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## 1.0 Superannuation in Australia

**Question 1:** *Within the current policy settings, what are the objectives against which the efficiency and competitiveness of the superannuation system should be assessed? How prescriptively should the objectives be expressed?*

To be efficient and effective, Australia's superannuation system must have clear and defined objectives. To date there has been a lack of clarity around three main issues:

- firstly, establishing and mapping clear strategic objectives of the system
- secondly, designing appropriate performance indicators to measure the efficiency and effectiveness of the system
- thirdly, the application of performance indicators to ensure the system continues to satisfy objectives and community expectations

Without clarity of purpose and the lack of being able to measure achievement of purpose, the system cannot deliver outcomes that are appropriate and delivered in an efficient manner. This leads to policy setting that is often inconsistent, complex, costly, inefficient, not based on sound public policy and based around budgetary considerations.

The Institute of Public Accountants believes that the objectives of Australia's superannuation system should be based around three main themes which take account of both social and fiscal considerations. Objectives need to consider:

- adequacy – the ability of the system to provide all retirees with a replacement income that provides for their needs in retirement. The objective may take the form of ensuring:
  - that the system provides all members with a minimum income based on ensuring a minimum “standard of living”.
  - that members receive an income based on a proportion of their pre-retirement income
- sustainability – the robustness of the retirement system to be able to support itself financially and be capable of delivering retirement benefits into the future. Objectives should consider:
  - the ability of the fund to support their future liabilities
  - the extent to which the rate of contributions by employers and/or employees is sufficient to fund the system
  - barriers to entry which may be impacting upon the efficiency of the system and member benefits
- integrity – the transparency of the system and the means by which the system is governed and regulated to ensure the continued confidence of the community. The objective should be designed around ensuring such issues as:
  - whether consumers have confidence in the system
  - the disclosure of information such that members are able to adequately compare fees and returns with other similar funds on a like-for-like basis
  - the extent to which members are provided with sufficient information to be able to determine and understand their future retirement entitlement based on existing inputs and outputs
  - enhancing the financial literacy of members and their engagement with their fund

The objectives will need to be expressed in such a manner that will allow for the appropriate assessment of their achievement. To ensure that the objective and assessment framework is both effective and achievable, the balance between prescriptiveness and flexibility will be an important balancing act.

## 2.0 What is the Commission's approach to assessment?

**Question 2:** *Do you agree with the broad approach of combining performance benchmarks with a test of barriers to efficient or competitive outcomes in the superannuation system?*

The size, maturity and increasing complexity of the superannuation system has highlighted the need to have a proper focus on the key objectives of adequacy, sustainability and integrity within the super system and to be able to measure the effectiveness of the system in achieving those objectives.

One of the accepted means of ensuring that best performance is being achieved is through the use of benchmarking. Benchmarking provides a number of benefits to an organization or system including: focus on best practice, continuous improvement and identifying gaps in an organization's processes

Due to the often competing nature of the objectives of an efficient super system (social v fiscal), it is unlikely that development of any one aggregate benchmark on its own would appropriately assess the efficiency of achieving all identified objectives. Further, the application of international composite benchmark indexes to test efficiency in the system is limited given the different institutional settings and characteristics of pension funds that exist in different countries. Existing reported benchmarks, particularly international composite indexes, do not currently provide the means to assess the efficiency of the system. Accordingly, the application of benchmarks on their own are likely to have limited application and will need to be complemented with a series of individual performance indicators tailored to the unique attributes of Australia's superannuation system.

Performance benchmarks however, will be significantly easier to establish, assess and report upon at a micro (member / individual fund) perspective, with enhancements in demand-side competition likely to lead to significant and measurable efficiency gains. Previous industry studies have recognised the importance of simple performance measure(s) in reducing the complexity of the information presented to consumers through its role in promoting consumer engagement and market competition (Coleman et al. 2003). The establishment of simple benchmarks around returns, fees, levels of service, projected income in retirement etc. will be relatively easy to construct, measure and report upon, and likely to lead to more immediate gains in competition and efficiency than constructing broad ranging benchmarks at the macro level.

One of the main issues that will need to be resolved at the fund level however, is the wide variety and lack of standardization in asset allocations even among similarly described diversified funds. The Institute of Public Accountants believes that greater standardization and uniformity of products, particularly within the default market, is likely to facilitate greater competition and therefore efficiency. This is discussed further in question 5.

