Forward Thinking – *The Murray Inquiry & superannuation* – Sydney 18 Feb 2015

The Government released David Murray's Financial System Inquiry final report in December. The FSI had a lot to say on superannuation. It recommended that Government clarify the objectives of superannuation, introduce a formal competitive process to allocate new default fund members to MySuper products (unless a review shows efficiency has improved), and require funds to provide post-retirement products. It also made recommendations on fund governance, fund borrowing, member engagement, financial advice and tax.

The government says it will respond to the FSI after its current round of consultation. The government also says it wants to bring competition to the market for default accounts – perhaps by removing superannuation from industrial awards.

A forthcoming Grattan report argues that the superannuation industry needs to become more efficient. There is much to be done to get a better deal for account holders: merge inefficient funds, close excess accounts, reduce complexity, and shift to lower cost investment management.

Join an expert panel for a discussion on superannuation and the FSI:

- Did the FSI 'get it right' on superannuation?
- How should Government respond?
- What should the goals for the superannuation system be?
- What is needed to improve retirement income design?
- Where are the inefficiencies in superannuation today and what causes them?
- How can policymakers and industry improve governance, disclosure, and competition?

Speakers: Jim Minifie, Grattan Institute
Sally Loane, CEO, Financial Services Council
Helen Rowell, APRA

JIM MINIFIE: Welcome to the State Library, my name's Jim Minifie from the Grattan Institute and I'm very excited to open this what I'm hoping is going to be an exciting and illuminating one-hour discussion about the Financial System Inquiry and superannuation here at the State Library. Grattan is delighted to be partnering with the State Library of New South Wales on these *Forward Thinking* series on policy challenges and what a great way to start the year with both Sally Loane, the Chief Executive Officer of the Financial Services Council which is the representative body for Australia's wealth management industry, and with Helen Rowell who's one of APRA's three members so-called and she has carriage and responsibility for the superannuation area.

I can't think of two people who in your institutional roles are better qualified to lead this discussion on what is now a huge part of the Australian economy. There are about $2trillion under management in the superannuation sector including self-managed, the choice, the default sector of super, all three of them very important to every Australian. It helps I think all of us to have a system which has been set up now in one form or another for over two decades and is continuing to develop as we prepare for retirement it has a bit impact on the budget in one way or another. And I think if you look at the role that superannuation played in the Financial System Inquiry report of 2014 and flicked back into earlier comparable inquiries from the 1990s and earlier you'll see that superannuation plays a much larger role.

So it's terrific to be able to open this event and I should just let people know we'll have plenty of time for questions. I know there are a lot of people in the audience with expertise that we would love to hear from. I should also tell you that we're recording this event and it'll be available on our website, so you should bear that in mind if and when you come to questions. How we thought we'd run tonight's event is to start with a brief overview of what the FSI did recommend; I'll pose a set of generic questions and then we'll go through those recommendations one-by-one; but we'll leave lots of time for questions.

So first, if I can just try to summarise what it was that the Financial System Inquiry made in terms of recommendations in super. There were quite a number of its recommendations that did touch on super. There are probably three that were very significant and there's a fourth one that we'll touch on as well. Interestingly, the Inquiry felt it appropriate to suggest that government seek broad agreement on what the roles of the superannuation system and the goals of the superannuation system ought to be and seek to enshrine that in legislation. I think that's really worth discussing, why might they have taken that view? So that's the first big recommendation and what those goals might be.

The second major recommendation was about improving efficiency inside the superannuation system during accumulation. So essentially the FSI took the view that there was an opportunity to reduce costs during the accumulation phase in a way that would lead to higher member net returns and the particular form of that recommendation is that unless a review held before 2020, and sometime in the window of 2017 to 2020, concludes that the current reforms, the Stronger Super reforms which are still being bedded down, have been effective in significantly improving competition and efficiency, that the government should use what it calls a competitive mechanism to drive efficiency, particularly in the default part of the industry, and we'll talk about each of these.

The third one is focused on the retirement phase and the recommendation was that superannuation trustees should be required to preselect a product that will generate income during retirement; the product would commence on the member's instruction or the member would be able to take their benefits in another way; impediments to product development should be removed. So they're really talking about shifting the focus of policy makers here towards the drawdown period. And then, as I mentioned, there's one other recommendation around governance of superannuation funds that we're going to touch on tonight. We may also get to choice of fund.

So the recommendation that the FSI made around governance was that every trustee group should have a majority of independent directors, include an independent chair, and there should be some other shifts that align the penalty regime for directors along with what is already in place for managed investments to strengthen the conflict of interest requirements. And just in passing I mentioned choice of fund, there was also a recommendation to ensure that all Australians have what most of us already do have, which is the ability to choose superannuation funds.

