State of Play: AE Experiences and Proposals in the UK and Ireland

Scoping Workshop

David Harris – Managing Director

TOR Financial Consulting
April 26, 2019
Global Drivers for Pension Reform

• ‘People Worried More About Living Too Long than Dying Too Soon’
• Government Fiscal Crunch: Baby Boomer retirement and the demands on the first and second pillar pension solutions
  • Disruption and Economic and Social Cohesion
  • Hard Compulsion > Auto Enrolment > Tax Incentives
• Accelerated transition from DB to DC – PAYG Impact and Political Considerations and Support
  • Infrastructure held by US, Canadian and Australian pension funds
  • Australia and New Zealand – Sharp Decline
• Social Activism/Media Considerations – Member attitudes
• Political reactions to a low interest rate environment – long term impact
  • Infrastructure considerations
• Economic Impact – Brexit and Economic Slowdown in China
• Decline in paternalism – pensions seen as more transactional
  • Scale and Transactional/Operational Costs
Global ‘Hot Button’ Issues - Investments

- Maximising Rates of Return
- Alternate and Infrastructure Elements
- ESG and Broader Social Issues
- Internal and External Investment Capacity
- Risk Propensity and Tolerance

Stakeholders
Members
UK – AE Backslapping But Really?

- Moved sharply to 5% employee contribution and 3% employer contribution – global and domestic uncertainty
- Minimal opt out rates but analysis on cessation of contributions are not clear. Coverage rates have surged pre and post AE.
- Price capping at 75 bps is promoting ‘vanilla solutions’ that generate profit margins. Smart default has not been widely accepted. Calls to lift price capping to encourage growth in UK infrastructure.
- NEST – State quango is due to have a loan balance of £1.29 billion providing DC schemes of last resort.
- Pension freedoms – corner stone of retirement income solutions – more government revenues and discretionary spending.
- Replacement rate – discussions around Collective Defined Contribution Schemes
- Dashboard Developments – appreciating your pots of retirement money.
- Number of providers is much smaller in number compared to New Zealand.
Ireland – AE and Its Strawman

- Brexit and the flattening of the Irish Economy + IORP II have slowed AE reforms
- Responses to the consultations – over 100 submissions have generated some political consternation
- The New Zealand KiwiSaver experience continues to provide the closest comparison with the likely Irish AE reforms
- Existing DC landscape + Newly created AE solutions.
- Price capping of 50 bps – economically sound to provide such solutions
- Creation of the Central Processing Authority (CPA) – arms length government agency that will select four providers – 5 year contractual period – suggested 10 years.
- Processing hub to be built allowing employee rather than employer choice.
- Suggestion EET tax approach with TTE – inconsistent – tax arbitrage.
- 2022-2028 – 6% from employer and employees
- Intergenerational fairness, wealth gap and housing access in the post global financial crisis
- Gender issues – not well developed or understood - wage levels, divorce timings and longevity risk
- Political risk – the first pillar will provide in perpetuity – really?
- Political cost of IT system designs - Delays and Cost Overruns
- 70/30 – What is the ideal replacement rate?
- Employee Choice vs Employer Choice
Questions and Thought Leadership for New Zealand

• Does the country need to rethink retirement income policy and housing access and ownership?

• Is there a need for New Zealand to embrace financial wellness approaches – to better understand consumer needs eg. Lifecents (USA)

• Is gender issues and intergenerational fairness ideal for the future of New Zealand – wealth gap?

• Need for indigenous providers to create infrastructure for future generations.

• Political risk for maintaining static first pillar pension solutions

• Is the level of fees and charges appropriate for returns generated?
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### New Zealand/Australia
#### Some Systems Comparison

**Nick Sherry**

<table>
<thead>
<tr>
<th></th>
<th>NZ</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start date</td>
<td>2007</td>
<td>1987</td>
</tr>
<tr>
<td>Contributions</td>
<td>3,4 or 8%</td>
<td>3% 1997, 3 to 9% 1992-02, 9.5%, 2013, 12% 2021-25</td>
</tr>
<tr>
<td>Size</td>
<td>$34b, 2016; $40b 2017; 15% GDP</td>
<td>A$2.65t 2018; 140% GDP</td>
</tr>
<tr>
<td>Contributions, mechanism</td>
<td>Central via one platform</td>
<td>Decentralised via fund</td>
</tr>
<tr>
<td>Governance</td>
<td>Corps Law, FMA license</td>
<td>Trustee (best interest member test), Corps Law, APRA/ASIC license both NFP and retail</td>
</tr>
<tr>
<td>Default fund</td>
<td>Individual selects, if no, default</td>
<td>Default then individual may opt out usually “advised” planner or accountant</td>
</tr>
<tr>
<td>Default investment option</td>
<td>Provider determined</td>
<td>Provider determined, My Super</td>
</tr>
</tbody>
</table>
Comparison continued...