**Question 3:** *To what extent do different data reporting formats make it difficult to compare SMSFs and APRA-regulated funds, and hence to assess the performance of the superannuation system as a whole?*

Consistency, transparency and standards of reporting in the disclosure of data is vital if a proper assessment of the efficiency and effectiveness of the various components of the super system are to be performed. The Cooper report found that there is currently a lack of “systematic transparency” in the superannuation funds industry; specifically, there is a lack of standardised methodology for the calculation and disclosure format of investment options, risk, return and costs of funds to provide quality information for any expert analysis (Cooper, 2010).

The Institute is of the opinion that a standard methodology of reporting across all super funds would enhance the ability of both the ATO and APRA to share and match data which would likely lead to the reduction of the reporting burden of funds by reducing and streamlining reporting obligations.

**Question 4:** *Which of the existing cross-country composite measures of pension system performance would be most relevant to this study and why? What are the challenges in using those measures to assess the efficiency and competitiveness of Australia’s superannuation system? What measures and criteria are comparable across different countries?*

As previously discussed, there is unlikely to be a single composite measure able to benchmark a complete set of performance indicators to appropriately assess the efficiency of the superannuation system. The different institutional settings of pension funds across countries will typically make direct comparisons meaningless, and the aggregate nature of the data forming the index will make the interpretation of sub-performance or changes against the benchmark performance difficult to isolate.

However, given the recommended system objectives outlined in question 1, the Institute believes that the three sub-indexes used within Melbourne Mercer Global Pension Index are likely to provide a reasonable basis for assessing the extent to which the outputs / objectives of the super system are being achieved - adequacy, sustainability and integrity. However, such a benchmark is likely to be less informative in determining the overall efficiency and competitiveness of the system. Appropriate individual performance indicators able to assess different parts of the system will need to be utilised.

### **3.0 Assessing competitiveness**

**Question 5:** *What are the key ways in which competition can improve efficiency in the superannuation system?*

Competition is central to the operation of financial markets and fosters innovation, productivity, growth and efficiency. In an efficient market setting, more efficient super funds would be expected to generate higher output and increase their market share, thereby increasing industry concentration. Increased competition should result in the system whereby (i) costs are minimised, (ii) returns on investments are maximised, (iii) funds have incentives to improve and innovate their product range to meet the needs of the market, (iv) there are improvements in the quality of service for members, (v) there is continual improvements in technology and systems resulting in product

enhancements and cost reductions and offerings and (vi) funds have an incentive to keep members better informed and educated allowing members to make more informed choices.

However, studies show that the Australia's financial system is an imperfect market with a number of peculiarities (Qu, 2014):

- Market Power is negatively related to the technical efficiency of super funds.
- The number of investment options decreases technical efficiency of super funds.
- Super funds that offer their membership to the general public are less efficient than closed funds.

These latter two findings have important policy implications, as they seem to argue against recent regulatory moves to open up of the market to greater consumer choice in the selection of super funds.

Various reports have highlighted that fees and charges have not fallen by as much as would be expected given the growth and scale of the superannuation system, the spate of recent consolidation and the recent introduction of the MySuper and SuperStream reforms, and this has been raised as evidence that competition is not providing the expected efficiencies in the system. The Cooper Review suggested that cost transparency is a major factor likely to hinder pricing competition among competitors, thereby providing little incentive for super funds to reduce the underlying cost to deliver services.

However, the extent to which this is evidence of lack of competition rather than system issues such as market fragmentation, investment allocation, continual policy changes, increased government regulation and the provision of ancillary benefits such as insurance, requires greater research.

Calls have been made to make the MySuper default system more competitive by having firms periodically tender for licenses at auctions run by the government. Given that the MySuper and SuperStream reforms have only been in existence for a relatively short period, it is recommended that more time needs to elapse to be able to fully evaluate the effectiveness of the reforms.

The Institute of Public Accountants believes that there is currently sufficient emphasis on competition in the regulation of super funds but analysis is required to determine whether system inefficiencies are due to a lack of competition in the marketplace or structural problems associated with the super system.

