

8 September 2016

Dear Commissioners,

Submission in response to the Productivity Commission Draft Report on “How to assess the competitiveness and efficiency of the superannuation system”

About the IQ Group

The IQ Group is an Australian independent consulting company that specialises in the Superannuation and Wealth Management industry.

With customers’ needs at the heart of our business, we make it our business to understand and influence change at government and industry body level. Our clients gain from our internal capability of specialist working groups and forums that promote collaboration of knowledge exchange within our team.

The IQ Group has deep superannuation domain expertise, and we work with a large and diverse group of clients throughout the industry to improve their efficiency of their back offices.

In recent past IQ has been involved in all aspects of SuperStream design, implementation and operation, both at a system and super fund level. This includes representation on all key forums, and we continue to be on the ATO’s SuperStream Reference Group

Introduction

The IQ Group welcomes the evidence-based framework proposed by the Productivity Commission for assessing the efficiency of the superannuation system, and focuses in this submission on suggesting ways of improving a key criteria, that of cost minimisation.

However, we submit that the Commission may have cast the net too wide in terms of both the proposed criteria and subsequent indicators. In our view, the key criteria should be about the superannuation system and super funds pursuing net returns and cost minimisation, and that many of the other criteria have less impact to members.

This submission argues for back office efficiency and cost efficiency to be given a higher priority in the criteria to be used in assessing the efficiency of the superannuation industry.

Importance of cost minimisation

The Commission proposes a criterion of maximizing net returns to members over the long term as a relatively straightforward measure to judge the efficiency of the superannuation system. While the value of this is not disputed, it may also have the effect of masking the cost of services to members.

The cost of services to members, and any increasing efficiency in this, cannot be assessed from return data. A specific benchmark should be developed that includes cost to members, and changes to it over time, and a recommendation about this is detailed later in this submission.

In addition, costs themselves also should be further disaggregated. Historically, many costs in superannuation have tended to be conflated. Investment costs have sometimes included administration costs and vice versa; gross investment returns have sometimes been reduced by administration costs that have not been disclosed; and some costs have been hidden as transaction costs. Of course, best practice businesses have not engaged in these practices, but they have been harmed by them. A best practice business can look expensive or appear to be achieving lower investment returns than their less scrupulous competitor.

Why this remains unfinished business

The Stronger Super Review recommended a range of initiatives to improve the transparent and comparable disclosure of superannuation return and fee information. In part, these have been incorporated into the architecture of MySuper through the requirement to pursue risk-adjusted long-term net returns and the associated MySuper product dashboard.

However, we believe there are at least two pieces of unfinished business associated with this. Firstly, this disclosure does not extend across the whole of superannuation products (i.e., not to Choice investment products); secondly, the mechanisms designed to deliver consistent and comparable disclosure are either not fully in place or are not delivering disclosure on this basis.

The Commission draft seems to make the assumption it is simple and straightforward to provide this information on a meaningful level-playing-field basis, when history suggests this is not the case.

ASIC has been involved in discussions with representatives of the superannuation industry for three years about disclosing fees and costs in Product Disclosure Statements and periodic statements. While the new regulatory guide (RG 97) is scheduled to come into operation in February next year, it contains numerous exclusions and inconsistencies, and has been met with widespread confusion.

The superannuation industry writ large continues to agitate for change, and is widely dissatisfied with this guidance. It is also not controversial to state that regulated disclosure requirements do not generally deliver information that is meaningful to most consumers.

APRA has faced different but related problems in relation to its data responsibilities. APRA data reporting has similar issues with consistent definitions and levels of disclosure – although the new regime contains greater and more detailed guidance than before, and the client tool through which super funds submit data to meet their reporting requirements (D2A) is in serious need of updating.

Therefore, the promotion of criteria using such metrics when these metrics are not yet fit for purpose is problematic. Two learnings flow from this. Firstly, priority attention needs to be given to the resolution of existing issues with disclosure and reporting requirements so that these can be better utilised in the assessment of the efficiency of the superannuation system. Secondly, there should be a new focus on identifying some standard basic measures of efficiency, especially cost minimisation and especially in ways that impact on consumers of superannuation.

The Commission identifies 84 items of evidence required for the system assessment, and concludes that 43 of these items require new data sets. IQ submits that this both overestimates the utility of the 41 existing items (including for the reasons given above) and underestimates the administrative burden and the design and consistency challenges in gathering the 43 new data sets. IQ again suggests focus on a small number of basic efficiency measures, and suggests the basic indicators for cost efficiency below.

Learning from SuperStream

One regulatory change that has increased the efficiency of superannuation system from a consumer perspective has been the introduction of a maximum three-day transaction processing time as part of SuperStream. This replaced a previous thirty day requirement, and has been instrumental in speeding up the processing of both rollovers and contributions. This also improves the quality of service to fund members.

Adherence to or improvement to this measure of service quality is the sort of criteria that could be used to measure service quality. Other SuperStream-related measures could include the efficient operation of a contribution pass through service, reliability of contribution portals for both members and employers, and access to multiple channels for fund information (e.g., mobile, text, telephone).

However, despite this, if a fund has an inefficient cost structure and is not passing cost efficiencies on to its members, the fund will be inefficient overall. The draft report states that an efficient superannuation system broadly means costs are minimized, and includes an assessment criteria for cost minimisation.

