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Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION

MR P HARRIS, Presiding Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

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MR HARRIS: Good morning. Thanks, everybody, for attending the hearings here and to the second phase of our three-phase superannuation inquiry. I'm Peter Harris, the Chairman of the Productivity Commission. With me is Karen Chester who's our Deputy Chair. Before we start up all the phase of the hearings things, I don't know whether no one else has gone through it. I don't think they probably have. I have to tell you the evacuation procedures, which basically are pretty straightforward.

See exit sign. Follow instructions of people wearing red hats, and we'll be walking down the stairs if there is a need for evacuation; straight out there and down there. I should also tell people that we try and avoid, because we are recording this and, in the end, we'll publish the nature of the transcript, we try and avoid making defamatory remarks. If, indeed, we feel you are likely to lurch into defaming any particular individual, we will ask you to cease. That has actually happened once or twice in my time doing this job. People do get a little bit passionate. Perhaps we can just encourage everybody to be the least passionate they can be. We tend to be only doing inquiries in areas where people do get passionate, so it's a pretty normal sort of thing.

We do allow people to utilise social media from the room. There's no restrictions of the nature of that kind of thing. But we don't take questions from the floor. The purpose of this hearing is to hear from the individuals who've registered for the hearings. But at the end, if those of you who wish to wait patiently around, if there is anybody here who hasn't registered and would like to make a comment or ask a question, we're happy to take those right at the tail end of the hearings.

Thank you very much then. I think we'll start out. Can you please, for the record, identify yourself?

MR DALEY: I'm Brian Daley, I'm the Capital Stewardship Officer at the Australian Council of Trade Unions.

MR HARRIS: Brian, do you want to make a few limited comments at the outset? We've got submissions, but I know there hasn't been a lot of time for everybody to read them.

MR DALEY: I do. Thank you, Chair. I do have a very brief submission basically pointing to the issues that the ACTU particularly wanted to, I guess, make in a public sense as well too. It's a short one page. I'm happy to give the Commission a copy of what I intend to say in that.

MR HARRIS: We're recording it all anyway, so we'll be okay with that.

MR DALEY: Even in respect of the comments, they're very brief. I'm sort of slightly – sort of expand on what's in here anyway. Essentially, the ACTU has made substantial comment in submission in relation to the issue of superannuation and fund choice being treated as an industrial issue. Suffice to say for the purpose of these hearings, we note that two of the alternate models proposed by the Commission, being assisted employee choice and assisted employer choice, are both models which have an industrial relations character in that they involve one of the participants in the workforce – that's the employer – being engaged in a decision in relation to an industrial matter.

We assert our view that this, thus, requires the framework which is to be implemented, if those models are selected, to have a proper industrial relations character and should have workers and their representatives involved in that decision. On other substantive issues we make the following comments. Firstly, we urge the Commission to think about the basis for comparison not being its defined model of unassisted employee choice. In our view, this will not deal with the relevant issue for Australian workers looking to the review and subsequent legislation, that issue being, how will the Commission's recommendations affect my current situation?

We say that the models out there don't attempt to basically make any statement as to whether or not the models that people are in at the moment will be or will not be affected by the introduction of any alternate models. Our general view of that is this: is that if you're in a model which becomes one of the selected default funds, then you would probably argue the case that there is no impact on the person. Say the Commission selects – the processes lead to a situation where 10 funds are selected and they cover essentially half the workforce at the moment and that half the workforce are in default funds and those people will probably be unaffected. But half the workforce will have an impact if the fund that they're in is not selected as a default fund.

Again, our almost back of the envelope calculations in this we'd say something like that if you're in a typical call it a retail fund where the asset allocation is likely to be completely unaffected by whether it's a default fund or not, then that perhaps 20 per cent of the remaining 50 would be unaffected. But potentially for the remaining 80 per cent of the 50, that is, 40 per cent of the population, there is a real risk in this process that their default situation or their superannuation situation will be worsened by the implementation of the report models.

MR HARRIS: Can I just clarify though with you, you're creating a sort of static division of today's funds and saying, "If there's only four or five, then even if they're the biggest four or five, they only cover half of the workforce."

MR DALEY: That's a broad assumption, yes.

MR HARRIS: Therefore, there's this other half that aren't definitionally either currently members of those winning four or five and therefore they're not necessarily going to make any active choice as a consequence of this and move to those four or five, they're going to remain passive and stick where they are and therefore they're not, as it were, winners from the system; that's basically what you're saying?

MR DALEY: Broadly. We'd say this: that one of the implications of the review is that if you're in a fund that is not a winner and whose performance is likely to be affected by the fact that they lose access to default people, one of the pieces of advice to that fund may well be merge or get out or, essentially, if you're a member of the fund you may be better off thinking about getting out of that fund and into one of the other default funds.

Over time there will clearly be, if you like, a level of advice and rationalisation of what happens to the sector. What we do say is that people will look at, if you like, the utility of this review and say, "At the time that change happens or default funds come in, am I better or am I worse by the system?" If you're in a fund that's not selected, that has to change its asset allocation because of the fact that it hasn't got the flow of default members, you are likely to be in a situation where your fund is worse off than before the change happened.

MS CHESTER: Brian, we were very mindful in how we developed the models and some of the key elements to all four models about your issue of system stability, like how this would transition over time. By limiting the models to just the new job entrant it's not all the default turnover market. Indeed, it's 400,000 and there's 400,000 new job entrants each year, which is worth a couple billion. Then you've got over 1 million that are the rest of the default market, people changing jobs every year. Again, the default is only kind of like 40 per cent of the total super system contribution. And we're only doing it once every four years.

So we've been very mindful to make sure that if there's any underperforming fund that continually doesn't get through on any of our models they would still have their existing default members, they still can go and play in the choice market. So it would be a very gradual transition, very mindful of the impact on those members that would still remain in those funds.

MR DALEY: I'd say this about it is that there are a range of people who stay, because of the nature of their employment at the moment or the fact that a fund is a common fund at their place of employment – may not be a default fund but they may want to stay with that fund for a period of time. Now, if many of those funds are pushed into situations where they lose access to a large number of default members, then the nature of the way in which they do their investments will change. They will have a situation where they may well be in negative cash flow in a very short period of time because they're not getting the new members and new cash flow into the fund that they would normally expect. If they are in that position, then the trustees of those funds would have to essentially take a decision to look at the asset allocation of those funds to decide whether or not they could continue to invest in liquid assets, whether they had to have a greater weighting to cash assets and the like. We say that is likely in those cases those funds will perform worse than they did before they had the default flow, before the (indistinct) flow.

MS CHESTER: But that's in the current super system we already have that. We've got 80 of the APRA regulated funds already in net outflow territory.

MR DALEY: There's a very skew curve about who's in negative territory at the moment. Yes, there may be 80 or several hundred funds are in there. It may well be that after this system comes in there may be 10 funds in positive cash flow territory and everybody else in negative cash flow territory.

MS CHESTER: Maybe if we kind of bring it back to maybe just a really simple fundamental question. And very happy just for a yes/no answer, Brian. Do you think in the default segment of the super system that poor-performing funds, so funds that continue to poorly perform over time, should exit and that new entrants, high-performing new entrants, should be able to provide default super products? I'm happy for a yes/no and then you can elaborate on it.

MR DALEY: The answer is yes, we believe there should be a test on performance. If you went – our submission into the first stage of stage 2 where we proposed a model that looked at how the expert panel might be guided to choose funds, we said performance was an issue.

MS CHESTER: We agree on performance. But, I guess, going back to my question, do you think poor-performing funds over time should exit and we should allow new entrants that are high performing to enter the default segment?

MR DALEY: It's a bit of a question of whether or not this model will actually lead to an opportunity for new entrants to enter the marketplace.

MS CHESTER: I guess my question is totally separate to the models. Just in principle, do you think that should be able to happen?

MR DALEY: It's not the way in which the superannuation will operate. It's a bit like other financial services. You don't say because one bank is underperforming at the moment that we expect that someone is going to invent a new bank out there and there's going to be a fifth pillar in the banking system. That just doesn't happen. The same thing will happen in superannuation. Once there is a strong default basis in there, there won't be an advent of new entrants to the market saying, "Look, we can offer these services. We've got a track record. We can get scale." That just won't happen. There'll be inertia around – a form of oligopoly of the major funds.

But we do say this, and we've said this all along, that there should be a test about poor-performing funds and if poor-performing funds are not performing, then their right to basically hold their position in any default arrangement should be under question.

MR HARRIS: It's hard to see this working in practice now because we do have just about everybody – I mean, I think you've just made a sort of lean, at least, towards answering Karen's question in the affirmative, and so does just about everybody. But very few people can come up with how that catalytic effect should occur. Right now it seems to be mentally attributed in most of the submissions we've received and the sort of general comments we get to, "Well, APRA should do something more." But no one's really prepared to be too explicit about how far APRA otherwise should go. You can understand the position of a regulator who perhaps – I don't want to put words in their mouth – but really doesn't want to go and put the heavy hand on the shoulder and say to somebody, "Gee, your time is up, number 7, come in."

We're very interested in this because of the member impact. It's probably time, now we're five minutes into this, one of the things I found remarkable in this process has been the limited number of times that members are mentioned individually versus funds. Funds come up right at the start. Everybody wants to speak on behalf of a fund. There is a view about members, but it sort of comes next. We're interested in the APRA side of things because somebody should be up there querying on behalf of those members, don't you think? Somebody should be saying, as it were, "Come in, number 7, your time is up," but nobody seems to be able to come up with a proposition by which that should occur.

Now, I'm not saying we won't. I'm actually alluding to the value of the question being we probably will. But we're really interested in getting advice on it first.

MR DALEY: We have urged that to be a proper position is the first point of our comparison is that there should be some – our statement today is that there should be some rigorous approach to seeing whether members are going to be better off or not better off under the system. And the unassisted employee choice model doesn't do that.

MR HARRIS: I think we've had this discussion previously. It's not really a model, it's the zero benchmark by which we decided that the most objective way of coming up with a set of criteria which said, "Now, how do each of the active actual models," 1, 2, 3, 4 in our proposition, "how do they look versus zero?" and it answers the question why have a default system. So we accept your proposition that it's a dreadful model. We counter-argue it was never a model, and I think we should move on from that, acknowledging that both positions can be held together and still look at this APRA-based question. I'm very interested in this APRA-based question.

MR DALEY: We said that there is a model that you should be comparing from and that's the current default models, but you've chosen not to do that.

MR HARRIS: We're in phase 2, as we pointed out. In phase 3 I'm sure the whole question of the industrial relations system will come up definitionally. We'll be happy to get to it then, but right now I'm interested in this question of what happens with poorly-performing funds. By the bye, just in case anybody who's otherwise taking notes from this thinks otherwise, poorly-performing funds include all kinds of funds.

MR DALEY: Our response to that is that the current system is robust enough to deal with that, that you have an expert panel appointed by Fair Work Australia and you have a potential for a Full Bench and other aspects of Fair Work Australia which can basically take a more proactive position on underperforming funds in the default system. They should be allowed to be given that opportunity. That legislation should be, I guess, encouraged to work and be given an opportunity to work before we venture into other models that don't that system.

MR HARRIS: You actually see the Fair Work Commission acting in place of APRA as the regulator?

MR DALEY: Not as the regulator, but it's in a position where, based on the advice of the expert panel, it should make a decision as to whether or not a fund is a default fund for a particular industry sector. One of the issues that it should have regard to is performance.

MR HARRIS: You are at the – I don't know what percentage it is – but the percentage of the market that's covered by industrial arrangements. We're actually interested in all of the members, the hundred per cent of superannuation where there are a bunch of poorly-performing funds and in some cases presumably the industrial relations system will not be able to act as sort of the default regulator in terms of trying to encourage some merger by saying, "You're no longer registered in the enterprise bargain," or, "You're no longer relevant to an industrial award."

MR DALEY: Our system said that there are processes that allow the Fair Work Commission to cover a hundred per cent of the workforce. There's no limitation on thinking that people who are covered by EBs alone or awards alone are limited to this. There are practical measures that you can have to have a hundred per cent of the workforce covered by the Fair Work Commission process.

MR HARRIS: That would confirm really for me then that you do see the Fair Work Commission as acting as the alternate regulator.

MR DALEY: Well, not regulator as such. Like APRA has a specific role as regulator and a specific inquiry function. It meets with funds on a regular basis and it deals issues on governance and responds to a whole range of issues within the system. It's appropriate to have a number of tests within the system that essentially are there to decide whether or not a fund should continue as a default fund. That's a matter – and we've suggested a number of those in our submission. We don't say that they necessarily are as comprehensive as they might be. But there are an opportunity to put a series of issues in there, performance, governance, a whole range of other standards, which the Fair Work Commission should be able to take into account and determine whether or not a fund should continue as a default fund.

MS CHESTER: Brian, one of the core parts of your submissions today – and we do thank you for your submission and getting it in on time.

MR HARRIS: I didn't say that at the start; I should because I know people have laboured to do this.

MR DALEY: Thank you.

MS CHESTER: Is the role of collective bargaining in default super. It sort of follows on from the point that Peter was making. We're concerned here with the whole default market. Some default members are covered by EBs, some default members are covered by awards and then the rest it's just the employer deciding where to put them. How many then are really – of the two-thirds of super members today that are in default, how many are really covered by your collective bargaining?

MR DALEY: Again, we looked at the current model – and I think that their estimates and even in the Commission's report it was something like 70 per cent of people are covered by the award system at the moment. I think I've seen estimates something of the order of about 50 per cent of the workforce at large could be actively seen to be, I guess, fully covered by the default arrangement. But when you analyse what's out there in the remaining 30 per cent above the 70 per cent many of those people are very easily covered by the award system as it stands at the moment.

Many of those people are misclassified as contractors when they should be employees. Many of those people work in occupations where the award system doesn't necessarily pick them up. But industry identification of those occupations would say that they are within an industry of an employer which could be covered by the way the award system works. It's very easy to extend the award system from 70 per cent to a hundred per cent.

MS CHESTER: Heaven forbid we revisit award coverages in Australia. I think we had a go at that a couple of years ago and government has got that report. But from our perspective then, if being within the industrial system with employees and employers – and we're trying to get full coverage – I guess our model too is probably the closest to the current arrangements, which is employer assisted choice.

MR DALEY: It is, except that one of the industrial participants doesn't get a say in the model.

MS CHESTER: Well, they still could if they work hand in hand with particular likeminded employers. But just bear me out. If we all agree that investment performance is what really matters and getting defaulting members to the best-performing funds, if we all agree that's what matters, and we have an independent body – and we'll come back to the principles in a moment – doesn't model 2 sort of deliver on most of that?

MR DALEY: You're talking about assisted employer choice?

MS CHESTER: Yes. So where the employer can only put their employee, the member, into either one of the short or the long list where we sort of up the ante based on investment performance about who they can choose. And it's an independent body.

MR DALEY: Well, assisted employer choice has some of the features of the industrial system at the moment. It clearly does lack one of those core tenets of the industrial system, that the workforce have got a say in what happens to their industrial arrangements in the workplace. But the other issue that's of significance in this issue is whether or not it's then a workforce-wide issue or whether or not it's better as an industry by industry issue. That's not encompassed in model 2 either.

MS CHESTER: I guess we're dealing with default members who aren't engaged in any way, shape or form.

MR DALEY: They are as soon as they enter the workforce.

MR HARRIS: Can I just clarify that a little bit? You seem to be implying that – and it's a plausible view. I'm not saying it's wrong, but I want to be sure I've got the understanding correctly. You seem to be implying a decision that says model 2, our assisted employer choice model, can't work with the industrial relations system as it is today. Now, I'm not certain of that and I don't think we wrote it up to that effect. I can see why you could argue that some kind of action to also change industrial relations law could achieve that outcome. But just the model itself, just given we are in a phase 2 kind of position – that's the way we look at it, anyway, we're in a phase 2 inquiry where we put up a model.

If the actions that we propose to implement our model 2, assisted employer choice, were taken, that would create a long list of sort of strengthened MySuper kind and a short preferred but not obligatory kind of list. Those lists could then be taken into an industrial relations negotiation, for example, into an EBA, and drawn from – in other words, employers would get guidance from this as to what they could agree to within that circumstance – but it wouldn't prevent the industrial negotiation otherwise taking place around those lists.

MR DALEY: Essentially, you're right. But to this extent the industrial system, in many cases, is beyond the issues of simply, if you like, an employer/union negotiation at every individual workplace in the country. They are then underpinned by conciliation and arbitration and award systems which then basically say, "We have procedures which allow for industry application of those provisions," as opposed to site by site application. That would need to be one of the tenets that occurred within the model.

The name obviously, assisted employer choice, is a bit of a complaint that we would make in naming it because it basically indicates that one party to the system has a say in it. But the fundamental features of a model in which the industrial system chose the outcome could be an adaptation of what you called assisted employer choice.

MR HARRIS: I'm not saying it's written up as that. I'm just saying I just want to be sure, from my perspective at this stage of the inquiry, certainly it's not something that's out of court. But I just want to be sure you didn't know something that I didn't know. Having done workplace relations system and this, I sort of thought I had a reasonable understanding of it. Anyway, sorry, I've interrupted your - - -

MS CHESTER: No, that was a good interruption.

MR DALEY: I did have two other issues I just wanted to raise on the way through. I appreciate time is very - - -

MR HARRIS: I should stop talking.

MR DALEY: We did in our submission urge the Commission to rethink the issue on insurance as part of the characteristics of the default model. Superannuation historically has been a way in which people receive payment for however they left the workforce, whether they were disabled or died. It has become essentially the basis of insurance coverage for – the money basis of insurance coverage for 80 per cent of the workforce. To remove it from the default system leaves a gap in, I guess, a common condition or a common feature of the system, which would be a problem, we think, going forward.

MS CHESTER: Brian, I think it's great that you've raised that in the hearings because I think a lot of people misunderstood how we deal with insurance in the new models. Maybe if I ask a question. The current arrangements in terms of what's required by APRA and the SIS regulations and the Act, the trustees at the moment with insurance, is the ACTU happy with how they're working?

MR DALEY: In a broad sense we are. We're conscious that insurance - - -

MS CHESTER: I know there's some issues.

MR DALEY: Has been a major issue and needs reform. But, yes, we're broadly confident that APRA raises insurance in a proper fashion with funds.

MS CHESTER: Because I guess all of our four models do require that each of the funds to be eligible, to be best in show on the longer list, actually meet all of those obligations. Otherwise you don't even get to the beginning of the race. So we do deal with insurance by saying it's highly regulated. We don't want to go comparing different insurance products. If the trustee is meeting those obligations and they're doing what they need to do by APRA, then, hey, you're up and running and eligible for the different models. So we do deal with insurance, we deal with it in that way. If you're comfortable with the current arrangements – and that's kind of the threshold to get into the competition – then how else would you want us to deal with insurance?

MR DALEY: By simply making it clear that it's a feature of the system. We'd say it's simply a bit opaque at the moment by saying, "Look, it's subject to APRA regulations," which are variable from time to time. But if we're going to make comparisons on default arrangements, then let's make sure we get all the features properly on the table.

