



**Productivity Commission Issues Paper:  
Superannuation Efficiency and  
Competitiveness**

**20 April 2016**

**AIST Submission**

## AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$650 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

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The significance of Australia’s super system - both to the retirement outcomes of Australian workers and the national economy - means it is vital that our system operates at optimal efficiency.

AIST’s submission recognises that there are key areas where efficiency can be improved. When examining the issue of “is the system delivering for members”, AIST recommends a range of measures including improved meaningful disclosure and consumer engagement, strengthened conflicts of interest management, and an equal disclosure and APRA reporting regime for MySuper and Choice.

AIST strongly supports appropriate and robust measures to test the efficiency of the system. We acknowledge that there are complicating factors in establishing appropriate efficiency measures such as consistency and comparability in definitions, quantification methodologies and the removal of conflicts. Existing disclosure practices and calculation parameters differ greatly between funds and make the exercise, while not impossible, very complex. For the Commission to develop criteria, AIST recommends the following:

- System objectives must first be set. Such an objective is of its very nature broadly stated and needs to be properly supported and governed through an evidence-based framework balancing the need for adequacy, fairness, and sustainability of the system.
- Efficiency objectives should underpin system objectives and include quantitative measures such as super as a percent of GDP and assessing financial stability through to qualitative measures such as consumer protection (transparency of fees, costs and investments), and the impact of institutional behaviours and relationships on consumer outcomes (cost of intermediaries).
- Barriers to efficiency such as a lack of equal disclosure and APRA reporting within the super system must be identified and removed.

A central tenet of this submission is that efficiency and competition measures must focus on long-term net returns to members and optimising retirement incomes, and not on maximising profit for shareholders and intermediaries. Accordingly, efficiency and competition measures should not focus on just cost.

It will always be the case that because of the long-term horizon of super and the compulsory nature of our system, that the majority of members will be disengaged. Our submission recognises that member disengagement is widespread across all sectors in the super sector – including members of Self-Managed Superannuation Funds (SMSFs) and members acting under advice.

To ensure that member retirement savings are preserved, consumer protections will always need to be a strong feature of our super system. While measures to improve financial literacy are very important, they are unlikely to have a significant impact on engagement and will never replace the need for robust consumer protection.

The Productivity Commission has not identified any problems it has with the current default system – a system that has strong consumer protection measures in place and has delivered superior returns to members over the long term. This system is based on the model designed by the Productivity Commission for the Fair Work Commission and serves the interests of disengaged members, as well as those members who actively chose to be in a default fund.

By contrast, this submission argues that the interests of members in the Choice arena are not well-served. AIST raises concerns about the impact of competition in the Choice area where research points to competition in this sector benefiting employers and financial planners, rather than super fund members.

We argue that the lack of a level playing field for disclosure across MySuper and Choice has led to consumers not being properly protected and has resulted in a system which cannot be fully analysed for efficiency and competitiveness.

This submission also argues that profit driven related party arrangements in the retail fund sector is associated with anti-competitive behaviour and results in major inefficiency.

We also raise concerns that the Issues Paper is too narrowly focused on targeting outcomes at the point of retirement rather than whole-of-life.

We also submit that the administrative and demographic efficiency, regulatory stability and technological neutrality should be explicitly identified and addressed as measures to improve the efficiency of the system.

The industry's work over the past five years on SuperStream is evidence that greater efficiencies can be created in the system when the will to improve outcomes for all stakeholders exists and has bipartisan support.

AIST supports a similar industry-led, collaborative approach on the appropriate and fair determination of efficiency measures for our system going forward.

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## 2 Summary of recommendations

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### 2.1 System objectives

#### 1 Relevance of previous findings by the Commission

The Productivity Commission should explicitly address whether or not its previous findings on the efficiency of the superannuation system within the context of the Fair Work Commission, remain relevant.

#### 2 Objective of superannuation

The Productivity Commission should ensure that its work does not conflict with the principle-based objective of superannuation currently being developed by the Government. AIST supports a principles-based, legislated objective of the super system. The objective needs to be backed up with a framework to assess performance against the objective and a suitable governance mechanism to undertake this assessment.

#### 3 Adequacy, sustainability and fairness

Assessment of individual fund performance against benchmarks must only occur after the setting of system objectives that effectively balance adequacy, sustainability and fairness and take into account Australia's three-pillar retirement income system.

#### 4 Assessment of system performance

Assessment of the Australian superannuation system's performance needs to be addressed from two perspectives: Comparison of Australia with other countries; and assessment based on measures set by Australia. The AIST-Mercer Super Tracker provides a methodology of an assessment of the Australian Super System.

#### 5 Primary criteria

The primary criteria should be the maximised value of retirement income, as this is the output that is ultimately received by consumers, and that is the optimal measure of success both for individual superannuation funds and the overall superannuation system. The other proposed criteria should be subsidiary to this objective.

#### 6 Segments of the super system

All segments of the super system should be taken into account when examining system efficiency, and the differences recognised.

## 2.2 Consumer protection and comparability, disclosure and transparency

### 7 Information and disclosure

Informed and meaningful information and disclosure by superannuation funds, regulators and others is a cornerstone requirement for improved efficiency.

### 8 Conflicts of interest reporting

Conflicts of interest reporting should be strengthened as recommended in ASIC's Report 474 on *Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry*.

### 9 Review of structural arrangements

The Commission should recommend that the causes and the impact of principle-agent relationships and other structural arrangements in the industry should be the subject of a comprehensive review in 2018, one year after the date for the completion of transfers of Accrued Default Amounts into MySuper. Criteria for the assessment of the superannuation system should be examined following the reviews recommended in this submission.

### 10 Commissions

Commissions paid on life insurance products should be banned.

### 11 Disengaged consumers

Disengaged consumers are across all segments of the system and need protection.

### 12 Competitive assessment

Competition assessment criteria should include assessment of organisational behaviour as well as the outcomes from the development of a Financial Literacy Benchmark.

## 2.3 Level playing field

### 13 Disclosure and reporting of Choice products

Disclosure and reporting related to Choice and MySuper products should be aligned so that a proper assessment of system efficiency can be made as well as better protecting consumers.

### 14 Update APRA research

The Commission should recommend that the 2010 APRA research into superannuation outsourcing, fees, related parties and concentrated markets be updated. Given the introduction

of MySuper, this research should also include an assessment of MySuper and Choice.

## 15 Public release of APRA data

The Commission should recommend that APRA publicly release data that they have collected from funds in order to promote competition without delay. The Commission should also recommend that APRA conclude work on their data dissemination tool in the interests of consumers and funds alike.

## 2.4 Efficiency

### 16 Benchmarking operational efficiency

AIST agrees with the illustrative criteria for benchmarking operational efficiency listed in Table 2 of the Issues paper but recommends that these should not be given equal priority and weighting.

The primary criterion for benchmarking operational efficiency should be the maximised value of retirement income – all other criteria should be subsidiary to this objective.

MySuper investment returns should be assessed on a rolling ten-year net-net return basis. This timeframe could be extended as the super system matures.

The Standard Risk Measure in the Product Dashboard should not be used to assess maximised return criteria on a risk-adjusted basis. AIST recommends use of the Sharpe Ratio or some variant.

### 17 Administrative efficiency

Administrative efficiency should be an explicit assessment criteria for examining the operational efficiency of the superannuation system. The Productivity Commission should consider the benefits that administrative efficiencies promote in the interests of consumers.

### 18 SuperStream and other drivers of administrative efficiency

It is recommended that the Productivity Commission recognise and explore the key role of SuperStream and other drivers of administrative efficiency.

### 19 Dynamic efficiency

The dynamic efficiency criterion should be more clearly linked with achieving optimal outcomes for consumers.

### 20 Consumer comprehension of mandated disclosure

Consumer comprehension of disclosure is low and a plan to correct this should be in place prior



to benchmarking the superannuation sector's operational efficiency.

## 21 Benchmarking allocative efficiency

AIST does not agree with the assessment criteria for benchmarking allocative efficiency in the accumulation stage and recommends that issues of transparency and the relevance of sequencing risk in the accumulation phase be addressed. AIST supports the objective of optimal investment allocation and the illustrative criteria for benchmarking allocative efficiency in the decumulation stage.

## 22 Innovation and technological change

Innovation and technological change should be the focus of assessing dynamic efficiency.

## 23 Tailoring of new products and services

The introduction and widespread use of new cost-effective products and services that are tailored to individual needs would be a better indicator of dynamic efficiency than reflective asset allocation.

## 24 Technological neutrality, innovation and quality improvement

Technological neutrality and a regulatory system that encourages innovation and quality improvement should be added as assessment criteria.

## 25 Stable regulatory system

A stable regulatory system that does not impede improvements in efficiency should be added as an assessment criterion.

## 2.5 Competition and barriers to entry

### 26 Competition must not be at expense of consumer protection

Measures to increase competition must be designed with commensurate consumer protection, and must not be at the expense of existing consumer protection or members' net returns.

## 2.6 Fund level sustainability

### 27 Best interests of members in a specific occupational group

Funds that service a specific occupational group and can demonstrate that this delivers benefits in the best interests of those members are more appropriate to be listed as a default fund in an industrial instrument than funds that do not.



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### 3 Introduction

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AIST thanks the Productivity Commission for the opportunity to comment on the matters raised in the Issues Paper, and for the opportunity to discuss these issues directly with the Commissioners.

AIST supports ongoing review of the efficiency and competitiveness of the superannuation system, including this review. Australia is unusual as a developed country in that it regularly and routinely reviews the operation of its financial services sector outside of financial and economic crises, and reviews such as this contribute to the strong and robust nature of the sector.

We would welcome the opportunity to provide further input as the Commission sees fit.

