them out of
30 the world of default and control command and all of a sudden they’re free
range. There’s two ways then to deal with the free range during
retirement with the CIPR product, one is to allow them to continue to be
free range, another one is do you go for an allocative model like we’re
looking at doing here in default, or do you we go to an accreditation
35 model. Think of our long list.

 I wasn’t quite sure in reading your submission where your thinking
has landed, if it has landed in that yet, and I do note this is just sort of
preliminary, because we’ll be getting into those issues more substantively
40 in stage 3.

MR KIRKLAND: No. So our thinking hasn’t landed on any of those
options. All we’re saying is that obviously we need to look at CIPRs as
part of this broader consideration and how do we encourage greater
45 competition and choice. So to the extent you’re able to do that in the final
stages of your report, we’d welcome it, and to the extent there may be any

work that you feel you're not able to do within your Terms of Reference, we'd be encouraging you to be suggesting that that might be some further work that's required to the Government.

5 **MS CHESTER:** Just one other area that I had questions, and that's
around insurance. We kind of dealt with it in our models by not dealing
with it in a competitive sense but in a regulated sense. So to be eligible to
compete, you need to have met the minimum standards, plus we added in
10 a few more things just to take it up a little bit higher than what MySuper
currently requires of trustees.

Others have suggested (1) you need to compete on the insurance, and
we kind of struggle with that, and then others have suggested, well, it's all
too difficult, they don't have the data on the members, why don't we just
15 make it that it's default in, not default out, the insurance. Or they default
only once they hit 25, so they're more likely than not to need some of
these insurance products.

So I've probably bundled two or three questions in there, Allan and
20 Xavier, for you, sorry about that.

MR HARRIS: Hope you're taking notes.

25 **MS CHESTER:** So just go to the first question, are you comfortable
with how we've dealt with insurance in the models, i.e. to compete you
have to do what you're required under regulations and show that a little bit
more than you are at the moment?

30 **MR KIRKLAND:** We are comfortable with where you settled in the
draft report, yes. I mean, the only comment we would make, which I
think comes through in the submission, is that everyone's pinning a lot of
hopes on the working group that's looking at insurance and super at the
moment, and I think that we probably need to – I don't think it affects
35 your draft recommendations in this area, but I think that we need to
perhaps reassess the adequacy of the whole regulatory arrangements
around insurance, super once we see what that process delivers.

40 **MS CHESTER:** Yes, because we're assuming that that water tide will
rise as well, through those processes. But if it doesn't, then we need to go
back and agree. Then on the issue of defaulting, opting in versus opting
out of insurance, what's CHOICE's thoughts on that?

45 **MR O'HALLORAN:** So I think we're broadly supportive of the current
approach that defaults. We can see reasons why even younger people
would need a very basic level of insurance in some circumstances even if

it was just to cover say a funeral, which would be a very small amount of cover and possibly quite a lot more affordable than what some of the default options currently offer.

5 So we can definitely see a space for it. I don't think that it would be provided or people would adequately be protected if it did exist as it currently does. But we've, obviously through a lot of our submissions, been very sceptical of the way it is currently being provided. So our investing time in improving it through the insurance and super working group and that's where a lot of our focus has been. But as Allan just mentioned, that may need to be revisited depending on the outcomes of that process.

15 **MS CHESTER:** What about the dividing line for the under 25s, when some of the particularly life insurance is probably – the first thing I did with my daughter over the Christmas holidays, when she finally had an employer, asked what super fund and I told her which one – I'll never say which one it is in this forum. But the first thing we did before her payment was even made was jump in and opt out of insurance. So not every kid has a parent that does that sort of thing. So some have suggested that the under 25s, particularly for life insurance, could just opt in until after 25. Just good to get your thoughts on that.

25 **MR KIRKLAND:** So we haven't advanced a clear position about where the line has been, but in some of our other submissions we've said that we think that there needs to be a line in terms of age below which you don't have default life insurance because that's unlikely to be providing value for the vast majority of consumers at that age.

30 **MR HARRIS:** I have no other questions.

MS CHESTER: Nor do I.

35 **MR HARRIS:** Thanks very much again for your participation here today and for your submission and I encourage you to remain with us through phase 3 where it will be even more exciting and fun than this phase has been.

40 **MR KIRKLAND:** Look forward to it, thank you.

MR HARRIS: Thanks very much.

MS CHESTER: Thank you.

MR HARRIS: I think we have the Australian Institute of Superannuation Trustees next. If you guys are settled, could you identify yourselves for the record please?

5 **MS SCHEERLINK:** Sure, Eva Scheerlink, CEO of the Australian Institute of Superannuation Trustees.

MR WEBB: And Richard Webb, policy and regulatory analyst at AIST.

10 **MR HARRIS:** Thanks. Eva, do you have a couple of opening remarks?

MS SCHEERLINK: Yes, I do, if that's all right. Thank you very much for the opportunity. So AIST speaks for the profit-to-member superannuation sector, we have 62 member funds who are a combination
15 of industry funds, public sector funds and corporate funds.

We would like to express our appreciation for the flexibility shown by the Commission to give us an extension in putting our submission. Last we the - - -

20 **MR HARRIS:** A big sub, so you were obviously working for a while.

MS SCHEERLINK: The extra days were incredibly important to us, particularly because we do have such a large membership to consult, and
25 the issues before us are not simple and incredibly important to the 14.9 million MySuper account holders in Australia.

We strongly consider that choice in superannuation is promoted for ideological and commercial reasons, rather than in the interest of
30 members. There is extensive academic research showing that the great majority of pension fund members both here in Australia and overseas choose not to exercise choice. We have no objection to it obviously when members expressly seek it, however, we note that the exercise of choice correlates at an aggregate level with lower nett returns to members here in
35 Australia, and there's lots of evidence of that.

We think that the offer of death and TPD insurance should continue to be a requirement for all default products with members able to opt out if they wish. The offer should not simply be a prequalification step, the
40 assessment of the offering should form a core part of the assessment of the suitability of funds and MySuper products to be accepted for default. Failure to include insurance in the selection process invites gouging and greatly advantages fully integrated wealth managers that can cross subsidise lower direct costs with higher insurance premiums.

45

5 We think that a reduction in the number of default fund offerings to six to 10 would risk stifling innovation and lead to a homogenised system. There's genuine value in funds which are tailored to a particular employer or industry offered as a default and we don't think this is currently adequately addressed in the Commission's draft report using the heavy filter shortlisting and then the light filter long list proposal.

10 So we take issue I guess with a proposal where we've got six to 10 default funds for the whole of the new job starter market versus, for example, perhaps a six to 10 default fund process per industry where that might be more appropriate depending on the industry cohort.

15 AIST considers that the current system, whereby an expert panel of the Fair Work Commission nominates funds for inclusion in industrial awards, has not been given an adequate chance to work as designed. We look forward to the Productivity Commission providing a proper review of that system in the next round.

20 We recognise that the process has not been the choosing of the Productivity Commission, but rather from the Government, however, we strongly believe and want to put on the record that the process of looking at alternate models before assessing the current model gives some legitimacy, whether rightly or wrongly, to the four models that have been put forward, and we would really like to see the politics taken out and the data put in.

30 We certainly agree with a high quality filter on a multi criteria framework and agree with an independent government body, but yes, we'd prefer to see the existing model given a chance to operate. Thanks.

MR HARRIS: Thank you for that. Are you going to start this one, or I can do my usual rambling, shambling?

35 **MS CHESTER:** No, you can ramble, shamble.

MR HARRIS: I can shamble. In your sub, you and a number of – I don't know whether your members, because I haven't done the cross referencing, but a number of, you called them profit-for-member funds.

40 **MS SCHEERLINK:** Yes.

45 **MR HARRIS:** So I was going to say not for profit, but I'll try and follow you with the profit-for-member. A number of them too made the argument that there were benefits to having industry specific default funds. We are of course all I think reasonably familiar with the fact that it

would be unreasonable for an employee to be encouraged to invest in their firm with their superannuation; Enron was a classic example in the United States of this. And of course, when a firm goes bust, the employees don't just lose their job they lose their superannuation and their pension investment as well. So we do actually encourage the principle of diversification.

So this is really in conflict a little here, it seems to me. The idea that we – I've read your thing, your subs says, "AIST supports a centralised system where employees are connected with default superannuation the most appropriate to them", and we think "most appropriate to them" sounds fair enough. "Such a system recognises that different industries have different demographics", so weren't into demographics now rather than industries, and we could potentially agree and there are examples around the world of different super systems that actually focus entirely on demographics, you know, the birthday kind of funds, but they're not industry based.

You've argued for industry specific default funds, but you've talked about appropriate things and demographics, whereas in fact industry specific suggests that you think that there are characteristics for particular industry super funds that say they should invest in industries that people work in. I'm a bit worried by that, I've got to tell you.

MS SCHEERLINK: I don't think we're suggesting that they need to invest in the industry that they work in, just that there are funds that have been set up that obviously cater for particularly vulnerable cohorts within our community, for example. So going back to the need for having insurance as part of the consideration in default fund selection, there are occupations that find that incredibly difficult to find insurance for death and TPD, including obviously emergency services personnel or the high risk injuries in terms of injury such as building and construction, even nursing.

There are issues that are very specific to those industries and the people working within them. I think having just a whole of employee based approach rather than actually allowing specific focus for those, we would suggest, more vulnerable cohorts, missed an opportunity to look after the whole community.

MR HARRIS: So just to be clear though, you're not suggesting that industry specific default funds are desirable because they should invest in the industry or associated industries where they employees work?

MS SCHEERLINK: No.

MR HARRIS: You're not suggesting that.

MS SCHEERLINK: No.

5

MS CHESTER: So we do hear this and we've heard it from several – in several submissions and a couple of folk that have been involved in our public hearing processes, that the examples that they cite when they talk about allocating default members by industry always immediately goes to the high risk employees and insurance. I'm still yet to understand, we're talking about a default super product, so if we just set insurance and the high risk insurance needs aside just for a moment. For a default super product, what kind matters? Is it industry, is it demographics, or is it nett investment performance?

15

MS SCHEERLINK: All of those things, we would suggest.

MS CHESTER: So explain to me how industry would make a difference for the investment strategy or the super component of the product.

20

MS SCHEERLINK: So a default fund that has principally young member working in low paid industries will have a different investment approach than those that are – have more mature members and that have much higher incomes, for example.

25

MS CHESTER: So we're talking default.

MS SCHEERLINK: Yes.

MS CHESTER: We're talking disengaged member, why would the investment strategy differ based on industry?