MS CHESTER: If it's made clearer that that's an eligibility threshold issue, then that would address your concerns around how we deal with insurance.

MR DALEY: I believe so. The final issue we wanted to raise today is the issue of urging the Commission to think about a default regime for retirement. We think it's an area where people are vulnerable. We think that the system would benefit greatly from a regime in which the default system also applied at that stage.

MS CHESTER: A couple of thoughts there. (1) We're very conscious that the government has got a separate process running around CIPR, the Comprehensive Income Product in Retirement, which Murray kind of intimated might become a soft default. So that's a separate process, but it's one that we'll look at when we get to stage 3 because we agree there's no use doing a great job in accumulation if you then get the product and tailoring wrong for the retiree. I guess we're very mindful though that at the moment in retirement there's a world of choice.

MR DALEY: Non-default arrangements are not suiting public policy goals in retirement and there should be a discussion about whether alternate systems would help overcome some of those issues.

MR HARRIS: There's not a strong incentive for your current fund, whatever it is, when you hit the point at which you want to start converting to being a retiree – there's not a strong incentive for them to offer you a good product just simply for the purposes of ensuring that they don't go through this cash flow problem that you were alluding to earlier when we were talking about coming up with a relatively small number of default members?

MR DALEY: All funds offer services and extensive services to people at that stage. We are seeing incredible leakage from that system. We're actually also seeing, I guess, a considerable dilation of the asset allocation issues that occur post-retirement as well too. That's one of the factors leading to a potentially significant underperformance against, if you like, national policy objectives.

MR HARRIS: First-timers pool, our concept of just converting that, now, unless I missed it, I didn't hear – and I may have – I'd like to get a view from the ACTU on shifting to once-only default arrangements.

MR DALEY: We've supported the concept. In our submission we've supported the concept of the way in which, if you like, MyGov and Single Touch Payroll will identify a single fund for a person. That idea, which I guess flows from the first timer default model, is a concept, we think, is a worthy concept and a way in which the system should mature going forward. Now, how you get that person into that chosen or default fund within the sort of MyGov listings and things is an issue that's open for some considerations. But the aim of first default appears to us to get people into that system. We think there are better ways of getting people in that system but once they're in that system we think the system is a worthy development.

MR HARRIS: Thanks.

MS CHESTER: How do we then deal with where people can't default out of a product once they've defaulted into it, so the 20 per cent that are kind of – if they move on to another job – what was really interesting is I think for the first time ever the Commission in our media release for a draft report said we'd like to actually hear from young Australians and their parents who might be interested in their wellbeing in the super system. We actually got quite a few submissions where they said that there's a frustration, even with the MyGov and the ATO helping with account proliferation and consolidation, that some people just can't consolidate everything. They can't because of some of the EBA arrangements and some of the award arrangements. How do we deal with those if we don't require – so we agree with further streamline arrangements with the ATO. But if we don't make it a rule that you default once unless you choose to go somewhere else, how do we get rid of the multiple accounts?

MR DALEY: In most cases consolidation is not a difficulty under any part of the system at the moment. Awards per se as opposed to agreements generally don't prescribe that an employee has no choice or no ability to consolidate in a fund that might be not one of the ones named in defaults. There is an issue about whether or not enterprise bargaining agreements prescribe a single fund – and the government has proposed legislation to deal with that. That legislation failed because the parliament lapsed. If that legislation was dealt with in a new parliament, then that would be, I think in our view, the only part of a system that at the moment limits people from being able to completely consolidate.

MS CHESTER: I'd welcome you to read some of the subs we're getting from some young Australian, including Michelle MacDonald and Tim Limmings, because they're kind of suggesting it's a bit tough for them to do that at the moment. I just wanted to ask a couple more quick questions. We set out some principles for the body or the expert panel that would help us get to the best performing funds, be it a short list or a longer list; MySuper on steroids, some have suggested. It would be good to get ACTU's view on those principles.

MR DALEY: I don't have an answer for you today on that, Karen. I can take it on notice, if you like. We've obviously made a comment in respect of partisanship in this and we've sort of taken, if you like, a bit of exception to the Commission saying that, "Look, the only people you'd want to exclude are employees and employers from expert panels" – employee representatives and employers from expert panels because, your view, that that's where partisanship exists. But having said that, there have been significant issues in identifying expert panels at Fair Work Australia.

It is difficult to find people with adequate knowledge, background who have no conflicts of interest at all in this model. The problem with identifying an expert panel has been the pool becomes so small that it becomes difficult to identify. But we're happy to basically have another look at that and, if appropriate, provide a comment for you.

MS CHESTER: It's really the practicalities of getting the independent non-conflicted members of that panel that causes you concern?

MR DALEY: Our more overt comment was that the history of appointments to these panels in recent times has been completely partisan and, on that basis, no one would have any great confidence that a panel appointed under this process at the moment would be other than politically partisan.

MS CHESTER: We had one terrific suggestion from PWC in a submission that they gave us. And it comes back to one of our last principles and making sure that there's accountability with the decisions that any such panel would make, because accountability is kind of the best way to make sure that they are acting in the members' interests and they are independent and truly non-conflicted. PWC – and it's a really good suggestion – said that the ultimate way of getting that accountability was for that panel, after they've made their decision – so after they've locked and loaded – then there has to be disclosure of the decision-making. Would that address your concerns?

MR DALEY: It may do. We think that, again, there is a process already in place where the expert panel's work is reviewed by a Full Bench of Fair Work Australia. That level of independent scrutiny, taking into account, if you like, superannuation and non-superannuation factors, is a way of providing a second set of eyes over the panel's decision. We think that's the most preferable system at the moment.

MR HARRIS: It seems to me, just as an observation, that partisan appointments are an accusation that occurs regularly within the workplace relations system as well and we commented on our workplace relations report at length. You almost in principle rule out any expert advice if you say, "You may be an expert but there's a fear you'll be partisan." It sort of like says, "Well, there's no solutions here," rather than perhaps the wise regulator will come in and choose – and we have had that suggestion, which may be why I asked at the outset who you sought as a regulator and I can see that you lean towards the workplace relations system.

But it's been suggested that APRA itself could actually do this now. We find that a potential conflict with their own role otherwise in terms of both selecting winners and then scrutinising them. It's somewhat problematic. So really the observation I'd make on the accusation of partisanship is it can be made against any human choice whatsoever when it really appears to be a default argument which says, "Well, then just leave everything alone and we'll pray that members work out the matter for themselves." That's quite hard to say because you've got a lot of members right now not making any choices at all.

MR DALEY: Beyond pray, we've got a history of 30 years of performance where the system hasn't been, I guess, accused of partisanship.

MR HARRIS: It’s not just partisanship, I was worried about members again. I’m back to members and the performance. We do have a lot of members who are not making any decisions in their own interests and are staying in funds which are not performing well. They are not just any particular kind of fund, for profit or not-for-profit. We have this stickiness of members and lack of information that seems to be readily accepted by people taking what are quite complex financial decisions over a very long-term period.

Normally you would expect that there would be a better information flow encouraged in some way which could, for example – take our model 2, our employer assisted choice, it actually has a better information outer kind of selection process and a preferred group, which is, again, better information. And you might encourage members to pay greater attention to it simply by the publication of that information as well as employers. I guess I’m still saying even that has some form of panel inside it, therefore, all of those panels are subject to exactly the same problem, aren’t they, that one party or other can simply say, “This is clearly biased.”

MR DALEY: There seems to be to me a bit of a problem in definition in this in that the Commission is basically saying, “Look, we’re interested in first starters and a default arrangement for those people and that’s where the recommendations end.”

MR HARRIS: That’s because that’s what this phase is about.

MR DALEY: And that’s what we’ve set about doing, alternate default models for superannuation. We’re not in a situation of sort of saying, “Are we providing really good choice options and information for 42-year-olds changing their job for the fifth time in their workplace and are they getting out of default arrangements and consolidating properly?” What we’re doing is establishing a system for the default people at the start and then the rest of the system on how people will get information, change funds default, move when they change jobs will be the same as it is now.

MS CHESTER: I think that’s where we probably differ in how we’re viewing the role of the new alternative model. We would actually see the existing system benefiting greatly from the greater information and transparency around performance in the new alternative models that the elevated role of the ATO in saying, “Well, here’s the best in show. This is what their track record is like and this is what they’re offering.” Also, the requirement that if a super fund does get best in show, they have to offer the benefits to their existing default members. So we do see this better fitting the entire system, not just the new job entrant.

MR DALEY: Funds do offer consistent terms to default members and non-default members. That's already a feature of most of the default arrangements that are in place now. But it's not as though, having established a best in show gong, is then going to change the mindset of a 17-year-old joining the café for the first time who's going to say, "Gee, I wonder who the Commission's recommended for these funds and whether I should pick X, Y, Z from the defaults." They will basically be defaulted the way in which people are essentially currently defaulted now and their choice regime will emerge later in their working life. Whatever information you provide about the best default funds at that stage is a bit of a leap beyond what we're doing with the default people at the start.

MS CHESTER: I guess the one risk we're trying to mitigate – and, indeed, it's a shared view with one of the largest industry super fund submissions to us is the greatest risk for a default member is being defaulted into a poor-performing product. Do you agree with that?

MR DALEY: Yes is the answer.

MS CHESTER: I just have one more quick query or question and then we're already running late, which is going to be my fault now. Mergers. I got a sense from reading the ACTU submission, Brian, that you guys are pretty comfortable with how mergers are dealt with at the moment. You identify a commonality of interest between the merger partners as being quite important when we made this recommendation about greater merger disclosure.

MR DALEY: Yes.

MS CHESTER: I just wanted to get a kind of understanding is what would be some examples of commonality of interest between the merger parties?

MR DALEY: Some of it may well go to the demographics around memberships. Often a feature in the way in which, I guess, the parties have historically talked about mergers it's often been people who worked in aligned industries who have common workers in those industries as a basis for wanting to talk about a merger if a smaller fund wants to, I guess, basically have a different future than what it's got at the moment. Yes, I think it's that sort of – part of that is an automatic flow in demography. But it's often an alignment in industry characteristics is probably the most significant feature that we've seen.

MS CHESTER: I guess if we're dealing with a default member and it's a pretty sort of basic product that they would need – it needs to have good long-term investment performance, good intra-fund advice, good admin services - - -

MR HARRIS: Good insurance.

MS CHESTER: And adding in that they meet their requirements under insurance, then I guess would any merger that resulted in one of the members for one merging party would benefit from greater investment performance through – although a cost through the merger, it wouldn't necessarily be based – I'm just trying to understand. People say you need to differentiate the default product based on members, industry and demography. If it's kind of like a basic product and you just want good investment performance, I just struggle with that one.

MR DALEY: There's clearly an underlying feature at the moment where small and medium sized funds are in positions where, I guess, positive cash flow is under question and therefore their ability to basically deliver the asset allocations that deliver the long-term performance that's never consistent are under consideration. That's an overarching factor. It's sort of a given factor that for the medium-sized funds moving into a larger fund with a larger cash flow and a more stable asset allocation is probably going to improve long-term performance.

I think that is a common feature and a given feature and a feature which shouldn't be discarded but is a feature that's an important part of why mergers happen. Having taken that as a given as to why you're doing it, it's then a matter of which are the best alignments that you might have going forward that will make the merge the most successful that you can?

MR HARRIS: I'm done. Are you okay?

MS CHESTER: I'm done.

MR HARRIS: Brian, thank you very much for your participation of the ACTU's submission to this. Hopefully you'll stick with us through phase 3 as well.

MR DALEY: Certainly will do.

MR HARRIS: Industry Super Australia I think is next. Once you settle, for the record, if you guys could identify yourselves, that would be good. Thanks.

MR MAY: Good morning, Chairman Harris, Deputy Chairman Chester.

I'm Zak May with Industry Super Australia and I'm joined by Matt Linden who's the Director of Public Affairs for Industry Super Australia. We're really grateful for the opportunity to appear today. We think Australia's superannuation system sits upon a very strong foundation, a very strong cornerstone of compulsory savings with guaranteed minimum contributions enforced by the Superannuation Guarantee and supplemented by collective agreement at the industrial and enterprise level. If building and maintaining a strong funded retirement income system involves more than merely placing savings into the system, these savings placed in the system need to be connected to high quality providers that deliver the appropriate benefits to members.

The inquiry has been asked to develop an alternative to the current way of connecting savings to providers, at least for default members. But thankfully, the inquiry is not starting with a blank slate. Superannuation has been around for decades in Australia and many times that in other past economies. There is an enormous and rich body of real world experience and evidence about what works and what doesn't work here in this country and elsewhere. Tapping into this body of evidence and performing detailed rigorous analysis would be of great benefit to the inquiry. First, it would help to inform the inquiry and help to focus on the key policy and institutional settings that the best-performing systems have in common. Second, it would alert the inquiry to the key risks and problems that plague the poorer-performing systems.

Now, around the world there are essentially three ways of connecting savings to providers. One way is to permit consumers to choose their own product supported by laws regulating disclosure and selling practices. This is the approach for the main part of the United States, although it's changing, and in Mexico, among other countries. The second way involves the government selecting one or more funds through a tender or auction process such as in Chile or New Zealand. A third way involves industrial parties either employers or in some countries the so-called social partners creating the providers for workers and specifying those providers. This is the approach in the Netherlands, Denmark and some other countries. In these countries the providers are not-for-profit.

In many countries, including Australia, more than one of these different approaches might be used. The choice between these approaches can make all the difference between a comfortable and secure retirement for most people or something else, or, to borrow from something (indistinct) said in the past, it makes the difference between steak and spaghetti. This cross-country evidence about the performance of these different approaches – retail choice and government selection process or industrial model process – are strong. There's strong evidence about how they perform. Jurisdiction with not-for-profit providers where workers are allocated the products under the aegis of the industrial parties subject to strong government regulation substantially outperform over the long term.

The very best funded retirement income systems in the world – Denmark and the Netherlands – operate in this way and the best performing part of the Australian system also uses this approach. However, in government tender or auction countries only mediocre outcomes are obtained because the private providers are often for profit, or actually they are for profit, and the selection systems have not prevented these providers from capturing value for themselves. This is shown in Chile where the providers have captured the spread between changes in operating fees and costs.

In addition, where the government is responsible for selecting funds there is a tendency to seek to minimise the risk to the government of choosing a bad fund rather than trying to maximise outcomes for members, as this may have been the case in New Zealand. Systems based on consumer choice are even worse. In Mexico the IMF have stated that their change to the system has "resulted in destruction of value". Of course, in Australia retail choice products underperform on average over long term and so do the vast majority of self-managed super funds.

A detailed investigation of systems' architecture and why different systems work well also would help the inquiry to identify the key challenges that the underperforming systems have. The poorer performing systems tend to perform poorly not just because individuals are poorly suited to managing the risks relating to providing themselves a retirement income and making relevant decisions, it is also because more private providers operate in these markets and seek to extract value for themselves. Indeed, in the real world it seems to us that choice is just a rosy word for "sales". In the real world they are two sides of the same coin.

It is hard to see that there could be any other explanation unless millions of people in this country and around the world, including millions of choice and SMF members of this country, have affirmatively chosen to be poor. Looking at the real world experience also makes it clear that the laws governing default selection is not a platonic system that operates disconnected from the participants and politics and other interests. Quite to the contrary, these laws are intensely political and the potential profits that banks and wealth management businesses can extract from these systems are enormous.

These commercial imperatives result in unrelenting direct lobbying by banks to change the system and indirect sales and marketing efforts to pull members out of any default system after combined with regulatory arbitrage to facilitate this. This is perhaps the area where the inquiry could make the greatest strides between now and the final report. To see superannuation in its evolutionary context which recognises the important functions that trade unions and political groups play in countries with high-quality superannuation systems. These groups pay a role not just in resisting financial sector lobbying, they're playing a role in that deliberation, but also reinforcing the cultural and (indistinct) funds who often (indistinct) out from the finance sector.

Another area the inquiry may wish to focus on between now and the final report is to test every way that for-profit providers might be able to seek to undermine the draft report's proposals and to use those proposals to their commercial advantages. Each of those alternative models in the draft report envisions a system where private sector and for-profit financial institutions can bid for and win pools of default superannuation or assisted choice members. Such an outcome will deliver to these providers a readymade government-sanctioned customer base and a very low acquisition cost.

Once those customer bases are acquired these institutions will upsell across other products. Today sophisticated members under professional advice enter into these products and wind up poor, yet the draft alternatives would furnish for-profit institutions with a customer base of less engaged default members who are likely to be even more susceptible to being sold products that may not be in their best interests and leave them worse off as well. Thank you for hearing our opening remarks and we are very pleased to answer any questions you might have.

MR HARRIS: Thanks very much. Again, we want to acknowledge your effort in putting in information to the inquiry. Since I may forget to put the ad in again, hopefully you'll stick with us through phase 3.

MR MAY: Certainly, Chairman, thank you.

MR HARRIS: You said in the opening remarks as an interesting way of looking at things, choice is just a rosy word for "sales". It does rather suggest that if we stepped outside superannuation where this terms has perhaps become passionately used – and I won't necessarily say partisan because we've already had a fiddle with partisan today – but this term "choices" is a matter that inflames passions. But in the remainder of the economy the ability to exercise choice seems to still be pretty widely accepted as a fundamentally good thing for individuals, even though they may not be necessarily fully versed in the nature of mobile telephony or the nature of electricity provision or things like that. We're still all in favour of choice, aren't we, he says hopefully?

MR MAY: I think you have to be very careful about how individual autonomy is manifested and how people make choices and realise (indistinct). There are many instances where people are quite well equipped to engage in product and other sorts of decisions. Telephony, they may not need to understand the back office, but they can make decisions here and now about that service, understand what's valuable to them, what the utility is and they have repeat opportunities to learn. They can compare relatively quickly about what is there. And the cost of getting it wrong aren't that significant.

I think there are a number of distinctions between those kind of product markets and what we see in superannuation where the information is much different, the opportunity to learn from the experience is difficult, the information symmetry is vastly higher about what even the benefits are that you're engaging with. I just look at the empirical evidence of what happens, Chairman, when people do make choices; they generally wind up poor, and significantly so. It's got to be that balance between providing people with individual agency, on the one hand, where it actually does real benefits for them and it's not just an appearance that we're giving you choice, to actually get something good out of it. On the one hand, they're achieving the social policy outcomes behind this system. We have significant tax concessions here and government is using its mandating power to correct behaviour to get an outcome.