## 4 Superannuation in Australia – context

AIST strongly recommends that the super system objectives should underpin the Commission’s future work in setting criteria (we examine this issue in section five). Any examination the super system in Australia must take into account that the super system is not uniform, but is characterised by distinct segments - the operation, regulation and behaviours of these segments are different and this impacts on efficiency as well as the degree of consumer protections needed. There are a number of assumptions made within the Issues Paper (such as the level of system maturity) that AIST seeks to address. AIST also strongly recommends that the Commission addresses whether its previous review findings into the efficiency of the system remain relevant.

### 4.1 Super system is not uniform - segments must be examined to gauge efficiency and ensure consumer protection

We welcome the wider view of competition throughout the Issues Paper, and especially the overview encapsulated in Figure 3 of the Issues Paper. While the review relates to the system as a whole, it is important to recognise that the superannuation industry is not uniform, but rather is characterised by distinct segments. The segmentation of the superannuation industry was considered and consulted upon by APRA in 2015. APRA found that segmentation illustrated below to be effective in that it improves understanding, investigation and importantly benchmarking of the industry.

Figure 1 - superannuation fund type segmentation

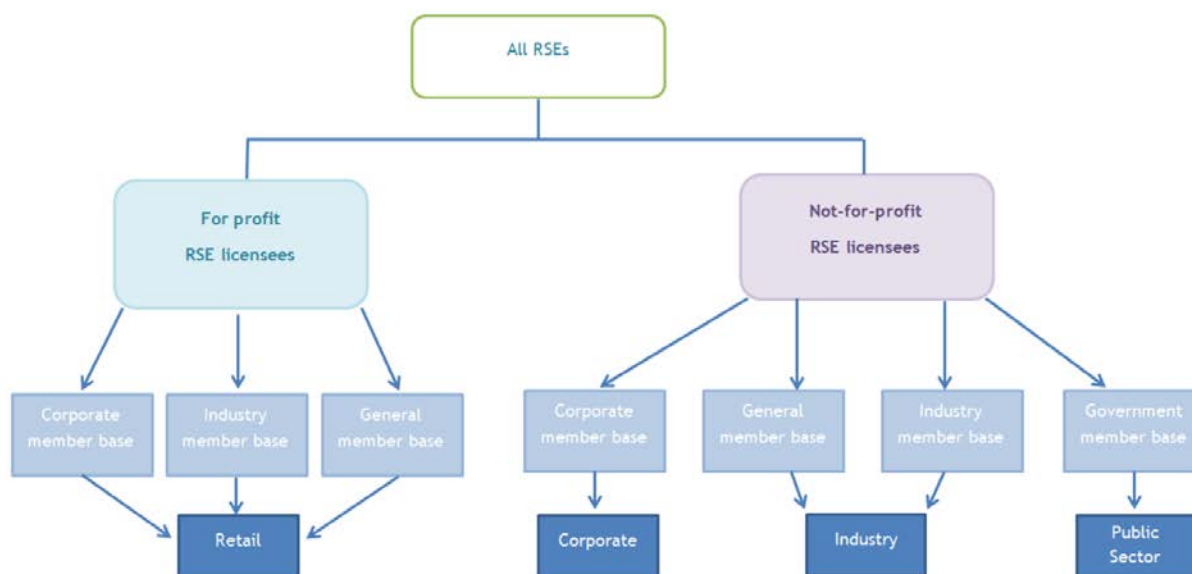


Figure 1

Source: APRA, Segmentation of superannuation entities, Issued 19 February 2015, p 2

The primary segmentation between for-profit and not-for-profit RSEs has proved particularly significant in APRA's analysis in relation to the key metrics of net returns for members, the management of conflicts of interest, and the inefficiencies in the use of related parties. The segmentation in Figure 3 of the Issues Paper should be enhanced to identify the segments which operate on a not-for-profit basis and a for-profit basis, and be informed by the existing evidence of inefficiencies within for-profit vertically integrated structures where principal-agent relationships have been found to not align with superannuation fund members' best interests (this research will be described in detail in the relevant sections below).

## 4.2 All segments must be taken into account when assessing inefficiencies

AIST recommends that the Commission avoids accepting untested assumptions about the superannuation industry or accepting the narrative handed to it by preceding inquiries – especially the Financial System Inquiry and the Government's response to it. We take special issue with the undue focus on the default system as a *cause* of inefficiencies, with the rationale of disengagement and limited pressure on fees. We argue that disengagement exists across the whole of superannuation – including those members in Choice options and SMSFs.

## 4.3 Consumers in all segments of super system must be protected

### 4.3.1 Current default system protects members

The default system is a fundamental protection for superannuation consumers, designed in recognition of widespread member disengagement.

In 2009, the Super System Review undertook an independent assessment of the structure and operation of the superannuation system, including its efficiency. In making its recommendations (many of which were adopted by Government), the Review accepted that a large number of uninterested and disengaged super fund members would continue into the future, and needed to be protected by higher prudential standards, simple and cost-effective structures, and supported by higher and more comparable disclosure. These recommendations led to the establishment of MySuper products.

AIST notes that the vast majority of retail fund members remain in Choice options, which (on the whole) experience fees of up to 300%<sup>1</sup> more expensive and lower returns. This issue is examined later.

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<sup>1</sup> SuperRatings, (2015). *Australian Institute of Superannuation Trustees Fee and performance analysis December 2015*. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/h6sgcth> [Accessed 8 Apr. 2016].

## 4.3.2 Advice protections have improved and more could be done

Improvements have recently been made to protect members who receive financial advice about their superannuation choices.

The Future of Financial Advice (FoFA) reforms legislated a requirement for advisers to act in the best interest of members, banned some conflicted forms of remuneration, and increased ASIC's enforcement powers. In this way, governments have sought to increase the alignment between financial advisers and those they advise. Many of those receiving advice may have low levels of financial literacy, little understanding of remuneration structures (and how they may have been conflicted) and may have been disengaged from the investment decisions they were ostensibly taking.

However, work in this space needs to continue. For example, AIST recently submitted<sup>2</sup> that it is structurally difficult given the lack of a clean separation of banking from wealth management to ensure consumers are fully protected - even when considering improvements to advice and remediation programs and the transparency and accessibility of consumer's documentation.

**It should therefore be a fundamental principle of this review by the Productivity Commission that any measures to increase competition must also incorporate commensurate consumer protection, and such measures should not be introduced at the expense of existing consumer protection or members' net returns.**

## 4.4 Assumptions about the super system which AIST seeks to address

### 4.4.1 Super system maturity is at a lower level than the Issues Paper suggests

AIST disagrees with assumptions made about the maturity of the system. The superannuation system will not be in a mature state following "the full implementation of the MySuper reforms (that is, after 1 July 2017)", nor will it reach maturity in the late 2030s as suggested on page 7 of the Issues Paper.

By 1 July 2017, all default super accounts are required to be in a MySuper product, but this cannot be taken as a proxy for maturity. For example, workers retiring in the late 2030s may have received super throughout their working life, this includes six years when their level of employer contributions was between 3% and 6%. The Superannuation Guarantee only reached 9% in 2003. People receiving at least 9% SG for the whole of their working life will only be retiring after 2050. Given the current Government's delays to the implementation of the increased Superannuation Guarantee, the SG rate will only reach 12% in 2022, and people receiving that rate for their entire working lives will only be retiring in the late 2060s.

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<sup>2</sup> AIST, (2016). *Consultation Paper 246 – Client Review and remediation programs and update to record keeping requirements*. [online] AIST. Available at: <http://tinyurl.com/gtm3jg4> [Accessed 15.4.16].

The system is therefore at a much lower level of maturity than the Issues Paper suggests, in reality reaching full maturity at least 20 years later.

#### 4.4.2 Disengaged consumers are across all segments of the super system

AIST also does not accept the assumptions implicit in the commentary on disengagement on page 6 of the Issues Paper. The Paper contrasts the lack of interest of members in default options with the engagement of members who actively choose their superannuation investments.

While AIST accepts that many, and probably most, super fund members are disengaged or uninterested, there is not a simple dichotomy between members in default funds and those in Choice products. The current mix of default and Choice arrangements is efficient – and effective – because it allows consumers the option of achieving a good retirement outcome within a MySuper structure with higher levels of consumer protections or the option of making another selection if they so wish. Consumers can - and do - decide to stay in a default option.

Research released by the Centre for International Finance and Regulation in 2015<sup>3</sup> showed that 64% of super fund members make an active choice about their superannuation, with 26% actively choosing the default fund, and 9% actively choosing the default investment option. This indicates that investment in default fund arrangements is not a reliable indicator of disengagement.

It is a rational and effective decision for a consumer to choose ‘not to choose’ and so stay in a default option. This decision may be based on the:

- Higher levels of consumer protections in a MySuper product;
- Higher governance standards applying to trustees of funds offering a MySuper product;
- Requirement for the investment strategy of a MySuper product to promote the financial interests of members by optimising long term net returns;
- Recognition that the trustee may be skilled in making investment decisions and otherwise running the fund in an efficient manner;
- Higher level of net investment returns to members in default funds, especially over the long term;
- Consumers’ lack of time to actively manage their superannuation;
- Consumers’ trust in the trustee to operate the fund in the best interest of members
- Consumers’ attitude to risk.

Each one of these is a significant reason in its own right: Taken together, the case for remaining in a default fund may be compelling.

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<sup>3</sup> Butt, A., Donald, S., Foster, D., Thorp, S. and Warren, G. (2015). *Delegation, trust and defaulting in retirement savings: Perspectives from plan executives and members*. Research Working Paper. [online] Sydney: Centre for International Finance and Regulation. Available at: <https://tinyurl.com/j36lcam> [Accessed 8 Apr. 2016].

The casual assumption that people managing their own superannuation fund or actively managing their investments are engaged and financially literate is also not supported. Evidence suggests that most people operating a self-managed fund or making investment decisions are doing so under advice, and in an environment where there is not necessarily (or at least not until recently) alignment between member and adviser interests. It should also be noted that 90% of SMSFs are funds with two or more members, and most of these are spousal unions<sup>4</sup>.