So those were the major recommendations and they obviously vary in their potential scale. I guess the questions that we thought would be appropriate to touch on this evening that would apply to all of those recommendations are did the FSI get it right in the sense of focusing on the areas that are most important? Did it tackle the right issues in the right way? Did it come to the right answers? And then I think for all of us in the near term there's an interesting perhaps more political question about whether and to what extent the recommendations of the Inquiry might align to what the current government appears to intend to do in this sector and then there's the question of how should the government respond?

In terms of a process, this evening's discussion is taking place during a consultation process which is going to accept submissions up until the end of March, so the government is actively accepting submissions from interested parties about how it should respond to the FSI until the end of March. And so I would encourage all of you who walk away from this discussion with a fire in your belly of one type of another to let the government know what you think it ought to do.

So with that by way of introduction, let me open the discussion about the objectives of the system. My first question to you Helen would be why would it be that an inquiry of this type would even feel the need to recommend that objectives should be made more explicit?

HELEN ROWELL: I think there are probably a couple of drivers for that. The first is a sense that came through certainly in a lot of submissions, and I know the industry feels quite strongly about this, that superannuation has been subject to a lot of change, a lot of policy change over the years. So in that sense a number of the policy settings are quite unstable and part of the reason for that is because there isn't actually a clear agreed objective about what the superannuation system is intended to do and, more importantly, it's not clear what it's not intended to do. And so the lobbying for it to be used for housing deposits, the latest one is pay off HECS debts or HELP debts apparently, bequest to children, those sorts of things. Whereas I think there's a general agreement, certainly within the industry and government and other political stakeholders, that the primary objective should be about providing income in retirement, and yet that's not the way the policy settings necessarily evolve.

So one argument for providing a clear objective and getting agreement on that objective is that you might then provide a stable framework within which policy decisions could be made on a more long term basis. And I think the other driver is probably a question mark about whether the system as it currently is and the current settings are actually driving towards that appropriate objective.

JIM MINIFIE: Sally, do you have thoughts about what might have been driving that question and, indeed, what the purpose ought to be of the system?

SALLY LOANE: Well I think certainly when it was envisaged, and I've read through some of the history and some of the Hansard and you read, and I was actually reporting down in Federal parliament at that point, and you do remember that at the time it was obviously very important, it was a very important part of the industrial system back then. I think a lot of it was wrapped up in certainly substitution at that point for a wage increase, I think about 3%, and back then I don't think anybody quite envisaged the size that it would be today and the importance in our economy. I'm not sure whether they did, they may well have, but certainly a lot of us didn't and I think it is time, certainly when it's in a more mature phase, that objectives do need to be re-affirmed.

I mean, we certainly see it as an important long term policy designed to alleviate pressure on age-related costs that threaten the stability of government finances. And I did a sample of a few young people, including my own children, who are just entering the workforce and did they understand what super was? And they actually do, I was quite surprised. They had a better understanding than I actually thought they would because a lot of people think young people are disengaged, they don't really know, but I think certainly to have a discussion around the objectives, it's a good opportunity now.

JIM MINIFIE: If I can just add to that, I would speculate that very specifically there are concerns about the way that the superannuation tax treatment interacts with the provision for retirement and the Inquiry was quite bold, I suppose, in putting forward what might be considered a draft purpose, to provide income in retirement as a substitution or supplement for the age pension. And that certainly implicitly raises the question of exactly how much of the overall tax treatment of the superannuation inflows and earnings in super are achieving that specific objective? So you can imagine potentially a process going forward that would surface those issues in a structured way, rather than doing it in what seems to be a very episodic way through the current political system.

But I note that one of the recommendations that the FSI did not make was to introduce some kind of counsel of elders or a superannuation governance policy development board, which had been put forward by some industry associations. Do you think that was a missed opportunity?

HELEN ROWELL: I personally don't simply because I think there are different frameworks by which you can achieve sound policy making and I think the way that the FSI has chosen to tackle it is to say, "If we get bipartisan agreement on what the objectives are that can then form the basis for policy making". You set some objectives, some measures that you can use to assess policy changers and that achieves what some sort of oversight board might have achieved without creating another level of oversight and accountability and bureaucracy that might not be effective.

SALLY LOANE: I think there's lesser appetite now for creating more layers of bureaucracy. It perhaps wouldn't have gone down well politically.

JIM MINIFIE: Yes, I'd agree with that. So my overall assessment of that recommendation is I think it's not a bad idea, but I don't think it's a game-changer, that would be my sense. I think there are limits to the extent to which it's even possible in a society where people have very different views to achieve broad agreement, and so I'm a bit sceptical about whether it's going to be much of a game-changer.

HELEN ROWELL. Interestingly Jim, one of the comments that I've written down in my notes is "easier said than done". Having worked with industry stakeholders many, many years ago to try and get some agreed principles that you might use as the basis for assessing policy changes, and that was a fraught process that really didn't get anywhere because even within the industry itself you couldn't get agreement on what the objectives and principles would be.