MR WEBB: Perhaps I can just add to what - - -

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MS CHESTER: I'm just struggling with that one.

MR WEBB: That's okay.

40

MS CHESTER: And just we've heard it a lot and nobody's ever been able to - - -

45

MR WEBB: No, that's fine, it's a good question. I think if I can add to what Eva's said, I suppose funds – you're quite right, funds do operate in different demographics where they have different aged based members and if you were to look at that purely and simply, you could say, well,

maybe they might have similar investment strategies to accommodate for that.

5 Unfortunately, employees who work in different industries who might
be of similar ages might not necessarily have the same set of
circumstances. We're aware of two funds which have, I guess, very
similar aged members if you look at them on a general sort of distribution,
however, in one fund you're looking at members with generally wealthier
10 account balances and longer life expectancy, on the other hand you're
looking at another fund which has generally poorer members with shorter
life expectancy.

15 So what we'd be looking at there, I guess, is that the fund will be
taking into account things like, for example, what does their exit profile
look like and should we be actually looking to deal with a fund that might
make its investment strategy with something like that in mind.

20 **MS CHESTER:** So I can understand those demographics and
socioeconomic really when you're approaching retirement and into
retirement, we're looking at new job entrants in the default market for
accumulation. I'm still just trying to work out whether this differentiation
argument's something for approaching retirement and into retirement, and
so it's something we'd look at in stage 3, or whether it really matters for
how we allocate default during accumulation for new job entrants.

25 **MR HARRIS:** We are on the default.

30 **MR WEBB:** No, that's quite correct. Anyone who's entering any fund
at any point in time is going to have a different – I talked about exit
profiles before. Contribution profiles is another thing to take into account,
are they likely to be in jobs for example where they're paid the same thing
for their whole life, or are they likely to be in jobs, for example, where
their contributions profile might increase as they get older.

35 **MS CHESTER:** So how would the investment strategy differ? You're
talking about having a marked differentiation based on an industry; we're
now talking about balances. How would an investment strategy in a
default product during accumulation differ depending on balance?

40 **MR WEBB:** I suppose it really does depend on those factors that you're
looking at there, but a lot of this work has been undertaken by – in the
early '80s, Bing(?), and in recent times, Durandra and Walk(?) have also
done a lot of work on this as well. Essentially you might actually be
looking at an entirely different investment strategy based on a number of

factors, including how much is going in, what times it's going on, and what times it's expected to come out again.

5 **MS CHESTER:** I think that works for a lot to transition and going into retirement, but I guess we're still facing a - - -

MR WEBB: I think essentially retirement really is just the flicking of the switch between the accumulation phase and the draw down phase.

10 **MR HARRIS:** I think we can see the demographics in here, without a doubt. I think what we're struggling with is default under the current system occurs every time you change a job. It would be extraordinary, and I notice no one has asserted in their submissions, that they do assess the member every time they receive one, because if you change jobs 20
15 times in your life, you know, it seems the impractical option.

So what we're trying to do is find out the answer, not just on insurance, which as you say people do – or as we said, I said, people do go to naturally as a sort way of showing this. But they also go to this
20 question of an actual assessment of the members. I can't see why, as I think Karen was alluding to, if you had a small balance, or a large balance, it would be a question of a size of your balance that affected the investment strategy, it surely should be much more likely to be the time of your life that would affect your investment strategy.

25 We're trying to get you to tell us something different because I always learn things through this. I just can't see why – I mean, take a really big fund, take Australian Super, it must get people with giant balances and people with tiny balances. Do they really change their
30 investment strategy in their default funds simply – and I would say clearly they don't. Surely they don't. I mean, you're in the default fund, you're in the balanced option, it has an investment strategy, people know what it is, it doesn't matter the size of your balance.

35 That's right, isn't it? I'm in the right area here?

MR WEBB: We are aware from various CEOs, and I think the – if memory serves me correctly, it was the CEO of HESTA a couple of weeks ago, did speak at a function where they talked about how they actually do
40 look at things like balances, things like occupational ratings for their staff, and obviously they service a lot of people in the health industry, as well as things like - - -

MR HARRIS: They spoke to us last week and I think it's in their
45 submission, the same thing.

MR WEBB: Yes, same thing. So they actually do look at their default strategy.

5 **MR HARRIS:** And we're trying to find out how this can be. Seriously, do you change the balanced fund option for a person with a low balance versus a large balance?

10 **MR WEBB:** That was what they were suggesting that they do, they make minor tweaks to it to reflect that overall change in the - - -

MR HARRIS: That's an interesting thing, I hadn't taken it that far, I had assumed it was a list of things and it wasn't really that – anyway, that's fair enough if that's true, that's great.

15 **MS SCHEERLINK:** Can I just add too, I guess if we're talking about a default for life situation, then the point of retirement does become an important factor.

20 **MR HARRIS:** We're always having choice, we're always having choice. It's not default for life, it's just under our proposal you get – you only defaulted once.

25 **MS SCHEERLINK:** Yes, we know people stay in the default, or 80 per cent of people do.

MR HARRIS: Yes. That's what we're also trying to address too, which I might go to that then. You were here for CHOICE and you heard me ask about this question.

30 **MS SCHEERLINK:** Yes.

MR HARRIS: Of how you get information into the hands of members, and each individual fund tells us they do a great job, and I don't doubt them, about their fund. But they're not the public interest trying to actually tell members about the generality of opportunities that are available across superannuation. So the question is, who owns that responsibility? Currently I can't find a participant in the regulatory space who really wants to anxiously tell me that they are that entity.

40
45 You heard the questions, but you can see where I was generally going. I'm trying to ask, does any entity in the regulatory system own that and should we have a mechanism by which information is provided to try and offset some of this substantial defaulting behaviour? Should we have someone?

MS SCHEERLINK: I think the entity that probably has the most data when it comes to the actual member is the ATO. They currently are doing a lot of work in terms of account consolidation, but nothing proactively.
5 So if the government was to give the ATO the power and the direction to encourage members to consolidate, to let them know about what the multiple accounts are rather than waiting for the moment to, of their own accord, go and find out whether or not they actually have multiple accounts.

10 Sometimes the system will work for someone and sometimes it won't. If the account was set up before the person was required to give over their tax file number, for example, then the information might not be so readily available. But there would be opportunity for the ATO to correlate
15 different types of data about a person in order to have that information. Similarly with the proliferation of multiple insurances, that is not information that is in the hands of the funds, for example. So while someone is contributing to their fund, and they're taking out their insurance premiums, they're not aware of what other insurances that
20 particular member might have in other multiple accounts.

MR HARRIS: Could we just stick with that one for a second, because we are interested in insurance too.

25 **MS SCHEERLINK:** Yes.

MR HARRIS: Yet it is in the information held by a particular fund that this account is inactive and is still paying insurance.

30 **MS SCHEERLINK:** Yes.

MR HARRIS: One would have thought that if I was interested in the member, I would try and do something about that as a fund. Because he's asked the question, communicate to their address "Are you still keen to
35 have the insurance or have you moved on to a different" – but again, no one seems to own responsibility for that either.

MS SCHEERLINK: Yes.

40 **MR WEBB:** It is a good question, does someone who's an inactive member want four premiums to continue to be taken out of their retirement savings whilst they're inactive. That is a really good question. My brother in law died about five years ago and had been unemployed for a particularly long period, mainly due to the fact that he had a few
45 unfortunate health issues. His accounts had been inactive for a

considerable period of time, but that death insurance that he had was able to not only pay for his funeral but also provide some assistance to his wife.

5 **MR HARRIS:** And we can all find examples like that, but my question was a threshold systemic one. Does anyone in the system own responsibility for communicating to a clearly observable passive account, and in that case it is the fund that is most in possession of that information, does anyone have the responsibility of asking the question of
10 the individual, do you still want to have this taken out?

MS SCHEERLINK: Well, it's a very good question and one of the serious considerations that the insurance and superannuation and working group is working towards, and particularly with the creation of a new
15 industry code of conduct for trustees in relation to insurance. It is on the agenda.

MR HARRIS: Actually, could that working group actually impose that or would it be a question of best endeavours by trustees?

20 **MS SCHEERLINK:** Well, the ultimate aim, and certainly from AIST's perspective, is to have a robust agreed code across the industry, which we know won't be an easy thing to achieve, but we're certainly aiming for that, and then making that an ASIC-regulated code.

25 **MR HARRIS:** So and backing it up with ASIC regulation?

MS SCHEERLINK: Absolutely.

30 **MR HARRIS:** That's certainly interesting.

MS CHESTER: While we're on the issue of account proliferation, and if I've read your submission correctly, you do want to prod the ATO but you're happy with the current processes with a prompt, am I right?

35 **MS SCHEERLINK:** Yes, that's right.

MS CHESTER: How do we then deal with the current arrangements that still allow members to default each time they change a job and indeed, a
40 material cohort of default members, they can't take moneys out of particular default products and consolidate them even if they so had the energy, inclination and willingness to do so.

 So I guess we're trying to solve for new job entrants today account
45 proliferation with a circuit breaker approach. Indeed, I think in our draft

report we went as far to say that it's been too little too long when it comes to account consolidation. So how do we deal with the issue of I think it's about 20 per cent of current default members do have problems in – because of the structures of current default arrangements and even getting account consolidation, even if the ATO were prodded with a very red hot cattle prod.

MS SCHEERLINK: Well, I'm not sure that I can answer that question in relation to those members that can't exit out of an existing fund.

MR WEBB: I wouldn't mind some clarification just on that question, Karen, if that's okay. The members who – are you referring to members who are locked into arrangements where the employee's required to use certain funds or are you referring to legacy products that people can't leave or have problems leaving because of large amounts of fees involved?

MS CHESTER: So HESTA was alive to this issue last week when they were here for the public hearings and indeed we've had submissions from members, particularly in the health education sectors where they've gone from being government employees to non-government employees and they can't consolidate, and these are default products. So even if we allow the ATO process to continue rolling for another 10 years, we're still going to have unintended multiple accounts, from the members' perspective.

So I guess we don't see a complete solution, we agree that an accelerated ATO role here would be good. Indeed, we like the ATO to have an elevated role and even perhaps further going to a clearing house model. But it still won't solve all the problems as we understand it. I guess one simple question that's kind of related to this, one of the large super funds suggested to us in a submission that the biggest risk for a default member today is being defaulted into a poor performing product.

That's really been part of the driving – well, the thinking behind our models, how do we make sure that that risk is minimised. You raise a concern in your submission that our allocated models would not act in members' best interest. But if we agreed that the biggest risk, and it's an open question for you to answer, if the biggest risk is for a default member being defaulted in a poor performing product, do you see that as the biggest risk in the default sector?