The ALRC report acknowledges that in the case of SMSFs (at paragraphs 19.40 – 19.43), there is the potential for coercion. It is also well established that many SMSFs have a combination of active and passive trustees, indicating that a large number of trustee-members are disengaged from their investments.

AIST believes that consumer driven choice is not a significant factor in reducing fees or improving investment performance in the Choice environment:

- Recently, AIST commissioned SuperRatings<sup>5</sup> to analyse comparisons of median fees across sectors. This research found that Choice products were considerably more expensive than MySuper products, particularly in the retail fund space. As a consequence of member disengagement, the incentive has been to engage with intermediaries including employers and financial planners rather than consumers, and has led to a widening not a narrowing of the interests between consumers and product providers.
- Financial adviser Hans Egger of Astute Wealth estimates that 10% of a financial adviser's own clients are disengaged<sup>6</sup>, and this figure may be underestimated: The obligation on financial advisers to provide fee disclosure statements to clients, introduced into the *Corporations Act 2001* via the *Corporations Amendment (Future of Financial Advice) Bill 2012*, is evidence that a considerable number of clients of financial advisers did not and may still not know how much they are paying their advisers.
- ASIC's *Report 279: Shadow shopping study of retirement advice* (REP 279) showed that 86% of participants felt that they had received good quality advice and that 81% said that they trusted

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<sup>4</sup> Australian Law Reform Commission, (2011). *Family Violence and Commonwealth Laws— Improving Legal Frameworks*. ALRC Report 117. [online] Sydney: ALRC. Available at: <https://tinyurl.com/hecqt16> [Accessed 8 Apr. 2016] at paragraph 19.37.

<sup>5</sup> SuperRatings, (2015). *Australian Institute of Superannuation Trustees Fee and performance analysis December 2015*. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <https://tinyurl.com/h6sgcth> [Accessed 8 Apr. 2016].

<sup>6</sup> Millan, L. (2013). Advisers battle to reconnect with disengaged clients. *Financial Standard*. [online] Available at: <https://tinyurl.com/zxgeagj> [Accessed 8 Apr. 2016].



their adviser ‘a lot’<sup>7</sup>. However, 39% of advice provided was poor, and only 3% of advice was considered to be of good quality (REP 279, paragraph 18).

The Issues Paper recognises there are problems with data reliability and availability in relation to member awareness and engagement, and that this can make it difficult to assess system (and product) performance. It is unclear however why the question focuses on comparing SMSF and APRA regulated funds, when the issues are far more widespread. AIST strongly believes that there are systemic risks inherent in the SMSF sector and that the responsibility to different regulators adds to inconsistency in reporting and creates a lack of true comparability. AIST would support an increased government focus on this area.

## 4.5 This review should explicitly address the findings from the 2012 Productivity Commission report into default superannuation

Arising from the Super System Review, the Government tasked the Productivity Commission to design criteria for the selection of super funds eligible for nomination as default funds in awards. In its 2012 report into the *Default Superannuation Funds in Modern Awards*, the Productivity Commission recommended changes to the default fund selection process by the Fair Work Commission that were substantially accepted by the Government of the day, and given legislative effect – but that have not yet been implemented.

The 2012 Review identified that a well-designed system should:

*Promote contestability and competition – all funds that offer an eligible default product should have an equal opportunity to be assessed for listing in awards, and competition should provide an incentive for the ongoing innovation, efficiency, performance and consumer focus of superannuation funds. (p.8)*

AIST supports this approach previously taken by the Productivity Commission to design such a system, and which was then reflected in the legislative arrangement.

AIST recommends that the Productivity Commission explicitly address whether or not its previous findings on the efficiency of the superannuation system within the context of the FWC, remain relevant.

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<sup>7</sup> Australian Securities & Investments Commission, (2012). *Shadow shopping study of retirement advice*. Report 279 (REP 279). [online] Canberra: ASIC. Available at: <https://tinyurl.com/kfquhzo> [Accessed 8 Apr. 2016] at paragraph 22.

**Recommendations – Superannuation in Australia (context)**

- All segments of the super system should be taken into account when examining system efficiency, and the differences recognised.
- Any measures to increase competition must incorporate commensurate consumer protection. Such measures should be at the expense of existing consumer protection or members' net returns.
- Disengaged consumers are across all segments of the system and need protection.
- The Productivity Commission explicitly address whether or not its previous findings on the efficiency of the superannuation system within the context of the FWC, remain relevant.

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## 5 Responses to questions in the Issues Paper

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### 5.1 Question on system efficiency objectives

AIST supports a legislated objective of superannuation and the development of an evidence-based retirement incomes framework for the proper assessment of the superannuation system. The Productivity Commission should not develop different objectives, and the hierarchy of objectives suggested in Figure 2 should be aligned with the Government's process to develop an objective.

One of the frequent criticisms of the superannuation system is that constant tinkering erodes public confidence. This lack of public confidence is reinforced through annual changes to superannuation through the Federal Budget announcements.

The FSI recommended the consideration of a number of other factors in supporting the primary objective, and these include the subsidiary objective of 'be simple and efficient, and provide safeguards'. AIST supports this subsidiary objective but it is concerned it may reduce the clarity and purpose of having a primary objective. AIST prefers the development of 'guiding principles' to underpin the primary objective of the retirement incomes.

We note the basic tenets underpinning our suggested primary objective and guiding principles are:

- Adequacy of retirement income for all Australians.
- Adequacy, sustainability and fairness.
- The three pillars of Australia's retirement income system need recognition.
- Private savings need to be taken into account through, for example, age pension means-testing.
- Retirement income and employment policies need to address the superannuation gender gap between women and men in relation to retirement savings and retirement incomes.
- Proposed policies should be assessed within a retirement incomes framework.
- Guiding principles should not detract from the primary objective.

AIST has been part of the recent discussion with Government about setting the primary objective of superannuation in legislation. In the context of these discussions, we have proposed the following primary objective and support it being set in legislation:

*To provide retirement income for all Australians that, when combined with or in replacement of any public pension, ensures a reasonably comfortable living standard, in the spirit of fairness within and between generations.*

This objective provides a basis for balancing adequacy, sustainability and fairness, and the balance between the three pillars. When this balance is optimised – and simplicity and efficiency is recognised as a subsidiary objective - the system will optimise its efficiency.

AIST strongly recommends that the objective needs to be properly supported and governed through an evidence-based framework. Otherwise, the piecemeal approach taken to the development of superannuation policy will remain – continuing consumer uncertainty, and a lack of cohesive policy which aids the development of inefficiencies.

We believe that there are six central elements for an appropriate retirement incomes framework requires:

1. Primary objective. This should emphasise adequacy to a reasonably comfortable standard of living, focussing on retirement income and encapsulating transition to retirement, as well as adequacy and fairness. We believe that this could be housed in its own legislation.
2. Guiding principles. These include adequacy, fairness, sustainability, intergenerational fairness, superannuation as a savings vehicle, gender and employment equity issues, structural change, sole purpose test, transparency, accountability and national savings.
3. Quantifiable goals (whether the objective is being met e.g. what is 'adequate'). Track whether the quantifiable goals have been met. The AIST-Mercer Super Tracker is a robust tool which is designed to track and test the adequacy and sustainability of the superannuation system and identify areas of the system that need attention: It is capable of road-testing the impact of policy changes on a series of metrics, including the already mentioned ambitions of adequacy, fairness, gender impacts on retirement savings, and sustainability.
4. Evidence-based decision-making: A method to test proposed policies to gauge how they might impact the system. The AIST-Mercer Super Tracker provides a methodology for evidence-based decision making within a consistent framework. This type of methodology would provide greater transparency and accountability regarding proposed superannuation policies. We outline the AIST-Mercer Super Tracker below.
5. A governance mechanism to:
  - a. Review and assess the quantifiable goals.
  - b. Assess whether the goals are being met.
  - c. Test policies.

A copy of our submission to Treasury on the Objective of Super is an annexure to this submission.

## 5.2 Questions about the approach to assessment

*AIST supports a principles-based, legislated objective of the super system. The objective needs to be backed up with a framework to assess performance against the objective (the AIST-Mercer Super Tracker provides a methodology), coupled with a suitable governance mechanism to undertake this assessment. AIST agrees that tracking performance objectives should be coupled with testing barriers to efficient or competitive outcomes.*

## 5.2.1 Use of tools to track whether system objectives are being met – international comparative tools

The Commission refers to several tools, including the Melbourne Mercer Global Pension Index (MMGPI) and the Allianz Pension Sustainability Index (APSI) and notes that while these do not have a system-wide perspective, the Commission may draw on them when developing criteria and indicators.

AIST recommends that the issue of the assessment of the Australian superannuation system performance needs to be addressed from two perspectives:

- Comparing the performance of the Australian system with other countries.
  - The Melbourne Mercer Global Pension Index (MMGPI) and the Allianz Pension Sustainability Index (APSI) provide comparisons of the Australian system with others.
- Assessing the Australian system based on measures set by Australia.
  - Inter-country comparison assessments need to be backed up by a methodology which assesses the Australian system based on measures set specifically for Australia, and which are appropriate to the size of our system.

## 5.2.2 Use of tools to track the Australian system performance –AIST-Mercer Super Tracker

AIST and Mercer have developed the AIST-Mercer Super Tracker ('the Tracker'). The Tracker – while drawing on the MMGPI - is different from both the MMGPI and the APSI in several key respects.

To assess the costs and benefits of the Australian superannuation system, the Tracker:

- Includes ten Key Performance Indicators, which (while not 'goals' of the superannuation system) are reasonable in the Australian context.
- Enables each KPI to be compared with the other KPIs, as each KPI is a score. The Tracker provides a methodology for balancing various competing objectives (such as adequacy and sustainability) against each other.
- Highlights which areas in the superannuation system may require more attention and potential policy development.
- Can also be used to assess policies to see how the outcomes and scores might vary if the policy was implemented. AIST has used the Tracker to road-test over 20 policies.
- The ability to assess competing objectives, as well as to test single or bundled policies, also aides the efficient assessment at system level.