A framework for cost minimisation

Superannuation funds are like other companies in wanting to provide their products at the lowest cost. This can be in order to maximize the return for their shareholders, minimize fees to their members, or some combination of both. This is the objective at a company level, but how this then relates to consumers depends on other factors.

In the world of superannuation, driven by both regulatory requirements and the trustee system underpinning the Australian system, improving retirement outcomes is a function of maximizing returns and minimizing costs – and also requiring there is not unnecessary leakage for other purposes, whether agents, shareholders or unnecessary services.

The IQ Group is not in the business of directly maximizing returns so our comments will concentrate on cost minimisation. However, in an environment where most consumers, whatever market segment they happen to use (e.g., retail or industry funds), are disengaged or uninformed, there is little direct price pressure from these consumers.

The experience of IQ nonetheless is that all super funds are very cost sensitive, are not tolerant of inflated cost structures. Nonetheless, the pertinent question is still, how to make costs and cost structures more visible and more accountable. A successful answer to this question will drive downward pressure on fees and improve system efficiency, and allow super funds to assess themselves against an industry standard – not least by allowing high-performing funds to advertise their results against a standard.

The idea supported and promoted by IQ is of having system-wide benchmarks together with a comprehensive but very focused set of functional level benchmarks.

While the Commission suggests comparing the overall cost of the Australian system with other systems, this is fraught with difficulties in comparability. We suggest the development of a model built from a baseline understanding of existing best practice examples from throughout the superannuation industry, and across administration, investments, insurance, advice and other services.

Each of these can be tested against a requirement for the best possible service offering at the lowest possible price. While this might seem aspirational, it is much less so when broken down into component parts, assessed and applied to a model superannuation fund.

For example, in the area IQ is most familiar with, this can be applied to the cost efficiency of superannuation administration. The core elements for administration can all be broken down into sub-components of cost, timeliness, accuracy, and usefulness to a member:

- How much does it cost to:
 - Process a contribution?
 - Transfer an account?
 - Pay a benefit?
 - Update member information?
 - Maintain underlying record-keeping functionality?
- How long does it take to:
 - Process a contributions?
 - Transfer an account?
 - Pay a benefit?
 - Update member information?
 - Keep the record-keeping system up-to-date?
- Does the fund accurately:
 - Process a contribution?
 - Transfer an account?
 - Pay a benefit?
 - Maintain member and other information?
- How is the cost, timeliness and accuracy of the product then reflected in the fees charged?

Interestingly, this information is not collected, collated or assessed on a standardised basis across the industry. A lot of information is collected through APRA data reporting but not this information.

On the face of it, it looks like information about the cost of contributions and rollovers are consistently collected through SuperStream benchmark reporting (see APRA SRF 711.0) but that is not the case. Each APRA-regulated super fund submits information according to its own methodology. The methodology has to be internally consistent but there is no requirement for consistency with other funds or across the industry as a whole.

Despite the introduction of the three day transaction processing requirement through SuperStream, there are widely differing levels of transactional performance in superannuation, and this is likely to continue. Some super funds, however, will deliver performance that consistently exceeds the regulatory requirements.

As a starting point, IQ suggests:

1. consulting with superannuation industry for the collection of the above information on a consistent and cost-effective basis for super funds and their products;
2. introducing a requirement for this over a reasonable period;
3. building a best practice administration measurement framework based on this information;
4. populating information collected into the framework, using a simple rating;
5. including assessment against the best practice administration framework as part of the APRA prudential supervision process;
6. allowing funds to publicise their performance;
7. The applicability of this approach for investments, insurance, advice and other services could also be considered.

As a result of this approach, and using the information collected, it will then be possible to address such questions as:

- How to cost-optimize contacts with member?
- How to most efficiently answer members' questions?
- What are the scale benefits of doing this on a bulk and mass market basis?
- Are there any inherent benefits to outsourcing or insourcing this?
- Are there benefits in greater levels of standardization and automation?

The use of the framework and standard measurement will enable a choice architecture to be put in place which will allow consumers to see that the most efficient level for service provision may be on a mass market basis, but will also allow them to see the premium cost for tailoring to meet their particular needs. It would be allocatively efficient to allow people to be able to make that choice, even if that choice is itself inefficient.

At the moment, consumers mainly have the option of MySuper, choice products and SMSFs. However, there is only a standard model and standard comparisons (e.g., product dashboard) for MySuper products. Despite the proliferation of superannuation products – into many tens of thousands of superannuation products – there is in fact a relatively small number of types of superannuation offerings.

A framework could be developed for each of these product types, to avoid the risk of just setting a lowest common denominator. On the other hand, it will also give an informed retail consumer the opportunity to understand the reason for differences between products and product types, and whether or not it is sufficient to justify any additional cost.

This approach has the value of greatly increasing fee and cost transparency in superannuation, and would have the systemic benefit of encouraging providers to concentrate on cost minimisation just as much as return maximisation.

The IQ Group would welcome the opportunity to discuss this submission further with the Commission, and to participate in forums that the Commission may conduct. We have practical, up-to-date, diverse and detailed understanding of the operation of the superannuation system, and am able to share our insights further with the Commission.

Yours sincerely,

Brian Peters
Chief Executive Officer