MR HARRIS: Since you touched on mandate, that was going to be the second part of my question. The other reason presumably we do actually favour the existence of a wide variety of choice and legislative support for it is because this is also mandatory, so it's you are required. Unlike mobile telephony – I suppose electricity is pretty close too, you can hardly function without it. But, nevertheless, it's not mandatory to have electricity but it is mandatory to give over a chunk of your pay to a superannuation provider. It seems to be, I would have thought, a highly defensible offset to the mandatory nature of this that you do actually have the ability – perhaps you don't have necessarily the capability – but you have the will to choose. Surely we wouldn't want to just denigrate choice as being a poor - - -

MR MAY: If you can get good outcomes from people, then that would be better. But, again, I come back to the evidence. It's making people poorer in general. What you want to do is to – and we tried to touch on some of these options for you to consider and I'm sure you might be able to come up with other better ideas. But where people are – to both ensure that the products that are available for people to choose are presented to them in a way that isn't designed to result in bad outcomes for them – there might be some exploration of individual's capability of actually making good financial decisions, not just self-assessed confidence, but actual measured capability to make those kinds of decisions and an ability to withstand losses if they happen to make a mistake.

There are a number of things that other jurisdictions – and we can explore them here – to try and have an outcomes-oriented ecosystem that does allow for choice that delivers good results.

MR HARRIS: I'm happy to accept your qualification or perhaps – I'm only labouring the point because it seems to me no one could fundamentally disagree that this is advisable in some form. We can argue about the form.

MR LINDEN: Could I just add a few further remarks? I think probably one of the key things to consider in the context of choice is how market participants respond, how they structure their products in light of choice. Obviously the inquiry is very familiar with the issues associated with behavioural finance and the information asymmetries. What we can see in the superannuation market at the moment is that there is no shortage of choice products and choice investment products. There's tens of thousands investment options. How anyone can make sense of those is beyond me.

But, nevertheless, we see some parts of the industry obviously hang their shingle up around offering choice and product tailoring. I think the purposes for them to doing so are not necessarily aligned with delivering the best possible retirement outcomes.

MS CHESTER: I think we all can agree that performance is kind of what matters and meaningful choice across high-performance products, which is kind of what we're trying to do in stage 2 here. Can I ask you, do you agree that – our stage 3 is kind of like the end product here and it's about competitiveness and efficiency and you say competition only matters if it delivers efficiency – does Industry Super Australia agree that efficiency is important to deliver performance outcomes for members?

MR MAY: Absolutely. In fact, as you've just done in that characterisation, efficiency or the net benefits to members over their lifetime is the determining factor, not competition.

MS CHESTER: So I don't lose my train of thought, sorry, the other systems that Industry Super Australia refers to in your submissions and your other participations in our inquiry, how have they been assessed in terms of efficiency?

MR MAY: We can look at the net returns that are present in those systems, and they are higher on average over the long term.

MS CHESTER: Set aside net investment performance, just efficiency. We're going to have to look at how we measure efficiency. Your submission refers to these other global systems that don't have choice but they're best in show globally. I think we're all familiar with the Mercer Global Index. I'm just wondering how is efficiency measured when those systems have been ranked and assessed?

MR MAY: I think that, again, the measure is are the contributions received into the system, what financial outcome are you generating for people? There are two aspects of efficiency. One is the net return on that. Then there are other kinds of risk (indistinct) efficiencies that some lifetime systems have. But we just focus on the returns, I think that is the determining characteristic of whether you have an efficient system.

MS CHESTER: And maybe I'm going to be labouring this point too much, but I kind of then went back and had a look at what was in that Mercer index. Couldn't find efficiency.

MR MAY: You don't need to look in the Mercer index. You can look at the OECD pension we provide in our submission which set out the long-term net returns for those different jurisdictions, and indicated they were higher than our own. They're higher than Chile's, they're higher than New Zealand's.

MS CHESTER: But none of them measure efficiency. That's okay, we're going to get to that in stage 3. Now, I'm going to take us back to some mind-numbingly boring process things so I can just kind of understand the status of your submission. Zak, just remind me, how many industry super funds are there all up at the moment?

MR MAY: I can't recall off the top of my head the number of not-for-profit funds. I think it's around 109, and those would be characterised as industry funds.

MS CHESTER: When we're reading your submission, how many of the industry super funds does your submission represent the views of?

MR MAY: It's an interesting question. We work closely with 15 but we also consult probably with other funds. I think you should take our submission as reflecting the views of ISA.

MS CHESTER: So it doesn't reflect the views of industry funds?

MR MAY: I would say it does, but I think particularly under the time constraints to consult with them, but our views are ISA's views.

MS CHESTER: So there hasn't been a process where your 15 members have signed off on your - - -

MR MAY: They've certainly seen drafts and consulted on it. We don't operate in that sort of a manner.

MS CHESTER: The only reason I ask is because we've had the joy of very quickly cantering through the 30-plus subs that we've received since Friday and there's two large industry funds that depart from the ISA view on the models. And I'll probably come back to that a little bit later, but one of them, indeed, supports model 2, assisted employer choice, and one is very supportive of – actually one of your 15, I think, one of your larger 15 – supports key elements of model 1 and 2, that is, the short list. So I'm just trying to work out - - -

MR MAY: They're certainly entitled to their views and we'll circle with them and we'll all try and get on the same page.

MS CHESTER: That's enough of boring process questions. Now, you'll know what my super question is going to be here, Zak, because I saw you in the backrow when I asked it of Brian. So maybe I don't even need to ask it again. But I will for the transcript.

MR HARRIS: For the benefit of everybody, Karen is going to ask this question to every (indistinct) because Karen is a structured process type person and I am the just wander all over the place.

MS CHESTER: I guess does Industry Super Australia agree – the question is, do you think poor-performing funds, if they're poor performing over a substantive period of time, should exit and should new entrants that have got a demonstrated track record of high performance should be able to enter and provide a default super product? I just want a yes/no answer.

MR MAY: You may want a yes/no answer but - - -

MS CHESTER: Just give me the yes/no answer and then you can give me the caveats but I want the yes/no first.

MR MAY: Yes, but – and this is why it's really important – let's start with some facts because we've always supported this, but it's important to think about it from a public policy perspective and from the interest of members. What does it mean for a fund to be poorly performing and what's the appropriate response to that and when do you decide that they exit? If you just nipped back and looked at the five year - again, performance is the strongest factor, in our view, and if you just start with that. Let's say you had five years of net returns up to 2011 and you looked at the funds in the bottom quartile and said, "If you're in the bottom quartile, you're out," and then look again in the five years to 2016 and see how many of those funds are still there.

If you applied that cut and taken them out, would they still have bad performing funds or did you need to give them a chance to rehabilitate? What's better for members, trying to allow a fund to rehabilitate or getting them out as soon as you have five years of net returns? I think those are the difficult questions that you have to explore before you say, "You're out." But at the end of the day, if you have been given an appropriate opportunity to rehabilitate and you're not delivering for members, then you need to no longer be managing those members' services.

MS CHESTER: Because I'm conscious of time, that's why I left it as a simple principle question. Do you think, regardless that you might get there one day – one of the key things in your post-draft report submission is the theme that the risk that initial default fund a person joins when they begin employment might not be ideal later. It comes back to this point that I'm struggling with about just because somebody changes a job, if they're in a good default product now or in 15 years' time or they get older, why would you need to differentiate the default product for them during the accumulation phase?

MR MAY: I'm happy to hear Matt's comments on this as well. When you think about what a default product is or any superannuation product is, two buckets of things are being provided there. One is the investment management piece and the other is the administration, disclosure, connection with community, education, those kinds of things. Even in a default product, as much as you might want to strip that second part back, there is something to it and there are different ways of communicating with people who have different levels of education. There are different ways of communicating and engaging in the community or different industries have different gender balances.

Then if you're looking in the future where you might have, aside from insurance, other forms of mortality pools, those become important factors.

So it's not just investment management that a default fund provides and those characteristics, education, gender balance - - -

MS CHESTER: Our best in show have to meet all of those as well. I'm just trying to work out - - -

MR MAY: That actually varies based on industry. Maybe I'm not answering your question. I apologise if not. You can think about a default system that looks at the national level or you think about a default system that (indistinct) by industry and there are additional value-adds on the administrative side of segmenting by industry because there are industry characteristics that differ from the broad national pool in terms of gender, education and other forms of relevant background areas.

MS CHESTER: Apart from member communication, what is it – if we all agree investment performance is kind of the be all and end all in the accumulation phase, what changes with age and with industry sector that means that if you've got a good investment performing default product you should move to another one because you've moved job?

MR MAY: You are having a fund which provides a topic for a broad range of people. You can provide a national fund or you can provide a fund setting for a particular segment of the economy that has a large number of women or a segment or a fund that caters to a large segment of the economy that has workers with higher levels of education or lower levels of education and you can provide different kinds of ways of engaging with them and explaining what their benefits are.

MS CHESTER: I said separate to – I'm just trying to understand it for the investment performance.

MR MAY: Just for the investment piece, from that perspective, we think that the investment approach should be relatively homogenous for all folks.

MS CHESTER: That's helpful to know. Would you agree then that maybe the biggest risk is just defaulting someone into a poor-performing product?

MR MAY: Not right now because the number of default products that are poorly performing is relatively low.

MS CHESTER: Overall, regardless of current metrics, is the biggest risk going forward defaulting someone into a poor-performing product?

MR MAY: No, I think the biggest risk is having people who have been defaulted into a product being extracted from that product and put into a poor-performing fund that is not their default. That's what we're seeing in the existing system. That's the greatest weakness in the existing superannuation system is the movement of members from high-performing default funds into a more poorly-performing - - -

MS CHESTER: I think we're agreeing, but we're getting caught up in semantics.

MR HARRIS: I'd be interested in that because it's sort of consistent with what I asked the ACTU a bit earlier. As Karen points out, we do have widely different views even amongst industry funds on what is the biggest risk. We're not saying who's right and who's wrong. I'm just trying to say it's not just us arguing. That's why curiosity is substantial here and, again, because we keep thinking about members – and I know everybody does, so that's not just – we keep thinking about members.

Do you have then some data which suggests that there are lots of people who have been moved from well-performing funds to poorly-performing funds? In other words, we don't see the amount of churn that you seem to be implying. We see a lot of people who are relatively stable in the superannuation system and when they move on to another job they get stuck in another fund and so, remarkably – and I know efforts have been made to try and help them reduce account proliferation. But we see that as being substantially a problem, and so do all other people who you encounter in an anecdotal sense.

But you emphasised data. So I'm interested in this data question. How much can you actually observe of people being taken out of what you might consider to be a highly desirable fund and put into a demonstrably poorer-performing fund.

MS CHESTER: And remember we're only interested in default members here. Within the default segment, where is that occurring?

MR HARRIS: We know the industry does sort of have data that isn't published by the primary regulators that we can talk to. We've been looking for database sources. So even if they're sort of like some kind of Rice Warner advice that you've got from somewhere, is there something that supports what you just said? You said that's the biggest risk.

MR MAY: I think that there's two parts to your question. I saw Matt start to get ready to answer the one about the data around transferring out of default funds and I can think of some data on that as well. But I'll ask

Matt to cover that one. Just quickly on the multiple accounts characterisation though, and this is one of the things we were surprised in the draft report was the characterisation of multiple accounts as the (indistinct) and emerges out of the default system. When you actually look at the propensity of inactive accounts by segment – so if you look in the retail sector, for example, the percentage of accounts in the retail sector that are inactive is actually higher than the percentage of accounts that are inactive in the not-for-profit sector, which is I'm sure it's surprising because the way it's been interpreted is that this is something about - - -

MS CHESTER: You're getting into stage 3 territory. We're just focusing on default here. Our report was about - - -

MR HARRIS: I can happily accept, since it's my question, Karen, that both retail and industry funds might have differing but, nevertheless, in our view, substantially undesirable proliferating of accounts. We are not here to say retail is horrible or industry is horrible. We're just trying to worry about members collectively and go, "Gee, proliferation doesn't seem to be in their interests."

MR MAY: We totally agree with that, Chairman. I apologise, the reason why I was making that point was not to cast aspersions. It was to say that the driving factor between inactive accounts is because of some of the behavioural risks around members that we wanted to (indistinct) in the introductory comments around inertia, a difficulty of remaining engaged. It wasn't to say that – and it's not a distribution model issue. It's just how people are.

MR HARRIS: I agree with that. The data question?

MR LINDEN: I'll come back to that.

MR HARRIS: Even if you don't have it with you, there's a hint here.

MR LINDEN: What I just wanted to say, what we'd encourage the inquiry to think about is – and thinking about models that have been put forward – how the market participants are going to respond, what sorts of incentives might there be to do certain things, particularly in thinking about these models that are being put forward. In our submission we make the point that in opening up the default market, in effect, will monetise default pools, certainly under some of the models. And how will some of the market participants respond to that?

I think one of the things which you're trying to emphasise is for the inquiry to think about whether or not there are adequate safeguards in the model that are being put forward as to what will be foreseeable behaviour. Now, coming back to the point about stage 3 – and I think this is maybe where we have a difference of opinion, obviously. You're working to the terms of reference which the inquiry has been given. We respectfully and we have respectfully said that it's the wrong way around.

MR HARRIS: I accept that our terms of reference are weird but we're not allowed to say this.

MR LINDEN: If we were to have a discussion about where the greatest gain is to be made in our system in terms of efficiency, we would not be looking at the default segment.

MS CHESTER: Matt, don't worry, we're not going to deprive you of the joy of that discussion, we're just going to have it in about nine months' time when we do actually look at perhaps one preferred model or two preferred models against the current arrangements. We will get there and you'll be sick of us by that stage, I'm sure. On the point that you make about the behaviour of participants, it was something we're very mindful of in the draft report; indeed, we had an information request about it. We do feel that there would need to be an elevation in certain prohibitions. So I think what you're getting at is kind of like the bait and switch issue, particularly if we allow some folk that offer more than one product into the default market.

We're in the same mindset that you are in terms of let's come up with the best belts and braces, mindful that that might occur, as to how we can stop that from occurring. PWC submission – and, again, I'm hoping a lot of people might read the submission because it was a really helpful one – came up with a few suggestions in response to that information request. Greater controls on inducements around non-super and member non-benefit products. They pointed to the FOFA best interest test being a new obligation that would apply here. They also suggested reporting to APRA in movement of members from default to related-provider products and then, of course, the current member best interest obligation. We would expect to see the regulator issue some greater guidance about how that would need to be achieved in a world of a person with related products entering into the default market.

It would be good to get your sense of those protections and whether they would address – so we have the same issue. We're conscious that there will be behavioural responses in different markets. What would your initial sense be around some of those protections?

MR MAY: If I may, I did promise that I'd give a little bit of information around the movement out of funds and then I'll come back to that one. Movement out of funds, I think that there's one publicly available source, at least, and then there's fund level information. On publicly available source there's a research house, Roy Morgan, which looks at the source of advice that is provided to members and what induces them to choose and then the different channels that wealth management firms use to draw people from. More potentially informative to the question you have asked would be fund-by-fund inquiries. Funds do keep careful information about when their members leave, where they go. If you were to ask industry funds about who their default members are and where those default members go they would be able to tell you.

MS CHESTER: These are members that choose to switch versus members that just end up in another fund because they've moved job?

MR MAY: The former.

MR HARRIS: Sorry to interrupt. Tell me to shut up if I'm – but you're not aware of some kind of like – because there's only relatively few advisers in the industry to most of these questions, you're not aware of anybody having ever, for example, offered you advice that aggregates it across a suite of funds or something like that? I'm trying to get to your question about the different risk.

MR LINDEN: We may well be able to talk to the funds about where members might be going within the system and provide some more information. There is that Roy Morgan survey. On the issue of multiple accounts, obviously in the submission we've made we've suggested a more vigorous and aggressive approach than the Productivity Commission has suggested. This is a discussion which has been going on for a long time around multiple accounts. In our submissions to the Cooper Review we said there needs to be a process of automatic consolidation. We recognise there's been improvements, obviously, with the ATO, with MyGov and the ability for people to see whether they've got accounts. I think the jury is still out on whether or not that's really that effective.

Our view would be if we want to ensure that we don't have two and a half or three on average multiple accounts per person, there needs to be auto-consolidation. Some parts of the industry have resisted that fiercely and you might be aware of some of the discussions, in fact, which are going at the moment around insurance is one of the reasons which were given for why auto-consolidation should not occur. But we've obviously suggested that there's a mechanism whereby there can be an opt out. So if someone knows that they're maintaining multiple accounts because of wanting to maintain particular insurance, then they'd be given the opportunity to opt out of auto-consolidation. But we think auto-consolidation in a market where most people are disengaged would, in fact, be the best approach and the benefits and cost savings would be significantly greater than the model that's been put forward.

MS CHESTER: I guess what we're trying to achieve is the same in terms of auto-consolidation. Your auto-consolidation is kind of like a going forward auto-consolidation, isn't it? So if you move a job, there's a new default product you're into and then everything hoovers across unless you opt to leave it there. Is that right? I guess what we're trying to do is the same thing, but we're wanting to make sure that auto-consolidation happens in the best performing default product for that member. So when you come back to us on the metrics around the examples of people that have been in default products that have moved into less desirable products, what we're focusing on here is within the default sector.

MR HARRIS: We're genuinely interested in this less desirable I think is another way of putting it. In other words, it can't just be they've moved. Because the allegation is really that there's a lot of bait and switch kind of tactics. We've got you and then we upsell you or we send you on to some kind of wrong fund for your interest where we earn more money. I'm just interested in knowing whether it's – because it's, of course, a rumoured problem. The question is, can we substantiate it as being a problem because – and then because we're asking the primary question, what's the risk here that we're meant to be addressing in default super as we make changes? You can say there's lots of risks. I'm just very interested in the one that we've generally settled on as being, is it accurate? That's this primary risk of - - -

MS CHESTER: We're agreeing now that we're going to have two sets of metrics from you, one where there's a bait and switch occurring – and that's obviously where someone's entered the choice market – or within the default segment someone's defaulted into a new product, consolidated, and that's a lower-performing default product, which is kind of what these models are about.

MR HARRIS: To the extent that that information is available, because we are quite familiar with the fact – can I just ask one question on your auto-consolidation sort of thing?

MR MAY: Yes.

MR HARRIS: As you know, we refer to the fact of the existence of SuperStream now in place. If you previously took this position in response to Cooper, then you wouldn't have had that option in front of you and wouldn't be a live existing arrangement. So today we're in a position, it seems somewhat, where the ATO is able to – it isn't charged with – it is able to exercise some activity. Would you see auto-consolidation triggered by a – or would you see it as being viable to see it triggered by the ATO? In other words, a person encountering in their second job the start-up of another fund and the ATO sending a crew back to the employer which says, "Tell me that this person has decided to have two funds rather than one." I'm just making it up, I'm making it up for a response to your position.

MR LINDEN: Look, I'm conscious and I think today there's a Senate Inquiry report that's been released into unpaid superannuation where the ATO figures highly. We know, of course, there's at the moment a framework around lost and inactive accounts, which the ATO – they are actually budget-savings measures to (indistinct) out of the system lost and inactive accounts. My understanding is the ATO is not being proactive in reconnecting those lost and inactive savings with an active superannuation account. So there may be incentives on the part of government and the ATO to keep money at the moment within those – I mean, my understanding of the budget (indistinct) is that it's booked to non-tax revenue when those moneys come in the door and expense when they need to be paid into accounts. There's some peculiar incentives in there at the moment in terms of whether or not there's an incentive for the ATO to reconnect members to savings.