JIM MINIFIE: Let's move onto the next one, so retirement income design. The Financial System Inquiry recommended that funds all be obliged to produce a comprehensive income product for the retirement or the drawdown phase, one that would also include some degree of longevity protection by which individuals might participate in a pooling arrangement such that they happen to live much longer than they expected to they wouldn't run out of money and, by the same token, that everybody wouldn't be over-saving concerned about the risk that they would run out of money, so that all seems sensible.

Helen, can I start with you? Is there strong evidence that we really need to change anything or are these products already available and it's a question of individual choice? Was there a strong case for this recommendation in your view?

HELEN ROWELL: I definitely think so and particularly if your premise is that the objective of superannuation is to provide income in your retirement I think there's enough evidence to suggest that it's not actually achieving that objective at the moment and I think that's because there's a lot of focus on how the superannuation is building up to the point of retirement and less so on then what happens after that. Part of that is society and attitudes and a preference, if you like, but a lot of it has to do with policy settings and tax settings and the fact that there just aren't the products there that people can use to meet their needs in retirement and to deal with the risks that they need to deal with in retirement.

So I think, if nothing else, having a change in the system to focus on the default being taking an income in retirement would be a step change, but it needs to be supported by other policy setting changes that would then foster innovation and the products that you need to then deal with the longevity risk issues and the sequencing risk issues and the other complexities around having adequate income through retirement.

SALLY LOANE: Yes, I think it's really timely, particularly as that bulk of baby boomers is now starting to retire so we've aged with the system, and this is absolutely right because more and more of us are starting to fixate more on the retirement point and less so on the accumulation point if you look at the demographics. So I think it's absolutely timely and we certainly support trustee discretion to develop default retirement products for those members who don't exercise choice.

JIM MINIFIE: So what is stopping a fund from coming up with a great retirement product today? Obviously there's a question about taxes and there was a period where, for example, annuities had a more preferential tax treatment than they have today. But just putting that aside, what are the main constraints from a policy perspective?

HELEN ROWELL: Well, part of it is to do with age pension eligibility and the tests around that which only allow a very limited range of products to be taken into account when looking at age pension eligibility, and so that drives people away from other products that would otherwise be available which means there's just not a market for them.

SALLY LOANE: So it's actually dampening down perhaps innovation of products, the system.

JIM MINIFIE: Are there also tax treatments around the flipping over from an accumulation product into an income product that are constraining the switch at this stage, or is that a second tier issue if at all?

HELEN ROWELL: I would have to confess Jim that I'm not an expert on the tax settings.

JIM MINIFIE: We may have somebody in the room.

HELEN ROWELL: That might be someone else who could answer that question, but I do know that there are a range of issues that industry has put forward as being impediments. I mean, you can tell there is currently increasing interest in provision of life annuities for example and so Challenger's sales of lifetime annuities are increasing. But that product doesn't necessarily suit everybody and I think one of the issues that you have is that a) people's needs change through retirement and even when people get to retirement what they needs in terms of products is very different. So deferred annuities for example aren't treated well under the age pension assessments, and so that means that someone who wants to have an account-based pension but have that protection for when they get old to make sure they've got some income at that point, they can't do that under the current policy settings.

JIM MINIFIE: How would a fund that doesn't have much of a balance sheet, take a non-profit fund that's not attached to a bank, how would it operate in a world where there were insurance characteristics to some of these income products?

HELEN ROWELL: That can be quite complex and I think it comes down to the design of the product and who's bearing what risk and who's funding that risk. And so if it's discretionary rather than guaranteed and you get a big enough pool, then the members in effect pool their resources and, subject to appropriate monitoring and the like, that can work. But as soon as you start getting into guaranteed incomes from particular dates or any other underpin on investment earnings through the retirement period you're actually really looking to need to partner with an insurer to provide that. And that can be more expensive, which is part of the other reason why it's not so attractive for people.

JIM MINIFIE: So overall, my sense and, again, from the industry there was broad support that it's now time to start thinking more clearly about what policy changes are needed and so this was broadly a welcome recommendation, at least from the industry.

Let me turn now to one which I think has been much more polarising which is the question of inefficiency in superannuation. And some of you here tonight might now that we at Grattan have done quite a lot of work on inefficiency and super; we've got another piece that will be coming out in the near future looking at this. The recommendation that I read out earlier was broadly that government should give the system a few years to see how current policy settings bed down and if criteria yet to be defined are not met then there would be this introduction of what the Inquiry called a "competitive mechanism" by which a reasonable interpretation would be that that would be a tender of some type by which funds would compete for the right to be offerable as a default.

So let me perhaps turn to you Sally. Does the FSC have a view about whether there is inefficiency in the system today, what's driving it and what ought to be done about it?

SALLY LOANE: I guess the main inefficiency would be the lack of competition particularly in the default system and we would say that opening the default system up to retail funds would be one way of driving competition which would hopefully drive out some inefficiencies and drive fees lower. And we think MySuper is obviously quite young, it needs to develop, it needs to mature as well, but also all the funds should be able to compete in that system.