We have included the Tracker to show how an Australian-designed tool may be used to balance adequacy, sustainability and fairness using publicly available data. Efficiency of the super system is not about provision of retirement incomes at minimal cost, as other important factors such as adequacy, sustainability and fairness must be key.

Figure 2 is a snapshot of how the Tracker assesses the performance of our superannuation system:

10 indicators of the performance of the Australian Superannuation System					Currently	What would get 10/10
Adequacy		Objective	Score (/10)	Weighting		
A1	Net Retirement Income for median income earners (F/T and P/T, M & F)	ASFA Retirement Standard Comfortable	7.8	20%	FT Male: 98.0% of ASFA Comfortable FT Female: 91.8% PT Male: 89.2% PT Female: 74.2%	If the income following retirement is the ASFA Comfortable Standard for a single person, irrespective of age and career.
A2	Fairness of Government Support (tax concessions and age pension)	Level support across income deciles	5.0	15%	Wide differences in spread of concessions across income deciles – see page 7 of Tracker assumptions report.	Zero variance in the spread of concessions across income deciles.
A3	Gender gap at Retirement (modelling and actual)	Same benefit at retirement for M & F	6.6	10%	ABS data: Median female balance 65.2% of median male balances. Projected to age 67: Female balance 65.9% of male balances.	No difference in median super balance for male and female (current and projected).
A4	Coverage of superannuation	80% of working age population	8.1	2.5%	68.6% of working Australians covered by superannuation schemes.	>80% of working population is covered by superannuation schemes.
A5	Level of personal (voluntary contributions)	3% of GDP	6.4	2.5%	1.91% of GDP	3% of GDP for past 12 months as measured by APRA
<b>Sustainability</b>						
S1	Total cost of Government support including ((a) age pension (current and in 2050) and (b) tax concessions)	2% of GDP	8.3	15%	Cost of (a) is 3% (current and projected - amongst lowest of OECD countries) and (b) is 1.45%	Combined cost not > 2% of GDP (lower than all but 2 OECD countries)
S2	Super assets as a % of GDP	150% of GDP	8.2	10%	123% (4 <sup>th</sup> largest pool in the world)	150% of GDP
S3	Labour force participation rate at ages 55 and over	85% for 55-59; 65% for 60-64; 20% for 65 and over	6.2	10%	55-59: 74.0% 60-64: 58.8% 65 and >: 12.5%	55-59: 85% 60-64: 65% 65 and >: 20%
S4	Length of Retirement, today and in 20 years' time	15 years (today) 13 years (20 years)	6.1	10%	Current (at age 65): Males: 19.22 Females: 22.05 Projected average: 18.9 (85.9 less 67)	Life expectancy at pension age is 15 years; projected life expectancy at birth in 20 years time is 13 years more than pension age
S5	Age pensioner population, today and in 2050	25% on full pension	5.3	5%	Current: 65% (50% full, 30% part) Projected 2050: 55% (30% full, 50% part)	Aged population receiving full pension: 25% (half weighting for part pension)
<b>Total Tracker Score</b>			<b>68.8</b>	<b>100%</b>		

Figure 2

AIST would be pleased to provide the Commission with a presentation of the Tracker.

## 5.2.3 AIST-Mercer Super Tracker draws on EU example

While it focuses on the Australian system, the Tracker has drawn on an intra-country perspective of assessing pension system performance adopted by the European Union. In 2012, the EU issued a White Paper<sup>8</sup> examining an agenda for adequate, safe and sustainable pensions. The paper examines a number of initiatives, including examining the sustainability of public pensions, supporting longer working life, and measuring the gender gap in savings. The Adequacy and Sustainability of Pensions Report<sup>9</sup> gives a concise overview of the KPIs of pension adequacy and sustainability in the EU. These indicators relate to adequacy of retirement benefits, the employment rate of older workers, and the sustainability challenge (the long term growth in pension expenditure as a percentage of GDP).

Assessing system performance should be coupled with an assessment of barriers to better outcomes. AIST supports performance assessment that includes both an analysis of the system's actual performance against a set of benchmarks, and an assessment of barriers to better outcomes. AIST reiterates its position that this should only occur after the setting of system objectives that effectively balance adequacy, sustainability and fairness – as the most efficient and effective system will optimise the balance between these elements. We outline key barriers below.

### Recommendations – approach to assessment

- AIST supports a principles-based, legislated objective of the super system.
- The objective needs to be backed up with a framework to assess performance against the objective and a suitable governance mechanism to undertake this assessment.

This assessment should be undertaken from two perspectives:

1. How the Australian super system compares with other countries.
2. An assessment of Australia based on measures set by Australia - The AIST-Mercer Super Tracker provides a methodology of an assessment of the Australian super system.

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<sup>8</sup> European Commission, (2012). *White Paper: An Agenda for Adequate, Safe and Sustainable Pensions*. Brussels: European Commission. Available at: <http://tinyurl.com/mmvnk26> [Accessed 5 April 2016].

<sup>9</sup> European Commission, (2013). *Adequacy and Sustainability of Pensions*. [online] European Commission. Available at: <http://tinyurl.com/o9efgrl> [Accessed 5 April 2016].

### 5.3 Questions about assessing competitiveness

*It is difficult to currently suitably assess competitiveness (or indeed efficiency) given the lack of alignment between MySuper and Choice disclosure and APRA reporting. Release of all remaining APRA data would also assist with proper assessment. AIST strongly recommends that disclosure and APRA reporting regarding both MySuper and Choice fees and costs should be brought into alignment. APRA research into the impacts of outsourcing, related parties and concentrated markets should be updated. AIST strongly believes that the causes and impact of principle-agent and other structural relationships should be the subject of a review in 2018 (one year after the completion of Accrued Default Amounts into MySuper). Given the need for better data inputs, AIST believes competition criteria should be developed only following these reviews. Competition assessment criteria should include a Financial Literacy Benchmark and a way of assessing organisational behaviour.*

*AIST will not respond to all questions about assessing competitiveness as part of this submission.*

#### 5.3.1 Role of competition in superannuation

Efficiency and competition measures must focus on long-term net returns to members and optimising retirement incomes, and not on maximising profit for shareholders and intermediaries.

AIST submits that competition is about more than price - it also includes competition for rollovers, distribution channels, advice, marketing and brand, and access to third party expertise in many areas.

Greater regulatory requirements for transparency and consistency, fuller disclosure of returns, fees and costs and conflicted relationships are needed to promote competition and to provide measures of competition.

Before turning to the balancing of competition, efficiency, and stability, we first turn to a number of key barriers to effective competition which are improving fee disclosure and comparability: the need for meaningful information, the impact of financial literacy, the management of conflicts of interest, and the offering of inducements to employers. These barriers are in addition to member disengagement and for-profit driven related party arrangements addressed elsewhere in this submission.

#### 5.3.2 Barriers to effective competition

***Barrier one: Improving fee disclosure and comparability as a fundamental requirement for assessing and improving competition***

AIST strongly supports the Productivity Commission's objective to identify current gaps and other issues with evidence regarding the superannuation system. AIST has long advocated that gaps in disclosure and reporting to APRA has led to a superannuation system that:

- Cannot be properly analysed in terms of its competitiveness and efficiency.
- Does not fully protect consumers and their best interests.



- Does not deliver a level playing field across financial services.

## **OECD principles require identification and closure of the gaps**

AIST supports the OECD's *G20 High Level Principles on Financial Consumer Protection*<sup>10</sup>.

As far as fee disclosure is concerned, these Principles may be summarised as follows:

- Standardisation, comparability, and consumer testing are all desirable.
- A level playing field across financial services is to be encouraged.
- Furthering responsible business conduct is important, e.g. ensuring that remuneration practices and conflicts are not detracting from proper disclosure.
- Remuneration/ conflicts of interests should be disclosed where conflicts cannot be avoided.
- Disclosure should help consumers distinguish between what is essential and what's less important.

## **What are the gaps?**

Whether members are in a MySuper or a Choice option, superannuation is still a compulsory retirement savings and investment system, and the protection of consumers - and their ongoing confidence in the system - remains paramount. This is particularly important given that many members are currently in Choice options, particularly in the retirement phase of their superannuation:

	<b>NFP - % of all NFP FUM</b>	<b>Retail - % of all retail FUM</b>
<b>MySuper</b>	65%	17%
<b>Choice</b>	35%	83%

Source: Derived from APRA<sup>11</sup>

For the purposes of this discussion we refer to 'Choice' options as meaning non-MySuper options.

The gaps identified below raise the questions 'Why aren't all consumer retirement monies being disclosed on an equal basis?' and 'Why aren't all superannuation investment options reported to APRA on an equal basis?'

<sup>10</sup> Organisation for Economic Co-operation and Development, (2011), *G20 High-Level Principles on Financial Consumer Protection*, Geneva: Organisation for Economic Co-operation and Development. (Endorsed by G20 Finance Ministers & Central Bank Governors 14-15 Oct 2011)  
Available at: <http://www.oecd.org/daf/fin/financial-markets/48892010.pdf>

<sup>11</sup> Derived from comments made: Rowell, H. (2015). *Governing Superannuation in 2015 and beyond: Facts, Fallacies and the Future*. [online] APRA. Available at: <http://tinyurl.com/hla6osb> [Accessed 19 Jan. 2016].

## ***Main gaps in fee disclosure and reporting to APRA***

AIST has identified in various submissions the main gaps which result in a lack of a level playing field and lack of suitable protection to consumers:

### ***1. Choice products do not disclose on the same basis as MySuper products and should be aligned.***

Platform products are excluded from the requirements of Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statement* (RG 97) and Class Order [CO 14/1252]. Securities and interests acquired via a platform are seen as not being acquired through an interposed vehicle. This means that retail funds have an opportunity to charge higher fees.