MS CHESTER: It's interesting in that context. You guys would be familiar with the New Zealand clearing house model.

MR LINDEN: Yes.

MS CHESTER: Where effectively their version of the ATO, if there's non-payment, they have to underwrite it. So there's really a set of eyes to make sure the employer is paying up. It would be good to get your views on the clearing house model. I know some of your – one of your members has supported it. Because it addresses a whole bunch of these problems and issues that, as you pointed out, perhaps progress is being made, but we've actually said in our report it's been a little too little too late.

MR MAY: I guess on the clearing house function, I mean, if you think about a payment system and clearance of that, you have – in SuperStream you have multiple clearing houses have been built. Then the question is, do you need to build a new national clearing house through the ATO at this time? What happens to the existing infrastructure that has been built and what's the additional benefit? If it's things like underwriting performance of payment, that's different from a clearing house function. Clearing house are just connecting payments between institutions and then recording the data around that.

MS CHESTER: We say in our report clearing house continues in the model, and we spent some time over there chatting with them about it.

MR MAY: That's all I was trying to say is there's a couple of things going on here. One is the system to enable the transfer of payments and the recording of data. I think that's been built in with multiple existing ones. If you think about securities clearing houses or any of those sorts of clearing houses you can have centralised or you can have a series of complementary ones. We have a series of complementary ones that have been built. If you think about the other functions of the New Zealand clearing house, they aren't necessarily intrinsic to the clearing function. They're supplemental functions and you might want to explore those or not. We don't have a view on - - -

MS CHESTER: Now, I know you took a note of it, I can still remember, but bait and switch, the protections that PWC suggested, Zak, did you have a view on those?

MR LINDEN: Honestly, I haven't read their submission.

MS CHESTER: I know, and that's an issue, but in principle, the four measures that they suggested, does it sound like it's heading in the right direction? You can give us feedback later more formally.

MR LINDEN: We'll have a closer look at it and I think it's important to – and for the Commission too to reflect upon what sorts of behaviours we've seen. The best interest duty, there are ways around it and it would appear as if at the moment ASIC is concerned that one very large financial institution, which is in the Federal Court at the moment, has potentially sidestepped best interest duty when recommending product consolidation. There's some limitations in respect to the FOFA regime and superannuation.

The other thing is, of course, which would be, we think, probably integral to the way in which for-profit institutions might look at the opportunities in obtaining a default pool is cross-sell opportunities for non-superannuation financial products which are potentially quite lucrative for them. Credit cards is an example of that. I can imagine that when you're thinking about - - -

MS CHESTER: The protections I mentioned before would get to that sort of stuff as well.

MR LINDEN: Yes. So when thinking – and these are the things which the Commission perhaps needs to be alive to in thinking about – as I said before, in thinking about these models and thinking about what incentives there are for the various providers and what risks flow from that and then thinking about how that flows through to the design that you're looking at.

MS CHESTER: I'm hoping we sort of tried to do that in the draft report. But if there's things that we've missed and the protections that we've suggested, plus others, don't get us there, please let us know.

MR MAY: The underscoring comment there is – and it is apparent in the cross-country data – for-profit providers are extremely creative and capable in undertaking regulatory arbitrage. It's just a fact. That's why we tried to make the comment around thinking about superannuation in an evolutionary context, that you don't set the rules of the game once. The rules of the game can be laid down. As soon as you hand your final report out it'll be dealt with, pressure will be put on how actually we get people into the real world. From then on, it'll be under constant arbitrage. The question, what are the parties and what's the power resources, if you will, in that ongoing ecology that you want?

MR HARRIS: We're going to run out of time, but one other – you have – I don't want to put words in your mouth, but you don't like clearing houses, you think they're going to be wasteful, you think our version of a clearing house is going to be wasteful.

MR MAY: I didn't mean to say that, Chairman.

MR HARRIS: No, I was thinking more of your submissions kind of information.

MR MAY: It's more that there is an existing – clearing houses are very valuable.

MR HARRIS: But the idea of using the ATO – I mean, in a sense the functionality is there. We may differ in our levels of knowledge of SuperStream but I had a little bit of involvement with SuperStream myself. It seems to me the functionality is potentially there. It's a question of allocating the responsibility and ensuring the staff to be able to follow it up. I'm quite interested in the idea because it does somewhat appeal. One of the things you can see around the world is the efficiency of this kind of – this level of the back office exchange does seem to be a pretty readily apparent efficiency (indistinct) but just efficiency.

MR LINDEN: We can look more closely at this, but the point we make is that, in effect, through SuperStream there is a clearing house that's been created through the SuperStream framework and various payment gateways which addressed – and I am aware of the fact that (indistinct) very early in the piece and pre-Cooper pushed this idea. Obviously the SuperStream architecture means within the payroll software systems that employers are using it aggregates payments which might fall to obviously multiple employees, potentially cross-multiple funds, and enables those payments to flow out into the system with minimum administrative burden on the part of employers.

MR HARRIS: I was just thinking the basic simplicity of saying, "Every time you submit your tax file number, your super fund comes up within the SuperStream system." This can happen, we can actually link the two systems and do this. You send the query back if another fund is nominated. But the query is – and this goes to your auto-consolidation point. I'm really trying to – because we are interested in the proliferation. It seems to be broadly accepted that it is a problem even though it is attempting to be addressed.

One way to address it is upfront, don't have any more account proliferation under the default system, just have a first-time arrangement. In your alternative preferences, we can deal with that by better efficiency over time in drawing out the proliferations occurring. I was just thinking if that was one of the propositions, I'm just trying to extend it into saying well, who would do that then? I'm assuming it would be the ATO.

MR LINDEN: I think probably you'll need to consider very carefully the existing SuperStream architecture. I'm aware of the fact that with the recent superannuation changes, new member attribute system, which means that, in effect, there'll be real-time information exchange between funds and the ATO about accounts and the ATO will be, in effect, getting a pipeline through the SuperStream system as well so they can see what payments are flowing through the system as well. I think the important thing is for the ATO to have the information rather than necessarily be the hub of having to deal with or process payments which come through the system for employers and then out to funds. I think the key thing is they have the data.

I think many of the things which you envisage or might be available through a central clearing house through the ATO are, in effect, already there. I think probably what we're concerned about is there's been significant cost already associated with establishing SuperStream that that's torn up and start again with some alternative arrangement which does very much the same things.

MR HARRIS: But you would have to accept cost – if you're going to say, "We're going to address proliferation and our position is through auto-consolidation," then you're going to have to accept that cost is part of auto-consolidation versus our version currently in the draft report which is no, make default in future just a once-only event.

MR MAY: I think that there's costs - - -

MR HARRIS: There's no cost to that.

MR MAY: There is and it is the cost that we touched on in a couple of other areas. It goes to what happens if you no longer a high-quality default fund and what happens – so there's two issues that arise from that. We noted one. If you lose your status as a default fund under the proposals, my recollection is you can change the terms and conditions on those default members and they're not moved into the higher-performing future default funds. That's one of the weaknesses of sticking in that fund forever.

The proposal we had means that if there's a refreshing of who those default funds are and you move to a new employment arrangement, you get an account in one of those high-performing funds and your existing members transfer over, unless you choose otherwise.

MS CHESTER: Your concern is – and maybe it's something that's not clear in our draft report – that if you're no longer top of pops but you stay still on the second longer list, you think once they're not top of the pops then they will dull down the benefits offered to members because they no longer have that status. Is that your concern, Zak?

MR MAY: My recollection from the draft report was that once you're no longer a default provider the requirements to stick to certain terms and conditions no longer hold. I can be wrong about that, but that's my recollection.

MR HARRIS: It's a useful point. I think the answer is we haven't answered that.

MS CHESTER: I think we have but maybe not through a model.

MR HARRIS: We have an information provision around when you fall off the list. We certainly have that. But you're going beyond that and you're saying, "And a year later, what happens?" It's a worthwhile point to make. Each of the models would need to think through “and what happens?” Anyway.

MR LINDEN: Can I just make a quick point about account consolidation? I detect that you might have misinterpreted what the proposal we put forward was. We’re not suggesting that the form of account consolidation we’re proposing is something which happens when people change jobs. Yes, there would be that process – that’s the alternate process – to setting up a single default at the start of your working life and working through. We’re talking about existing multiple accounts and active accounts and a process. Ultimately it would need to be driven by the ATO which would be to consolidate inactive accounts into one - - -

MR HARRIS: We’re just talking about inactive accounts, not – we’re talking about all of the accounts. We’re talking about everything. You’re talking about inactive accounts only in auto-consolidation.

MR LINDEN: Well, unless people are making contributions in the course of a 12-month period to multiple accounts, then it would pick up the vast majority of multiple accounts within the system which the proposal that the Commission has put forward wouldn’t.

MS CHESTER: But in your default model, your preferred default model, you have a forward auto-consolidation, when you move to a new - - -

MR MAY: We propose both. If it’s inactive, we should automatically rationalise existing – so the existing accounts and there’s proliferation. There’s existing multiple accounts, we can rationalise them if they’re inactive after a year. For going forward to deal with proliferation, every time you move jobs your existing benefits transfer into a single account, so you wind up with only one.

MS CHESTER: I’ve just got one more quick question. Mergers. I had a few questions here, but I’ll just ask one simple one. How does a member today know the reasons for a merger not proceeding and whether that was in their best interests?

MR MAY: There are disclosure obligations under the law and we could look at exactly what’s required. We touch on this a little bit in our submission. Mergers is interesting.

MS CHESTER: Can we just stick to my simple question, because I’m conscious of time? Where would a member today – so say we’ve heard lots of war stories of mergers not proceeding that maybe should have proceeded for different reasons. And we'll probably try to move beyond anecdotes to evidence when we get to stage 3. But at the moment we tried to address this by saying, "Well, let's just have greater disclosure," because I couldn't work out where a default member today could find out the merger did not proceed and this was the reasons why, "Okay, that's in my interests."

MR MAY: First on the set of the facts around this, so the number of not-for-profit funds has declined since 2004 by over 91 per cent.

MS CHESTER: We've got the submission, keep - - -

MR MAY: Yes, but it is important because is there a problem here? If you look at the nature of this system and not-for-profit side rationalised by 91 per cent, on the retail side by 57 per cent, on average, not-for-profit fund are 8 billion, retail funds are 4 billion in today's market. So you have significant decline in the number of funds over time and you have a significant increase in the average scale of those funds. The question is, while there are anecdotes of failures of mergers, is this an area where there is a significant barrier? There are some around tax and equivalent rights decisions. But are they materially preventing consolidation? It's a difficult empirical question.

But I think if you look at the data industry is consolidating a great deal. The question around disclosure, we'll come back to you on that. We outlined in our submission some legal requirement that trustees have to provide information that are quite strong. But we'll look at the specifics and maybe see if we can find some examples of information.

MR LINDEN: Can I just quickly add – I wanted to provide - - -

MR HARRIS: You're going to be the last comment.

MR LINDEN: Okay. I just wanted to provide a little bit of data. I think there's obviously been some public debate around the issue of mergers and its role in system efficiency. I think if you do hard-headed empirical analysis as to whether or not small funds are the reason why there's inefficiency of the system, I don't think the data supports it. If you have a look at the 10-year rates of return and look at the bottom quartile, it is true that the majority of funds by number in the bottom quartile are small funds under 2 billion. However, they only account for 3 per cent of assets in the bottom quartile and 8 per cent of member accounts in the bottom quartile. There are some very large funds and institutions in the bottom quartile and we think that's where significant efficiency gains could be made in the system.

MR HARRIS: I think your reference to hard-headed analysis will – we understand that APRA has the best analysis that anybody can currently have, and we have access to that. But I'm interested in knowing is there something else that you have which is database for that purpose. We would like to see it, please. Anything that – even if you can – even it's just a – as I said before, quite a few advisers – or there are relatively few advisers in this industry. Sometimes they do put together data sets of a proprietary nature. You might have access to them. If you're happy to share them with us, we'd be very interested in them because otherwise we have to go and buy them and we're not - - -

MS CHESTER: Because the APRA data would lead us to believe that size does matter in the long-standing under-performing funds. That if you were to look for one factor – anyway, we can - - -

MR HARRIS: Not to dismiss what you said, which I think we're familiar with, we're just interested in knowing there may be more behind this. Every occasion that I can ask for access to information that we're otherwise not going to get - - -

MR LINDEN: Look, we'd be delighted to come back and have a deeper discussion with you about the data around performance, around the system structure. I think it's important to understand because it may well influence your thinking about models.

MR HARRIS: Thank you very much.

MS CHESTER: Who's the Tom Cruise fan at the ISA?

MR MAY: I think it's a universally held admiration.

MS CHESTER: It's just that the title of my submission was "Risky Business". I had a flashback straightaway.

MR HARRIS: Managed to miss me entirely. Thank you very much again for your time here today.

ADJOURNED **[11.09 am]**

RESUMED **[11.16 am]**

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

MS DELAHUNTY: Yes, thank you, Chair. My name is Mary Delahunty, I'm the General Manager for Business Development and Policy for HESTA Superannuation Fund.

MR SAXTON: My name is Neil Saxton, I'm the Executive of Engagement Strategy at HESTA super fund.

MR HARRIS: Mary, do you have a few relatively succinct open comments to make?

MS DELAHUNTY: I do, indeed. Thank you, Chair. We appreciate the opportunity to be able to make not only those points but the submission as a whole and appreciate the opportunity to be able to continue the conversation. I'll take the submission as read. I understand you're running short of time. I thought there were, on reflection, some interesting points that you may find helpful in your further deliberations about HESTA and our role coming up to 30 years now as a safety net provider for members of the health and community services sector.

We've set out in our submission our typical member, but our typical member is someone that we keep at the front of our minds all the time. She's 43, she's very low balance, she has very broken work/life patterns. She has low engagement in her superannuation and she is incredibly unprepared for retirement. That is what we base both our product decision but also our whole fund around. We've always had a desire to reform as a fund and we've done so because we understand that our members face structural challenges that others don't. So we do enter these conversations with genuine intent to improve the system. We've done so for a long time. We did so in the 2012 design of the Fair Work Commission process that we believe should actually be the model that goes forward.

I've got a dual role at HESTA and this is something that I think is in addition to the submission which the Commission might find interesting. I'm responsible for policy responses which is, in general, an incredible honour because you do get to work on reforming the system. But my other role is in business development. That is for the growth of the fund and the fund at HESTA has grown organically since inception.

Now, that means that we don't sort of sit back and hope every day that a new member comes through the door, but we compete in tender situations quite often. I have on the go at the moment probably four live competitive races for safety net provision at an employer level in the health and community services space. I note that both in the first paper and in the draft report there's a seemingly – perhaps a lack of understanding as to how those competitive processes actually play out from the Commission's point of view in that there seems to be a continual conversation or commentary about the lack of competition in the sector. I can certainly assure you that a large part of my role is taken up with competition in the sector and so that's, in fact, not correct.

Like most of our funds of our genesis, members have overwhelmingly not chosen us, employers have chosen us for their members, for their disengaged members, and they do so with the help of industrial parties quite a lot because, as the Commission correctly points out, we're talking about members that are not actively making choices. So someone needs to stand in on their behalf. We believe that firmly to be the role of both the employer and the industrial parties to achieve a good result. They look at our performance, they look at our fees, they look at our insurance.

I note that the insurance is beyond the terms of reference for this draft, but it's sort of incomprehensible that it is beyond the terms of reference given it's a mandated requirement in the default offering and it's done so fairly much on a sector-by-sector basis, which differentiates the product and it makes it unique to, in our sense, the health and community services sector. I note we've got friends from Cbus here and in their world it makes their insurance unique to their sector as well. And it's why we've come from where we've come from.

When a member is defaulted into HESTA their retirement funds are directed to the corporal product. This corporal product obviously has a MySuper licence but it's 30 years old as well. So for a lot of industry funds when MySuper came about we could simply licence our existing investment products. It's the most appropriate place not only for default members to be but for most of us to be. It is our most diversified option and in that diversification it does have exposure to infrastructure assets, along with equities and some of the more usual exposures that you would see, but it has exposure to infrastructure and it has exposure to property, and it takes a very long-term investment view.

This financial year, in addition to – I guess I'm presenting information in addition to the submission, but I wanted to tell the Commission about some of our education concepts. Now, this financial year we will see around 70,000 of those members, whether they've been defaulted in or actively chosen in or been defaulted in and since become quite happy with where they are – so an engaged member – to educate them and to lift their ability to make good decisions about their retirement.

Now, this adds to our operational cost but it is something that is a gap in the Australian marketplace, this understanding of the compulsory nature of superannuation, understanding of how you actually make good decisions to build your retirement. It sits under Neil's area. We have an enormous team of member education managers who spend time in the workforce increasing people's knowledge of superannuation. The Commission quite rightly pointed out that there's policy intervention required to build an educated consumer base. At that moment that need is being met by funds to the detriment of our operational costs but it's an obligation that we can't leave behind.

So I would encourage policy intervention in that space. In the great spirit of being reformers, a compulsory situation or a compulsory marketplace like superannuation should have an informed consumer base. The concern that we have with many of the policy interventions that are proposed in the draft paper is that it seeks to lock in the apathy that currently we see as such a detriment to the system. I think that is inelegant policymaking and it's not exactly where the attention should be focused.

The other thing that impacts our operational cost is enacting reform, participating in reform and enacting regulatory changes. Some of these are very necessary. Indeed, we want to continue to shape what is, in fact, a very young system. But it has a real cost. I note, as we did in the submission, that we participated with great intent in the last process that sought to better strengthen their safety net provisions in superannuation. That resulted in a compromised position but, no doubt, a good one where the Fair Work Commission would play a large role in deciding default mechanisms.

We participated in that. It was at enormous expense to the taxpayer. It was an expense to our members and yet it hasn't even been enacted. So we find that to be a really disappointing waste not only of taxpayer funds but of member funds. We might differ from some of our industry counterparts in our belief on choice. We think that a mature superannuation system such as Australia's, everyone should be able to choose their own superannuation fund. But we don't believe that that is then – if everyone has choice, that then the safety net system isn't necessary. We think that the two go hand in hand.

In a mature, sophisticated retirement system everyone should be able to choose their fund, but if they don't, we need robust safety nets underneath them because they're compelled to be a part of this marketplace. So we certainly welcome the change, the seemingly changing language from the first report from the Commission to this one where we're, I think, a little bit more accepting that there needs to be a framework for default funds, that there needs to be a quality filter across them and it's over and above the MySuper licence, but that we all want to aim for choice. A part of that, as I said before, is about an educated consumer base.

Personally, I've had the great fortune of being awarded a Churchill Fellowship in 2015 where I studied a number of international pension funds, specifically on their gender equity measures for women. That included the Chilean system. So I'm quite familiar with how that actually works. I think it uses incredibly blunt policy instruments to achieve – well, it hasn't really achieved very much at the moment – but to seek to achieve some of the reform that the Commission has set out as well. So I'm happy to talk further on that.