MS SCHEERLINK: I don't know that I've considered what the biggest risk would be for a member. We certainly are aware of the bait and switch type risks which we think are - - -

MS CHESTER: We'll come back to that; we're just saying someone who's staying in the default sector, the biggest risk for them is being put into an underperforming product.

5 **MS SCHEERLINK:** Yes.

MS CHESTER: So I'll take that as a quiet perhaps yes answer?

10 **MS SCHEERLINK:** Well, yes. I'm just waiting for the next part.

MR HARRIS: That's right. No, I'd be in your position, I'd just be taking (indistinct) Karen.

15 **MS CHESTER:** Actively listening?

MR HARRIS: Saying, sort of, Karen, I sort of agree.

20 **MS CHESTER:** So how does the current system of default allocation manage that risk?

MS SCHEERLINK: So you're talking about people who are in an existing default. So even though there's a – if the process were allowed to function, every four years a review of who the appropriate defaults are.

25 **MS CHESTER:** Ignore our models for a minute.

30 **MS SCHEERLINK:** Yes. No, but in the current – under the Fair Work, if that process was actively working and every four years under the awards there was a review of the appropriateness of the defaults under that particular award, non-performing funds, depending on what your definition is of underperforming, so hence why my – I'm thinking what do you mean by that – then there is an opportunity there for that consideration to come up and potentially for the fund to be removed from the default list.

35 **MR HARRIS:** See, this is a bit why the – I say that with the industry fund comment. Because under the workplace relations induced system, there is a focus on an industry fund, if that industry fund is – and its ilk, even if there are a number of similar kinds of entities – if they're investing similarly with a particular focus on that industry or related industries, or
40 indeed if they're investing in a particular strategy because historically that area has had only small balances or something. Then you're actually not comparing the best performing funds, you're comparing a set of funds which have a particular focus.

45

5 So this question of are there, in a complete universe, much better options for some members, isn't made available to them, that information isn't being made available to them under that current system. As best we understand it, although as you say, that process has yet to have a chance to be observed in practice. But a question is, how do you get that best information available to them, which is the focus that we had in our – I think Karen calls her best in show version.

10 **MS SCHEERLINK:** Yes.

15 **MR HARRIS:** We're trying to work out how to best (a) construct that, and then (b) get it to either, under one option, employees, under another option, employers. That was the thinking behind the models. So I'm trying to now convert it and look at it from your round and say, well, if you've got these particular set of funds and they historically have been the funds in that industry, are they engaged in taking the received wisdom of, "This is how we invest in this particular sector"? Are they engaged in that, and therefore – or do they actually consider the broader universe of options available to them? I don't know this, and so I was asking you.

20 **MS SCHEERLINK:** Yes, of course, they're highly diversified investment strategies. But under the current system, any fund with a MySuper product is able to make the application to be a default fund under an award. No one's excluded from that.

25 **MR HARRIS:** No, I wasn't questioning whether they were able to make an application. The question is really about the focus on the current system where we've grown up with a set of industry funds, they tell us in their submissions they invest according to their members' needs, and you've put that in there too. You are saying some sectoral, if you like, judgment being made here.

35 I don't know what the sectoral judgment is, but if I take it at face value there is a sectoral judgment being made, it says "I'm not investing according to general advice on what a good balanced fund looks like across the Australian economy, I'm investing according to what a balanced fund looks like in the health sector", somehow, and I don't know what that is and that's why I keep asking this question, what is it that's the difference between what a balanced fund might look like across the Australian economy and what a balanced fund might look like in the health sector.

40 **MS SCHEERLINK:** I don't think it's as narrow as in the health sector, it's in terms of our members who predominantly work in the health sector and the demographics that apply to that.

45

MR HARRIS: Demographics, as I said, we can all I think accept demographics as a good guide. It goes to the insurance question as well of course, because it's the same thing as you pointed out, there are
5 differentiations that are made there. Sorry, I have more if you - - -

MS CHESTER: No, you go for your more and I'll come back for my more.

10 **MR HARRIS:** Okay. I think you've suggested that if we shrink the default pool for the first timer only, that people could end up in unsuitable products throughout their working lives. I guess I'm going to put words
15 in your mouth, I guess what you're saying is most people's first job is part-time, they will end up in a fund that operates primarily in part-time sectors, I might say that's presuming that the first timer pools acts inconsistent with the workplace relations system, whereas in fact the first timer pool acted without the workplace relations system it possibly
20 wouldn't be the case, but anyway, I can accept it. They're going to end up in retail or in hospitality or something like that, and that that becomes an unsuitable product for them throughout their working lives.

There is a choice available to them thought, which we have in the current system. But that comment sounds like a criticism as well then of retail and hospitality as being poorly performing funds and yet they don't
25 appear to be. So unsuitable, I see that contention, but I can't actually see the practice. They seem to be pretty reasonably performing funds. So can you explain that a bit more for me?

30 **MR WEBB:** I suppose aside from the other issue that we identified in our submission that your retail and hospitality part-timers who are under 18 are being expected to make a decision on a complex product that - - -

MR HARRIS: They're not making a decision, they're default members, they're not making a decision.
35

MR WEBB: Default members. Yes, it is, but the suggestion is that unless they are prodded into making choices later on when they are actually I suppose in a better position to make a choice, or at the very least be put into something that's a little bit more appropriate to them in
40 different industries, I mean, someone who works in retail is not always going to work in retail.

There are people who are, and certainly I've got nothing against that, but the idea that your average school person might have a retail job part-time and then probably will always stay in that particular industry means
45

that the fund that they were set up to do might not necessarily be as suitable for them going forward, even at later points in life when they continue to choose to defer their choice of super fund.

5 **MR HARRIS:** But a solution really is to give them better information, give them a chance to make the choice decision, isn't it?

10 **MR WEBB:** The solution is absolutely to give them better information. This is something that of course getting this information can be tricky, in fact, we've talked to a couple of people, a couple of ratings agencies around town, who have expressed great difficulty in attempting to objectively rank MySuper products against each other.

15 **MS CHESTER:** So if we come back to our twin lists under assisted employee choice and assisted employer choice, given it seems to be everybody else hates the option model and dislikes strongly the multi criteria tender, so if we stick with model 1 and model number 2 - - -

20 **MR HARRIS:** Tell New Zealand.

25 **MS CHESTER:** I think they already know. So under those two models you have a much higher – so you have a long list, MySuper but stronger than MySuper, which really lifts the bar, particularly around investment performance over time, and appropriateness of investment strategy. So that for me mitigates part of the risk of defaulting a member into another performing product over time. Then you've got the short list which keeps everyone on their toes because everybody wants to get onto the preferred list by being best in show every four years.

30 If I read your submission right, and this leads on from what Peter was asking, you're saying if we default once we're going to default them into the lowest common denominator because they'll move onto another job down the track. But if they can only be in a product that's either on the very best in show list or the incredibly elevated MySuper list, how are we
35 getting them to a lowest common denominator?

MS SCHEERLINK: Well, it depends on what the criteria are to get them into the list.

40 **MS CHESTER:** So we've said what that is in the draft submission, what do you think we're missing there in terms of what would be required? So we've articulated how we take it higher than MySuper.

45 **MS SCHEERLINK:** Yes.

MS CHESTER: And we've said what would be the – what the product characteristics would need to be and then what were the factors we'd be looking at for best in show, and in fact it's probably not all that dissimilar from the multi criteria tender.

5

MS SCHEERLINK: Well, certainly the heavy filter list is preferable to the light filter, I suppose, having – if we are going to look at defaulting members into a fund, and then throughout their working life not give them other prompts other than sort of advertising around choice products or inducements around the choice products, then – I've completely lost my train of thought.

10

MS CHESTER: No, it's a good train, because I guess what I'm getting at, your point is you obviously strongly believe there is something to the sector that they're working in.

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MS SCHEERLINK: Yes.

MS CHESTER: We're still kind of struggling to see that, but we accept that that's your position. If you've got the short list, which some folk under 1 or 2 would go to immediately because it's a shorter list and it's easier for them to cognitively deal with it, and they've got some basic metrics to help guide them. But if they're in a particular sector like construction, and we do have the longer list, higher than MySuper, but it's still a longer list, so less likely to be an underperforming product, wouldn't from that list of 20 or 30, the funds could then appeal to them in terms of we are very good, we're on this list, and we're for the construction sector? I'm just trying to - - -

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MS SCHEERLINK: Appeal to who? To the member or to the employer?

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MS CHESTER: Well, to either.

MS SCHEERLINK: Because with default we're talking about the disengaged and so how are you getting through to – if there's a need there to get through to the member to help them to make that choice, then it's choice and not default.

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MR HARRIS: So that goes to the question I was asking, choice – but you can imagine, could you not, that rather than creating a new super account every time you change your job, because the tax file number is registered, it goes to the ATO, you could have an information provision thing that goes back via the employer to the employee which says, “You've just started here, your existing fund is a retail fund”, because you

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were once a part-time retail employee, that's where your super's going, unless you make a decision, by the way, here it is now", then there's a number of models we've got, it could be the information from any of those models. If we're just talking of – anyway, a gathered list of some form or other, or as I speculated to the people from CHOICE who were here, it could actually be in a rating tables.

I noted your comment earlier that said some people find it very hard to create them, but others to find them. So if we're worried about the politicisation of panels, why don't we just take some of those ratings funds information and put them in the hands of the employee, the member, at a point where they have just changed their job and otherwise they're going to remain in their default. So we sort of help them out.

Now, we know we've got the system, SuperStream, almost set up that could enable two-way communication of this kind, plausible, see it happen. Shouldn't put a lot of burden on the employer. It's a question of the physical handing over I guess of the information, but it's not much more than that. We had the Council of Small Business of Australia on the record as saying they'd like to make sure the employers had the least possible role, and we understand that entirely.

So it's this information provision thing. So in answer to your query then, that is one way you could see this start occurring. It just says rather than – I mean, other people have hypothesised on every birthday we will tell you this, well, I'm not sure I want a MyGov message on every birthday as saying, "Have you considered changing your super fund". But you can imagine the changing of job one. So today we have a system which says you get a new super fund every time you change your job, I'm thinking, why wouldn't you have the alternative, we just give you the choice every time you change your job.

MS SCHEERLINK: Yes. I think that's what the new single touch payroll form is supposed to try and generate, is that as you're sitting there filling in your tax declaration - - -

MR HARRIS: Well, the clause would be opposite, tell you you've got duplicated funds, that's what it tells you doesn't it?