The *Superannuation Legislation Amendment (Transparency Measures) Bill 2016* proposes to extend the requirement for MySuper products to disclose product dashboards to Choice products. If the Bill is enacted, there could be key areas where a level playing field would not be produced. While full details are contained in our submission<sup>12</sup>, our key concerns are:

- These requirements would apply to only to the top 10 Choice member investment choice options by Funds Under Management. This includes those instances where a platform falls within one of the top 10 options by Funds Under Management. AIST has advocated that the need to prepare and disclose a product dashboard should apply to all Choice investment options.
- The Bill would enable regulations to have the ability to prescribe conditions for exclusion, whereas prescription is important to ensure consistency and comparability.
- The Portfolio Disclosure Holdings requirements would put infrastructure investments at a disadvantage.
- The Portfolio Disclosure Holdings requirements would impose a 5 percent threshold of certain assets being eligible for non-disclosure. AIST believes this could be subject to manipulation and an “if not, why not” approach would better protect consumers in those cases where the fund can demonstrate to ASIC where it is in the members’ interest not to disclose.
- Legacy products which have been closed to consumers for at least 5 years have been excluded. AIST believes these should be included in order to better protect consumers invested in those products.

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<sup>12</sup> AIST, (2016), *Improved Superannuation Transparency 2016*. [online] AIST. Available at <http://tinyurl.com/jxu9czt>

## *2. All Choice products must be reported to APRA on same basis as MySuper.*

In 2014, APRA requested feedback on draft reporting standards for select investment (or ‘Choice’) options. Our submission<sup>13</sup> was the sole submission that advocated the alignment of MySuper and Choice reporting standards.

AIST is pleased that a greater degree of alignment in reporting between MySuper and Choice is being introduced. However, since only those Choice member investment options which are within the top 10 by Funds Under Management for each fund are reported, we continue to seek full alignment.

## *3. Commissions on life insurance in superannuation should be banned.*

AIST has advocated<sup>14</sup> that a separate review of insurance disclosure arrangements should be conducted by ASIC. Such a review should cover as a minimum:

- That premiums should be disclosed gross of tax.
- Calculation methodologies should be standardised.
- An agreed methodology for showing the value (price and quantum) and comparability of insurances for disclosure in PDSs.
- Commissions and insurance. AIST supports the exemption on benefits paid in relation to life insurance products from the ban on conflicted remuneration but we seek an end to commissions on life insurance products<sup>15</sup>.

### ***What have these gaps led to?***

AIST strongly believes that the lack of a level playing field between MySuper and Choice – and the various exemptions platforms are provided with – has led to consumers not being properly protected and a system which cannot be fully analysed for efficiency and competitiveness.

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<sup>13</sup> AIST, (2014). *APRA – Draft reporting standards for select investment options* 2014. [online] AIST. Available at: <http://tinyurl.com/qfuzfpp>

<sup>14</sup> AIST, (2015) *ASIC Review of Regulatory Guide 97-Disclosing fees and costs in PDSs and periodic statements* 2015. [online] AIST. Available at <http://tinyurl.com/ogyg3fb>

<sup>15</sup> AIST, (2016), *Senate Economics Legislation Committee Inquiry: Corporations Amendment 9(Life Insurance Remuneration Arrangements) Bill 2016* [online] AIST. Available at <http://tinyurl.com/hdjscoco>

## 1. Huge number of investment choices are supply driven, not consumer driven

There are currently over 40,000 member investment choices. Employer default contributions go into a MySuper product – which can only have one investment option – unless the consumer chooses another investment option (Select Investment Options). Rainmaker<sup>16</sup> estimates that Choice products offered by not-for-profit industry funds have an average of 8 investment choices and for-profit superannuation funds average 56.

Based on this, AIST suggests that the number of investment options in the non-MySuper space is primarily supply-driven and not member driven. The capacity to make choices was a key element of the Stronger Super initiatives. However, AIST suggests that the offering of so many choices is a competitive decision at the superannuation fund level and that consumers are confused by the amount of choice and lack the information to make informed choices.

## 2. Higher costs and the question of cross-subsidisation

AIST has commissioned research<sup>17</sup> through SuperRatings to examine what consumers are getting from not-for-profit superannuation funds when compared with superannuation funds run for profit (mainly by banks). The research examines over 5,000 investment options. The research analyses fees, investment returns, and whether the assets underlying the investments are comparable – what is happening on a *like for like* basis?

- With MySuper, consumers pay 28% more if they are in a for-profit fund. This is based on median fees, regardless of the option utilised (while noting that less than 10% of MySuper products offer a non-Balanced style).
- With Choice, consumers could be paying between 85% and 300% more in fees if they invest in a for-profit fund:
  - Not-for-profit funds have outperformed across **all** of these investment options over 7 and 10 years.
  - Not-for-profit funds have outperformed across all of these investment options over 1, 3 and 5 years with the exception of international share investment options and property investment options.
- MySuper has witnessed for-profit funds lowering their fees, but this has not occurred with for-profit Choice products (which have more Funds Under Management).

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<sup>16</sup> Source: Rainmaker, based on a sample of 300 funds for which Rainmaker monitors fees, returns and investment options

<sup>17</sup> SuperRatings, *Australian Institute of Superannuation Trustees Fee and performance analysis* December 2015 [online] AIST. Available at: <http://tinyurl.com/h6sgcth>

AIST notes that given the findings within the SuperRatings report, the concerns raised in APRA's 2010 report remain. APRA found that when it "considers whether the fund has been established on a not-for-profit basis, or as a retail commercial endeavour, trustees of retail funds pay significantly higher fees to related service providers. ... The largest difference relates to administrative services..."<sup>18</sup>

## ***What's needed to help close the gaps***

AIST makes the following recommendations to help close the gaps:

1. All Choice products must disclose on the same basis as MySuper.
2. All Choice products must report to APRA on same basis as MySuper.
3. APRA's 2010<sup>19</sup> report on the impacts of vertical integration should be updated.
4. Commissions on life insurance in superannuation should be banned.
5. Conflicts of interest reporting should be strengthened as recommended in a recent ASIC<sup>20</sup> report.

## ***Barrier two: A lack of meaningful information***

Financially literate consumers are able to make decisions in their own best interests if they are provided with meaningful information about competing superannuation products. This information should be disclosed to consumers on a consistent and simple basis, be readily comparable and be readily comprehensible.

Most consumers however have a limited capacity to compare complex products, and complexity inhibits engagement, efficient decision-making and overall system competition and efficiency.

The Wallis Inquiry took the approach that lower levels of regulation would generally result in resources being allocated more efficiently. This however was coupled with the view that "financial markets cannot work well unless participants act with integrity and there is adequate disclosure to facilitate informed judgement."

There is little evidence to suggest that subsequent disclosure requirements have been effective in improving meaningful decision-making. Product Disclosure Statements (PDS) are often not clear, concise and effective, and are rarely read by consumers. Short-form PDSs are a step in the right direction but they too are rarely read by consumers.

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<sup>18</sup> APRA, (2010). *Working Paper Australian superannuation outsourcing - fees, related parties and concentrated markets*. APRA. [online] Available at: <http://tinyurl.com/hkmhken>

<sup>19</sup> APRA (2010), *ibid*.

<sup>20</sup> ASIC, *Report 474 Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry* [online] ASIC. Available at: <http://tinyurl.com/hdw2d5b>.

The Super System Review recognised these problems with disclosure and the importance of meaningful information. Their recommendations to introduce MySuper, enhanced APRA reporting, mandatory website disclosure, the introduction of product dashboards and requirement to disclose superannuation fund asset holdings were accepted and implemented by the Government.

It is arguable that the reporting and disclosure initiatives of Stronger Super have been the least successful part of these reforms, and AIST argues that the Commission should identify informed and meaningful information as a cornerstone requirement for improved efficiency. A component of this should include greater testing of member comprehension.

### **Barrier three: Financial literacy**

A high level of financial literacy across all Australians is critical if consumers are to manage their finances – including superannuation – effectively. Research has found that while many Australians do not understand concepts like investments and superannuation<sup>21</sup>. For this reason, consumer protections in our compulsory retirement savings system are vitally important. While it is likely that financial literacy levels will never reach the levels required to allow policy makers to reduce consumer protection levels, attempts to improve literacy levels should not be abandoned.

Super funds can and do provide a range of tools to assist consumers in understanding how the system works and how decisions will impact on their retirement savings. The use of calculators and other web-based tools such as automated advice increases the levels of understanding, potentially engagement and better decision-making.

To help identify and assess financial literacy in Australia, AIST recommends that a financial literacy benchmark be established, which should include an assessment of the understanding of investment and superannuation concepts.

### **Barrier four: Managing conflicts of interest**

The Future of Financial Advice (FoFA) reforms are intended to ensure financial advice is provided in consumer's best interests, and that conflicts of interest are disclosed and appropriately managed particularly in disclosing remuneration incentives.

ASIC's recently released report<sup>22</sup> on vertically integrated businesses in the funds management industry examined financial services entities involved in at least two funds management functions, including:

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<sup>21</sup> Worthington, AC. *Financial Literacy And Financial Literacy Programs In Australia*. Griffith University, 2005. Available at: <http://tinyurl.com/jyznpw7>

<sup>22</sup> Australian Securities & Investments Commission, (2016). *Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry*. Report 474 (REP 474). [online] Canberra: ASIC. Available at: <http://tinyurl.com/hvyv9v5> [Accessed 14 Apr. 2016].

- Investment management;
- Acting as a responsible entity or wholesale trustee;
- Acting as a trustee of a registrable superannuation entity;
- Operating a platform (e.g. IDPS or IDPS-like scheme); or
- Acting as custodian, which may include investment administration.

The focus of the report centred on how these entities identify and manage conflicts of interest. However, ASIC did note a “tick the boxes” approach to compliance, with businesses adopting policies without appropriately embedding expectations, or properly managing conflicts of interest identified.