JIM MINIFIE: Helen, do you have an assessment of the importance of any remaining inefficiencies that there might be in the super system?

HELEN ROWELL: I think there are complexities which lead to costs being higher than they might otherwise be. I would express a note of caution, and I know you've heard me say this before though, that if you focus too much just on fee levels you're not actually looking at that end outcome and purpose of the system which is it delivering good or adequate retirement incomes at the end of the day?

So in looking at whether the system is delivering and efficient and effective, I think you need to look at a range of measures, not just fees and costs. I think there's definitely some work that could be done to remove some of the complexities around investments which are perhaps adding cost, but there are also other inefficiencies, for example how tax is managed by funds where they use multiple managers and they don't pool and effectively utilise or manage the tax that's paid. And that actually I think has the potential to have as much impact as reducing fees and costs in the system, other sort of fees and costs in the system.

Just the sheer fact that we have a system that has over 40,000 different investment options for members to choose from to me seems quite extraordinary and unnecessarily. And so there is a trade-off I think that needs to be thought about between having choice and how far that should go because of the impact that it has on complexity and therefore costs in the system.

SALLY LOANE: Would mergers of funds be a good way for more efficiency do you think?

JIM MINIFIE: Yes, so we've looked at that in detail. At the moment there are about 150 APRA regulated public offer funds. There are a lot of smaller products, corporate products and so forth, but just looking at that 150 and by examining the way that costs vary with scale you can get a pretty good idea about how much cost could be taken out through significant mergers. We estimate just as a thought experiment that if you merged every fund with its next door neighbour in scale, so you essentially ended up with 75 funds that are twice as large, you would remove about a billion dollars of cost from the system. This is from a system that's got a total cost of about $16billion including $2billion of advice, $8billion-or-so of investment and the rest in admin.

So it would be material but it wouldn't be a game-changer to do that level of mergers, and you could also roll up from the bottom. And so that probably is a significant enough opportunity that it ought to be facilitated and we think there are policy steps that could be taken to do that, but there's still a large remaining gap and I guess one of the questions for current policy makers are what type of competitive pressure is likely to lead to aggressive cost reduction?

So one vision would be we can do it through essentially a retail form of competition in which all funds compete for the business of firms in providing superannuation products for their employees. And the vision that the FSI seems to be pushing towards is to say, "Well, we're not convinced that that's going to work". There's another model that has been shown to work in some other jurisdictions which is to run this type of wholesale tender and that's definitely where Grattan would see an opportunity in the detail space. And it's worth just I think putting on the record the reason why we think that on balance the freeing up, if you like, to that form of retail competition in the default space is unlikely to be a major opportunity is that while you would put pressure on the least efficient industry fund and that would be a plus and you would probably see some share gain of the more efficiency industry funds and the more efficient retail funds, we'd be concerned that many funds would end up being trapped in the type of cost increasing product differentiation and marketing exercises that have tended to push up fees and costs in some other parts of the industry.

So overall, our sense is that the FSI's recommendation should be given very, very careful consideration by government. We're actually less persuaded that three or five years from now the cost base is going to fall very much because we've seen that MySuper hasn't made a huge impact. There's been some reduction in retail default fees, but otherwise nothing much has changed. Perhaps the wild card is around FOFA (Future of Financial Advice) and it might be worth touching on that because I think, reading between the lines of the FSI, there's been a support for an improvement in adviser competence and professionalism, and perhaps we can move into that area because certainly there is one view about how the industry might go which says the much bigger and indeed the higher cost part of the industry is the choice part.

Do either of you have a view about whether FOFA is going to lead to significant savings over time and whether the FSI's recommendations are needed given that FOFA's now in place?

HELEN ROWELL: Sorry Jim, can I just go back to that issue of the competitive tender? I mean, we'd say that open market competition is a better solution because only efficient funds would be able to compete and no government intervention would be needed, and in a competitive tender that would add to that cost. Sorry to take it back, but I just wanted to pick up on that.

JIM MINIFIE: No, it's a key issue.

HELEN ROWELL: So we would always say that open market competition is the best deliverer of lower fees in any market.

JIM MINIFIE: I guess the paradox is that the areas of the market that do have that already have got higher fees in default, so the question really is why would policy makers be confident that you'd get a lower fee than you would from a process which has got a degree of tender-like characteristic today? We would not regard it as a particularly efficient model, but at the moment there's at least a short listing process that tends to produce lower fees than you see in the part of the market with open competition.

HELEN ROWELL: Those two segments of the market are very different, the default market and the choice market, and just the strict comparison of fees isn't necessarily a balanced or an appropriate comparison because you need to actually look at the underlying offerings and what they are because they're not all the same. And so I guess I come back and, again, you know this is my view that I think this undue focus on fees and costs risks narrowing the policy decision making too much and that there are a much wider set of issues. Yes, it is important to make the system more efficient and more effective, but that's not the be all and end all of where the debate should be.