<table>
<thead>
<tr>
<th>Contributing/ No. of members accounts</th>
<th>1.57m, 2.7m</th>
<th>15.5m, 28m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early Access</td>
<td>Hardship and first home</td>
<td>Hardship, first home (voluntary conts. only)</td>
</tr>
<tr>
<td>Retirement</td>
<td>Lump sum at 65/ little developed</td>
<td>Lump sum at 60, semi developed-mainly drawdown, transition to retirement, or term annuity</td>
</tr>
</tbody>
</table>

Note: New Zealand a simple system. Australian system has many other features, contributions type, insurance, estate, transition to retirement, tax, etc. Very complex. Admin cost 20 to 40 bp.
## New Zealand/Australia Providers

### New Zealand

<table>
<thead>
<tr>
<th>Provider no.</th>
<th>Default</th>
<th>Employer selected</th>
<th>Complying super funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>9</td>
<td>20,000</td>
<td>16</td>
</tr>
</tbody>
</table>

### Australia

<table>
<thead>
<tr>
<th>Number of Funds</th>
<th>2002</th>
<th>2012</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate (WFP)</td>
<td>2484</td>
<td>119</td>
<td>22</td>
</tr>
<tr>
<td>Industry (NFP)</td>
<td>134</td>
<td>56</td>
<td>38</td>
</tr>
<tr>
<td>Public (NFB)</td>
<td>76</td>
<td>38</td>
<td>18</td>
</tr>
<tr>
<td>Retail</td>
<td>254</td>
<td>131</td>
<td>116</td>
</tr>
<tr>
<td>Self managed</td>
<td>.250 m</td>
<td>.500 m</td>
<td>.600 m</td>
</tr>
</tbody>
</table>

Funds with more than $20b; 2 corporate, 7 industry, 8 public sector, 6 retail. 86 MyS

<table>
<thead>
<tr>
<th>Assets $b</th>
<th>2012</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>58</td>
<td>54</td>
</tr>
<tr>
<td>Industry</td>
<td>292</td>
<td>630</td>
</tr>
<tr>
<td>Public</td>
<td>237</td>
<td>461</td>
</tr>
<tr>
<td>Retail</td>
<td>397</td>
<td>589</td>
</tr>
<tr>
<td>Self Managed</td>
<td>478</td>
<td>727</td>
</tr>
</tbody>
</table>
## New Zealand/Australia
### Returns and Fees

<table>
<thead>
<tr>
<th>New Zealand -Best 10</th>
<th>Return%</th>
<th>Average</th>
<th>Fees%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conservative</td>
<td>4.17 to 5.76</td>
<td>4.18</td>
<td>.81 to 1.48</td>
</tr>
<tr>
<td>Defensive</td>
<td>2.49 to 6.39</td>
<td>2.51</td>
<td>.74 to 1.19</td>
</tr>
<tr>
<td>Balanced</td>
<td>5.86 to 9.29</td>
<td>5.48</td>
<td>.81 to 2.10</td>
</tr>
<tr>
<td>Growth</td>
<td>6.78 to 12.59</td>
<td>6.42</td>
<td>.84 to 2</td>
</tr>
<tr>
<td>Aggressive</td>
<td>7.93 to 11.55</td>
<td>7.07</td>
<td>.77 to 2.11</td>
</tr>
<tr>
<td>Australia -Best 10</td>
<td>Return</td>
<td>Average</td>
<td>Fees %</td>
</tr>
<tr>
<td>-------------------------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>Conservative</td>
<td>6 to 8.6</td>
<td>n/a</td>
<td>.5 to .52</td>
</tr>
<tr>
<td>Defensive</td>
<td>6.9 to 7.4</td>
<td>n/a</td>
<td>.4 to .52</td>
</tr>
<tr>
<td>Balanced (My Super)</td>
<td>9 to 11.2</td>
<td>n/a</td>
<td>.58 to .72</td>
</tr>
<tr>
<td>growth in NZ</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggressive</td>
<td>11.6 to 13.6</td>
<td>n/a</td>
<td>.67 to .77</td>
</tr>
</tbody>
</table>

All industry, public or corporate funds. All $10b plus in size. The majority of members in.