ASIC noted APRA’s findings in their *Conflicts of Interest thematic review*<sup>23</sup> showing there were significant differences between RSE licensees in their conflicts of interest management, and that there was a strong correlation between sound risk culture with both thoroughness and effectiveness of risk management framework implementation.

ASIC noted that (at paragraph 38):

*It is apparent that additional conflicts of interest may arise where an AFS licensee is part of a larger group of companies with different financial services businesses. As a result of the structure, and the economies and efficiencies of scale achieved through that structure, it may be that it is more challenging for the entity to identify and manage situations where the different parts of the business are conflicted with the interests of the same clients or clients in other parts of the business. Equally, a vertically integrated structure may have the benefit of resources or structural arrangements that avoid or mitigate the potential impact of particular conflicts of interest.*

ASIC further noted that these conflicts may arise due to different duties owed to different customers or stakeholders.

In addition, ASIC noted that many policies were generic or high level, and that only a few organisations appeared to specifically consider and address the key conflicts of interest of their organisation and discuss how those conflicts should be managed.

ASIC recommended improvements to remedy the shortcomings identified. Amongst these were recommendations aimed at considering conflicts of interest more effectively, as well as conducting formal due diligence in relation to the use of related entities and their products to see if these were comparable on the basis of value with third parties from outside the group. In other words, bring due diligence for related parties into line with outsourcing requirements.

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<sup>23</sup> Australian Prudential Regulation Authority, (2015). Conflicts of interest thematic review. *Insight*, [online] (Issue 1, 2015). Available at: <http://tinyurl.com/jrks8ym> [Accessed 18 Apr. 2016].

Although the review did not include deposit-taking, insurance or financial planning operations, it is considered<sup>24</sup> that the principles set out in the report are likely to be applied by ASIC to all of these businesses.

AIST recommends that conflicts of interest reporting should be strengthened as has been highlighted in ASIC's REP 474.

### **Barrier five: Inducements**

ASIC<sup>25</sup> has recently emphasised to employers that they need to be very wary of trustees offering them inducements to pick their funds. The offering of any inducements is a barrier to competition. The Productivity Commission previously found in its 2012 report that the offering of bundled services is a significant barrier to a competitive and efficient superannuation system. In this regard, AIST emphasises a comment made earlier in this submission that it is structurally difficult given the lack of a clean separation of banking from wealth management to ensure that consumers are fully protected from profit-driven arrangements. The impact of profit-driven arrangements requires investigation.

### **5.3.3 Scale and contracting competitive services – intermediaries – members best interests must be the key objective**

The scale of not-for profit superannuation funds has been shown to be largely irrelevant in terms of the benefits that they provide. Liu and Arnold, in research undertaken by APRA in 2010<sup>26</sup> explained that not-for-profit funds join in collaborative ventures, thereby attaining economies of scale without paying third-party profits. This is a way of reducing costs to members by ensuring that efficiency gains are captured by super funds and distributed to members (including via the provision of superannuation products and services), rather than to or by outsourced providers.

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<sup>24</sup> Kemp, M. and Soljo, S. (2016). *Allens: Publication: Client Update: ASIC's guidance on conflicts in vertically integrated funds-management businesses*. [online] Allens Linklaters. Available at: <http://tinyurl.com/zjjw3mc> [Accessed 14 Apr. 2016].

<sup>25</sup> ASIC, 16-038MR ASIC Guidance to employers about super, ASIC. [online] Available at: <http://tinyurl.com/h8lgjby> [Accessed 14 Apr. 2016]

<sup>26</sup> Liu, K. and Arnold, B. (2010). *Australian superannuation – the outsourcing landscape*. APRA Working Paper. [online] Sydney: Australian Prudential Regulation Authority. Available at: <http://tinyurl.com/zehxj8h> [Accessed 12 Apr. 2016].



However, Sy in his submission to the Productivity Commission in 2012<sup>27</sup>, went further again, concluding that:

*Using official data and new econometric models on how the industry actually works, we show the benefits of scale for members are limited and confined to the not-for-profit sector which is structured to incur relatively low fixed costs compared with much higher variable costs. Australian institutional superannuation, most efficiency gains, such as those from economics of scale, are captured as profits for financial intermediaries, with little benefit for members. Recent regulatory reforms on fee disclosure and scale requirements have the unintended consequence of further reducing competition and benefitting the large financial conglomerates.*

Liu and Arnold noted that the objective of this type outsourcing for not-for-profit funds may be a function of minimising member expense, by providing the service at less of a cost than if the fund provided the service itself. However, as Liu and Arnold (p.5) also noted:

*This is patently not the case when the trustees of retail funds contract services to affiliates. As the companion paper<sup>28</sup> has been able to establish, outsourcing to affiliated service providers, particularly in respect of administrative services, can result in significantly higher costs for members. Thus outsourcing does not necessarily reflect whether the trustee has the appetite and/or capabilities to render the service, but for some retail funds might be viewed as part of the business model.*

Liu and Arnold are significantly more blunt about this in their other paper<sup>29</sup> (also commissioned by APRA), concluding that:

*[In all arrangements discussed, analysis by the authors showed that] related-party outsourcing has roughly the same impact on fund members as outsourcing to independent service providers. This indicates a consistency in approach by trustees of not-for-profit funds, to minimise the cost of delivering superannuation to the fund's members.*

*This contrasts greatly with outsourcing in the retail sector. Our analysis shows that the fees paid to related-party service providers are significantly higher than fees paid to third parties. Outsourcing by retail funds does not appear to be intended to reduce members' costs, but instead may constitute part of the revenue model for the retail superannuation product.*

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<sup>27</sup> Sy, W. (2012). *Scale and Competition in Australian Superannuation*. Submission to Productivity Commission. [online] Sydney: Productivity Commission. Available at: <http://tinyurl.com/hk6m5my> [Accessed 12 Apr. 2016] in Abstract, page 2.

<sup>28</sup> Liu, K. and Arnold, B. (2010). *Australian superannuation outsourcing – fees, related parties and concentrated markets*. APRA Working Paper. [online] Sydney: Australian Prudential Regulation Authority. Available at: <http://tinyurl.com/qazuuml> [Accessed 12 Apr. 2016].

<sup>29</sup> Liu, K. and Arnold, B. (2010). *Australian superannuation outsourcing – fees, related parties and concentrated markets*. APRA Working Paper. [online] Sydney: Australian Prudential Regulation Authority. Available at: <http://tinyurl.com/qazuuml> [Accessed 12 Apr. 2016].

We therefore submit that the Productivity Commission's review should be informed by previous work undertaken by the Commission with respect to identifying current inefficiencies in the system, which have had detrimental impacts on member outcomes. The APRA reports have provided evidence of anti-competitive behaviour within the for-profit segment of the superannuation system, and we strongly urge that this be addressed as part of this review. The research we mentioned earlier conducted by SuperRatings demonstrate that these issues still remain – some ten years after the APRA analysis of the impact of related parties.

### 5.3.4 Inter-relatedness of the super system and its intermediaries and effect on competitiveness

The Issues Paper identifies the complex nature of the system but equally important is the mandatory and long-term nature of the system that puts responsibility for outcomes in the hands of others. Note that this is equally true of SMSFs that almost invariably involve intermediaries.

The financial system is highly connected. Research by Donald et al.<sup>30</sup> showed that the different linkages meant that the scale of failure can be spread by these linkages.

Donald's paper defined the superannuation system as comprising:

*...a wide range of entities that interact in a variety of ways.*

*These entities, and the interactions between them, can be said to 'constitute' the system in the sense that together they give it form. The key institution in the system is the superannuation fund. A superannuation fund can take one of two basic forms; intermediated and self-managed. There are currently approximately 330 intermediated funds responsible for administering \$1,080bn on behalf of approximately 31 million member accounts, and approximately 500,000 self-managed funds holding \$496bn in assets on behalf of 914,000 members.<sup>31</sup>*

It should be noted that where Donald differentiates between intermediated superannuation funds and SMSFs, the widespread presence of intermediaries servicing self-managed superannuation fund trustees such as accountants, auditors and back-office administration services in addition to providers of financial services such as banks, insurers and fund managers means that immunity to financial contagion cannot be ruled out. The increased use of intermediaries in the SMSF sector has been an increased focus of ATO

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<sup>30</sup> Donald, S., Arnold, B., Bateman, H., Buckley, R. and Liu, K. (2013). *The implications of complexity for systemic risk in the superannuation system*. CLMR Research Paper Series Working Paper No. 13-3. [online] Sydney: Centre for Law, Markets and Regulation, University of New South Wales. Available at: <http://tinyurl.com/z77bk4q> [Accessed 11 Apr. 2016].

<sup>31</sup> Donald et al. (2013, p.4)

compliance work<sup>32</sup> since 2014, and has seen costs rise as a result. Arnold et al. demonstrates that, even in the absence of formal management, the mean reported expenses of the sample of SMSFs over 2008-2010 were 1.33% of assets, or \$7,299<sup>33</sup>. The widespread presence of related parties in the sector means that principal-agent conflicts are a real risk.

### 5.3.5 The principal-agent relationship can lead to a loss of focus on the consumer

AIST is concerned that there have been frequent cases of a misalignment of interests between investors and the entities set up to manage investor monies. AIST draws attention to the following examples:

- Recent problems in the Australian financial sector (including the failure of large agribusiness schemes such as Timbercorp and Great Southern Plantations, as well as investment managers such as Trio Capital) revealed a complete breakdown in principal-agent relationships between investors and their investment managers, due to information asymmetries between investors and their investment managers.
- At the other end of the spectrum, problems were caused by financial advisers, ostensibly there to provide investment advice to clients, in cases such as the collapses of Opes Prime and Storm Financial.

We note the following reviews and legislative interventions:

- There have been several reviews at a Parliamentary committee level, with the most recent inquiry making recommendations aimed at protecting investors in forestry and agribusiness schemes, however the relationship between financial advisers and product manufacturers has been allowed to continue.
- FoFA reforms outlawed practices such as conflicted remuneration as well as imposing a best interest obligation upon financial advisers in relation to retail clients.