We still think improvements could be made in the safety net area in the quality filter even though we completely endorse the Fair Work Commission process and we endorse that it remains an industrial matter. We think that those improvements should really look at whether or not, philosophically, on a principles-based decision, funds or businesses should be able to profit from inert money. We would certainly encourage the Commission in the stage 3 process to turn your mind to whether or not that is an appropriate outcome of a sophisticated mature system of whether profiteering or value cash up from members who have never made a decision is something that, as policymakers, we want to entrench.

We don't support any of the proposed models in the draft report in their entirety. There's a couple that almost replicate, with some notable exceptions, the Fair Work Commission process. But I'll come back to that process because it was carved from compromise by industry participants who genuinely believe it should be given a chance to run. Even if it's not given a chance to run, it should at least have been tested in this stage. So we welcome any discussion on that.

MR HARRIS: Thank you very much. Your most controversial point is your penultimate point, I think, you're really strongly hinting, perhaps you're explicitly stating, that you think at some later stage in this superannuation inquiry process we should consider whether any for-profit entity should be capable of offering a default fund to members, which is quite a substantial change to the existing system. Your view in that case, if I'm hearing correctly, is any profit incentive is inconsistent with members' interests. You've limited that though to default members. So your view is if you choose to go to a for-profit fund, that's your own lookout. But anybody who makes no decision should not have any chance of using a for-profit fund as a supplier.

MS DELAHUNTY: That's right.

MR HARRIS: It's worth noting. I took it from the submission that you were hinting at that, but you're pretty explicit now that's your – it's not so much for today's exercise, not in our view the way the terms of reference operate, but it will come up, therefore, in stage 3.

MS DELAHUNTY: That's right. To expand on that a little bit, having had the great benefit of seeing some of the other systems internationally and although their architecture might differ from Australia's, what is common is that we are actually a leading, obviously, provider of retirement benefits in the world. Now, we get the chance to rethink it, not to take some of the bits from the other parts of the world. We get the chance to actually design it ourselves. If we lift from the bottom, as we say, where we educate a consumer base, where we have consumers who are more able to choose because they're more informed, but yet we still have an element of compulsion and a need for a safety net, do we really imagine that it's okay for people to be profiting from those unengaged members, from people who have never made a choice but yet are compelled to buy into a product? Is it really okay in a world-leading system that we say you can come on in and make profit from those members?

MR HARRIS: Would you have seen the IR system, if it were in operation, as having enforced this particular proposition?

MS DELAHUNTY: The Fair Work Commission system currently? No, I don't imagine so. The filters that are over and above the MySuper licence at the moment don't have that particular element to them. But on that, if that Fair Work Commission system had have been allowed to run when it was legislated we would be coming up to now the fourth year next year. I would imagine policymakers and bodies such as yourselves would be ready to assess that and we would be having conversations about building on a system that was already legislated and improving it instead of throwing it out the window and starting again.

In those conversations about building on something and improving it I no doubt would be having a conversation about whether or not, as a country, we think it's okay that people have made profits out of members who have never made a choice without there being any policy intervention in the education of the consumer base.

MR HARRIS: I just wanted to clarify since you made it in your sub and in your remarks.

MS CHESTER: That's good. I'm going to reverse all my questions now and go to the simple one last. Mary, thanks for HESTA submission and for your involvement and participation, and Debbie's as well, along the way. It was neat to see on page 9 of your sub that you liked three parts of model 1 and model 2. You like the short list, you like the MySuper on steroids, which I think you more eloquently called it an elevated MySuper, and you like the independent body with oversight. I guess model 2 is probably the closest to our current arrangements which we call assisted employer choice. Your key sort of deal breaker issue being only a not-for-profit could have access to the default segment, if our model 2, assisted employer choice, was just not-for-profits with the short list elevated MySuper independent body with oversight, would model 2 then be the kind of model that you'd be comfortable with?

MS DELAHUNTY: Model 2 has more concerns than just what we would think would be an additional reform to the system in that people shouldn't profit from inert money.

MS CHESTER: I'm modifying model 2 for you by saying - - -

MS DELAHUNTY: Yes, but I'm going to request that you modify it even further, because one of the other points that we made on model 2, which we don't support, is that independent body at the moment – and I should say that model 2 probably gets the bulk of our support because it most closely replicates what has already been legislated and yet not enacted, except for the notable exception – and it's a massive exception – that the independent body is more closely aligned to the political system than it is to the industrial system. It seems to me to be a contrary view held in the paper that we want more independence and more transparency and for superannuation to stand on its own and yet one of the most important elements is that we move it closer by having ministerial oversight and therefore appointments and therefore removals of people who are assessing and encapsulating that quality filter parameters. It's a big cross against that model 2 for that particular reason.

MS CHESTER: Model 2 with only not-for-profit and with the FWC being the body.

MS DELAHUNTY: To be clear, the model that we support is the current Fair Work Commission model. If that was to be improved, we believe that people shouldn't be able to profit from inert money.

MS CHESTER: I guess what I'm suggesting is – because we're looking down the track to stage 3 – that model 2, with your tweaks, could be interpreted as an improvement of the current arrangements.

MS DELAHUNTY: Model 2 with the modifications that I've just said – no, sorry, model 2, if the independent body was held in the industrial system and has oversight from the Fair Work Commission, would actually be the current legislated process. It's just that it would have come with an enormous waste of time before it.

MS CHESTER: But you're still agreeing short list and elevated MySuper, which is not in the current legislated process.

MS DELAHUNTY: Well, I believe it is. We've got a MySuper licence in the current legislated process. There's a filter that goes on top of that. We're accepting that as the language now. But there's additional criteria that goes on top of that. Then there's a submission to a list. So there's the long list to sit on the award. Then in order to do that there's also a body that's appointed by the Fair Work Commission which, for lack of appointment, we would all be three years down the track in that insists on the - - -

MR HARRIS: Can I just clarify that - - -

MS CHESTER: Yes, because I need to clarify now too.

MR HARRIS: I think the two of you agree on something I don't think you actually intended to. Model 2, were it implemented, is generic. It's not award-based.

MS DELAHUNTY: Yes, that's right.

MR HARRIS: I don't think you agree with that either.

MS DELAHUNTY: No. What I'm saying that it belongs in the industrial system is - - -

MR HARRIS: Let's clarify. You're not agreeing to any part of model 2, really, because you want the other system.

MS DELAHUNTY: The name is nice.

MS CHESTER: Even though you say on page 9 you agree with the short list, you agree with the elevated MySuper and the independent body – but we can agree to disagree on who that might and we don't even have a view on who it should be yet on principles – you actually don't mean the short list that we're suggesting. You don't actually mean our version of elevated MySuper. I think other people might have misinterpreted your reading submission and not just myself, but anyway, that's all good; good to know.

Coming then to the principles, because we kind of like to go to principles before we decide who the body should be, we set out some principles in box 2. Did you have an issue with any of the principles?

MS DELAHUNTY: I'll go through it, if that's okay.

MS CHESTER: Yes. I've got it here, if it's helpful. Because in the submission you go straight to FWC but it would be helpful for us to know what HESTA's view is on the principles.

MS DELAHUNTY: The principles look very familiar from when we decided them in the current process. I think the principles, as in the dot points relevant to the composition and conduct of the selection body, are – we're okay with those.

MS CHESTER: How does the FWC meet the last principle, the first part of it?

MS DELAHUNTY: How do they meet being accountable for their decisions?

MS CHESTER: Yes. Who are they accountable to?

MS DELAHUNTY: The people who have standing at the Fair Work Commission, the rest of Australia. Well, I would see that the Fair Work Commission is an independent umpire that decides industrial matters every day. I mean, their accountability is to the country as a whole.

MR HARRIS: They're appointed, aren't they - - -

MS DELAHUNTY: They are.

MR HARRIS: - - - effectively for life as judges and able to – now, your panels, I know, so we can all go into incremental detail of it, but I'm simply saying the accountability that you've stated, from my knowledge of the Fair Work Commission system from our workplace relations inquiry, would say you can have one or the other. I can be utterly independent and therefore my decision can't be second-guessed other than on legal grounds or I'm accountable to somebody. You're not really accountable; you're independent. That's what the case is with the Fair Work Commission. They are utterly independent in their decision.

Presumably once the panel, if it were in operation, makes a decision, unless it's reviewed internally by – I don't quite know whom or who – that's it, baby, and so it's – the accountability is different to the accountability that a government itself might face where if it did, for example, as, I think some people have alluded to, appointed a partisan panel to come up with a horrible decision that was inconsistent with a criteria, it will be accountable at the ballot box every three years and presumably that would matter. We have an accountability definition perhaps is a little different from your own. I think you're really saying independence.

MS DELAHUNTY: Perhaps it is a little different, but I guess I have a little bit more faith that they would meet the accountability criteria and a lot less faith that a ministerial-appointed process would meet perhaps an obligation to act in the best interest of fund members. I think that there are balances to be struck within the priorities here and I genuinely have faith in the Fair Work Commission process and that accountabilities are understood, required and are broad.

MR HARRIS: Could the panel members appointed to the Fair Work Commission process be equally partisan? And who appoints them?

MS DELAHUNTY: Potentially.

MR HARRIS: Who appoints them?

MS DELAHUNTY: There was to be an appointment by government.

MR HARRIS: Ministerial, you see. It's like we clarified, but I don't think you were here, with the ACTU earlier. Really the position on partisan appointments says you can't have any powers anywhere. If you're worried about partisanship it's always a relevant consideration and you can't, therefore, have a mechanism that says, "Let's bring in some expert and then put them in a position as decision-maker because in the end they could be accused of being partisan," i.e. my expertise makes me partisan. Therefore, you can have inexpert members of panels but then you'd say well, they could be utterly incompetent and get decisions badly wrong.

MS DELAHUNTY: Sorry to interrupt you, Chair. I think there's a process that goes beyond just the appointment of the panel when it sits in the industrial relations system that gives it a little bit more of a robust nature to protect the best interests of members. That is, that industrial parties and employer groups still get to have standing at the Fair Work Commission, still get to argue the case. It's, as I see it, a little bit beyond an arbitrary decision from a bunch of people in a room that were appointed by a minister. I would wonder too, if we're sort of talking about apples and apples in the appointment of a selection panel, why on earth it hasn't been appointed.

MR HARRIS: They'll both be very transparent, won't they?

MS DELAHUNTY: I would imagine so.

MR HARRIS: It's very unlikely you would not know who these people are and therefore the accusation of partisanship is immediately on the table, isn't it?

MS DELAHUNTY: But I think that comes back to your original point. There's transparency as in we know what you're doing and then there's accountability. I think that the Fair Work Commission almost entrenches accountability through its processes.

MR HARRIS: Anyway, we have, as you know, in phase 2 tried very hard not to play in the space. It's just that since you came up with such a relatively radical proposition it was - - -

MS CHESTER: You took it there, Mary.

MR HARRIS: You really did, and I can't sit there and ignore it and then be potentially accused of saying - - -

MS DELAHUNTY: Well, I might actually say that you took us there by your reference to the Chilean system which doesn't allow for for-profit or insurance funds to actually participate in the tender process.

MS CHESTER: Our terms of reference took us to the Chilean system. Mary, in your other opening remarks you sort of describe a system where competition is alive and well and you're happy to compete. Indeed, you have to roll up your sleeves and you're competing on four tenders at the moment. Why is it you think competitions are right or wrong and you're happy to compete in the super system but you're not happy for competition for access to the default market?

MS DELAHUNTY: This is for access to the default market. Just to clarify, because I might not have made myself clear at the start, but the competition that exists at the moment, which we made reference to in our earlier submission as well, it's just not as – well, it exists for default business, let's put it that way. It's just not systematic and we think that there is some improvements to be made that would make it a little bit more systematic and help employers understand how to actually impart that system on a tender process. There is competition at the moment. We are happy for there to be competition. The transparency of competition means that there can't be any sort of third line forcing elements that might go on with some people who have vertically integrated business models and there's – we've made reference to that in the submission as well. So I don't need to go into it in any detail.

But to answer your question, I'm not saying that there shouldn't be competition if we are to propose a different model or to propose an improvement on the current model. I'm not saying that there shouldn't be competition. I'm saying that competition should be restricted to businesses who don't seek to make a profit out of people who have never been engaged.

MR HARRIS: I wanted to ask about the greatest risk that occurs to a member. A lot of the time has been spent by many funds competing against other funds. In other words, it's a fund-to-fund comparison. We spent more time mentally trying to consider members – and your submission starts out with a described average member. So I think we're on common ground about members. The nature of the default system and the reason we went to our zero base, that there is no default system, what does that look like, we went to that because it tells you why you would have a default system. In other words, we don't say today's system is the best system. We say, instead, once upon a time the system was designed for default. The question is today if you didn't have it, what would be the risks?

So we go to this primary question of, what are the risks to members? It has been stated in some submissions to us that the greatest risk to a member is being a default member, therefore non-engaged, therefore not even, as it were, knowing what is happening to their money is to end up in a poorly-performing fund. That's the greatest risk. Now, this morning we've asked that question and we've got some differing answers. So we'd like to know whether you think that's the case as well; the greatest risk to a member is to get stuck in a poorly-performing fund.

MS DELAHUNTY: I had the benefit of sitting over there whilst you asked that the last time, so I did turn my mind to that. I think that's right, a poorly-performing fund – but it's a pretty subjective measure because it's not just on investment performance, it's on your ability to then engage with them. But I think the Commission has identified something that is a risk to members and to the system as a whole, which is not only just to be defaulted into a poorly-performing fund but to be defaulted there six times throughout your life and carry all of those accounts into retirement without ever having made an active choice to consolidate or by the time that you make an active choice to consolidate it's a little too late to reap the benefits of it.

I think it's twofold. If you think, as I think you correctly are, from the members' point of view what is – for our nurse, she starts off with HESTA. We're not usually the first fund. So if she defaults into HESTA she may have some other ones, which is why we take our obligation on education very seriously. If she starts with us when she's 23 and she carries four other funds until we finally get her engaged at 55, the greatest risk to her is that she's paid too many fees for things that she's never engaged in and that that impacts her ability to retire with any sort of level of dignity.

There's a little bit about the default system in there, there's a lot about an educated consumer base as the greatest risk to this system as a whole to our typical member, and there is the risk of poor performance on any or all of those funds, including the one that she chooses.

MR HARRIS: That's right, and the question is, how then do you get this information into people's hands about what is a poorly-performing fund? Because if you don't have a good mental benchmark, then a couple percent might still look sort of okay without realising that you're in the lowest quartile. The answer potentially can be well, of course, there's a lot of information out there. And we've talked about it ourselves and there may be other mechanisms by which we can use existing institutions to improve information. You've talked about the fact that you try and educate members on these things. But we've still got a very, very substantial membership base that is utterly disengaged.

MS DELAHUNTY: Yes.

MR HARRIS: Our view is one that says what can structure do to potentially address that?

MS DELAHUNTY: I think that that's really the crux of the issue here, because there's structure that any of the models purport here locks in that disengagement, in my opinion, in the fund's opinion. One of the benefits of being a sector-based fund, as HESTA is, is that – I heard that you were somewhat dismissive earlier about beyond – so beyond engagement, what is it that you can provide to members? Well, beyond engagement is sort of another story altogether. Engagement is incredibly important and being a sector-based fund, HESTA, Cbus, we understand how to get into a member's workplace and talk to them about money at the time when they are thinking about money, which is when they are at work. We also understand that we have a number of shift workers. So our communication not only styles but methods differ, depending on our sector.

That's the ability that a sector-based fund. The fact that many of the models are seeking to not only entrench the apathy but also break disconnect that sector responsibility and the fund is, I think, a retrograde step in that respect.

MR HARRIS: I'm not sure we'd accept your statement about intending to entrench apathy at all. The system itself has had 25 years and it hasn't really varied this. So I don't think you could say our new hypothetical models are designed to do anything more than what you would appear to have achieved over a long period already with the current system, which is a substantially disengaged membership which is at deep risk, as you, I think, have agreed with me, of being stuck in a poorly-performing fund if they're in the wrong place at the wrong time. Therefore, the current question is, from a member's perspective, what more can we do about that from a structural perspective?

We did get on in another part of the discussion, and you probably were present for that too then, that says even if we – and there are differing views, obviously, on each of the individual models. But we've also gone to this first time one-time only default option as being a way of cutting down proliferation. It can be an incentive itself to have a view but it may not be. Can I get a perspective from you on that?

MS DELAHUNTY: That's where I was referring to before that we see that as an entrenchment of apathy. A one-time only default when you enter the workforce does not either then encourage you to get engaged in your superannuation and make good decisions, whether or not that decision is to stay exactly where you are or to make sure that your investment options are right or to make sure that you know that if you just popped $5 more in. In answer to your question, our response to that is that we believe that to be policy intervention in exactly the wrong way.

MR HARRIS: You said earlier that you're not usually the first employer in your industry. Under our model a nurse would turn up possibly having done a part-time job and would be in a different fund. You're very active in the workplace. You're telling me we're entrenching apathy and yet your advocacy is going to be the workplace join us. I'm afraid I still don't see how you can come to that conclusion.

MS DELAHUNTY: For a nurse it might not be the first fund. For a childcare worker it's more than likely to be the first fund. For someone entering the aged care workforce we might be the first fund. I was referring to our typical member earlier for which we may not be the first fund. We're engaged in a number of sectors. The view that we're taking towards the one default for life is fund agnostic in that it's bad policy to say, "Look, we understand we've got a disengaged consumer base. Nonetheless, set that aside, let's not do anything to actually increase the engagement and let's just lock that down."

MR HARRIS: Wouldn't you be competing harder if you weren't the first fund? Would you, as an existing entity with a substantial education option in your own hands, wouldn't you actually be competing harder in those circumstances to get those members because they were one time only? In other words, to convince them to come to your product because, as you've said in your submission, were relevant to you and your workplace, we've got a better designed, which is another interesting angle, but you've got a better designed investment option, apparently, relevant to this particular workplace. Why wouldn't you be competing harder?

MS DELAHUNTY: Competing under these models to be the one default fund for life, is that your question?

MR HARRIS: No, I'm simply saying let's just take the first-time only option in future for default. Let's just hypothesise that. Your members turn up potentially having the first time only – they had a part-time job. They're somewhere in a different fund. Why won't you be competing harder? You've said we're entrenching apathy. I'm querying it. I can actually only see you competing that harder to get that member to understand your benefits rather than to simply go, "It's all too late now," and we'll do nothing.

MS DELAHUNTY: I think in my mind they're two separate issues. We do compete for members right now. We either compete at the employer level or we compete member directly and, as I've said, we've done so successfully because we've grown organically year on year. So we understand our competitive set. We understand how to compete. Setting that aside, we'll continue to compete very hard for our members; we do so already. Once we've got them, we continue to educate them. But setting that aside, they're not divergent views to then believe that it's bad policy to just have one default for life.