**A 2% fee rather than 1% reduces final balance by 20% over 30 years.**
Number of Lost Accounts $b

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>6.2m</td>
<td>5.7m</td>
<td>6.3m</td>
</tr>
<tr>
<td>$b</td>
<td>$16.2</td>
<td>$14.8</td>
<td>$18</td>
</tr>
</tbody>
</table>

The Clean Up
33m multiple/lost accounts in 2010. Now 28m.
- Auto consolidation of accounts less than $6000 from July 1, 2019 – 5m consolidated.
- $340m in duplicate administration fees removed.
Productivity Commission

Evidence

**Structural flaws** including - multiple accounts, underperforming funds/products, excessive fees.
Multiple accounts 28m for 13 m in the system - Retail, most poor performing; Industry, some poor performing (smaller under $10b funds); Self Managed poor performance under $1m assets (revised to $.5m).

**Major recommendations only**

- “Best in show” shortlist of 10 funds to **new members** to choose from or auto allocated for life
- Exiting underperforming funds
- Multiple accounts consolidation – increase over $6000
- Enquiry into Retirement Incomes – suspend increase in SG

**No political policy announcement on from either major political party.**
The Hayne Royal Commission
Royal Commission into misconduct in the Banking, Superannuation and Financial Services Industries

a salutary lesson in corporate governance

Calvert J Duffy & Associates
Governance Risk & Compliance Consultants
April 2019  ©
Hayne Royal Commission

In 2014, a Senate Committee recommended a Royal Commission into the Commonwealth Bank of Australia (CBA), following a multi-million-dollar financial planning scandal.

In 2017, more wrong doing was uncovered at the CBA’s insurance arm and other misconduct by the other banks, namely ANZ, NAB & Westpac. Add to that, the federal Opposition was pushing for a Royal Commission for 18 months - stating that it would make the sector stronger.

When even more pressure (cross benchers, media etc) was put on the Government the PM then relented.

Enter the Hayne Royal Commission 14 December 2017!
corporate governance

“GREED IS GOOD”
was there a culture of greed?
could it infiltrate NZ?

• conflicts of interest – Trustees & representatives

• KPIs – realistic?
corporate governance
changing the regulatory culture

• remuneration typologies

• punishment to fit the crime?
  what ‘crime’?... see “Downs Syndrome” matter from Insurer

• legislative remedy?

• consequences – political, economic, social and criminal
corporate governance the future?
for New Zealand ..... where to from here

• trustees – obligations vs actions
  • does this mean that Trustee Duties in NZ will need to be tightened up in some way?

• trustees in Australia – did they just fail?
  • If so – how do you mitigate that possibility?

• trustees – is it ‘profits at all costs’ or something else?
  • perhaps we should look to Australia for an answer
corporate governance
the future

• what else is in store for NZ .... in terms of governance? especially given that the ANZ holds 25% of KiwiSaver

• are there going to be issues in NZ such as the *clash* between Industry funds and not-for-profits as is the case in Australia?
New Zealand conduct & culture review findings and future focus

Scott McMurray
“...the Final Report can be seen as a ‘once in a lifetime’ opportunity to drive future success for the Australian financial services sector though a renewed focus on the areas of trust and governance. The same is true for New Zealand.”

MinterEllison
Hayne Commission themes

• Primary responsibility for misconduct lies with those who managed and controlled the entities
• Six norms should underpin conduct
• Connection between conduct and reward
• Asymmetry of power and information
• Conflicts associated with intermediation
FMA/RBNZ conduct & culture reviews

11 banks and 16 life insurers reviewed

650 interviews with 870 staff, including directors, managers and frontline staff

2,000+ documents received

2,000 consumers surveyed

Insights sought from 10 stakeholder groups
FMA/RBNZ conduct & culture reviews

Assessed the state of conduct maturity under four key areas:

- Delivering good customer outcomes
- Conduct and culture governance
- Conduct and culture risk management
- Issue identification and remediation
• Small number of instances of poor conduct – not widespread
• Weaknesses in management and governance of conduct risk
• Weaknesses in reporting of complaints and measuring customer outcomes
• Risk of poor customer outcomes heightened by sales based incentives
• Overall, insufficient board ownership and accountability
Conduct & culture review – life insurer findings

• Several examples of poor conduct and some cases of potential misconduct – not widespread

• Extensive weakness in the governance, and systems and controls for managing conduct risk

• A lack of focus on conduct issues and good customer outcomes

• Remediation of conduct issues generally poor

• Lack of oversight of advisers and intermediaries
Regulator expectations

- Boards to take ownership of conduct risks and culture
- Responses and actions plans
  - Invest in systems and controls
  - Identify and remediate conduct issues
- Review all incentive structures – internal and external
Key recommendations and outcomes

• Transform firms approach to conduct risks and customer focused culture

• Rebalance focus between shareholder and customer interests

• Government to address regulatory gaps
Future focus

- Work on changes to the FMA’s regulatory remit
- Conduct and culture recommendations apply to all financial service providers
- Strategic risk outlook and sector views
- KiwiSaver default providers review
- Investor engagement