Despite these reviews and legislative interventions, AIST draws attention to the fact that many consumers remain unprotected. Examples include:

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<sup>32</sup> Staff writer, (2014). ATO focus turns to SMSF 'intermediaries'. *Accountants Daily*. [online] Available at: <http://tinyurl.com/jp937eg> [Accessed 11 Apr. 2016].

<sup>33</sup> Arnold, B., Bateman, H., Ferguson, A. and Raftery, A. (2014). *The Size, Cost and Asset Allocation of Australian Self-Managed Superannuation Funds*. CIFR Working Paper No. 033/2014. [online] Sydney: Centre for International Finance and Regulation. Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2463886](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2463886) [Accessed 11 Apr. 2016], cited unpublished in Industry Super Australia, and Australian Institute of Superannuation Trustees, (2013). *Consultation Paper 21 6 Advice on self - managed superannuation funds: Specific disclosure requirements and SMSF costs*. Submission to ASIC. [online] Melbourne: ISA & AIST. Available at: <http://tinyurl.com/jd7a7t8> [Accessed 11 Apr. 2016].

- Whilst we applaud the FoFA changes, we note that the changes themselves only apply to retail investors, meaning that certain investors are unable to benefit from these protections on the grounds that one may be a “wholesale” or “sophisticated” investor.
- Post-FoFA, we note that the continued focus of many advice businesses has been on product sales rather than members’ best interests. Where it may be that a particular investment fund may be in investors’ best interests, retail product manufacturers have already made the options available through platforms which offer thousands of investment options, meaning that there is no realistic alternative to product manufacturers that are tied to advisers. Platforms enjoy significant exemptions from reporting and disclosure requirements which apply to ordinary APRA-regulated funds – we have discussed this issue above.
- The systemic misbehaviour in banks’ financial advice arms, as well as related advice services. We wrote in our submission to Treasury on the industry funding model for ASIC, that<sup>34</sup>:

*It is abundantly clear, however that since this inquiry [Senate Economics References Committee Inquiry into the performance of the Australian Securities and Investments Commission], a number of other irregularities have surfaced. The Committee made it clear in its report on this inquiry at recommendation 7 that a royal commission was warranted. In the dissenting report from Senator David Bushby, the recommendation for a royal commission was opposed on the basis that CFPL had embarked upon a process of investigation and restitution. Senator Bushby’s comments could not have foreseen the almost regular occurrence of problems at other institutions which would clearly impact even a well-resourced regulator’s ability to perform its other tasks as resources are directed into the one activity, even with access to ASIC’s Enforcement Special Account (ESA).*

**AIST is concerned that recent reforms designed to improve the superannuation experience for members, including MySuper and the FoFA reforms are not delivering benefits for all super fund members.**

### ***Consumer money not being transferred to MySuper in a timely fashion***

APRA statistics show members with accrued default amounts at around \$50 billion dollars<sup>35</sup>. Accrued default amounts show the total of funds in superannuation accounts which are yet to be moved into MySuper products as required by 1 July 2017. The MySuper requirements came into effect 1 January 2014 and the failure of some funds to move members money across in a timely manner disadvantages those members’ retirement incomes, and serves only to benefit profit margins and consequently shareholder

<sup>34</sup> AIST, (2014). *Proposed Industry Funding Model for the Australian Securities and Investments Commission*. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <http://tinyurl.com/nbdxejd> [Accessed 12 Apr. 2016].

<sup>35</sup> Australian Prudential Regulation Authority, (2015). *Superannuation Statistics Selected Feature - Accrued Default Amounts*. Statistics, September 2015, issued 19 November 2015. [online] Canberra: APRA. Available at: <http://tinyurl.com/zg5qoy3> [Accessed 18 Apr. 2016].

returns. With \$50 billion still remaining in these accounts, AIST maintains that these members should be moved into MySuper products without any further delay.

### ***Grandfathering arrangements where employers able to contribute to funds not named in Awards***

Another sizeable cohort of members exists in grandfathered arrangements, where employers are still allowed to contribute to funds that are not named in awards.

Some of these grandfathered arrangements are due to the arbitrary and anachronistic nature of exemptions which exist on life insurance, where commissions are allowed but only banned on products where MySuper is involved, or a group life arrangement is in place for a superannuation fund. Although commissions should have been removed in line with recommendations from the Cooper review, Ripoll report and further recommended as part of the Financial System Inquiry, these commission arrangements remain in place. Such arrangements present an opportunity for regulatory arbitrage, where advisers are incentivised to use expensive individually underwritten and/or non-superannuation arrangements in place of cheaper arrangements that may be in member's best interests.

Finally, there are still a substantial number of members of superannuation funds who may have ended up in grandfathered arrangements through relationships between employers and financial advisers, who are still paying conflicted remuneration to advisers that they have never met<sup>36</sup>.

**AIST strongly believes that both the causes and the impact of these arrangements should be addressed by the Productivity Commission. AIST recommends that the Productivity Commission should recommend a comprehensive review of structural arrangements in the industry in 2018, one year after the due date for completion of transfer of Accrued Default Amounts into MySuper.**

### **5.3.6 Need to access more data to better assess the system**

APRA has not released all of the information reported to it. We understand that there are various reasons why this might be the case, including confidentiality (APRA has the power to deem various items “non-confidential”), technology limitations including documented problems with the D2A system as well as the unavailability of the mooted data dissemination tool, the standstill with regards to research (APRA has not released a new working paper since 2012) and the largely aspirational consistency and conflict of interest requirements. This data can provide greater insights into the areas where economies of scale are being realised.

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<sup>36</sup> Kollmorgen, A. (2014). Where's my cut?. *CHOICE: Commission rebate schemes*. Available at: <http://tinyurl.com/hxrn9w> [Accessed 22 Apr. 2016].

AIST submits that the Productivity Commission should recommend that APRA release all remaining data without delay, and conclude work on their data dissemination tool in the interests of consumers and funds alike.

### 5.3.7 Competition assessment criteria and indicators

As Table 1 in the Issues Paper conveys, a competition assessment includes an examination of the supply and demand side. AIST notes that weaknesses on the supply side include:

- Formal and informal barriers to entry.
- Heterogeneity of products and their complexity.
- Limited number of suppliers.
- Cross-ownership of organisational structures.

On the demand side, weaknesses include:

- Consumer switching behaviour.
- Poor transparency around the nature of pricing and the quality of financial products and services.
- Financial literacy of consumers.
- Weakly functioning intermediaries.

We have covered these matters above.

AIST also strongly endorses research<sup>37</sup> which highlights that it is the conduct of financial institutions that determines competitive behaviour. AIST strongly believes behavioural indicators should be included and that the Productivity Commission should recommend that an investigation into the impact of profit-driven related party arrangements.

### Criteria

While AIST generally supports the criteria outlined in Table 1 in the Issues Paper, all of the above matters must be examined and taken into account when examining competition assessment criteria. AIST therefore recommends that the competition criteria not be finally determined until such time as any comprehensive review of structural arrangements in the industry in 2018 has occurred, one year after the due date for completion of transfer of Accrued Default Amounts into MySuper. This is an important step which would assist with determining the effectiveness of the current data regarding each of the matters referred to in Table 1.

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<sup>37</sup> Bikker, Jacob A. and Laura Spierdijk. *Measuring And Explaining Competition In The Financial Sector*. De Nederlandsche Bank, Utrecht University, and University of Groningen, 2009. [online]. Accessed 12 Apr. 2016. Available at <http://tinyurl.com/zdxcaua>



## Recommendations – assessments of competition

- Disclosure and reporting related to Choice and MySuper products should be aligned so that a proper assessment of system efficiency can be made as well as better protecting consumers.
- Commissions on life insurance products should be banned.
- The Commission should recommend that the 2010 APRA research into superannuation outsourcing, fees, related parties and concentrated markets be updated. Given the introduction of MySuper, this research should also include an assessment of MySuper and Choice.
- Conflicts of interest should be strengthened as recommended recently by ASIC.
- The Commission should recommend that the causes and the impact of principle-agent relationships and other structural arrangements in the industry should be the subject of a comprehensive review in 2018, one year after the date for the completion of transfers of Accrued Default Amounts into MySuper.
- The Commission should recommend that APRA release all remaining data without delay, and conclude work on their data dissemination tool in the interests of funds and consumers alike.
- Criteria for the assessment of the superannuation system should be examined following the reviews recommended in this submission.
- Criteria should include assessment of organisational behaviour as well as the outcomes from the development of a Financial Literacy Benchmark.

## 5.4 Questions on assessing efficiency of the system

*AIST agrees with the illustrative criteria for benchmarking operational efficiency listed in Table 2 of the Issues paper but strongly recommends that these should not be given equal weighting. The primary criterion should be the maximised value of retirement income. Administrative efficiency should also be included as a criterion. Benchmarking allocative efficiency should not be based on the assumption that a option is preferable, and instead should assess optimal investment allocation. Technological neutrality and a regulatory system which encourages innovation and quality improvement should also be included in the assessment.*

### 5.4.1 Operational efficiency

AIST supports benchmarking the assessment of ancillary services such as insurance and financial services, to put downward pressure on fees and upward pressure on the quality of services. However, such benchmarking will only add value if it is fully transparent, quantified, comparable and removes all conflicts of interest.

### **Issues associated with benchmarking operational efficiency**

If the apparent minimisation of cost of a service is achieved by cross-subsidisation, cross-selling or the gaming of fees (e.g., by moving fees from one fee class to another), then any increase in productive



efficiency is false and misleading. AIST believes that the following issues are an erosion to both operational efficiency as well as its assessment:

- As ASIC's shadow shopping of financial advice<sup>38</sup> has shown, the assessment of uninformed consumers should not be taken by itself as the measure of the level and quality of those services. What is needed is an independent and objective assessment or a learned intermediary. A learned and trusted intermediary can bridge the gap between complex product information and consumers. In financial services, a high proportion of transactions are undertaken without the provision of personalised advice by a professional with a fiduciary duty, such as a financial planner.

