



Law Council
OF AUSTRALIA

Superannuation efficiency and competitiveness

Superannuation – Productivity Commission

**Submission by the Superannuation Committee of the Legal Practice Section of the
Law Council of Australia**

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About the Law Council of Australia's Superannuation Committee

1. The Law Council of Australia is the peak national body of the Australian legal profession, representing some 60,000 legal practitioners nationwide. [Attachment A](#) provides a profile of the Law Council.
2. This submission has been prepared by the Law Council's Superannuation Committee (the **Committee**), which is a committee of the Legal Practice Section.
3. The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee makes submissions and provides comments on the legal aspects of proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

Superannuation Efficiency and Competitiveness

4. Most of the questions in the Productivity Commission's Issues Paper entitled [Superannuation Efficiency and Competitiveness](#) of March 2016 call for responses that are beyond the scope of the Committee's Charter.
5. This submission is confined to drawing attention to matters that the members of the Committee consider are relevant considerations for the Commission in assessing responses and in making its recommendations.
6. The Committee's response to the paper is in two short parts:
 - background; and
 - the Committee's submission.

Background

7. Following the Government's response to the Financial Services Inquiry on 20 October 2015, the Government has asked the Productivity Commission (**Commission**) to develop:
 - criteria to assess the efficiency and competitiveness of the superannuation system (which includes both choice and default superannuation) (**assessment criteria**); and
 - alternative models (**alternative models**) for a formal competitive process for allocating default fund members to superannuation products (**approved default funds**).
8. In determining the assessment criteria, the Commission may have regard to:
 - operational, allocative and dynamic efficiency;
 - the extent to which the superannuation system encourages optimal behaviour on the part of consumers;
 - the nature of competition in the superannuation system; and

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- the effect of government policy and regulation on the competitiveness and efficiency of the system.
9. The request for the development of the assessment criteria is driven by the Australian Government's concern that a lack of competitiveness and efficiency in the superannuation system may adversely affect the system's ability to provide members with retirement incomes and reduce reliance on the Age Pension.
10. In developing the alternative models the Commission may have regard to:
- auction, tender and other types of competitive processes;
 - whether the alternative models incentivise meeting the best interests of members;
 - encouraging competition;
 - whether the alternative models are feasible to administer;
 - the credibility and transparency of any alternative model; and
 - using the alternative models to hold superannuation funds accountable for their outcomes on a regular basis.
11. The Government intends that the alternative models will provide viable alternatives for the allocation of default members to Approved Default Funds, if required following a review of the efficiency and competitiveness of the superannuation system. A key consideration when choosing an alternative model will be its ability to enhance efficiency in the superannuation system, including by optimising long-term net returns to members, and building trust in funds regulated by the Australian Prudential Regulation Authority (**APRA**).

Submission

Assessment criteria

12. In order to develop Assessment Criteria to assess the 'efficiency' and 'competitiveness' of the superannuation system, the Committee submits that the Commission will first need to determine and plainly state:
- what is included in the superannuation system – the paper states that the Assessment Criteria will not go merely to assessing the efficiency and competitiveness of the superannuation industry. It also states that the superannuation system is broader than the superannuation industry, 'encompassing many horizontal and vertical relationships on the supply side. It includes the demand side — the decisions of users of the system — and it is also affected by the overarching government policy affecting both supply and demand' With respect to the Commission, this description does not clearly express the parameters of the system the Assessment Criteria will be used to assess;
 - what is meant by the terms efficiency and competitiveness in the context of a superannuation system.