MS SCHEERLINK: Yes.

MR HARRIS: This would be the reverse of that then. The system's the same it just inputs it differently.

MS SCHEERLINK: Yes.

MR HARRIS: But that would have no panel then, that would just have the existing ratings agencies, here's what three different rating agencies say are great pans.

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MS SCHEERLINK: We have lots of concerns about how the – the practices and the behaviours that the ratings agencies sort of creates, it's a real – in order to be on that list you need a very short term focus when things come out every quarter, say, or every year. To be in the top five performing, as the ratings change, we're looking at very short term performance indicators, rather than long term, and that would be a big concern.

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MR HARRIS: So what about the reverse? I don't know whether you were here earlier, but right at the starting one of the earlier sessions, I'd suggest, what about the reverse then? What about telling people that they're in the bottom quartile every time they change their job?

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MS CHESTER: Over the end to longer term.

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MR HARRIS: Again, I'm just sticking with ratings agencies. We can all argue about the content, I'm addressing the comment that we got from one of the largest superannuation funds in this country which said the biggest risk, the one Karen tried to outline earlier, the biggest risk is being defaulted into a poorly performing fund. What about we tell you at least? Is that really that threatening to the incumbent that says, we're going to expose the bottom quartile to members' knowledge, we're not going to force them to do anything? Is it really that threatening?

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MS SCHEERLINK: No, not at all. I think these members do need to be protected, but we need to make sure that the information that we give them actually assists them not overwhelms them and allows them actually to make appropriate choices.

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MR HARRIS: But again, no part of the current system, no regulatory part of the current system seems set up to provide that information. Neither the incumbent fund nor the workplace relations system, nor APRA communicates to a member and says, you're in the bottom performing quartile. Nobody does that.

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MS SCHEERLINK: That's right.

MR HARRIS: That's pretty poor on the behalf of members isn't it? Which goes to my comment about passive accounts still paying insurance. It seems all pretty poor on behalf of members if we start, as we have tried

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to do, or I have suggested we try to do here in default, is just to keep thinking, I'm a member, what do I want. These are certainly improvements and we just don't seem to get this back as advice. Anyway, maybe you can consider that for the purpose of phase 3.

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MS CHESTER: The body that decides the best in show.

MS SCHEERLINK: Yes.

10 **MS CHESTER:** We've suggested it couldn't be the regulator. I can't recall whether your submission – I know your submission does have views on this, but I couldn't recall whether - - -

15 **MS SCHEERLINK:** I don't think we made any comments about the regulator, did we?

MR WEBB: No.

20 **MS SCHEERLINK:** No.

MS CHESTER: Okay.

25 **MR HARRIS:** Sorry, "AIST recommends the Commission acknowledge the need for APRA to use existing powers to provide greater scrutiny to encourage fund and product consultation".

MS CHESTER: This is best in show though.

30 **MS SCHEERLINK:** Yes.

MR HARRIS: I thought you meant mergers.

MS CHESTER: Move onto mergers. Body first, then mergers.

35 **MS SCHEERLINK:** Probably wouldn't be seen by the industry as independent enough.

40 **MS CHESTER:** So can we go to the principles first, because we didn't say who the body should be, we just said, here's some principles to start with and we'll refer to it as an expert panel.

MS SCHEERLINK: Yes.

45 **MS CHESTER:** So does AIST have any problems with the principles that we articulated? Do you want to have a look at them?

- MS SCHEERLINK:** Yes, would you mind refreshing my - - -
- 5 **MS CHESTER:** Well, my helpful teenager thought I had this – that’s just the dot points.
- MS SCHEERLINK:** Dot points, thank you. No problem with the principles.
- 10 **MS CHESTER:** Yes.
- MS SCHEERLINK:** The question would be whether there’s something that’s perhaps missing, which I’d like to get back to you on, but otherwise - - -
- 15 **MR HARRIS:** Sure. No, that would be useful. It would be useful if you would find something else that belongs there.
- 20 **MS SCHEERLINK:** Yes. I think AIST is supportive of a quasi-judicial type arrangement for this to try and take politics out of it a little bit, to give certainty in terms of the people that are represented on that panel in terms of their powers and their ability to be reappointed, if you like, rather than if they haven’t done the relevant political party’s bidding at the time, that they might be removed and replaced.
- 25 **MS CHESTER:** So who makes the appointments to the FWC?
- MS SCHEERLINK:** The minister.
- 30 **MS CHESTER:** The government of the day.
- MS SCHEERLINK:** Government of the day, yes. But they’re appointed for a term not on an individual sessional basis, we would have an objection to that.
- 35 **MS CHESTER:** So you’ve got a penchant for a sort of semi judicial body, how are they then accountable to the government of the day for their decisions?
- 40 **MS SCHEERLINK:** They’re accountable under their Terms of Reference and they’d be probably required to appear before parliamentary committees in terms of their accountability.
- 45 **MS CHESTER:** You’re the FWC guru at this time.

- 5 **MR HARRIS:** No, I think we observed with HESTA last week, the independence the FWC can claim, I don't think you can make the panel accountable. It can publish its reasons, but the same would be true of a panel here. In other words, the panels in all cases are subject to the same going in perception. They can be politically appointed and I think everybody now assumes that since they can be they will be. It's unfortunate, but I think FWC's great claim to difference is "we're independent".
- 10 **MS SCHEERLINK:** Yes.
- MR HARRIS:** But I think you can't make them accountable.
- 15 **MS SCHEERLINK:** Unless there's some sort of appeal process to a decision.
- MR HARRIS:** Yes, that's the legalities you've got to appeal them on. Anyway, we shouldn't go into this.
- 20 **MS CHESTER:** So my one single question and then you can do your last one.
- MR HARRIS:** You've just done your one.
- 25 **MS CHESTER:** No. I didn't ask CHOICE this question because it was actually in their submission. So, Eva and Richard, this is just a question I've put to all inquiry participants and it just requires a yes/no answer. We talked about what potentially would be the biggest risk about underperformers. So do you agree in principle that underperforming funds should be required to exit if they continue to underperform medium to longer term, the default segment, and new higher performing funds should be able to come in and access the default segment?
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- MS SCHEERLINK:** Yes.
- 35 **MS CHESTER:** Thank you.
- MR HARRIS:** You will see our thematic here with my last question. You have recommended that, "APRA publish a league table showing net returns to members one, three, five and 10 years for all MySuper products and for each choice investment option above an agreed threshold of assets". That's in your sub. So you must imagine that someone's capable of constructing my versions of – I suggested earlier, you must imagine if APRA's capable of doing it, and I didn't ask about APRA, I was more saying why would we make APRA do it, why wouldn't we just publish
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the individual ratings agencies? Anyway, someone, somehow is capable of doing this.

5 **MR WEBB:** We'd like to think that someone somewhere is capable of doing this, yes.

10 **MR HARRIS:** So I can construe that as being positive support for the idea that if it was possible creating such a league table, because you recommended one, we could send it to members, it would be a not unreasonable thing to do, it would be good for engagement, even if – I wouldn't say it would work perfectly, but it's better than we currently seem to do. Would that be right?

15 **MS SCHEERLINK:** It would require some consumer testing though, I think, to see whether it did actually meet their needs, whether it was something that was digestible and helped inform their decision.

20 **MR HARRIS:** I guess I'm trying to characterise the two parts of yours, is APRA should publish and it's possible to create a league table. I'm really trying to get you on the record as saying it is indeed possible to create a league table, because you think it is. But you think APRA should publish it and I'm trying to get you to agree that it would be even better to have it proactively sent to the member rather than hope that the member reads the financial review page 23 where these things are usually
25 published. Would it not be better to do that for member engagement?

MR WEBB: What would probably be better would be for APRA to be able to publish this about all 44,000 investment options that people can choose from all the funds that are available about there. I realise that this
30 inquiry is concerned mainly with defaults, but if we're going to be publishing this for the benefit of members, there needs to be no carve outs, there needs to be the ability to be able to compare superannuation products. This is something that I know that a lot of entities struggle with.

35 **MR HARRIS:** We were doing so well here until you said that, until you said 44,000. You cannot seriously on the record here expect me to accept that you think communicating to members 44,000 comparators is a wise way of communication. Seriously.

40 **MR WEBB:** If we're talking about moving away from a default option to any other option, we're now starting to get into the realm of member choice.

45 **MR HARRIS:** But we're both familiar with communications principles, I'm going to expect. No one normally would say it is a wise method of

communication to a disengaged member to say, “Here are 44,000 choices, please work through them and work one out for yourself”.

5 **MR WEBB:** It depends on who this is being built for. If it’s being built for the benefit of someone who’s - - -

MR HARRIS: Members.

10 **MR WEBB:** No, well, I’m not sure that if we’re talking default options that is being built for the benefit of members. Remember, the idea of a default option is someone who has not made a choice for whatever reason, and is going into something, I guess, that’s chosen for them by someone somewhere. So is it for the benefit of members, or is it not?

15 **MR HARRIS:** We’re trying to design it for members, that’s why in this inquiry, to the frustration of a number of parties, we went back to zero and said, imagine there is no default system, and then said, these are the faults and flaws, and then try and build up four models that address those. We did that quite deliberately, and in the course of doing it you encounter the
20 wisdom of a financial service inquiry which just said, why are we forcing all these people to default continuously. So we have our smaller pool proposal. And we also find that people are disengaged primarily because the number of choices in front of them is just very, very large.

25 I can’t imagine that you could possibly address a failure to make a choice because there’s a large number of choices by expanding the choices even more. Which was what, 44,000, I can’t imagine that that would be a serious option. Seriously.

30 **MS SCHEERLINK:** No. But some serious work needs to be done in terms of consolidating a lot of those 44,000 choices, particularly where there are lots of choices within one particular fund, that all look and smell exactly the same except for that their fees model is different. Some work needs to be done there in relation to intra-fund consolidation.

35 **MR HARRIS:** Okay. As I said, we were doing so well, I thought we might actually have agreement on this little piece of paragraph in the report, but I would say – in your contribution, but I would say we don’t. Thank you very much for your time today.

40 **MS SCHEERLINK:** Thank you.

MR HARRIS: For persisting, and also persist please into phase 3, because more of the things that I think you were somewhat frustrated

about we couldn't do in phase 2 will be up and available in phase 3.
Thank you very much.

MS SCHEERLINK: Thank you.

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MR HARRIS: SunSuper. And I'm running 10 minutes behind schedule, but I don't know what comes after SunSuper, so we may have all the time in the world.