The Institute believes that demand side factors are considered to a key inhibitor of competition within the Australian superannuation environment. Lack of financial literacy and engagement by members must be addressed if competition and efficiency in the system is to be realised. Lack of engagement is due to a range of factors including:

- the long-term nature of superannuation
- lack of knowledge and understanding of the system by members
- lack of information around what a member's accumulated super balance is projected to be at retirement and whether the income generated is likely to meet their needs-heterogeneity issues associated with product and investment offerings
- lack of transparency resulting in the inability to be able to compare funds on a like-by-like basis in terms of after-fee (investment) returns, administration expenses, service etc.

Whilst the first two issues are harder to address in the short-term, the introduction of a more homogeneous or standardised product and greater transparency of performance indicators are able to be addressed relatively easily at the member level and enable members to more effectively compare funds and choose an offering that best suits their needs. This should result in – a simpler and easier to understand super system, reduced fees, better risk adjusted returns, a better service offering and more innovative products particularly at the pension phase,

Whilst MySuper is a step in the right direction in terms of trying to encourage a more homogeneous product offering in the default market, the lack of regulation governing uniformity of asset allocation makes effective comparisons of risk-adjusted returns and investment fees largely meaningless. This issue is even more pronounced in the choice market with the diversity of investment options available to members. The lack of competitor or benchmark information currently contained within MySuper dashboards means that members have no means of comparing the efficiency of their fund against the average, market leaders or against their peers. The New Zealand KiwiSaver scheme provides a useful exemplar in this regard.

The Institute of Public Accountants believes that reforms on the demand side particularly around the introduction of standardised products and enhanced transparency of information to members should focus the need on fund providers to improve the efficiency of their operations and offerings. These pressures should also result in greater innovation and product development as providers continually strive to both maintain and grow their membership base.

It's worth noting at this stage with this review into the competitiveness of the superannuation system, that whilst competition is generally seen to be important in promoting lower prices, higher returns and innovation, greater competition may not necessarily lead to intended welfare gains or desired objectives. Competition which leads to a greater number of profit-making entrants to the marketplace seeking to differentiate themselves through a greater offering of non-standardised products and spending significant sums on advertisement and promotion in order to attract new members is unlikely to lead to a more efficient system. Accordingly the focus must on measures to improve efficiency and effectiveness and appreciate that competition and efficiency within the superannuation system may not be synonymous.

**Question 6:** Is there sufficient emphasis on competition in the regulation of superannuation?

The amount of regulation in the system is a tight balancing act between the need to regulate and maintain the integrity of the system whilst not imposing excess compliance and reporting obligations on the industry hampering the ability to achieve efficiency gains and delivering better outcomes to members.

Research has found that the current regulatory framework is inadequate in promoting efficiencies within the superannuation system. They found that increased regulatory expenditures such as licensing costs and the recent MySuper reforms served to discourage small and highly efficient corporate funds from participating in the market. (QU, 2014).

The Cooper Review also found that a reduction in redundant regulatory requirements could promote better resource allocation and greater competition in the industry resulting in a reduction in fees and an improvement in customer service. Again, the focus should be on improving efficiency gains rather than on competition per se.

**Question 7:** What are the ways of realizing economies of scale, in addition to fund mergers?

The Superannuation System Review made a large number of recommendations around the benefits of increased scale in the superannuation industry and the desirability of improving the efficiency of the superannuation system. However, as previously discussed, research has found that market power is negatively related to the technical efficiency of super funds. Accordingly, a focus on promoting increased scale may not necessarily lead to enhanced efficiencies in the system.

Other than through fund mergers, specialisation is a further means of achieving economies of scale as it allows for increased output. Economies of scale are achievable in areas that lend themselves to being efficiently undertaken by more efficient external service providers such as asset management, information and communication, technology and insurance. This was supported by the Wallis inquiry (1997) into the Australian banking sector which found that specialist providers may result in a reduction of inefficient product pricing by existing firms.

The Financial Services inquiry has proposed a formal competitive process to allocate new default fund members to MySuper products as a means of improving economies of scale and competition. The Institute of Public Accountants supports choice and reforms that promote efficiency. On the basis that economies of scale may not necessarily lead to efficiency gains, the Institute believes there is a need for a full implementation of MySuper to allow it to be comprehensively evaluated prior to any major reforms to the system being undertaken.

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