Now, whether that's the HESTA default or someone else, the model to get to that one default for life is a race to the bottom on fees. It doesn't encourage funds to then engage a membership. If the policymakers aren't encouraging engagement, why would the marketplace? If engagement falls any lower, then people are not making good decisions on their retirement. If they're not making good decisions, then it impacts the money they'll take into it.

MS CHESTER: Set aside the auction model for a moment, if the whole raison d'etre of our models is to get default members to the best-performing funds, then what's the problem with the one default model if you agreed earlier that the biggest risk was them defaulting into a poor-performing fund?

MS DELAHUNTY: I agreed earlier that the biggest risk to them was defaulting into a poor-performing fund but that performance is subjective and it's not always about the numbers, it's not always about the fees; it's also about how the fund engages. So there's that. You can't necessarily have an abstract concept of a one default for life and not understand how you would get to a situation like that. How you propose to get to a situation like that talks directly to locking in the apathy, locking in low fees, locking in investment choices that don't necessarily have a long-term time horizon. That's always going to have a detrimental effect on someone like our average member.

MR HARRIS: That's a commentary in practice, not on the option. It's a commentary on the fund that you imagine is going to be that very first fund locking in low fees, things like that. So you're actually extrapolating from a vision that you have of the particular lucky beneficiaries of being the first timer rather than the policy principle, I think. I still can't understand how, if you are an effective competitor now and you're facing with not having a default member fall into your lap because under the enterprise agreement that's your lucky win, I can't understand how, if you are an effective competitor now, you wouldn't compete the harder to get that member. I think it's sort of almost counterintuitive to imagine that you wouldn't, that you would just give up and go home.

That's why you did make some comments on competition and how strong it was in your opening statement in which you've asserted you don't understand – in your submissions you don't understand how our model would work for competition, and it's actually that. The more that you don't have something falling in your lap through the industrial relations system, the more that you have only two choices in life. One is to give up, the other is to compete the harder and convince the relevant member, now an employee in your particular sector-based field of operation, that you're a much better party for them to have. That, to our mind, encourages choice, encourages engagement, is worthwhile. I can't see this locking thing at all, given that choice does exist.

Now, I could see it if the enterprise agreement says, "There's only one fund for you, pal, and you must get in this one." I can see that we've actually exploited choice. But I can't see it other than in those circumstances.

MS DELAHUNTY: I might just correct the premise, if that's okay. I think it's important because the gentleman sitting beside me is my boss and if he thinks that things are just falling into my lap, then I probably don't deserve to be drawing a salary today. But it's not the case that where you might have a default arrangement that members just fall into your lap. My opening comments about competition was to inform the Commission that there is competition going on at different levels whereby nothing falls into your lap and employers and industrial parties take their responsibilities, so far as we've seen, pretty seriously.

We've also seen employers be the subject of some fairly inappropriate behaviour from people who seek to profit from members who don't make any choices. There's no such thing as a member falling in your lap. Some decisions have been made along the way. The Fair Work Commission process sought to make those decisions more relevant to sectors, more transparent and more systematic. The one default for life seeks to say, in my mind, "Okay, we've got a disengaged consumer base and there's nothing we can do about it. So we'll just put them in one fund."

You can't then say it doesn't matter how we get to that point because everyone is going to compete over here. It does matter how we get to that point because they're disengaged and someone's got to help them.

MS CHESTER: I might stray from traditional practice and we might hear from your 43-year-old female member. Her name is Michelle MacDonald, she's submission number 77, and I think she's a HESTA fund member by what she said in her submission to us. But I'm going to quote her because often we don't get to hear the voices of members at our public hearings.

> *After making a concerted effort to consolidate 10 super accounts (all default) into one super product of my own choice in 2011, I then proceeded to be employed in five jobs, two of which I was not able to choose my own super fund, due to a compulsory default fund in the Enterprise Agreements. One of those two I was not even permitted to roll over when I left that job and sector. That account has $8000 in it that I can't touch, and its returns simply fund its admin costs.*
>
> *Back in 2011, my aim was to take control of my super.*

So she's engaged.

> *As a woman working in the health and education sectors, this has been impossible – due to compulsory default accounts that I had no interest in joining but was given no choice.*

I don't say that to appear despondent, just so we can hear the voice of your member.

MS DELAHUNTY: It is interesting and, if it's okay, Deputy Chair, may I respond?

MR HARRIS: Sure.

MS DELAHUNTY: I haven't had the chance to read her submission. Isn't that nice to get an actual super fund member engaging in this? But one of the reasons that we support choice holus-bolus across the superannuation sector is because we do see in health and community services that members who work in a public sector are required to have a fund there. When we support choice HESTA had on it is going to mean that we will lose members, but it's better for them. Michelle, wasn't it, is quite right. Like it must be very, very frustrating. And we've seen that.

Now, there are still some closed systems in the public sector. That doesn't explain all of the proliferation of the multiple accounts, but it does go some way and it certainly explains a lot of them in the health and community services space because there's a lot of public sector workers in that space.

MR HARRIS: Can you ask your last question because we're off time.

MS CHESTER: I was just about to do that, Chair. The simple question I just want to put – and a yes or no answer, please – is do you think poor-performing funds, so poor performing over an extended period of time, should exit and high-performing new entrants should be allowed to provide default super?

MS DELAHUNTY: Yes.

MR HARRIS: Good job. Thank you very much. Thank you for having what I genuinely – a big attempt in the submission to answer the points that we made in a particular way. I hope to see you in phase 3 because you've got quite a specific notion to put forward then.

MS DELAHUNTY: Thank you.

MR HARRIS: I appreciate your time and effort.

MS DELAHUNTY: Thank you. Apologies from Jenny who's currently on a plane and she would have loved to have been here.

MR HARRIS: I think Karen knows her.

MS DELAHUNTY: Yes.

MS CHESTER: I've been on one too many panels already.

MR HARRIS: Thank you very much for your time. I think that says Grattan. Is that right? Jim has been waiting patiently here this morning and can answer all questions without us even asking them because - - -

MS CHESTER: We're going to ask Jim different ones though.

MR HARRIS: No, I'm not. For the record, please.

MR MINIFIE: For the record, my name is Jim Minifie. I'm the Productivity Growth Program Director at the Grattan Institute. Also for the record, strictly speaking, this is a submission in a personal capacity. Grattan doesn't make institutional representations.

MR HARRIS: I'm glad you've found a workaround.

MR MINIFIE: What I'm going to say – that's right – is based on, among other sources, on work that I've done at the Grattan Institute. I've really just got three areas of comments to make about what, to my mind, would be sensible for the Commission to focus on as it rounds out the draft. The first is that I think there's more work that could be done to provide more detail and flesh on the options and to begin a process or continue a process of assessing those options. The second is there are some extensions to those models that I think are worth considering, so essentially to look at some alternative models, at least to some level of detail. The third, could I echo what some of the other comments this morning have already touched on, is just to step back and to ensure that you've absorbed more deeply, I guess, the data about the root causes or the data that would lead to views about the root causes of performance differences between funds and between different systems.

Let me just make a few comments on each of those areas. First on rounding out the design and the assessment of the options. There are several areas where each of the models I think can be assessed potentially with reference to data at a deeper level than you've got to in the draft. The first is around upsell. There's already been some discussion this morning around that risk. Indeed, in the report you talk about upsell as well. To my mind, the question about upsell arises with respect to all the models, not just to the option and the tender, which if I recall correctly, was the context in which upsell was discussed in the draft.

I think we've all heard this morning the context in which it might be advantageous to a fund to seek to essentially use a low cost winning bid, if you like, in an option context or a low cost winning product on an advisory shortlist as an opportunity to seek a more profitable essentially product down the track and to sell up on the way. Now, the question is, how material an issue is that? I've proposed in the written notes that one thing you could look at to begin to try to calibrate that is to look at the experience of what happened to the accrued default amounts that were still in the system at the start of the MySuper transition period.

Now, we don't have full visibility into what's happened to those, and I suspect that the vast bulk of those did come into MySuper products. But I know from speaking to one fund that successful efforts were underway to essentially sell people into non-MySuper products. That's not strictly identical to getting people out of a MySuper product or a subsequent product but essentially they were looking to prevent people going into attractively priced MySuper products. You could look past the aggregates that APRA has reported to try to understand how that might have transpired.

I think the second area that all of the models need to pay really close attention to is that as you move to a more performance focused environment and therefore the metrics around performance become more important, gaining essentially competitive pressures leading funds to present their performance in an attractive light becomes more critical. It's already important in today's model. But as you move to a higher performance environment it's finding ways to report fees that make you look good becomes an area that funds are going to be forced competitively to spend more time thinking about. And I've set out – I won't go through them now – some of the ways in which funds can tend to do that.

Just a wrinkle around all of the models again is how do you think about performance fees? Those are a function of your asset performance. They might not be listed as part of your fees. If I move to a model with very low base but high performance, am I a high-fee fund or a low-fee fund? You've got to think through how those things might work, and that can affect the attractiveness when you're comparing an option or a tender of a purely fee-based tender, would tend to push you – to the extent to which performance fees are appropriate, that pushes you towards a multidimensional tender. It's worth thinking through. Then there are details around entry and exit fees and so forth, ensuring that funds aren't finding ways to look cheap on the relevant metrics.

My second comments around the rounding up the design and assessment of options is just to look explicitly at the likely cost to members of marketing efforts because there's a broader issue than just upsell. If you've got purely advisory shortlists for employer choice or employee choice, then it's clear that products that are not in that short list are going to try their hand at the market and they'll have a degree of success and costs will be incurred both by them and the funds on the shortlist. The full cost to the member, of course, is not just the marketing costs that are incurred by the funds, but also the (indistinct) performance to be members that are induced into lower quality products.

As an empirical exercise what I've suggested is it might be possible to learn from some of the systems which have got characteristics like full choice today and the 401K arrangements in the US could be a good example. What we've seen there over time is that while average fees have come down – and if you're on a large 401K plan today your average fees are quite attractive. But there's quite a significant tail, mostly populated by smaller plans, smaller employers, essentially – there's a closer link between those two things. While, as I understand it, there's no advisory shortlisting process in a 401K environment, many of the competitive attributes of that environment would be similar to what we would have if you went down the advisory route. That would be informative to you about how big the tail might be and that could provide you with a baseline to assess that model against others on a databased model.

Now, moving to the tenders and auctions, it strikes us – and we thought about this a lot in the context of our work in this area – that there's two stages of challenge – and you've picked this up in your draft as well. The first is, how do you design the initial selection phase; and the second is, what do you do after that with the funds that are winners? In your draft you've called that the performance monitoring phase and you've put forward a view that essentially says, "Well, if you did badly enough, then you'd sort of be removed," and presumably having relatively frequent additional rounds of the tender would mean that funds who wanted to stay on that list in order to be accessing future (indistinct) would be incented to provide to performance.

But as we've seen elsewhere in the super system, you've got this question about what happens to the orphans, if you like. You're a member of a former default product or a former winning product. It's kind of like what you would have if you had a member of a MySuper product that is no longer on the list. How do you provide incentives in a broad way for continuing efforts towards performance? It's a big challenge. I don't think there's a perfect way to do this. But one of the ways that was put forward by the Centre for Market Design in a brief piece that they did for the financial system inquiry is that rather than having just a performance monitoring phase for the winning group, they proposed having what they called a tournament. What they mean by that is that they have something like the New Zealand model where members are randomised into the shortlisted firms, but the probability of being randomised into a given fund would be a function of a measure of performance.

This is in a sense their view, the Centre for Market Design's view, about the two parts dovetailing together. These become quite technical issues, I think, figuring out, "Well, would this really work?" and what properties of that system. Recognising that, the Centre for Market Design proposed that significant additional work be done to flesh out, refine, evaluate, test, possibly in a desktop environment, that type of a model. I believe that it's appropriate to do that because this question of how you manage the ongoing performance incentives in a tender model is really key.

I don't think that your model has got zero incentives at all. For one thing, the funds are continuing to engage with their existing members outside of this kind of – the contest for new members. Then, as I've said, they've got the repeated tender that they'll seek to win. But an alternative where you've got essentially variable inflow could be worth examining. But it needs to be examined in quite some detail to develop confidence about how it would work. In my view, it's this phase, it's phase 2, where that kind of work ought to be done. If you leave it until phase 3 I think you want to very much be in assessment mode at that time with a clear view about the relative strengths and weaknesses of the models that you've assessed here in phase 2 so that you can sharply contrast and ultimately come to a position where policymakers can draw pretty clear inferences from your work. I'd strongly recommend doing more detailed work about the property of those systems.

Additional points. Thinking through the strategic asset allocation at the time of the tender or auction and afterwards becomes important. One of the attractive things about some kind of continuous tournament – and to the extent that other models also incent additional performance – is you want funds to retain discretion over their asset allocation and over their investor – their asset manager selection. So you want them to be free to respond to market movements and the whole set of very complicated developments in the world of what assets are listed and what assets are unlisted and what have you. You don't want to be more prescriptive about those things than you need to be. There's inherently a tension between being clear enough in the first phase that you can have a like-for-like comparison and giving freedom after the fact.

If you really believe that the unlisted is very important and if you believe that adjustments to strategic asset allocation ex-post are going to remain very important, which I think is in some degree an empirical question – I'm not convinced that's true. It could be true. Then you'll be tending more towards a tender in the first phase because you're going to have to look at these multiple dimensions include fees and past performance, and you'll be tending more to think about the ex-post tournament as potentially a mechanism that might be producing incentives.

Let me just step now to potentially some alternatives to the models you've put forward. The first would be, as you've requested, I've got a couple of comments on expanding the potential coverage outside of the first timer pool. I think that would be really sensible to look at that in great detail because - - -

MR HARRIS: But you're happy with the initial starting out point being first timer.

MR MINIFIE: No. You're talking about every year – in the first year you run this you'll get less than $1 billion of (indistinct). This is a system that's got over $500 billion in default. So it's going to take many, many years before you begin to have a material, if you like, "market share". Now, of course you're going to get more because some of the winning funds might be quite large and so their income and members will come across. But I think this just needs to be carefully thought through because the – you might find people sharpen their pencils quite hard to win significant new inflows.

MR HARRIS: Just to be sure then, Jim, as you go and describe this, because it's a curious concept to me and not one I necessarily intellectually can get my head around. You're going to explain that. But that says to me that you're in favour of proliferation at the moment because first timer pool is a response to proliferation. If you're not saying first timer, you're saying incumbent system - - -

MR MINIFIE: Yes.

MR HARRIS: But you've got a wrinkle to add to the incumbent system. Tell me that it's going to deal with proliferation.

MR MINIFIE: Today, I think the most recent figures for the number of new accounts created is about a bit over 2 million a year, 2.3 million, something like that. A fraction of those are new to the labour force, maybe a fifth, something on that order, maybe less. If you were to have a default process whereby people who switch jobs defaulted into one of the winning firms, shortlisted firms, give them full choice to retain their fund, if they prefer. Then you wouldn't have account proliferation. What you'd have at the time of switching jobs is that people would flip into this new winning product if they did nothing and if they exercised a choice to retain their existing account, they would retain that relationship. So you wouldn't have additional funds, but you'd have much, much larger inflows in the early years.

MS CHESTER: Jim, your primary concern – maybe you can just separate from account proliferation first, Peter. Your primary concern is the new entrant pool is not big enough – it doesn't answer the supermodel question: Will they get out of bed and compete for it? Is that your - - -

MR MINIFIE: Well, even if they do – so there is that question, and it's not clear to me that a major fund would find it optimal - - -

MS CHESTER: It will impact 400,000 members each year. That's the new job entrant, 400,000 each year. If those funds are some of the bigger funds – so they've got other default members – you could see within four to five years you're starting to get a large chunk of the default market in terms of how the models would trickle out to them.

MR MINIFIE: If it was about a fifth the size of the transition – and you obviously won't have any impact on people who are already in the workforce, with the exception of those who are with winning funds. It's a question of the coverage - - -

MS CHESTER: That's why I say, is it the supermodel question? Because you - - -

MR MINIFIE: No.

MS CHESTER: Sorry, if you want the trickle-on effect to be greatest in what the biggest default funds today – the high performing – to be winning the best in show because then we get to all of their default members.

MR MINIFIE: Yes, that's one way to achieve it. You could have a tiny thing, as long as you've got a big tail being dragged along. But the other way to do it just to increase the coverage by ensuring that people who are potentially in the market for a new super fund anyway because they're moving jobs have got a different default than the one they've got today.

MS CHESTER: You're going back to what was our issues paper position of you want the whole job churn and you won't use defaulting and it's just a job churn, you want them to be subject to the new model.

MR MINIFIE: Yes, I think you just need to evaluate the pros and cons. To my mind, there are significant pros of the bigger pool.

MS CHESTER: We can see the pros of the bigger pool. The biggest thing we're grappling with, in addition to account proliferation, is the system stability issues. Indeed, you touched on it with your remarks about what do you deal with those that aren't successful.

MR MINIFIE: Yes.

MS CHESTER: That's why we pull back from the job churn to the new job entrant but trying to make sure the models would have as big a ripple effect as possible, and it was to manage, effectively, the exit of the default funds that don't get the gig and they're already in an outflow territory. We're trading with a system stability.

MR MINIFIE: It's a trade-off. My sense is that you may find that large funds do not find it attractive to make a significant change to their business model in order to cut their fees sufficiently to win the tender for a small inflow - - -

MR HARRIS: If it were fee-based. But if it were performance-based, then your problem doesn't actually emerge. In other words, let's say fees were not a consideration, it was just performance. Let's be extreme. That's not actually the case. But if it were performance-based, then the fact that I've had very good performance the last four years makes me a guaranteed winner in this contest. So the fact that I've got 600,000 incumbent members that I'm still going to have to offer that promise too, hey, I've just offered it to them for the last four years. I'm a guaranteed winner here.

MR MINIFIE: Just can I say in passing with a really broad look at that performance on a risk-adjusted basis, you do find – I mean, you see it very strongly in one year, but you see at even five year that high performers in period T tend to be low performance in period T+1 because they are the risk takers.

MS CHESTER: I think we say five to 10 years. We want to get as close to 10 as we can.

MR HARRIS: And we do worry about that. Industry Super themselves made a point that's worth us following up too about what happens subsequent to it about that variation that does occur. We haven't worried about it. We have got some design work on it. We need to probably do a bit more.

MR MINIFIE: That's right. I won't belabour the point. But my sense is that that choice, to my mind, you haven't really proven yet that you've got the balance right. Not having carefully analysed it myself, my sense is that you may find you get very, very slow ramp-up and that small funds will tend to win. Let me just move along. The next one is how much attention do you need to give to today's default arrangements? My sense is thinking through very clearly and just ensuring that you're in a position in phase 3 to very quickly use the data that, I presume, is going to be in place, to make a call about whether today's arrangement made sufficient headway or not you just need to be very explicit about well, what are the criteria you're going to assess these new models against and is the analysis you've done in phase 2 going to neatly dovetail into all of the criteria that you set out in phase 1?

To my mind, it's not clear that that's the case. I'm not saying I think it's not the case, but to my mind, the final product - - -

MS CHESTER: We'll show you where it is in the report later.