10 **MS CHESTER:** Okay.

MR HARRIS: So nominally you guys are running through till 12.10, but we're running 10 minutes late, so we're going to try and claw what we can out of it, out of you or the next participant, or whoever comes after that.

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MR SOMMER: Understood.

MR HARRIS: For the benefit of the record, please, could you identify yourselves?

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MR SOMMER: Sure, so Jason Sommer, I'm an executive at SunSuper.

MR EAST: Lachlan East, an executive at SunSuper.

25 **MR HARRIS:** Do you have any preliminary comments to make? Thank you for your submission, by the way.

30 **MR SOMMER:** Thank you for the time of the panel and the opportunity to participate today. There are a few things I would like to call out in advance of questions and a number of these are in the report. Firstly, we do think there is opportunity to improve the efficiency of the system as it stands today. So a number of those points are made in our report, those include things like choice, genuine choice, cleaning up of legacy products, addressing cross subsidies within MySuper products, the old flipping concern, amongst a number of others.

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So we do think there is opportunity while the current changes to the default system are still being bedded down, MySuper's not fully implemented yet, and we do think there is opportunity to improve.

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As it relates to the models put forward in the draft report, SunSuper's view is that model 2 is the optimal one of those models put forward, and that really boils down to a couple of things. We think that it's a good idea for employers still to play a role in selecting default funds, there's a particular level of knowledge and experience that employers bring around

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their workforce that we think is of value. Importantly, like other models, model 2 also narrows and, hopefully, lifts the quality of default funds available for employer decision. So we think that's – model 2 really gives us the best of both worlds.

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We certainly support the premise of allocating a default product once for a person when they join the workforce, we think that's a very good thing, address some of the more systemic issues that we have in the industry around multiple accounts.

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SunSuper doesn't support a formal framework with public disclosure around mergers, we think that will inhibit discussions and ultimately be counter-productive, and we're a big supporter of group insurance within super. It's not the say it doesn't have areas where it needs to be improved, but as a whole it's a good thing for the Australian public, it's high value, relatively low cost, and it meets a social need around insurance, and there is still a large insurance gap in Australia.

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So they're the points I'd like to make, and happy to take any questions, as it my colleague.

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MR HARRIS: Thank you very much. You start?

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MS CHESTER: Yes. So thank you, it's a bit of what I call a unicorn submission, i.e. you're a unique beast, having been a fund to support one of our models, so we thank you for that. The decision between model 1 and model 2, you see the role for the employer, and I know SunSuper's done a lot of work in this space. I guess we see a broader lens of employers, we hear from COSBOA about employers that don't want to even think about superannuation and we look at the CHOICE survey that says just under half of employers spend less than five minutes deciding the default fund they're going to stick their employees in.

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You've obviously got a different lens through which you view employers, is it by size? What sort of cohort of employers are you thinking of when SunSuper's immediately attracted to our model 2, assisted employer choice?

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MR SOMMER: So there's a couple of things. Certainly there's an aspect which is compared against the other options. We think that employer being involved in making the decision, given the inherent knowledge, and that includes small, medium and larger employers, and there will be some in there that take less of an interest. But our experience of our 90,000 employers is that employers do want to do the right thing for their employees and do want to make the right choice.

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5 So it's really bearing in mind our experience with our employers, and some of the other models sequentially allocate members to funds, which we think is less optimal than the employer actually being involved and making a choice around a subset of a smaller number of funds of good quality.

10 **MS CHESTER:** Of the 90,000, Jason, that SunSuper's dealing with, you say that this was across the spectrum from small, medium to large.

MR SOMMER: Yes.

15 **MS CHESTER:** Are we able to get a little bit of a – not here today, but later – a bit of a profile, because I guess we kind of deal with it through the twin lists anyway, so we've got employers that are smaller and not well enough engaged to make decisions on behalf of their employees, they've got the smaller list that they can go to, the longer list can be for those that want to tailor.

20 You talk about wanting to transition to the twin list. What's your thinking behind the need for a transition to the twin list under assisted employer choice?

25 **MR SOMMER:** So having been a fund which has been involved in some transitions over time, they're fairly large, complex exercises, and our concern would be if we go from say 120 MySupers to something a lot less, and we do think MySuper is a good criteria to actually try to narrow that opportunity set for employers, rather than introducing say another criteria, that could force the dynamics of a lot of funds into a very precarious position, be it around new member flow, fund flow, increasing administrative costs.

35 All of a sudden if a fund turns around to be in a growth position to a net loss position of be it members or fund, that has implications for costs, services, asset strategies, et cetera, et cetera. So we think a phased transition helps minimise that risk that some funds will get wobbly quick.

40 **MS CHESTER:** So I guess we tried to address the system stability issues, which I think you're coming to in terms of how can a large number of funds who are no longer getting default inflows transition their way out by only going for the new job entrants. So it's 400,000 each year worth about 800 million. So we look at that in the context of the entire system, let alone just the default component, which is about 486 billion, I think.

45 **MR SOMMER:** Yes.

MS CHESTER: Those transitional issues are much less than they would otherwise be if we're cracking open the entire default dollar churn.

5 **MR SOMMER:** So I think that certainly helps the phased transition. I guess it will lead to them, then put the question of what about the changing jobs part. So if it's just new entrants coming in, we could see that at some point in time or even before these inquiries are finished that the question will get asked was, what about when people change jobs,
10 because it will take 40 years for the old default system evidence is washed through the system.

 So we think that question probably inevitably will come up, and nevertheless, if it's a smaller subset of funds which an employer, for
15 example, is choosing from, that will send a signal to the market and employers around, well, what's my current fund if it's not on that list and do I need to make a change. So I think there is some signals it will send to the market beyond the 400,000 members.

20 **MS CHESTER:** This may be a bit of an unfair question, but why is SunSuper the unicorn here? What is it about you, SunSuper, that's – you basically nearly agreed to one of our models in its entirety.

MR SOMMER: I'll take that as a compliment.
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MR HARRIS: We intended it that way.

MS CHESTER: We did. I don't normally.

30 **MR SOMMER:** I probably can't answer that question, Karen, in all fairness. Mind you, we do have comments on your model 2 which we think could be improved.

MS CHESTER: Fair enough.
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MR SOMMER: But it's SunSuper's view that fundamentally it would result in a better outcome for the Australian public.

40 **MS CHESTER:** We have had one other large fund say to us that they think the biggest risk for a default member today is being defaulted into an underperforming fund product. Would that be your view of what the biggest risk a default member could face today?

45 **MR SOMMER:** I don't know it's the biggest risk but it's certainly substantial risk. We know that, this is just compound interest and

mathematics, that over time you get a little bit of up performance, accumulated over many, many years, it does have a large impact at retirement. So I think that's (indistinct).

5 **MR HARRIS:** You've made in fact a bold statement which I'm planning that we will record in the final report, "Every current and future policy move in superannuation should be designed to encourage further member engagement as the system matures in coming decades". Which would suggest that mechanisms to ensure people aren't trapped in poorly performing funds would be desirable policy leaders, to me anyway.

10 **MR SOMMER:** So that principle you're referring to, Peter, I'll just come to that first it's our view that if you can get members engaged in their super, take an interest in their super, make sensible decisions for them, that results in better retirement outcomes. So that as a principle, it's a principle we operate within our business and we think it results in better outcomes. That principle is in the construct of the existing fund. I think if a fund – if we can get a higher quality level of fund that employers can select from that will only produce good outcomes, and part of that will mean some funds exit. At the moment we have 115 MySupers to choose from, that is too many. It's too many; it's too hard a choice.

15 **MR HARRIS:** The proposition I was putting earlier to people about using the mechanism where we – if we do have some form of rating, and I note the model that you've endorsed, which would have some form of rating, but simply having that communicated to members directly, there is no one in the current system who owns responsibility for communicating direct to members, other than about their own fund at the moment.

20 There does not appear to be any, and I'm waiting for someone to tell me you've missed this agency which does this great job, but I can't see it. In which case we have the information available to us, it's held by APRA, on which funds are the poorly performing funds over whatever period. And that's why I was asking you earlier, because they had suggested that it was possible at least to have such a league table. Who do we not have a system that requires that to be communicated to a member? Not published just in the newspaper and pray some reads it, but actually directly published.

25 **MR SOMMER:** I think that there is – we just would have to be careful around a proposal like that. There's a few things which come to mind, is that if we're talking about investment performance we've got the old past performance is no indicator future performance. Also performance can vary between funds because of growth defensive asset splits, assets allocations, a whole range of factors. So while the intent is good, on

investment performance that does become challenging, and you wouldn't want to mislead members.

5 So I think investment performance is one measure of how a fund performs, a very, very important measure, but there are other measures as well.

10 **MR HARRIS:** So currently APRA is charged though with doing just this itself. So it's either an impossible task and that's why APRA isn't actually encouraging mergers of smaller and poorer performing funds, or it isn't an impossible task. In other words, APRA is capable of developing whatever information system so let's not stick with just returns, although I would say someone who's failed a – a fund that's failed to be in the – or hasn't moved out of the bottom quartile in one, 15 three, five and seven years is probably doing pretty poorly. But you never know.

20 But otherwise we have mechanisms nominally here which we say are meant to encourage through the current regulator a focus on funds redirecting themselves towards each other such that incidentally or secondarily or subsequently members benefit, but we don't have anything for members. Yet we say we're all worried about member disengagement. Almost every submission has told us they're worried about this, but no one has a proposition to utilise the kinds of mechanisms that we have 25 suggested, use competition between whatever it, benchmarking competition if nothing else, to create a league table or something, and put that directly to members, as well as everything else you do. Why is that not desirable?

30 **MR SOMMER:** I did say it was desirable, I think it fundamentally comes down to make sure the execution of that's right, Peter. So if I think about some of the other disclosure which is available for members, things like the superannuation – MySuper dashboard and also a look through on holdings for investments. Those things I think come with good intent too, 35 but probably haven't had the cut through. I think I agree with the intent, we've just got to make sure that the execution of it really hits the mark.

40 **MR HARRIS:** But we think APRA can do it. Most submissions are saying, more work for APRA. So we think APRA can do it?

MR SOMMER: I think it can be done to have much better disclosure at particular at change in jobs time to allow members to make better choices.

45 **MS CHESTER:** From reading your submission and some of the earlier involvement we've had with SunSuper, you're clearly identifying the

default one is a solution to a systemic problem we've got with account proliferation and non-consolidation, albeit everyone keeps pointing to the ATO's doing a good job, just do a bit more. We then hear, you don't want members to default once from any of our lists, best in show or even the longer list, because if they change job down the track, that different job will mean that that default product is no longer appropriate for them. This is the concept we're kind of struggling with.