I think there is scope for changes to advice models and the way advice is charged that might have an impact and I think we're seeing some developments in that space with more efficient advice models being implemented. Whether that will just happen anyway from a competition point of view or whether it's going to be driven by FOFA I don't have a particular view on. I think there are a number of ways that you can improve the efficiency of the system but I just wouldn't want us to lose sight of the end game of okay, you can have the lowest cost system in the world but if it's not actually delivering good retirement outcomes then what have you actually achieved?

SALLY LOANE: Exactly and in the choice market you may want to make a choice to pay quite a bit of money for a bespoke product, that is your choice in a market, you've got the ability to do that. So yes, I agree with Helen on that.

JIM MINIFIE: Any other thoughts on advice before we switch to governance? Let me move then to governance. So, as I mentioned, one of the other major recommendations of the FSI is that all superannuation funds should have a trustee structure with a majority of independent directors, a chair ought to be independent – this is for all public offer funds. And as for the other recommendations, I think the interesting questions are what's the basis for the recommendation, is that a well-founded recommendation and what would the potential impact of it be?

Let me start with you Helen, do you think that's a recommendation for which there's a strong evidence base?

HELEN ROWELL: I think it's a contentious issue as to what the driver is of sound governance and APRA takes a very broad view of governance and it's not just about board composition, it's actually about the overall controls and processes and frameworks that you have in place. And our view is that if we look at where the superannuation industry is at relative to the other industries that we regulate, the governance practices, the risk management practices are a little bit behind and there's room for them to improve.

We've set some clear expectations in the new framework and our review to-date suggests that there's many funds that have a bit of work to do to meet those expectations and those expectations are pretty consistent with our expectations of other industries. And our view is that actually the composition of the board is key there because there's such a wide range of issues that need to be covered by the boards in terms of the scale and scope of the operations that you need a broad skillset and broad capabilities. And our experience, particularly in the other industries and also in the super industry where there are independent directors on boards, is that the level of governance and oversight is heightened simply because you've got some different thinking and different capabilities and different skills around the table.

JIM MINIFIE: But is there any necessary connection between independence per se and expertise? I would have thought that it's possible to have appropriate diversity of expertise without necessarily needing or not needing a –

SALLY LOANE: It depends whether you want to manage conflict of interest though. I think that's a really important test as well. David Murray was very strong on governance, I heard him give several interviews and this is one of the strongest themes that he actually came out with and we would agree with him wholeheartedly. In fact, the FSC developed a Standard 20 which is from our members, majority independent directors and an independent chair, and we've actually developed the strongest test of independence which is basically I think a combination of APRA standards and ASX guidelines. And we actually think that that is the best and highest benchmark and we think that diversity leads to better governance as well.

HELEN ROWELL: I think the issue is where are you drawing your pool of directors from? And in the industry at the moment I think that pool is quite narrow, and so you're not getting independence or people that are don't have conflicts.

SALLY LOANE: Yes, well, transition to independence can take some time, but we think it's worth it. With our members now that have to meet Standard 20, I think our members have got some excellent results, there are ex-regulators, consumer group representatives on boards, and we would say that it's definitely been worth it. It's been a difficult process, but we recognise we wanted to manage conflicts of interest and that's why we've done it.

HELEN ROWELL: But it also needs to be borne in mind that not all independent directors are good directors and so you have to be careful who you choose as well. So it's not a panacea, suddenly you wave a magic wand, independent directors, the world is right. There is a process around making sure you've got the right skills and capabilities as well as that independence.

JIM MINIFIE: What would you say to the point of view, that's not represented on the panel tonight, that would say independence is a key factor in a profit making entity where you want to have directors who are able to put the interests of the shareholders above those of management, for example? In the non-profit world the character of the conflict's very different and a representative board, it would be argued, has got a more appropriate fit.

HELEN ROWELL: The conflicts are still there, there are still related party arrangements and interactions that need to be managed. And so it's as much an issue in the not-for-profit or profit-for-members sector as it is in the retail sector.

SALLY LOANE: And it does seem I suppose to me, just coming in from working for a long with a publically listed company, that directors of these very large super funds managing a great deal of money don't have the same standards of governance as the companies that they're choosing to invest in. It just seems misaligned to me.

JIM MINIFIE: We've got about 20 minutes left and I think it would be terrific to get questions and observations from the floor.

AUDIENCE: I know you touched on annuities and what a post-retirement world might look like. Are you able to talk about how a shift in how retirements are managed might impact to sort of counterparty risk and a lot of people putting their retirement savings with third party groups, like Challenger or insurance companies, just your opinions on that wholesale shift of risk in that world?

HELEN ROWELL: I think that could be an issue, it very much depends on how the industry as a whole or the financial sector as a whole responds to any policy setting changes that lead to a wider range of products being available.