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13. The Committee submits that a central part of the superannuation system (and industry) are the means by which it accumulates and distributes retirement incomes. The Committee also submits that efficiency and competitiveness must be defined and assessed in light of the system's fitness to accumulate and distribute retirement incomes.
14. In doing that, the Commission should consider the extent to which:
- 'efficiency' and 'competitiveness' are synonymous with net returns to members; and
 - they should be assessed as a function of investment returns achieved against costs incurred or also to take into account less measurable (but often costly) outcomes such as good governance, safety and confidence.
15. The Committee submits that 'efficiency' and 'competitiveness' need to be assessed against:
- what members expect to be delivered by the superannuation system; and
 - the objectives of the superannuation system (which as at the date of this submission have not yet been finalised).
16. Any assessment criteria developed should not only take into consideration the matters stated above in the section headed 'Background' above, but should also take into account other Government imperatives and policies, i.e. optimising long-term returns, promoting good governance, minimising unintended regulatory impediments and building trust and confidence in APRA regulated funds.
17. In developing the assessment criteria, the Committee submits that the following considerations are relevant:
- The assessment criteria should be reliable, valid and appropriate for assessing a fund's performance as efficient, competitive and consistent with the Government's superannuation system objectives. For example, data showing a fund's investment returns over five years may not be a reliable means of determining whether a fund will optimise returns over a member's working life. As such, the assessment criteria should identify any inherent limitations on their applicability and how these can be overcome.
 - Use of the assessment criteria should not result in oversimplified assessment of variables. For example, fees payable in different jurisdictions around the world which may appear comparable on their face may not in fact be comparable, for less apparent reasons. For example, higher fees may be payable in a jurisdiction such as Australia (as compared to other OECD countries) because of a bias towards equity investments, a greater use of international managers, higher bid costs in relation to unlisted assets or a bias towards actively managed investments. Assessment criteria which are sophisticated in design and application will be more likely to identify true inefficiencies within the superannuation system.
 - To properly assess efficiency, both quantitative (i.e. investment returns over a set period) and qualitative measures (i.e. financial stability and governance) should be considered. For example, each member indirectly bears a portion of the cost of regulating the superannuation system which impacts on their investment returns. This cost, however, is offset to the extent it protects the

member against losses caused by fraud or system failure, for which they may be unable to be adequately compensated.

Alternative model

18. The Committee notes that the Commission has not asked for submissions on the alternative models yet, but nevertheless thinks it worthwhile to make some points about the considerations that will be relevant to any alternatives because they are also relevant to the Commission's initial consideration of how the superannuation system is to be identified and how its efficiency and competitiveness are to be assessed. This is because both of those things will then be relevant to the alternative models.
19. Any alternative models proposed by the Commission should also be consistent with the objectives of the superannuation system once finalised by the Government.
20. In developing alternative models, the Committee submits that the Commission should have regard to:
 - the extent to which there is a real practical difference between potential Approved Default Funds in light of the introduction of MySuper;
 - the extent to which any criteria used to select Approved Default Funds overlap with the legislative requirements of the MySuper products and whether the model would effectively duplicate APRA's role in assessing funds that are authorised to accept superannuation guarantee contributions;
 - the rationale for developing an alternative process for allocating default fund members to superannuation products; and
 - the difference between choice and default superannuation members and, in particular, the needs of default members who represent the majority of superannuation members in Australia and are considered to be relatively disengaged participants in the superannuation system.
21. The Committee submits that the following factors be considered when assessing the alternative models:
 - the extent to which parts of the superannuation system are provided by the private sector and where it does the necessity to provide reasonable returns to shareholders;
 - a comparison of fees should not be solely based on their quantum without considering the benefits (including any good governance and regulatory benefits) those fees have supported;
 - the extent to which the alternative models encourage funds to cater for the specific needs of their intended membership and to engage with and educate default members so they are can prepare for retirement;
 - the extent to which the alternative models promote financial stability of the superannuation system by including appropriate deterrents to unacceptably risky behaviour or unethical behaviour; and
 - whether the alternative model will provide an Approved Default Fund with certainty of continued allocation of members for a minimum period, to guide decisions around investing in long-term assets (i.e. infrastructure) and upgrading internal systems.

22. The Committee submits that any alternative model proposed for the selection of Approved Default Funds should be structured to avoid the following unintended consequences:

- an alternative model may inadvertently favour one sector within the superannuation system over another sector without good reason;
- assessing the appropriateness of fees may favour funds with less transparent fees structures over other, more transparent, funds. Depending on the criteria selected, there may also be issues with reviewing a fund's fees over time. For example, a fund's position in a 'league table' in terms of fees, performance or other matters may vary widely over even relatively short periods. It would clearly not be feasible to revisit assessments on a frequent basis to reflect such variations;
- it is estimated that 80% of employees do not exercise choice and are placed in a default fund.¹ If a fund is not selected to be an Approved Default Fund, the fund's viability may be adversely impacted to the extent the fund relied on default contributions for its cash flow, and the fund may have a lower chance of being selected in the future (depending on the alternative model chosen);
- placing a limit on the number of funds which may become an Approved Default Fund may inadvertently reduce competition in the system. As discussed above, funds which do not have access to default contributions will find it more difficult to be selected as an Approved Default Fund in the future, potentially threatening their viability and the number of funds in the system;
- the criteria for selection as an Approved Default Fund and the period between competitive processes for selection (i.e. the period of time that a fund is named an Approved Default Fund), should not promote short-termism. In particular, the chosen alternative model should not encourage superannuation funds to 'game' the model – that is, prioritise conduct to ensure their selection as an Approved Default Fund at the expense of the best interests of the beneficiaries of the fund or the Government's objectives (as mentioned above);
- the criteria for selection as an Approved Default Fund should not have short term application, i.e. it should be able to be applied now and in the future. For example:
 - (i) criteria which puts too much weight on (say) investment returns will favour certain funds at the top of their investment cycle to the detriment of other funds that may end up being better long-terms performers; and
 - (ii) the criteria should give due weight to funds that are able to adapt to changing economic, demographic, regulatory and other variable conditions; and
- the adoption of a Chilean-style auction model (referred to in the 2014 Financial System Inquiry Final Report) could result in superannuation funds engaging in a "race to the bottom" to lower fees as they compete for default superannuation monies. This model would discourage new participants from

¹ Cooper Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, 30 June 2010

entering the market, destabilise existing funds and remove incentives for the development of new member products. For these reasons, the Committee does not support a proposal to adopt that model.

23. From an operational perspective, the Committee is concerned about who will be responsible for applying the chosen alternative model and whether they will have the expertise, independence or resources to meaningfully do so. This is particularly given:

- the diverse nature of the factors that are likely to be applied in selecting an Approved Default Fund;
- the need to understand the particularities of the industries in which members are employed;
- the number of funds that are likely to apply for Approved Default Fund status;
- the amount of information required (and that is likely to be provided) to assess each fund's application; and
- the resources required, noting that APRA is currently required to undertake similar assessments on an on-going basis.

24. The Committee suggests that in considering any alternative model, consideration should be given to whether it should apply to new employees of employers entering the system and not to existing employees who are already members of funds. The removal of a fund as an Approved Default Fund should not result in:

- disruption and potential for employees to suffer loss as a result of their superannuation arrangements having to be moved to new Approved Default Funds from their current default funds in which they have been members for many years at a time not of their choosing. This may have significant effects of employees' insurance cover and fees and charges payable to employees on multiple accounts;
- an adverse impact on longer term investment in product development, systems and efficiencies by funds that are only able to do so on the basis that they will have scale and long-term contribution in-flows; and
- an adverse impact on longer term investments (such as infrastructure) by funds that have done so on the basis that they will have long term contribution in-flows, and are not subject to sudden significant out-flows.

25. The process of selecting the Approved Default Funds by applying the chosen alternative model should be governed by principles of transparency and accountability. Consistent with this, the decisions of the entity which undertakes this process (**approving entity**) ought to be published. Consideration also needs to be given to the possibility of:

- an applicant fund seeking judicial review of the decision; and
- exposure to legal actions (in the form of individual or class actions) for compensation to:
 - (i) a fund that is excluded from becoming an Approved Default Fund as a result of an error made in the assessment process;

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- (ii) a fund that has suffered a loss as a result of a publication of the approving entity; and
 - (iii) employers or employees for loss suffered as a result of contributing to an Approved Default Fund as selected by the approving entity.

Contacts

26. The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

- Ms Michelle Levy, Chair, Superannuation Committee T: 02 9230 5170
E: michelle.levy@allens.com.au or
- Mr Luke Barrett, Deputy Chair, Superannuation Committee T: 03 8831 6145
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Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2016 Executive as at 1 January 2016 are:

- Mr S. Stuart Clark AM, President
- Ms Fiona McLeod SC, President-Elect
- Mr Morry Bailes, Treasurer
- Mr Arthur Moses SC, Executive Member
- Mr Konrad de Kerloy, Executive Member
- Mr Michael Fitzgerald, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.