We kind of think if it's on one of the two lists, if it's best in show or it's on the slightly longer list, setting aside insurance for high risk employees, from SunSuper's perspective, would that be a defaulting to the lowest common denominator, if they then changed a job but stayed in a fund product that's in one of our two lists?

MR SOMMER: I think it's hard to put insurance to one side; it's such a critical part of superannuation. So I sort of appreciate that you're trying to narrow down the issue, Karen, but I think it is difficult to put insurance, because it is a very valuable benefit.

MS CHESTER: We're still having insurance in there and it's a pre-eligibility requirement that to get into any of our competitions on any of our lists you've got to meet the minimum standards and, indeed, we're hoping that they will be raised with this working group that's underway. So you've got to have done that, so you've got the member in appropriate insurance, whatever the appropriate insurance might be for that member.

MR SOMMER: I think I come back to our submission, which is we think there is value in narrowing down, particularly via the MySuper criteria, the number of funds employers can select. Then ultimately you get into a position where an employer is making a better choice than they would be today because there is a lift in the quality of the funds.

MR HARRIS: Yes, the insurance is such a complication for product cross-comparisons. If you are aiming as a current industry fund at a particular sector and you have a particular insurance product, that is actually valuable because the employees in that sector are – they're in construction, say, and therefore they're at more high risk. It's a bit of a hard ask to say to that particular fund, "Well, we should compare you with someone whose member mix is generic and in far less risky operations therefore and has a much lower premium or a relatively lower premium".

The models here were constructed leaving insurance out because it would be unfair to some competitors to stick it in, but it would be a preliminary, as Karen has outlined, which is you should have an insurance product and it should be of the relevant quality that is to meet the

standards in the SIS Act. But beyond that, we would say it's not a good way of making comparisons because some funds will have particular focuses and it will be harder for them to say their insurance product should be the same price as someone else's insurance product. Almost
5 says you should have a MySuper for insurance, but we didn't decide to widen the speculation beyond to that kind of level.

We do acknowledge the significance of insurance; we just weren't proposing that it would be one of the mechanisms by which you would
10 select the winning fund.

MR SOMMER: I think it is hard to completely disregard it. The fact of the matter is a lot of Australians don't quite make it to retirement, or if they do, they have significant health issues. So it is a real benefit of the system, but I do take your point, it is bundled. And fundamentally I think
15 that's a good thing.

MS CHESTER: So with the advantage then of assisted employer choice, so under assisted employee choice, if they moved into a particular high risk sector where they needed specific insurance, because I'm still trying
20 to work out how investment strategies would be different depending on what sector you work in, we're then relying on that super fund to be on one of the lists.

25 **MR HARRIS:** Correct.

MS CHESTER: More than likely would be, because we know which one we're thinking of, and it's a pretty good performing fund – to be on one of those lists and for them to market to the member.
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MR HARRIS: Yes.

MS CHESTER: You've defaulted, now go to choice and come to us; we're on this good list. The advantage of model number 2 is the employer
35 also plays that prodding role, it's not just the fund.

MR HARRIS: And that information will still be available under the models. In other words, if you were in a particular industry that had a particular risk option, you'd still be under model 2 which we're talking
40 about, the one that you've supported; you're still within the outer rim if you like. You may also be in the inner preferred, but there's a reason not to take a preferred fund, amongst – one good reason for an employer would be, we're in a high risk industry and we haven't chosen one of the preferred funds because they don't offer the right insurance product.
45 Straightforward really, same call and how are you for that.

5 **MS CHESTER:** Mergers. How does a member know today, a default member know today, two years after the event that a merger didn't happen and that reason was or was not in my best interests?

MR SOMMER: How does a member know that today?

10 **MS CHESTER:** Yes. So funds report to their members. Funds put a bunch of stuff on their websites, some of if you can find, some of it you can't as easily as you'd like to.

MR SOMMER: Sure.

15 **MS CHESTER:** How does a member know today – because you were concerned with our disclosure suggesting in our draft report, and you got to one of the issues that we were indeed concerned about, that it could result in some first disincentives and discourage people from either courting before they go to the altar. But how does a member know today?

20 **MR SOMMER:** Well, ultimately it would be dependent on the view of the trustee around level of disclosure they'd like to provide. But our concern with the report, as it relates to this particular item, is that if there is a requirement to disclose, particularly early on, once you get to a certain stage of a merger there's things that inevitably are out there in the public domain. But prior to that you would want to encourage discussion and our concern is that if there is public disclosure prior to that – in that early stage, those discussions wouldn't have happened, and ultimately would not be in the interests of them.

25 **MS CHESTER:** So it's the timing of the disclosure. I think someone from our team helpfully got in contact with you on Friday to say could you have a look at an idea that we've received from PWC in their submission, which suggested a latter time horizon, i.e. discussions with APRA post MOU, and then disclosure well after the event. Does that kind of address the concerns that you've got?

30 **MR SOMMER:** It does in part, and then the ultimate question would be well, exactly when is that. Because each successful fund transfer is a little different and the process may be a bit different, but something later in the day would help to address our concerns. But I guess it probably then comes down to the difficulty of potentially executing on that and what would that look like. But once it's out in the public domain, then I think it's – the trustees really have an obligation to comment on it to members and employers and other stakeholders.

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5 **MS CHESTER:** The other suggestion that PWC had was to help remove and mitigate some of the obvious overt conflicts that trustee board members and indeed CEOs of these organisations would have would be to defer consideration of who's going to be on the merged board, who the new CEO will be, until the real robust due diligence around is this in members' best interests is completed. I mean, we've all heard the war stories of mergers that didn't go ahead for purported reasons. Is that proposal by PWC one that will kind of sit well with SunSuper's experience around mergers in terms of - - -

10 **MR SOMMER:** I think you're almost ignoring the elephant in the room and I don't think it's appropriate that one of the bigger issues in any sort of merger could be a super fund or any type of business sort of trying to put that to one side, I don't know if that would really work in practice. I could see where PWC are going with this, but it really comes back I think to our initial point around we just have to be really careful around public disclosure. It's a tricky issue.

20 **MS CHESTER:** So this wouldn't be disclosure, this would be APRA giving guidance to the trustees to say, do your due diligence around whether or not this merger is in members' best interests, but as part of that initial due diligence, when you come to (indistinct), just purely from the respect of the members, you're not considering who the CEO's going to be or who the trustee board is. You'll decide that after the event in terms of who you think is best qualified to do that. But to keep that direct conflict out of the due diligence phase.

30 **MR SOMMER:** I think it's too big an issue, Karen, to sort of say to put it to one side and we're not going to consider it prior to due diligence or during due diligence. I just – it feels like something that's difficult to legislate, certainly, and even via a framework, I think that would be tough to do. Have some APRA guidance on how to approach mergers I think, in principle, is generally a good thing. But I think that would be tough to implement.

35 **MR HARRIS:** So you're a supporter of our first-timer pool, you really have – you're a unicorn with extra spots. You've put it down that they're primarily – you refer to a "Perpetuating the legacy problems the industry faces today". You do note that there's a – that the single touch payroll system is meant to be in place for this purpose, but when we were putting together this proposition in favour of the first-timer pool, I guess one of the concerns that we had about our own option was this question I think I went to with AIST a bit earlier, that it will mean that certain funds that are likely prospective funds for people starting a first job, casual jobs, part-time jobs, will get first crack if you like at the default members.

5 SunSuper's not naturally in that category I guess, or maybe you are and I'm unaware of it. So can you tell – because again, this goes to your unique status, that you're not afraid of a policy option that would certainly reduce account proliferation in the way that some other funds seem to be. Why is that so? Why are you not afraid of this?

10 **MR SOMMER:** There's a couple of things I guess to bear in mind, Peter, is that we ultimately think that this will be in the public good. Multiple accounts isn't an ideal component of our current system, and so we believe that if it's in the public good it's something we should reasonably support. SunSuper, I don't think would be a net beneficiary or loser out of that position, and we're a fund that is happy to and willing to compete with other funds in the right way to attract members and keep
15 them over time. So I can't comment on other funds, but that's SunSuper's position.

MR HARRIS: No, but just in your own case.

20 **MR SOMMER:** Yes.

MR HARRIS: So you're saying you have confidence in your product sufficient to say we think we can be competitive?

25 **MR SOMMER:** Correct.

MR HARRIS: And our relationships with employers and that kind of thing too. Okay, that's fair enough, I just wanted to get that on the record somewhere, because often we only get – well, in fact so far, with one
30 other exception, we haven't had too many positive comments from this perspective.

MR SOMMER: If I can just make a further comment too. We certainly agree with the intent, we've made it clear in our submission too, that
35 perhaps the way it's gone about and how we – because an industry would look to potentially execute that, we have differing views, we don't necessarily agree that a centralised government clearing house would be the way to go.

40 **MS CHESTER:** We'll come back to that.

MR SOMMER: I think the intent is absolutely right, we just try to minimise other accounts.

MR HARRIS: Of course you don't need the clearing house for that policy option. You don't need it, it's potentially of benefit, but you don't need it. However, I think the clearing house attraction is as much as anything a possible two way option for information as well.

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MS CHESTER: We will come to the clearing house, but before we do, more of a natural segue to the question then, if any of our four models got up, one of the things we're trying to assess is because we've gone just with the new job entrant, so it's only 400,00 each year or 800 million but getting up to \$2 billion each year, would SunSuper from a business case perspective be involved in all of those – regardless of which model got up with government, would you go for the best in show under model 1 and model number 2, multi criteria tender of fee option? Would you be a participant?

15

MR SOMMER: We would certainly be interested in having access to those new employees to the workforce. We support model 2, adjusted, as per our submission, and on model 1 and model 4, and we think there are some pretty significant flaws in them so we're not supportive of those models, and the multi tender, we think there's some positive aspects, in fact it seems to blend with model 2 in certain aspects as well. But as it relates to model 2, absolutely.

20

MS CHESTER: I guess my question is more generic than that, so if we just set the models aside for the moment, is if there was a competitive process for that new job entrant market, and there could be four to 10 winners coming out of that process, would that still be enticement enough for you guys to have a business case to go through with the cost involved in entering that process?

30

MR SOMMER: I think under model 2 in our submission we said there's a top tier and there's the second tier, and we suggested a number of funds which we think should participate under that – in both those tiers and type of MySuper criteria. So we would absolutely spend the time, energy and effort to get on ideally both those tiers.