So one of the things that APRA always is concerned about is concentration risk in any particular segment of the industry and so I think it is important to ensure that where there are changes made to policy settings that you have a wide enough pool of providers to mitigate against that counterparty risk. Now, I think for the foreseeable future you will see that a lot of funds will provide pension options themselves that involve pooling and other arrangements, rather than necessarily having to go out and buy an annuity or some other product from a third party provider. So as long as you've got that mix in terms of how the income is being provided, that counterparty risk and concentration can be mitigated but it is definitely something that would need to be watched.

AUDIENCE: Just a quick question about the erosion of superannuation funds in relation to the objectives of superannuation itself. Post-SBS250 and the other regulations around the erosion of super, do you think if you want to define the objective of superannuation to be the retirement income that perhaps a recommended or a mandatory superannuation guarantee cap, say 75% of your SG as a maximum, that could go towards a life insurance premium would better achieve that objective than say a recommended cap or leaving it up to trustees to decide what constitutes an erosion of funds?

JIM MINIFIE: That's an actuarial question surely Helen?

HELEN ROWELL: It is an interesting question and it's a live issue that many trustees are actually grappling with which is how much of the contribution towards superannuation and ultimate retirement should be diverted, if you like, towards providing insurance coverage.

Now, there are some definite benefits to providing insurance coverage through superannuation and it's certainly made insurance coverage available to a much wider range of people than would otherwise be the case. But I think, even if there's no mandated requirement, trustees do need to be seriously thinking about how much that erosion is. And certainly in our conversations with funds we have been saying, "Well, do you need to look at the design of your insurance offering and perhaps have less generous benefits so that the costs come down so that there is more going away to retirement?" I'm wearing my personal hat rather than my APRA hat at the moment, I'm not an advocate for hard limits and caps and rules around that sort of thing, but I do think that it is something that if a trustee is actually meeting their obligations under SIS (Superannuation Industry (Supervision) Act) they should be seriously considering.

JIM MINIFIE: Let's take a previously submitted question before we return to the floor. Sally, there are a couple of questions around the position of people who may not be full-time in the workforce during the period of which they are of working age, so that might be predominantly women who are doing more childcare, there are obviously people for many different reasons who might be working part-time. The FSI didn't touch much on that question. Do you think there are issues that the FSI should have touched on or that are important in superannuation policy design in that area?

SALLY LOANE: Yes, I think it's really worth looking at. The gap that women do suffer in super is very stark. I've seen it in a corporate super fund where it starts off being fairly equal and then women of course go into childbearing years and then it really drops off and women never catch up, and I think that is something that really does need to be addressed. I think companies are addressing it, some companies are. I think there's an example that we were talking about earlier Helen of a company, I think it's Rice Warner, that has actually got permission to raise the level for women of their super SG payments just for women.

Now I know in my own personal space when I took time out of the workforce to have children I fell back. You not only fall back, you sort of fall off the, I suppose, career track, but you do fall off in superannuation. When I come into the FSC we have an example in our own staff where we are having one of our staff going off on maternity leave and I've had that very conversation with her today where I said, "We're going to maintain your superannuation contribution payments all the way through your maternity leave" and that is something that is up to the discretion of employers. And I think it's a good one for women and I'd encourage women to ask for that when they're going on maternity leave.

JIM MINIFIE: It seems to me it's almost part of the "What are the objectives of super?" There needs to be a discussion about the role of super in those issues.

SALLY LOANE: Yes.

AUDIENCE: My question relates to the consultation process and I just wanted to ask is the government reaching out to consult as well and, if so, who are they reaching out to and what are the hot topics?

JIM MINIFIE: Now, I don't know the answer to that question beyond the fact that there is a consultation process which involves submissions. There's always a back channel as well and I don't know what's going on in that back channel.

HELEN ROWELL: As far as I know, Treasury is organising meetings as well with various industry stakeholders. I don't know how broad that range of stakeholders is, but it is both reaching out for input as well as just asking for submissions.

SALLY LOANE: And there's a lot going on. There's the tax whitepaper of course too which is also on the agenda and a lot of people are working very hard consulting on that, putting in submissions.

AUDIENCE: Australia currently spends about $16billion administering its APRA regulated funds, so that's obviously both the fund management fee and the administration fee. A rough guess for SMSF would add about $4billion to that, so we're spending about $20billion a year running superannuation and that's more than 1% of GDF. Do you think it's plausible that that's an appropriate allocation of national resources?

JIM MINIFIE: If I can just give a quick view to that. If you look around the world, systems with somewhat different design features that retain a high degree of choice and appropriate asset allocation can deliver superannuation for about a third of that. Now, retaining all of our decentralised processes you probably can't get quite that far. If you were to run a tender our estimate is you could probably knock about $3billion off the total and there are a number of other steps, for example the fund consolidation, that would knock off further billions.