MR MINIFIE: - - - would look very, very alone. Are you saying it's already in the draft?

MS CHESTER: We've addressed how we'll do it in stage 3 in the draft. Jim, I'm conscious of time. I've got a bunch of questions and I'm sure Peter has got a couple as well.

MR HARRIS: I've only got one really but it's two parts to it, but anyway, you go.

MR MINIFIE: Why don't we flip over?

MS CHESTER: We jump into questions? That'd be great. The issues around bait and switch or upselling, you might have heard before, we said that we were very mindful of that being a risk across all models, and we've had an information request. I guess what would be helpful is hearing back as to what you think we need to put in place. We had a couple of goes at it, but PWC has also had a probably better go at it than we did and they're focused on it. They've come up with four suggestions but two of them are key, and it would be good to get your thoughts back on those. They are that you would have explicit controls on inducements that are non-super products or super products that don't have member benefits, clear member benefits. Then your point earlier about reporting to APRA in movement of members from default to related-provider products.

The funds who win best in show, the default, would have to provide say quarterly or annual reporting to APRA on that sort of flow of movement. That way APRA would then step in and play the regulator roles to have a bit of a look as to whether that's inappropriate or not. Then they've got a couple of other – the vote for best interest and members' best interest obligation and all the rest of it. But those were the two key ones for me. It would be good to know whether you think they would help and if there's anything else that's needed around that concern that you raised as your number 1.

MR MINIFIE: Look, I brought it up first but I wouldn't say it was my top concern. I suspect actually that the sort of – my bigger concern about the first two models is it's difficult to incent sufficient fund consolidation. Obviously you've got some other initiatives that deal with that. Both of those proposals look sensible, the inducements and the reporting; they look sensible.

MS CHESTER: One thing you didn't mention in your opening remarks that you did in your submission that interested me was you felt we'd gone a little bit too far in paring back the default product. We sort of identify the five things that we thought were must-haves and good-to-haves. What do you think we've pared back that we shouldn't have pared back on?

MR MINIFIE: First, the bigger picture here is that to the extent that you've got a very, very pared back product you will tend to find that active people, active, more engaged members may leave that product. You'll find that the coverage of – let's assume that the investment performance is very good. You might find that the coverage of that product is going to be smaller than otherwise.

MS CHESTER: Someone chooses to then exercise choice.

MR MINIFIE: Per the discussion we've already had this morning, there are some paradoxical aspects to choice. Obviously choice is a good thing in its own right. Many people do better when they exercise choice. Not everybody does. That's one question. Then I heard one of your other submissions this morning. There are also potentially benefits from engagement and if you do create a product that is highly stripped down, then people won't understand potentially as much about their position versus their retirement goals and there are defined retirement goals, so forth. So I think there's just a question about whether in providing a highly, highly stripped down product you've got the right trade-offs.

MS CHESTER: I guess I wouldn't see it, and we didn't intend for it to be, a highly stripped back. We got what I think are kind of the poor manilas, the investment (indistinct) intra-fund advice, admin services and the intra-fund advise should help members understand the super system. They're informed about the performance of their investment product, the fees they're paying, the switching options and the process for exiting. Let us know what else is missing that we need to kind of add in there.

MR MINIFIE: I'll come back to you.

MS CHESTER: And we're not overly prescriptive about the investment, just said it's got to be good investment performance.

MR HARRIS: My primary question, Jim, is, how do you go about dealing then in your preferred vision of this – how do you go about dealing with what I think collectively this morning most people have agreed is the greater risk about being stuck in a poorly-performing fund as a default disengaged member? Most of the models - - -

MR MINIFIE: Do you mean in today's system how do we fix the problem? Because that is one of the big problems to the system.

MR HARRIS: No, I don't. Hopefully you're with us on this page because not too many people are. In this phase we went to zero and then moved up. So that told us, as we say, what a default system is really doing. So we have four models and a first-timer pool, all of which would create quite a lot of incentive in one form or another for the losers to do something. Today there is no such incentive for the least-performing funds, other than that APRA is meant to look over their shoulder.

Now, we've heard an argument that the Fair Work Commission might have a crack at that. I find it's still all uncertain how that might occur, but we'll certainly give that thought. We've heard various things, you've been sitting through most of it. I'm interested in sort of knowing what the Jim Minifie view is about how we deal with that, presuming you're going to accept, as I think you probably will, that is probably the biggest single risk. You've got people who are not engaged where we've mandatorily taken their money and we're putting it in the hands of another party. At the moment it's driven by a variety of factors as to which that party is, but it's definitionally not their decision. So the risk that they have is that they get stuck with a bad one. They don't even know that because, by definition, they're disengaged, i.e. they're default members, they're disengaged. What's your version of how to approach that?

MR MINIFIE: Just to be clear we're talking about the same thing, we're talking about somebody who enters the workforce say in 2020 who is defaulted into a fund that wins this process but turns out to be a - - -

MR HARRIS: No, I'm talking about today's system. I'm trying to work out whether you actually think that we're going to get positive shifts and incentives towards either winding up poorly-performing funds or increased member engagement or something else from one or more of the models and the first-timer pool. It's a judgment about what you thought when you read the overall draft report.

MR MINIFIE: It's very difficult to get a hundred per cent coverage for the reason that has been already in discussion this morning, which is that some smaller or otherwise poor-performing funds appear to be very reluctant to merge. Now, whether they're just not an attractive merger target for the other funds or there are other reasons why the funds may not wish to merge, it's very difficult to do more than what APRA has already said they're going to do. You're going to mandate that those funds be closed down, that would be the end result.

To my mind, the way to minimise that problem is actually very close to what you propose, which is you need to have several different complementary streams policy development, one of which is to ensure that there aren't as many of those people going forward. That's to ensure that new - - -

MR HARRIS: Exactly.

MR MINIFIE: The second one is to try to ensure that the back book is predominantly larger scale and so forth. So encourage consolidation and remove account – you're still going to have some high cost funds. Then the third area that will work for some of the people who have fallen out of those two cracks is about engagement. But we know engagement is pretty weak. Then beyond that, it's just about well, how aggressively do you mandate. Beyond that, I don't see any way to do it. So what we put forward in 2014 has actually got something in common with some of the improvements you put forward for the choice environment.

We said could you potentially an ATO process to ensure that people are presented with just the shortlist, the winning funds, some comparison between where they are today, and you get some level of uptick. But I think intrinsically if you're not going to mandate that people are moved you're always going to have a tail of people who are on very bad products, most of whom, of course, are actually outside of the default space.

MS CHESTER: On the legacy then, the rump, which is kind of I think the key issue we're now talking with, we read it in terms of people seem to be – well, we get different answers on this. Some people think there's no problems with mergers and some people think there are problems with mergers for the small underperforming funds. Those like us who think there might be a problem are frustrated with the current response is the regulator has a role with the scale test, which we still don't quite know how that's going to work, and then there's conversations with the regulator. And we know that they've certainly dolled that up recently.

As answer was let's get a bit more transparency around it. So we suggested more disclosure around merger discussions but then we've got people coming back to us saying that could result in unintended perverse effects and discourage those discussions from occurring. We've received one or two submissions which have helpfully suggested well, let's really up the enhanced role of APRA here where there would have to be real-time disclosure post-MOU to APRA on an outcome of merger due diligence and if it's not proceeding, why. The scale test be assessed for its effectiveness, although I'm not sure what we're assessing just yet. And greater guidance on managing conflicts of interest re selection of merged entity.

They've given some examples. For example, you don't decide on who the CO in the new board is going to be until after you've done all the due diligence from the perspective of members' best interests. We went disclosure but we knew that there could be some wrinkles around that, so we had an information request. People have come back saying let's really elevate the role of the regulator here. It would be good to get your thoughts of those two streams and which one we should continue our endeavour because you've suggested a couple of errors of our continuing professional endeavour.

MR MINIFIE: I would agree that the disclosure has got potentially some risk of unintended consequences. I would tend to go to just, for all of its imperfections, something like the aggressive application of scale test which, incidentally, would interact quite strongly with an effective process choking off inflows to weak performing funds. Now, that's going to be uncomfortable for the members of those funds for a period of time, until they merge, till they get to a better product. In a sense the policy decision has to be, do I want to have an environment where ultimately I don't have people in underperforming funds at the same rate as I do today? I suspect that the combination of quite aggressively choking off inflows to poor-performing funds, which, incidentally, would tend to push you very hard towards the job switcher pool, not just the new entrants pool, and an aggressive application to scale test may be as close to as good as you can get. I find it hard to imagine that disclosure would make a big difference because there's already quite a high degree of disclosure. Everybody knows their subscale. Everybody knows what their fees are.

MS CHESTER: Two quick questions and they're one-word answers. If you had to choose one of our models that we do more homework, as you've suggested, Jim, which model, 1, 2, 3 or 4?

MR MINIFIE: I'd go for the multidimensional tender. Is that 4 or 3?

MS CHESTER: Three, excellent. You know the simple question; what's your answer?

MR MINIFIE: The answer is no. Which version was the question?

MS CHESTER: Should low-performing funds exit and new - - -

MR MINIFIE: Yes, they should exit.

MS CHESTER: Thank you.

MR HARRIS: Thanks for your time, Jim, and your ongoing advice as well.

MS CHESTER: And that help on the roundtables and the workshops and everything too, Jim, much appreciated.

MR HARRIS: We're going to try, for anybody who's going to be an audience for this, to dial into New Zealand now and get Sam Stubbs and Peter Nielson on the phone.

MS CHESTER: Good afternoon. Is that Sam and Peter on the line?

MR STUBBS: Yes, this is Sam Stubbs.

MS CHESTER: Terrific. Welcome to our public hearings, Sam and Peter. This is Karen Chester. We met about six or eight weeks ago in New Zealand. I'm also joined by my Chairman, Peter Harris. You're sound surrounded in a room in sunny Melbourne with about 15 people listening in from the docks and a gentleman taking the transcript. So the main thing you need to know is that we're recording everything you say and there'll be a lovely transcript of record of it that you can show your grandchildren in future years. But to help the gentleman who's doing the recording, if you could just separately state your name and who you represent for voice recognition and then we can get underway?

MR STUBBS: My name is Sam Stubbs from Simplicity in New Zealand.

MS CHESTER: Is Peter with you?

MR STUBBS: No, it's just myself.

MS CHESTER: That makes it easier for voice recognition.

MR HARRIS: Thanks, Sam. It's Peter Harris here. Karen has heard and our little team that went over to see you a little while back and you've offered some intriguing comments to us and a short submission which has put those down on paper about the potential for running an online-only low fee style product which could offer a substantial potential competitive benefit to members in the default super space in Australia. We're particularly interested, I think, in some comment that you've made on the nature of the system that is offered by the Internal Revenue Service, I think, in New Zealand which assists you in running a clearing house operation. I'm just wondering if you could put a few comments down or make a few comments on that topic for us.

MR STUBBS: Sure. It would not be possible for us to run this business without the IRD here providing the services that they do. I can describe this hopefully very easily to you from a contextual point of view. What Simplicity does is we run the lowest fee scheme here and we have our business future proof now so that in approximately five years' time we'll be able to offer a full online superannuation scheme which is fully invested at a flat annual fee. We're targeting something in the region of between $50 and $100, which will be the maximum fee that anybody will pay no matter how large their balance was.

Now, one of the critical aspects to that is that if you think about the payments structure of our scheme the money that comes in and, most importantly, the money that comes in, to (indistinct) keep the money that goes out as well, that is done via a single relationship with our IRD. So they act as the collection agent for all of the contributions via salaries by (indistinct) relationship of every employers. So they do all of that point to point relationship with employees and we only have to deal with one institution. (Indistinct) we have an incredibly low cost, indeed efficient way, of receiving money. If we didn't have that we would have to establish individual relationships via (indistinct) or via employee contribution systems which would require us to have either very manual systems or very, very many different automated systems for handling money. That would make the economics of our business just impossible.

The other advantage I guess of using the IRD is that if there are any changes, a couple of modifications, you're only doing that with one party. From the employers' perspective, they like it as well because they don't have to establish a relationship with multiple superannuation providers. They only have to make one series of payments to the IRD on behalf of their employees. So from their point of view it's extremely simple as well. The one party that might be a bit unhappy about the extra workload here is the IRD. But I think you'll find that even though they would acknowledge that their (indistinct) facilitation of the payments makes for a much more efficient system. (Indistinct) had any dealing with the competition which greatly affects the efficiency but hopefully (indistinct).

MR HARRIS: Sam, the other thing I got but I can't remember from the notes whether it was from the discussions that the team had with you or whether it was with internal revenue themselves is a view that the SuperStream system that we have now set up here in Australia would be I won't say absolutely simple but would be relatively simple to adapt to the purpose that you have in mind for your model. Now, it may have been internal revenue said that to us. Anyway, do you have a view on that?

MR STUBBS: I don't have a specific view, but I will say that our model is – certainly under the current structure we would not consider offering our services in Australia. But if two things were possible, then we would be able to offer it (indistinct). First of all, there's some degree of mutual recognition of our products so that we would be able to do a reasonable amount of (indistinct) here and offer the product into Australia. But I think that's a super issue that provided there was a degree of mutual recognition (indistinct) amount of due diligence as if we were a new operator in Australia. By the time (indistinct) would have been an experienced operator here.

But I think the two things that are probably more relevant to your investigation now are we would have to be able to sign members up online. We provide a 100 per cent online service. That removes the need for us to (indistinct) physical distribution of the structure, either in the form of branches or sales agents or paying commission. So we have a direct relationship with our clients. There's a lot (indistinct) online and that requires members to sign up online without requiring a signature on a piece of paper where people have to show proof of identification and so on. Having the IRD as the agency it really facilitates (indistinct) play some part of assisting us in verifying people online, people that all have (indistinct) new IRD member. So they have an identifier. That would be the first thing. The second part will be that the IRD will (indistinct) would need to be a centralised collection agent for the information and for the payments. Now, my only concern about having anyone other than the IRD is that I would strongly prefer it not to be a privately owned organisation because in doing that you will effectively be handling a quasi-monopoly on payments. I cannot believe that the processing of that over time would be inflicted (indistinct) situation. (Indistinct) and know that we wouldn't ultimately – paying through the nose for what would be a government agent fee.

But I'm unfamiliar with the organisation you're talking about, unfamiliar with their workings and structures and so on. But my only concern would be that (indistinct) that it would work government-related entity that only controlled that.

MR HARRIS: That's fair enough.

MS CHESTER: I think, Sam, it's interesting - - -

MR STUBBS: If both of those things were in place we could really (indistinct) with those three things in place we could easily compete. With any one of those three (indistinct) difficult. It's nearly impossible.

MS CHESTER: Sam, I think it's the second one, the fact that you can do it all online, which is where we put the suggestion of the ATO potentially transitioning to this clearing house role akin to New Zealand in the future, we didn't articulate that akin to New Zealand means you also get the same regulations that allows you to do it online, because all of the super funds thought, "Well, this is just basically what Link and some others do for us at the moment and giving it to the ATO." It completely changes the admin cost structure if you can do it online. Do you have a sense of the order of magnitude of what it would mean to – what your fee structures would be, your 50 to a hundred bucks a year, in the absence of the New Zealand clearing house model? So you can't do it online but you might still be able to go to a provider that can do it for you.

MR STUBBS: (Indistinct) clearing house model via the IRD.

MS CHESTER: Yes.

MR STUBBS: It would be – gosh, I can't think that it would be many multiples.

MS CHESTER: That might be handy for us to get those metrics from you - - -

MR STUBBS: We would literally need to maintain relationships with thousands of parties. Even if you had multiple product (indistinct) suppliers doing that for you, still maintaining multiple relationships (indistinct) change management issues and so on. I would think that it would be in the order of – given that (indistinct) system in New Zealand – in theory we should be able to go to a fixed cost model. I would think that it would be, gosh, four or five times would be my best guess.

MS CHESTER: It would be great and very helpful for us, Sam - - -

MR STUBBS: Certainly with that we would be charging – sorry, one other comment. I don't think we'd ever be able to (indistinct) by going to a fixed cost model. We would always be charging (indistinct) under management under those circumstances. If that was the case, that would, by definition, for large balances be a much more expensive proposition.

MS CHESTER: It would be really helpful for us - - -

MR STUBBS: It would be something that (indistinct) from the industry, (indistinct) I don't think they would knock the efficiency of having a centralised payment agent because it really does move a lot of the reasons they otherwise have for charging the fees that they do. Even in New Zealand when you challenge them on this (indistinct) but that with the entering of competition by Simplicity coming in, they're eventually going to have to address that and things will come tumbling down.

MS CHESTER: Sam, on that last point, is that because you've basically stripped out most of your admin cost? So the lion share of the fees that you're paying that are really investment management fees. So you get greater transparency around that?

MR STUBBS: Yes, sure. (Indistinct) there's the fund management costs and, as we're well aware, there are a variety of options (indistinct). The second issue is the administration costs. By that we mean fund accounting, unit trust registry, those functions. Those costs in New Zealand are significantly lower than Australia because the administrator is liaising with the IRD. So they're building an API with the IRD for all of the key information they need to do, unit registry, money coming in, all those sorts of things. So it's not ourselves who (indistinct) in Australia. But the administrator doesn't have to have thousands of (indistinct) individual employers. So that's the second component of the cost. The first one we call funds management. The second one we call registry administration fund account. The third part of the cost is the funding of the business, the customer service, sales, marketing, branding, all those sorts of names.

If you think about the cost structure in New Zealand, because of 100 per cent online operations, we're able to do customer service, customer acquisition and so on far cheaper than anyone who has branches, commission sales or agents. You think about the second component, the administrator can do those functions far more efficiently because they're only dealing with one party, the IRD, for all of their members. So it's much more efficient. We have fixed price contracts in place which are extremely – well, they are based on a dollar per member basis and they get very low cost very quickly because (indistinct). The third part about the asset management is all in place via (indistinct).

MR HARRIS: If I can clarify – it's Peter Harris here again, Sam – because it's asserted, of course, that low fee based funds are also poor-performing funds. Can you give us a sense of – just a generic benchmark how well you rate in a performance sense and an investment performance sense?

MR STUBBS: We've only been operating seven and a half months. But I believe now (indistinct) we're second out of 16 operators, number 2 out of 16. And in Australia I think you (indistinct) the opposite view there. There is an increasing wealth of evidence that shows that fees are the single (indistinct) determinant of long-term returns in both (indistinct). If I could just give a slightly different perspective. Simplicity has volunteered actually fund managers from – that represented 60 per cent (indistinct) so the lion's share of the market. We collectively made a decision about the asset management style that would most be fair for our members. So with not-for-profit, you get no motive other than increasing members' wealth. So we could have invested it any way we wanted it; hedge funds, asset management. We unanimously chose the lowest cost, asset management, as being the style that would return the most money to our members. We were not at all influenced or swayed by how much money we would make personally because (indistinct).