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MS CHESTER: Anything else?

MR HARRIS: Done.

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MS CHESTER: One thing also that was unique about your submission was you actually looked in a forward sense to workforce mobility, complexity of markets, complexity of jobs, people churning through job, which got you to the landing, yes, a single clearing house is a great idea. But then you said, horror, forbid, don't give it to government to do this. I

45

guess our focus on the clearing house came from our trip to New Zealand. People always tend to read a little bit too much more into when we travel, our Chair travelled to Chile, I got New Zealand – I know which one I'd prefer.

5

MR HARRIS: I had other reasons to be in Chile.

MS CHESTER: So we do like to go and look, pick the eyes of international jurisdictions; look for the good, bad and the ugly. The one resounding good that we heard from every participant that we spoke to in the New Zealand system was their version of the ATO playing the clearing house role was the one thing they absolutely got right and for a couple of reasons.

15 Firstly – but and importantly, and maybe this is something that participants like yourself were not aware, the clearing house model in New Zealand also goes hand in hand with the regulation that allows members to do everything on line. There's no mail outs to members, it's all on line. And the IRD clearing house role has to ensure that the funds, and IRD have those email addresses and contact details to allow that to occur. So you can see all of a sudden you've shifted a huge cost from the funds to the government, and it's made for a market that allows itself to track people, payments not having been made, account consolidation.

20
25 So for us it was very appealing. But your stumbling block is government, whereas I guess we've seen an example just across the Tasman where government actually seems to be doing it pretty okay. So is it government doing the role that's the stumbling block for you?

30 **MR SOMMER:** I guess there's a few points to make there, Karen. By government – I think the Financial Services Industry Australian has been well served by government regulating, setting or regulating by regulators, and letting the market, largely, get on with the business of providing financial services. We think a government clearing house at that level would be quite an intervention in the market firstly. If you compare us to say the New Zealand market, I think it's fair to say we're probably quite different, arguably more complex than that market.

35
40 The other thing is we've spent as an industry many hundreds of millions of dollars trying to get SuperStream up and running, that's still not finished, and our view would be let the industry solve this problem, piggybacking off the significant investment that's been made in SuperStream to date.

We sort of believe that the industry can better respond to the needs of the market, than having a centralised government clearing house trying to do the same thing. We think a market based model would be more adaptable and flexible over time as well as needs change.

5

MR HARRIS: Done?

MS CHESTER: Yes.

10 **MR HARRIS:** Done. Thank you very much for your submission and for your time and participation, really appreciate it.

MR SOMMER: Thank you.

15 **MR HARRIS:** You may not want to stick with us through phase 3, but I'll still give you the ad anyway. In phase 3 we'll have even more exciting time.

20 **MS CHESTER:** We're happy for you to retain the best in show uniform title.

25 **MR HARRIS:** I think he'll be turning it down. I think we have Workplace Super Specialists Australia. When you get a chance, once you're settled there, if you could identify yourselves for the record, that would be great.

MR LATTO: My name's Douglas Latto, I'm the Chief Executive Officer of Workplace Super Specialists Australia, WSSA.

30 **MR RHODES:** Terry Rhodes, president of the WSSA.

MR HARRIS: Okay. Do you have any opening remarks? Thank you for your submission, by the way, but do you have any other opening remarks?

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40 **MR RHODES:** Yes, if you don't mind, we'll kick off with a statement. Thank you for the opportunity to address you today. Our submission is made from the viewpoint of industry practitioners, financial advice firms. So we represent financial advice firms that are providing services, education and advice to employers and employees in a workplace on a daily basis. So we're actually at the coal face of the default super industry.

45 We've also been a major contributor to assisting employers in selecting appropriate default funds for them, and this is especially the case

in the small to medium sized market. So our members have a high level of exposure to workplace superannuation, both employer and employee level, and our members provide advice and support to employers around legislative, regulative, and policy committee issues, as well as providing education and advice to support fund members.

So our collective experience has led us to believe in an open market approach where superannuation funds can compete freely. It is our belief that a superannuation fund should be first chosen by an individual, and if an individual does not exercise choice, then they become a default member in their company's chosen super fund. We believe that the employer is the most qualified party to select a default fund on behalf of the employee.

We say this because employers are aware of the demographics of their workforce and can select a default which best suits their demographic. Many employers also use superannuation and insurance as a tool to distinguish themselves from others and often provide an increased benefits to their workforce, and this can be in the way of higher contributions, payment of insurance premiums, or payment of superannuation fund fees.

So removing the employer's ability to select a default fund from a broad choice will remove this benefit and could potentially have a negative impact on their employees. This is hardly a desirable outcome.

We also believe that education is the key to solving the problem of employee disengagement and we also believe that allowing employers to provide a default, which includes the service of an advised firm, allows for the provision of education in the workplace, and this is something that we do every day. Fund member engagement improves if members are educated, and without education there is little impetus for the currently disengaged fund member to take control of their financial future.

MR LATTO: If I can just continue on and finish that off. MySuper was intended to provide a solution to the selection of default funds when it was first brought in, that was what it was by design. It has not reached maturity; we still haven't reached 30 June 2017 when all the moneys have been transitioned across. It's still in implementation phase and it really hasn't operated in an open and unfettered market. It is therefore impossible to judge how effective MySuper could be in proving a default fund selection criteria, or how competitive MySuper funds could be over time.

MySuper criterion could be tightened to expedite the attrition of non-competitive funds. There has also already been some significant market

consolidation of the last few years. Arbitrarily limiting the number of default funds stifles innovation, provides an unfair advantage for the chosen few and places barriers upon new entrants.

5 Good performing funds which are not selected will struggle to survive and with outflows likely to exceed inflows over time. A selection panel selected under any of the proposed models could be subject to external influences, including political. While it's suggested that a selection panel should be accountable for its decisions, how can this be monitored or
10 enforced?

 How can potentially millions of Australians be compensated for losses resulting from poor default fund selection by such a panel? It would be a brave panel member who accepted such a position. There
15 could be a regulatory cost attached to this as well.

 So choosing a default fund on first commencing employment can also be flawed. Many individuals work in, as you said, in retail and hospitality, it's their first job, potentially whilst studying and established
20 their career. If a first time pool is created, then this will lead to many people being pooled in a fund that may not be appropriate for them over their entire working lives. Single touch payroll is likely to be mandatory from July '18 for employers of 20 or more employees. This would have a major impact on the reducing the proliferation of individuals with multiple
25 super funds.

 In summary, the WSSA supports model 2, assisted employer choice. With strengthened MySuper criteria, this would be a sufficient filter. Heavier filters would continue to distort the market, this will enable both
30 competition and innovation to survive going forward, which can only benefit the members of super funds.

 And just there's one point of differentiation, we're actually both not just representors of the association, we're actually both practitioners
35 running such practices, which might be slightly different from what you've spoken to.

MR HARRIS: Sure. Again, you're an unusual entity, without a doubt.

40 **MS CHESTER:** You practice what you preach.

MR HARRIS: Pretty successful, from what you're suggesting here. I wanted to ask a little bit about education and I want to ask about the first timer pool as well, those were the two topics that I had in mind.
45

MS CHESTER: Mine are separate, you go first.

5 **MR HARRIS:** So education. In your submission you suggest that education would be more accessible if the cost could be met from a MySuper fund's administration fee.

MR LATTO: Right.

10 **MR HARRIS:** And I didn't understand that, I've got to tell you, because some funds tell us that they educate like crazy, including some of the MySuper ones.

15 **MR LATTO:** There's different types of education, what we call reactive and proactive education. I believe that when many funds talk about education they mean that somebody rings them up so they'll give them some information, it's a reactive approach. WSSA members believe in a proactive approach, and I want to go out there and do certain things and some of the funds have recognised that.

20 They recognise that they can't go out there and do it all themselves because they don't have the resources, so they outsource it to people of our association. And they will go out there on site and do the education in many different ways, from seminars, we use technology and online facilities as well, we might do personal meetings. There's many, many
25 different ways.

MR HARRIS: So that means right now – I was taking this on its face as meaning (a) my super fund couldn't pay you or somebody else - - -

30 **MR LATTO:** That's correct. That's correct.

MR HARRIS: - - - to actually do financial education, they're not allowed to do it?

35 **MR LATTO:** It's actually a clause in the MySuper legislation barring that.

MR HARRIS: Do you know anything about the history of that? Is it
40 some example of graft and corruption here?

MR LATTO: The history before, there was – there's commissions and there's fees coming out of there and some people just took commissions and, to be fair, didn't provide services that they should for the moneys that they got, and they shouldn't be in the industry. Other people went to the
45 employer and would negotiate a fee and that fee used to come out of the

superannuation fund, usually out of the member's account. That has been barred.

5 So the employer still wanted to be employers of choice, they still wanted those services, but they weren't allowed to take the costs out of their funds any more. So - - -

MR HARRIS: Sorry, the employer wasn't allowed to?

10 **MR LATTO:** Yes, the employer wasn't allowed the cost to come out of the members' account in any form or fashion. So now we have to say, well, if we deliver services how do we get rewarded for doing that. We're a commercial enterprise. So what the funds have – some of the funds have said, that we still have to deliver this, we still have to have policy
15 committee meetings, because that's a legal requirement, we need people to run that, if somebody wants a seminar we need someone to run that. And we getting basically, through outsources arrangements, providing those services for those funds.

20 **MR HARRIS:** A workaround. Seems very undesirable.

MR LATTO: It's a workaround.

MR HARRIS: Yes, very undesirable.
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MR LATTO: Which is never desirable.

MR HARRIS: No. And my other questions for you guys were in relation to the first timer pool. I would have thought that it would
30 simplify your business proposition by comparison with today's situation to have a first timer pool. So I was sort of curious for – you're more in favour of a system that creates continuous proliferation than I would have thought was consistent with what I understood again from your submission about how you run the business.

35 Is that simply because the default market shrinks and that's an unfortunate business outcome for you guys? Is it that or is it - - -

MR LATTO: No, shrinking doesn't affect us. We would want to work
40 with the quality default funds, and if that's a smaller market, then we would be very happy with that.

MR HARRIS: So it's not the size of the first timer pool?

45 **MR LATTO:** No.

MR HARRIS: Well, that was what I had.

5 **MS CHESTER:** I have a little background question first. I just want to try to better understand, because your overarching premise is that employers are best placed to make the decisions on behalf of default members, I guess I kind of wanted to get a bit of a look through as to your membership base and what sort of employers they're advising.