There's still an open question about how you get costs down in the choice space, but I think there's no question that a significant fraction of that 1% of GDP is the result of funds being trapped in expensive competition to try to drive their own scale and deliver value to their members. And so policy makers do need to be thinking hard about whether they can achieve very much the same, if you like, gross return outcomes but have a stronger net outcome to members by using the types of mechanisms that the FSI put forward.

SALLY LOANE: There are also constraints around rationalising people out of legacy products which mean that the ability for the industry to remove some of those more expensive product options is problematic. So I guess the government has not pursued that because doing that would have some tax implications and so, again, you get into a trade-off question here of what's the bigger issue over the longer term and is it better to take a small tax hit now to allow funds to rationalise and get rid of those legacy products which also have all sorts of other risks associated with them so that you could bring costs down?

AUDIENCE: How can funds protect themselves or manage the four-year cycles of governments who come in and see this honeypot that's too good to be true? They're spreading what's expected of it for HECS, for other things, for tax revenue, you hear the current government talking about getting more tax revenue out of it. How can you create certainty for retirees when everyone's looking at this? It's like a sea of change in four-year cycles.

SALLY LOANE: I think if we start at the end, if we start with the premise that we want a system that delivers the very best retirement outcomes for the majority of Australians and work back from there and have those objectives and policy settings that deliver that and take it out of that sort of constant budget cycle of it being attractive. I think that's what we started with when we talked about the objectives, but I think if we start with what we want and work back we might have a reasonable system that's sustainable.

HELEN ROWELL: I think that's right and hopefully if that recommendation gets picked up and the tax whitepaper also canvasses the appropriate targeting of the tax concessions in superannuation and how that links with the age pension, then you might end up with a bipartisan policy framework that provides that policy or that certainty for retirees. In the absence of that, it's a challenge.

AUDIENCE: My question is particularly for Helen, but I'd also be interested to hear what Sally has to say. Of all the recommendations in the final report from the FSI, what is the one that you'd like to see action taken on most urgently?

HELEN ROWELL: In the superannuation space, I will limit myself to the superannuation space, I actually think the one around retirement income options and the policy settings that are needed to implement that would be a step change in the right direction.

SALLY LOANE: Probably the ones that we've talked about. Recommendation 13 mandating the majority of independent directors on the board, as I said, that was something that David Murray did seem to be very strong on. Recommendation 12 providing all employees with the ability to choose the fund into which their superannuation guarantee contributions are paid, that's another very – how many are we allowed to have?

AUDIENCE: Your top three.

SALLY LOANE: Okay. I might stick with those top two. The rest obviously are very important.

JIM MINIFIE: You didn't ask me, but for what it's worth I would recommend that the government not only accept the recommendation about driving efficiency by moving to a competitive process, but that they accelerate it because when the government looks at the evidence about where the current policy settings are going to drive excess costs out of the system I think it should have a lot of confidence that it's not going to get anywhere near the frontier unless it takes the lessons from the overseas jurisdictions that have been more successful in doing that.

AUDIENCE: This is not a Murray Inquiry question, this is a question relating to the story in the AFR this morning with the Grattan Institute's top five picks for how to fix the budget deficit and the superannuation one that the Grattan Institute chose was imposing an earnings tax in the pension phase, I presume on the earnings of the fund. I was wondering why you chose that particular tax mix change rather than, say, increasing contributions tax?

JIM MINIFIE: So there's somebody in the audience who might be able to provide a view or a response to that given that I think you might have been the author of those five, John Daley from Grattan.

JOHN DALEY: I was responsible for that, so let me answer the question rather than getting Jim to do it. I think actually when I spoke to Jacob Greber from the Finn Review I actually nominated both of those. We've certainly historically suggested that both of those changes would be desirable. The contributions is clearly an issue, it essentially results in people who are very well off paying a great deal less tax than they would otherwise, and in terms of the earnings phase, as indeed I think the Murray Inquiry pointed out, the different tax in the pre-pension and post-pension phase leads to all sorts of mucking around.

I suspect one of the things that lies behind the growth of SMSFs is that financial planners have figured out that you can basically buy a balanced basket of stocks, hold them in your own name and then essentially only sell them when you hit 60 and therefore avoid paying any capital gains tax on them at all and, indeed, if you're not getting that advice from your SMSF financial planner then you should probably find another one because it's a very, very tax effective strategy. So it deals with that problem and it also deals with the problem that, again, it's a tax exemption that primarily benefits those who are very well off and we have people now with literally tens of millions dollars in their superannuation funds that are paying no tax at all on the earnings, and there's clearly enormous social inequity that's involved in that.

JIM MINIFIE: Thank you.