In that sense, as a fund manager, we're perhaps operating from a slightly more objective (indistinct) significantly more objective (indistinct) in terms of our motivation, which is very clear. That's what we read into those. The other advantage of that is that it removes the argument, which is prevalent here in New Zealand too, that asset management costs are a lot more than justifies the terms. It just doesn't. The cost of the fund managers and the fund management process relatively (indistinct) in terms of costs. My previous job I was managing $5 billion (indistinct) with my previous employer. They're a relatively serious argument but it is one that is used and has some credence, particularly (indistinct) to justify the two structures.

MR HARRIS: We might find a way of quoting you on that, I think.

MR STUBBS: I'm trying to be polite here, but my answer to that (indistinct) it's just not true. But it is a very good way of justifying fee structures. (Indistinct) some sympathy for that in Australia (indistinct) much more complex. I don't know whether you allow a hundred per cent online signing up for these things. But in this country that makes (indistinct) and significantly increases competition or it can significantly increase the potential for competition.

MS CHESTER: I've got two little questions. Member statements and member accounts, who sends them out to members and is it online?

MR STUBBS: Yes. It's a hundred per cent online and member statements and accounts are prepared by the administrator and then we stick our logo on it and (indistinct) and send it out to members. It is extremely more efficient.

MS CHESTER: Just following on from Peter's question about comparing your performance with others, for your own internal purposes, what's your sort of performance benchmark? What do you use to know whether or not you're doing the right thing by members?

MR STUBBS: I don't think you would have heard this from any other supplier before. What we do is we just take the market (indistinct) as distributed by Morning Star every year – sorry, every six months. That's our benchmark. So we benchmark ourselves against all 15 other providers. That's a publicly available report that becomes – we do our asset allocation twice a year based on those averages. (Indistinct) we don't have a competitive advantage in asset allocation. We're no smarter than anybody. But we would like all of those (indistinct) economists and bank economists would like to take advantage of their (indistinct) and we'll just (indistinct) as our benchmark.

MS CHESTER: Thanks very much, Sam. Thanks again for meeting with us. Also, the team was very impressed with your low-cost DNA such that you weren't going to fly across the Tasman, we had to do this over the phone. So we can see you're definitely not-for-profit.

MR STUBBS: Yes, indeed.

MS CHESTER: Thanks, Sam.

MR HARRIS: Thank you very much.

MS CHESTER: Have a good day.

MR STUBBS: Thank you. Cheers, bye-bye.

MR HARRIS: We have one last, which is COSBOA, I think, when we get Peter Strong on the phone. Peter, are you there, Peter Harris? Good afternoon. We're running late, sorry, mate. I've got Karen Chester here with me and a vast array, a roomful of people waiting to hear pearls of wisdom from you on the topic of default superannuation.

MR STRONG: I bet you they know what I'm going to say.

MR HARRIS: Well, I'm going to give you the chance to open up. I'll put you on the record myself. This is Peter Strong from the Council of Small Businesses of Australia on the phone. You're going to tell us a little bit about your opinion on default super. If you do get to it, Peter, and when you get a chance, particularly I think the potential for administrative support and supporting small businesses out of the ATO and SuperStream, we're particularly interested if you've got a view on that, but otherwise happy to take your comments over the phone now.

MR STRONG: The default fund issue from a business point of view means that a business is dealing with an entity and it hasn't chosen to deal with that entity. So the entity in a lot of the super funds do struggle to keep their records. We don't have a choice. We have to deal with the – whether it's efficient or not, whether it provides a good service, whether it's a good business to deal with, we have no choice in that supply. To us, it's provided by – is chosen by somebody else. So it sort of fails a business test in that we should have – if we're going to have to use superannuation we should have a lot more say in who to use or perhaps the super funds themselves can be graded on their ability to provide a service to the employer as well as to their members. Then if they don't supply good service they should never be considered to be a default fund if we continue with default funds, because it's not just our members we're looking after, it's the people that supply the money for them and in most (indistinct) small businesses when you look at the numbers.

The best way to resolve that, of course, is to make the default fund (indistinct) if there needs to be one, make that decision come from the Tax Office, although under what we're proposing there would be no need for that. If the Tax Office (indistinct) included in the tax collection, then the first time a fund is chosen by someone is the first time they (indistinct) a tax return to the Tax Office, which is normally after your first job. That's when they choose a fund because the Tax Office will ask them to select a fund. I think that process is much simpler, takes away the need for a default fund, takes it out of the workplace relations system and puts it into the tax system where it probably belongs.

I know the report came out yesterday on the superannuation and it was from the Senate Committee (indistinct). But certainly a lot of these inquiries wouldn't happen, the Senate Committee inquiry wouldn't have happened. This phone call wouldn't be happening if we were taken out of the collection process. It would be an issue between the funds and the people that owned the funds. Any questions on the way that should work? As I said, going back to the first choice is when I employed people I couldn't believe that I had to work with some of the industry funds – some of the super funds, not just industry funds – some of the super funds. They were just appalling at their data collecting. Their communication was appalling, was hopeless and they used to lose information all the time. As a business, I wouldn't work with someone that does that, but I had no choice.

MR HARRIS: This has been a theme of yours for some time, as I recall. I don't know whether in reading our draft report you might have noticed at one point we did mention the possible role of the future funds as a sort of a last-resort entity to do investing. Did you have a view on who should be the investing subsequently or are you reasonably agnostic about that?

MR STRONG: Reasonably agnostic. I mean, that's up to the funds to provide a choice. Our proposal increases competition, of course, because there's no default. You pick a fund based upon its performance, and not just on its performance but on the products it presents. Younger people may go more for the ethical funds. Older people may go more for funds where they've got more say in where the investments are put. So that market would then respond to the needs of the consumer and that's how it would work. The future fund, that's one option. Our proposal means there will be competition but beyond that, we're agnostic. That's up to the individuals who own the funds to work out what they do with it. Our concern is the collection process that puts an onerous demand on employers that I don't think should be there.

MS CHESTER: Peter, I've been the CO of a small medium sized business as well. I guess while it is the employee's money, as an employer, I would want my employee to be getting best bang for buck out of that salary because it's a cost to me. It's part of our wages but it's mandated as savings. So I would have thought employers would want to make sure that the employees – and here we're talking about default – is being defaulted into the best fund, the best-performing fund. Your view is that - - -

MR STRONG: I agree with you. As someone that employed people they would often ask me what was a good fund. I told them straightaway I'm not qualified to tell someone what's a good fund or not. I think we're putting a demand on employers that, to a degree, is illegal. You're not allowed to give advice on financial products, and neither should we. The advice I gave my people, I said, "Go and look up which one is performing best and which one" – because a lot of my staff were into the ethics of it all and I said, "Look up the ones that have the best ethics." Australian Ethical Investments was one that I always pointed to, but again, that was – I don't think it was allowed to be a default fund for some reason. It's none of our business per se to be giving them advice.

What we, I think, as employers we've got to do is make sure that they get the right wages, that they have a safe workplace and that they have a secure job. Beyond that, yes, we can get involved in other things such as – that's up to each employer. But I think the less we have to do beyond those (indistinct) then that means the employee can concentrate on what they need to do. I always did struggle with the fact that a default fund may be chosen by an employer when in actual fact they're not qualified financial advisors.

I note that some of the enterprise agreement that the default fund is chosen by the enterprise agreement, by the employer and (indistinct) involved. I've always scratched my head a bit about that as well. What are their qualifications to select a default fund? If that fund was to go bankrupt or something, who would be responsible for it? I understand the law removes that responsibility from the employer. That's what I've been told. But, again, that should be none of our business. That's the business of the person who owns the money and who's going to retire with it.

The other argument I've heard quite often is that workers perform better and they're more productive when the employer looks after them. Every study I've seen that says that is about big business. I've never ever seen a study that says if a small business owner worked another two hours on the weekend that everybody's happy and productivity increases because it's just not true. Putting extra demands on an individual to either pay someone to do the work or to do it themselves is what is not going to increase productivity.

MR HARRIS: In your experience of dealing with the ATO, now we've got a SuperStream operation up, so payroll providers are all linked in and that kind of thing, will that – I mean, I'm going to assume it's going to simplify your proposal. But do you – you see this, effectively, that superannuation becomes part of taxation remit now – taxation remit in terms of timing is a little different from the current timing of superannuation payments, if I recall rightly. I mean, super, I think, is paid quarterly. Is that at all an issue, do you think, from a business perspective?

MR STRONG: I've gone to members and talked to them about this because basically we could lodge our PAYG quarterly, if we wish, and we can lodge the superannuation quarterly. The temptation becomes not to lodge it; that's the problem. There's no excuse for that, by the way; you should lodge it. There's no excuse, but that's the problem, you get that choice. Now, under our proposal you wouldn't have (indistinct) it's all in one sum of PAYG which means once a quarter you pay (indistinct) if that's the way you want to do it. I went to my members and said, "Anybody concerned about that impact upon cash flow management?" I've got to say all of them said, "Look, we've got to remove that temptation to use superannuation as cash flow management," because I think, as you said before, it's someone's pay, it's not our money.

We know that employees steal from the workplace. Well, the best way of fixing that is remove the temptation. That's the same thing here is people aren't putting their super in, well, just remove the temptation, stick it in PAYG. The Tax Office, of course, that's part of their DNA to chase tax and to chase PAYG. They're higher on the list if a company goes belly-up. They get access to the money so the super is better protected. As I say, a couple of people said, "But, gee, that might make it more difficult with cash flow management." But even those people, when I discussed it with them, they said, "You're right. We've got to remove the temptation to use it for that purpose." We've got still got it for three months because cash flow management is (indistinct). You've got (indistinct) you've got something in others. So we've got it there to use for cash flow management for three months. So it's still (indistinct), it's just it's one lump sum instead of two or three or four.

MR HARRIS: That sounds pretty reasonable to me. That was the extent of the questions we wanted to get on the record for you. Have we got anything else before we sign off?

MR STRONG: No. We'll keep pushing but these things are going to happen. Can I say also I've just got to say that the Tax Office clearing house (indistinct) it is better. It is a lot better than having to deal with individual funds. In talking to bookkeepers and different people out there, the problem is still the industry – the super funds still contact the employer. They still send letters threatening legal action when there's no money owed. They still send us so much paperwork it's just ridiculous. So the payment process is certainly easier, but the paperwork is still coming in through the door and through emails, et cetera, and threats are still coming from the funds. Take the employer out of the situation and there won't be any need for threats to be made. Thank you for your time.

MR HARRIS: I appreciate that, Peter, thank you for your time.

MS CHESTER: Thanks, Peter.

MR STRONG: Thank you.

MR HARRIS: I think we're now at the end point where anybody who's remained dedicatedly throughout this and wishes to make any comment at all now gets the opportunity to make a comment. Have I got any comments from the floor that anybody wants to make? If not, then I think we're adjourned till Sydney next week. Thank you very much.

MATTER ADJOURNED AT 1.09 PM UNTIL MONDAY, 8 MAY 2017

Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION

MR P HARRIS, Presiding Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT 77 YORK STREET, SYDNEY
ON MONDAY, 8 MAY 2017 AT 8.59 AM

INDEX

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.

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.

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.

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

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

MR BONARIUS: Nathan Bonarius, Rice Warner.

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

MR RICE: I do.

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.

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 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: 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 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 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 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 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.

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.

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.

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.

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?

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.

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?

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".

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 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 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 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 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.

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.

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?

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.

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 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.

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". 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.

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 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.

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 income protection.

MR HARRIS: Yes.

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.

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.

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.

MR RICE: Yes.

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

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 - - -

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 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.

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 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. 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 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 - - -

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.

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.

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.

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.

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 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?

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 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.

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 four or five that dominate the market, everybody else could shift and choice is less regulated.

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".

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.

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

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.

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.

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?

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.

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.

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.

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.

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 - - -

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

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.

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.

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.

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?

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 alter 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.

MR RICE: Yes.

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.

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.

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.

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.

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.

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.

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".

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.

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 allowed to enter the default market?

MR RICE: Yes.

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 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 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 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 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.

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.

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

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.

MS CHESTER: The marathon.

MR HARRIS: Thanks very much.

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.

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?

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

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.

MR HARRIS: No problems.

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

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.

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.

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.

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.

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.

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.

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.

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.

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.

MR HARRIS: Do you want to start?

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.

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.

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.

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.

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?

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.

MR PREMETIS: 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 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 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?

MR PREMETIS: 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.

MR HARRIS: Okay.

MR BRIGGS: I think the proof of that is the Commission looked at, I 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 meaningful market share, but it would actually more or less turn the tables on how the industry works completely.

MR PREMETIS: 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 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.

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 then those trying every four years to get to the top four, including new entrants.

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 decision, feel comfortable moving into the longer list.

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.

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 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 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.

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.

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 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 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 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 - - -

MR PREMETIS: Page 17 of our submission.

MR HARRIS: That one, okay.

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".

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 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 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.

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 what the ongoing competitive tension within the default market. You want access to a 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 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.

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 PREMETIS: I think if I also could add, what you're saying is – 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 markets, you're kind of highlighting competition - - -

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

MR PREMETIS: And we're saying that - - -

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 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.

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.

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.

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.

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.

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 - - -

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

MS CHESTER: Yes.

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.

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.

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.

MR BRIGGS: Yes.

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?

MR BRIGGS: I would expect that - - -

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

MR PREMETIS: 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 - - -

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

MR PREMETIS: 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.

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.

MR PREMETIS: 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?

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.

But what I think assorts 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.

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.

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.

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.

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.

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 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 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 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 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, 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.

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 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.

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 PREMETIS: 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 PREMETIS: 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.

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.

MR PREMETIS: 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 question is one that - - -

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

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

MS LOANE: Yes.

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 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?

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 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.

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 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.

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.

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 – 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.

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 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 current provider, the one with a significantly lower cost bid, was it Movida, from memory?

MR HARRIS: Yes.

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.

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 - - -

MR PREMETIS: 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.

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 - - -

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.

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 - - -

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 thank you very much for this.

MS CHESTER: Thank you.

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.

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 come back in about 10 or 15 minutes.

ADJOURNED **[10.19 am]**

RESUMED **[10.34 am]**

MR HARRIS: We have a submission and some representatives from 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 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 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 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 challenges, as acknowledged in the draft report. They can discourage engagement, meaning that many people can end up with products that 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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 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.

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.

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, 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.

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, 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 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.

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.

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.

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.

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.

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.

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.

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.

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 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?

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.

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 tough market, complex market, it's got to be under 10, the list's got to be under 10.

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.

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.

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 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.

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.

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.

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.

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.

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.

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 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 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 – 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 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 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 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 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 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.

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 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 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 Xavier, for you, sorry about that.

MR HARRIS: Hope you're taking notes.

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?

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 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.

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?

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.

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.

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.

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.

MR HARRIS: I have no other questions.

MS CHESTER: Nor do I.

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.

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?

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

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

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 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 - - -

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 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 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 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 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.

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.

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.

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.

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.

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?

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.

MS SCHEERLINK: Yes.

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.

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?

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.

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.

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 - - -

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

MR WEBB: That's okay.

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

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.

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 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.

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.

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.

MR HARRIS: We are on the default.

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.

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 different depending on balance?

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.

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.

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 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 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.

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 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.

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 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 submission, the same thing.

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

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?

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.

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.

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.

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.

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.

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. 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.

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 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 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.

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.

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 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.

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 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.

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 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 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?

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.

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

MS SCHEERLINK: Absolutely.

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?

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 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 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 preforming 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.

MS SCHEERLINK: Yes.

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

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.

MS CHESTER: Actively listening?

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

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.

MS CHESTER: Ignore our models for a minute.

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.

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 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.

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.

MS SCHEERLINK: Yes.

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.

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.

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.

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.

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.

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 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.

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 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 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 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?

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.

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 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 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.

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

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.

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 - - -

MR HARRIS: Tell New Zealand.

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.

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 getting them to a lowest common denominator?

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

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.

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.

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.

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.

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 - - -

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

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.

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 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.

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.

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?

MS CHESTER: Over the end to longer term.

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?

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.

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.

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 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.

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

MS SCHEERLINK: Yes.

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 - - -

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

MR WEBB: No.

MS SCHEERLINK: No.

MS CHESTER: Okay.

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.

MS SCHEERLINK: Yes.

MR HARRIS: I thought you meant mergers.

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

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

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.

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 - - -

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.

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 - - -

MR HARRIS: Sure. No, that would be useful. It would be useful if you would find something else that belongs there.

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.

MS CHESTER: So who makes the appointments to the FWC?

MS SCHEERLINK: The minister.

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.

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?

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.

MS CHESTER: You're the FWC guru at this time.

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".

MS SCHEERLINK: Yes.

MR HARRIS: But I think you can't make them accountable.

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.

MS CHESTER: So my one single question and then you can do your last one.

MR HARRIS: You've just done your one.

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?

MS SCHEERLINK: Yes.

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 the individual ratings agencies? Anyway, someone, somehow is capable of doing this.

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

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?

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.

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 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 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.

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.

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.

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".

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.

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?

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 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.

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.

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.

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.

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.

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.

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.

MR SOMMER: Understood.

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

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

MR EAST: Lachlan East, an executive at SunSuper.

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

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.

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.

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 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.

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.

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.

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

MR HARRIS: Thank you very much. You start?

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.

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?

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.

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.

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.

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.

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?

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.

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.

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.

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.

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, 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 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.

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.

MR HARRIS: We intended it that way.

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

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.

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

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?

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).

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.

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.

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.

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.

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.

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.

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, three, five and seven years is probably doing pretty poorly. But you never know.

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 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?

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, 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.

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.

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 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 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 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 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.

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.

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 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 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. Straightforward really, same call and how are you for that.

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?

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.

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?

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.

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?

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.

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 - - -

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.

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.

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.

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.

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?

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 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.

MR SOMMER: Yes.

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

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 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 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.

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.

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?

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.

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?

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.

MS CHESTER: Anything else?

MR HARRIS: Done.

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 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.

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.

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.

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?

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.

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.

MR HARRIS: Done?

MS CHESTER: Yes.

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

MR SOMMER: Thank you.

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.

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

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.

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?

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.

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 education, 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.

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 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 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 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 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 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 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.

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.

MS CHESTER: Mine are separate, you go first.

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.

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.

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.

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 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 - - -

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

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

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 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 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.

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?

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 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.

MR HARRIS: A workaround. Seems very undesirable.

MR LATTO: It's a workaround.

MR HARRIS: Yes, very undesirable.

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 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.

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 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?

MR LATTO: No.

MR HARRIS: Well, that was what I had.

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.

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?

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 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.

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.

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

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.

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.

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're recruited your 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 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.

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.

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?

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 - - -

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 - - -

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.

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 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, what I - - -

MR LATTO: A modified longer list.

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

MR LATTO: Yes.

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.

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 - - -

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.

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

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?

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.

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 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 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 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 a simple as that.

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

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 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 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.

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 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 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.

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.

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.

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.

MR LATTO: I can't (indistinct).

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

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.

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.

MR HARRIS: Yes.

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.

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.

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.

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

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

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.

MATTER ADJOURNED AT 12.51 PM