10 Normally when we get the submission, we get a little bit of a blurb about the association, like how many members we have and who we advise and stuff. So could you just give us a little bit more detail there about your membership size and what sort of employers they're advising today?

15 **MR RHODES:** So there are approximately 70 firms across the country that are significant serious players in the corporate space. Now, obviously there's a pool of some 18,000 advisors across the country, that's licenced advisors, and this is firms we're talking about, and within those firms
20 they'll have multiple advisors working in that space. So there are 70 follow on people who are involved in the space, and they might have three to four people involved in the corporate super space. So it is somewhere in the region of 150 to 180 advisors out there talking with firms every single day.

25 The vast majority of those people are members of the WSSA. Then there is a range of part-timers that are progressively moving out of the market because it's harder to be involved now unless you're a serious advisor.

30 **MS CHESTER:** So sorry, your membership is most of the 70 or most of the 150?

35 **MR RHODES:** Most of the 70, and within that there are three or four people within the firm who would be involved in the corporate super space.

MS CHESTER: Yes.

40 **MR RHODES:** So in terms of who we look out for, my own practice, I would have 40 to 50 firms that we look out for, where we are the appointed advisor to the default fund within that firm. We may not have selected that fund, we might have been appointed because they needed support services and we're appointed to become that advisor.

45

But the breadth of industries that we cover is just enormous. So we're not into a specific area, it could be as broad as can be from my kitchen company in Wetherill Park to a helicopter company in Perth. So it's very broad, very diverse, but the fundamental commentary is about we are the advisors to their default fund, whatever their appointed default fund is, and we look out for them on that default fund.

MS CHESTER: So I can understand the service in helping them choose the default fund, which is kind of what our core business is with this inquiry, it's who's best placed to make that decision on behalf of members. So how much of your 70 firms of their sort of revenue or their business would be about helping employers decide who's the best default fund product for their employees?

MR LATTO: That would be at the smaller end. Their prime business is the education and delivery of other services in the workplace, that's prime. But because they have the relationships with the employers, because they have – and they know industry so well, they will be engaged by the employer from time to time to look at the market and decide whether it's the right fund.

MS CHESTER: So if an employer's chosen the default fund for their members, and your firms may or may not have helped them do that, and then the super fund's there to provide the members with all the advice that they need and all the educative tools and all the rest of it, what is it – so the employers are paying you, right?

MR LATTO: No, the funds are paying for us to deliver them certain services. The employers - - -

MS CHESTER: So that's the outsourcing model.

MR LATTO: Yes. There's a few employers that pay us, but very little.

MS CHESTER: So who decides the outsourcing? Is it the fund or the employer? Does the employer decide that they've recruited you or has the super fund decided, given your location and the services you require, we want an outsource model?

MR LATTO: The employer will not outsource us to the employer unless the employer wants our services in the first place. But it's really a matter of whether the employer is prepared to pay for the services directly or not. And if the employer's not, then the funds say, "Well, we've got them to deliver it, so we're going to pay you to do the service". So it's really a matter of who's paying for it, whether it's the fund or whether the

5 employer. Many employers are not – especially, as I said, we’re in the small to medium enterprise market, we’re not in the BHPs and we’re able to pay for these extra services. So they’re wanting some services but they want us to provide it. However, before the moneys used to come out of the super fund through the members’ account, no longer that is the case, that’s gone.

MS CHESTER: Okay.

10 **MR LATTO:** But they still want them, and the funds are – said, “Well, the funds that we can’t deliver, we haven’t got the resources or skills”, and so they go to the funds and the funds pay us to deliver us to deliver it on their behalf.

15 **MS CHESTER:** So across the firms that you’re dealing with, how many – what sort of size of the default market are we talking about? How many super funds are you dealing with, how many members are you covering?

20 **MR LATTO:** Members, we’ve got the figures.

MR RHODES: Well, it’s around the 15.

MS CHESTER: I just want to get a sense of - - -

25 **MR RHODES:** \$15 billion is the area that we glean in terms of the corporate world, that’s our best estimate; it’s around \$15 billion.

MR LATTO: That’s just amongst our members, not - - -

30 **MR RHODES:** And we know that with their collective group – well, these tend to be the retail master trusts. We know that within their business pool, their corporate focus if you like, rather than their individual personal clients, there’s upwards of a million people within that business community, that they look out for.

35 **MS CHESTER:** These might sound like inane questions, but I’m just trying to get a handle on we hear from COSBOA, we hear from CHOICE, we heard from COSBOA that who they represent, which is a large number of small and medium-sized enterprises, their membership do not want to be involved in making default selection. And we hear from CHOICE that
40 just under 50 per cent of employers spend less than five minutes making the decision on the default fund. I’m not sure whether that’s including your advisory services or not. So we’re hearing very different stories, which takes us to the twin lists. So you’re supportive of the longer list,
45 what I - - -

MR LATTO: A modified longer list.

5 **MS CHESTER:** - - - inelegantly call MySuper on steroids, you've got some modifications.

MR LATTO: Yes.

10 **MS CHESTER:** Which would kind of suit an employer who's informed, the longer list. They can look at a longer list of 30 or 40 and decide, okay, fund Z is going to do a good job for my employees. For the employers that we hear from COSBOA and maybe from the half that CHOICE has surveyed, spending less than five minutes, maybe the smaller list is what's going to help them.

15 I'm just trying to understand your concern with the smaller list. If employers, the ones that you're advising that are very switched on and wanting to be a bit more engaged about their employees, have still got that longer list to - - -

20 **MR LATTO:** For the reasons you've said, I would agree that the smaller list does have some merits, but it's some other reasons that concern us with the short list. It's really the on flow effect, because those who do not make the short list, I think in a previous conversation you talked about number 11 or whatever it is that doesn't make the short list, have to survive. And over time they're not going to get the default flows of money.

30 **MS CHESTER:** But they can still be on the long still and still getting a flow, it's just the new job entrants.

35 **MR LATTO:** Yes, but I sort of believe that once the long list and short list is known, and a short list is endorsed, why would the employer go to the longer list?

40 **MR HARRIS:** Well, we think the insurance product might make quite a difference, as people were discussing earlier. It may be that the construction industry superannuation has a particular benefit through its insurance product which says if I was an employer in that area I would stick with them. So there are that kind of reason.

45 The other reason we thought of, and I mentioned it earlier too, if you're a very large superannuation fund with a back book, I think we called it, of members, existing default members, under our construct you'd be offering whatever better deal, you'd offer it to all of your back book as

well as your future inflows. Some of them may not bid for the right therefore to be a default fund because of the cost of passing it backwards to all the incumbent members. So I think it's rather simplistic thinking from the market analysis perspective to say it's solely the incumbent, very
5 largest funds that would win out. It's possible, but they don't have to become a participant in the products.

MR LATTO: I don't think all the other funds would disappear, but you would find that those funds who don't make a best of breed list will
10 probably have to look a little bit to the choice market.

MR HARRIS: They will. No, we agree with that.

MR LATTO: And those that do look in the choice and are successful
15 will be those with distribution to be able to do so. And that could be like banks if they didn't get on it or maybe some other institution. Those without the distribution will not be able to survive, it's as simple as that.

MR HARRIS: That's probably true, as an effect.
20

MR LATTO: Yes.

MR HARRIS: But you're right, it depends on their other investment – in other words, what their incumbent advantage has been to date and
25 therefore what fund that they maintain through the longer term.

MS CHESTER: With the proviso that we have an elevated role for the ATO or somebody, and we ventilated this in our draft report, playing more of a telegraphing role about not just the best in show, but that
30 MySuper on steroids list and the metrics.

MR LATTO: But actual and perception are two things, and if I was an employer and I saw that this list was best of breed, I think I would immediately go to the best of breed without any hesitation.
35

MS CHESTER: Thus the competitive dynamic from the best in show.

MR LATTO: Yes. What you've got to then do is in four years' time when you come and have a look at it, how many funds realistically are
40 going to be left to choose from to replace a fund that may decide to remove from the list.

MS CHESTER: Well, I think you still need to look at the metrics of it. So I can understand if you've got a fund, that's still a smaller performing
45 fund, but they're in nett outflow territory. Them missing out on some

inflows for a couple of years will hasten exits. For those that aren't in serious nett outflow territory, and you know those metrics from APRA, it's only four years, they've still got incoming flows from their existing default members.

5

MR LATTO: It does take time to work out, but then if I'm running a business, I've got to decide whether I'm likely to get in, even wait for four years and then find it's still a failed product, you've got to make a business decision.

10

MS CHESTER: Although, interestingly enough, it would be very good for your business model for those on the longer lists that didn't make the shorter list, because they're going to have to work harder.

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MR HARRIS: This is the question that we're charged in this one with thinking, what can competition do. I don't think for a moment we would pretend that it won't have an impact on some funds in the way that you've outlined. The question is what's the adjustment response, and some funds will be better able to adjust and some won't. But we can't actually think, and when we do ask this at some of our roundtable discussions, some of the largest funds may not choose under one of these models to play.

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MR LATTO: I can't (indistinct).

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MR HARRIS: And therefore the landscape won't simply be the automatic response.

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MR LATTO: One other thing which hasn't been said at all in room amongst all this, we do help people with tenders, and when we do a tender we have to do a thing called a statement of advice for an employer, just like we do for a personal client.

MR HARRIS: Yes.

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MR LATTO: Under 44 law you have to be in the best interest of the client. Where before the industry, before 44 came in we used to think we would operate in the best interest of the members, but the law now requires us to do it in the best of the employer.

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MR HARRIS: Yes.

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MR LATTO: So I don't know if you're aware of that, but now tenders are done in the best interest of the employer not in the best interest of the member, which we think is an unintended consequence, but it still is a fact, that we have to operate under those guidelines.

5 **MR HARRIS:** I can sort of understand it in concept, given the future of financial advice was aimed at the client, who's paying for this, and therefore that's your client, isn't it.

MR LATTO: Yes. So nothing changed.

10 **MR HARRIS:** That's an interesting aspect. Well, thank you for drawing that to our attention, we might just do a little bit more examination of that too. I don't have anything else, do you have anything?

MS CHESTER: No, I think that's fine.

15 **MR HARRIS:** Thank you very much for persisting through this morning.

MR RHODES: Thank you very much, last of the list.

20 **MR HARRIS:** And you've been very patient with us too. We really appreciate your input. And I think I'm going to, unless anybody wants to make a statement from the floor, which you always get the chance to do at the last moment. No? No statements from the floor. I'm going to close the hearings. Thank you very much everybody for your participation.

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MATTER ADJOURNED AT 12.51 PM