AUDIENCE: My question is the issue in terms of actually providing consumers with better information to make decisions in regards to the choice. There are 25.9million account holders, which is more than there are employees in the workforce. There are successive surveys, and I was reading actually the Rice Warner submission over Christmas which basically said that superannuation, as we know, is the second-largest personal asset after someone's prime residence for which they have the least interaction in terms of making the decision as to where their superannuation funds actually go, both in terms of their SGC contributions and obviously in terms of investment choice. Sally, you talk about competition and the like which is all well and good, but open markets tend to work where there is also equal information and not asymmetric information.

So what does the panel see can be done to ensure actually consumers are better informed and better able to make an informed choice as to where their money goes?

JIM MINIFIE: So just quickly, I think the position of Grattan would be that comparability is a good thing, MySuper makes some steps towards comparability, and having a product disclosure regime that facilitates comparison across all super products, not just MySuper, would be a good thing. But there are strong limitations to the ability of standalone consumers to engage with super and that's why you need to have a default that intrinsically is a good product. Even most employers are not engaged as well. So fundamentally there are real limitations for engagement and disclosure to drive strong outcomes. Now, of course, you always want to have those things, you want to have choice that is informed by appropriate disclosure and that's appropriate for sophisticated decision makers, but there's always going to be many, many people in society who are not and that's why you need to have a more wholesale mechanism to drive efficiency for that group.

SALLY LOANE: I Googled a whole lot of things when I was moving into this job and one of the things I found quite difficult to understand was "I am a young man and I'm going to work on a building site, how do I know what super fund I can go into?" It was incredibly difficult to actually find anything comprehensive that told me that and I went on multiple sites. And I take your point, I think there is a lot of opacity, I suppose, around information. I don't think we should underestimate the ability of young people to grasp the importance of money. When you start talking to them from a very early age about money and super they actually do get it and I think it's incumbent upon all of us to actually take responsibility for engaging our own kids and educating them. I mean, financial literacy is enormously important and we've got to take responsibility about so many things in our life and that should, to me, be one of the first. That's my personal view.

HELEN ROWELL: Yes, I'd just add I think there were some steps take in the Stronger Super reforms to improve transparency and comparability, not all of those are in place yet so, for example, we still haven't got a final product dashboard for choice. That goes someway but, as Jim said, there are limitations around standard comparison just because of the nature of the products. So you also need the advice model and access to affordable advice because it is complex to make a lot of the decisions that need to be made.

AUDIENCE: Actually that is part of the problem, I just finished a Diploma of Financial Planning and I'm still confused. I think that says something. My question is, can you list those countries please that do perform better on cost but also make a comment on how they perform overall in terms of what they deliver to investors?

JIM MINIFIE: There are really two key vehicles. So if you look for example at Denmark, Sweden and New Zealand, all of whom have got a central payments gateway, where rather than the Australian system which is highly decentralised, essentially the funds go through the equivalent of the ATO or a specialised body. So the admin costs are radically lower on that basis. Sweden has a system whereby people have full choice to all of Europe's, a huge list of European fund managers, but there's no personal relationship with those managers so essentially there's a wholesale pooling of the funds which are then essentially made available to each of those managers at a reduced rate.

In the US the Thrift Savings Plan, which has got hundreds of thousands of public servants, has a combination of admin and investment savings thanks to tendering, essentially, the administration. There are a number of South American countries that have shifted to a tender system for their defaults. And the one big shift that government would need to do is to be comfortable in putting forward one or more asset allocations. It wouldn't need to be the whole decision maker with respect to that, you could have another decentralised process to choose asset allocations.

So those are some of the countries and they use a range of models, but the outcomes that they achieve in terms of having low cost access to particular asset classes is strikingly cheaper than we have in Australia. Now there's a mixture of evidence about whether you need to get exposure to individual asset managers inside those asset classes, but broadly over the long run low cost exposure asset classes are shown to outperform. And so in terms of providing retirement outcomes those systems are better because they give you low cost access to essentially the same asset classes that we would have in Australia.

I don't know if there are other observations that the parties would need to make, do you have thoughts about those alternative systems?

HELEN ROWELL: My only observation is that you need to look at all of the components of the system. We have a three pillar system which is age pension, super guarantee, voluntary savings. The models in a lot of jurisdictions are very, very different and so you need to be careful when you're comparing that you're comparing like with like, and that's very, very challenging.

SALLY LOANE: And also our health system obviously too is considered far superior than a lot of the countries.

JIM MINIFIE: I'm reluctantly drawing this discussion to a close. Thank you Sally so much, Sally Loane CEO of the Financial Services Council, it's been great to have you on the panel. Helen Rowell, APRA member, it's been also terrific to have you. I've got a token of Grattan's gratitude. And to the group who's assembled for the discussion, thank you so much for joining and I hope that we can continue that in some form directly afterwards and in the future.

As I said, I encourage all of you to make a submission to the government if you've got a strong view about where policy in this sector ought to go. So on behalf of Grattan, thanks to our hosts, the State Library of New South Wales, and thanks to our panellists.

END OF RECORDING