Unfortunately however, in many instances where a financial planner is engaged the planner is not independent, is often conflicted and there are widespread issues with transparency and disclosure. The FoFA reforms are in part aimed at improving the quality and accessibility of financial advice. If successful, this will help to bridge the gap between disclosure by product and service providers and consumers. However, even with these improvements, it is likely that the take-up rate of financial planning advice will remain low, and not be used by many who could derive a benefit from it. This is a problem given the importance of these decisions for people's long-term income security.

- Many disclosure obligations in superannuation are intended to simplify and clarify information provided by the product provider to the point where consumers can digest it without professional advice. The complexity of many products and the behavioural traits of consumer decision-making have made it difficult to design disclosure regimes that work well without additional professional advice. ASIC research has confirmed that levels of consumer comprehension of disclosure requirements remain very low. This means that there is likely to remain a meaningful gap in the financial services sector. This gap needs to be filled as a pre-condition to moving towards the benchmarking of operational efficiency.

### **Criteria for benchmarking operational efficiency**

AIST agrees with the illustrative criteria for benchmarking operational efficiency listed in Table 2 in the Issues Paper but argues that these should not be given equal priority and weighting.

The primary criterion should be the maximised value of retirement income, as this is the output that is ultimately received by consumers, and that is the optimal measure of success both for individual

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<sup>38</sup> Australian Securities & Investments Commission, (2012). *Shadow shopping study of retirement advice*. Report 279 (REP 279). [online] Canberra: ASIC. Available at: <https://tinyurl.com/kfquhzo> [Accessed 8 Apr. 2016]

superannuation funds and the overall superannuation system. All other proposed criteria should be subsidiary to this objective, providing the system remains sustainable for the long term. The objective should align with the government's stated objective for superannuation, once finalised.

Regarding the maximised investment return criteria:

- If the maximised return criteria are to be assessed on a risk-adjusted basis, it should not be related to the Standard Risk Measure in the Product Dashboard for the reasons given elsewhere in this submission. Use of the Sharpe Ratio or some variant (as suggested) is a more appropriate risk metric.
- 'Maximised investment return' when assessed net of investment and administration fees is also an appropriate criterion. It tells consumers of the efficiency of their super fund in growing their benefit that will ultimately be taken as retirement income or a lump sum. This should not be a measure of short term returns, nor only net of investment fees, as both approaches would send inaccurate and misleading messages to consumers.
- As a long-term, mandatory investment, it is universally accepted that returns should also be assessed over the long-term. Gross returns do not reflect the actual outcome received by consumers, and net investment returns allow fees to be gamed between investment and administration fees: moving investment fees inappropriately into administration fees can be used to make investment returns look higher than they should (as can lack of look-through disclosure on fees). Equally, non-disclosure of fees and costs in certain funds, where paid by employers or shareholders, creates distortions in market information, and reduces the potential for effective and efficient operation of the system.
- MySuper products must have an investment strategy that promotes the financial best interests of members. This has to be assessed by pursuing optimal rolling ten-year net-net returns. AIST submits that this is the appropriate assessment criteria for maximising investment return at this stage in the development of the superannuation system. As the system matures, AIST recommends that consideration be given to assessing investment performance over a longer period, for example, twenty years.

Regarding maximised value of retirement income:

- AIST has previously recommended<sup>39</sup> that various inefficiencies to retirement products be removed. These – if implemented – would assist.

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<sup>39</sup> AIST, (2015). *Supplementary response to Tax Discussion Paper Re-think Retirement Incomes Review* [online] AIST. Available at: <http://tinyurl.com/qe53tu6> [Accessed 15.4.16].

Regarding cost-effectiveness of ancillary services:

- AIST agrees with the commentary on page 15 of the Issues Paper that irrelevant product features may be distractions that add little benefit to the end user. However, it is not just uninformed consumers who may be confused by this. All consumers may be confused and have their decision-making powers diminished by complexity and unnecessary detail. Great care should therefore be taken in using the effectiveness of ancillary services as a measure of operational efficiency.

Other criteria:

- AIST submits that administrative efficiency should be an explicit assessment criterion for examining the operational efficiency of the superannuation system. We outline this issue in more detail below.
- Ratings agencies have increasingly assessed super funds against a growing list of criteria. These have included the quality of fund marketing material. As attractive as it may superficially appear to include a broad-base of assessment criteria, each additional criterion diminishes the value of net-returns-to-members and the provision of retirement income.

During the Stronger Super consultations about the design of MySuper, there was debate about the extent of variability allowable within MySuper. At different times in the process, proposals were made to allow one fund to offer multiple MySuper products, for multiple pricings within one MySuper product, many variations in versions of MySuper, as well as other variations in MySuper.

In the end, the legislated framework for MySuper allows a trustee to offer a large employer MySuper product for employers with more than 500 members in the fund, products with a maximum of four price points and differing insurance. Large employer MySuper products can offer a discounted fee where this is supported by administrative efficiencies.

Even with this relatively limited range of variants, and supported by disclosure and comparison requirements that have not been as effective as intended, effective outcome-based indicators of competition do not exist.

AIST argues the continuing need for clear, simple and easily understood metrics based on maximising retirement incomes through the pursuit of optimal long-term net returns. Anything else will be a distraction from the assessment of competition in the superannuation system.

## 5.4.2 Administrative efficiency

AIST submits that administrative efficiency should be an explicit assessment criterion for examining the operational efficiency of the superannuation system. We note that, as it is also the vehicle by which innovation, cost reduction and quality improvement are introduced; administrative efficiency is also relevant to dynamic efficiency.

The Productivity Commission's 2012 review paid particular attention to administrative efficiency and recommended (Recommendation 6.3) that consideration of administrative efficiency should be a criterion in the selection of default funds.

Administrative efficiency as recommended by the Commission is one of the quality filters to be applied by the FWC. Under current legislation, and initial structures and processes put in place by the FWC, quality filters over and above MySuper requirements are an integral part of default selection. That is, there is already a legislatively-based mechanism in place to consider the administrative efficiency of default funds.

In circumstances where a quality filter (including an efficiency measure) already exists, closely based on a structure recommended by the Productivity Commission, that has been legislated by the Parliament of Australia and given Royal Assent, and not since amended, it is incumbent on the Commission to justify why a new approach to the assessment of efficiency is required. This is especially the case in the present circumstance where the structure proposed by the Productivity Commission has not been given the opportunity to commence, and where a change would require significant legislative amendment.

In the 2012 review, the Commission decided that administration efficiency benchmarks should not be set, citing cost concerns, and noting that SuperStream would improve the administrative practices of super funds. SuperStream has indeed improved administrative practices but the setting of objective measures of success is an integral part of its implementation.

The Government has estimated that the annual savings to employers using SuperStream to process employer superannuation contributions has been hundreds of millions of dollars. The savings to super funds (after significant implementation costs) are of a similar magnitude, and these savings are being tracked through mandatory super fund reporting to APRA (SRF 711.0, SuperStream Benchmarking Measures). Savings to Government are also significant.

SuperStream is not a free market for transactions. SuperStream requires employers and super funds to send superannuation transaction data through the Superannuation Transaction Network using common data standards and to subscribe to strict interoperability rules. The STN also relies on the existence of Gateways which act as routers for transactional data, and simplify the flow of data.

As a key element of the Stronger Super reforms, implementation of SuperStream for contributions and rollovers has exceeded expectations and has strong bipartisan support. It has delivered high levels of savings, and increased productivity and efficiencies to most Australian employers and super funds. Furthermore, the extent of these savings are likely to greatly increase as SuperStream is fully implemented and matures. SuperStream is also going to be leveraged to create further efficiencies and savings with the development of Single Touch Payroll, rationalised super fund reporting to the ATO, new payment platforms and the extension of Standard Business Reporting.

While SuperStream did not feature in the PC's Issues Paper, it illustrates that the industry is able to achieve things collaboratively to increase efficiency. There is no doubt that efficiencies can be created in the

system when there is bipartisan support, a well-thought-out process and the will to achieve improved outcomes for stakeholders in the system.

**It is recommended that the Productivity Commission:**

- **Recognise and explore the key role of SuperStream and other drivers of administrative efficiency in enhancing efficiency in the superannuation system.**
- **Assess the most effective administration efficiency benchmarks, having regard to existing tools.**
- **Consider the benefits that administrative efficiencies promote the interests of consumers.**

### 5.4.3 Allocative efficiency

AIST does not agree with the assessment criteria for benchmarking allocative efficiency in the accumulation stage. The criterion of an optimal risk-return trade-off is assessed in part by reference to a reflective asset allocation. This is based on the unsupported assumption that an investment strategy is preferable to a single investment strategy in a fund.

Funds may reasonably support either a generic or a life-cycle strategy. The assessment criteria should be the optimised investment return (i.e., the legislated objective of a MySuper product) and the degree to which superannuation savings have increased the retirement wellbeing of individuals, potentially measured by the percentage of members who adopt an income stream in retirement, and / or are able to augment income from the Age Pension.

While high quality lifecycle products are available, there are nonetheless issues of lack of transparency on fees and returns, and complicated and confusing structures with some lifecycle products. These characteristics reduce competition and downward pressure on fees.

AIST also questions the suggestion of managing sequencing risk as an indicator during the accumulation stage. A retiree may spend almost as long in retirement as they did in the workforce, and their focus – and that of the system - should be on maximising their retirement income. The transition to retirement, with the crystallising of a member's financial position at the point of retirement, is an artificial construct of the superannuation and taxation systems, and detracts from a proper retirement income focus.

AIST agrees however, with the objective of optimal investment allocation. The assessment of this objective should be based on a diversified investment strategy that optimises returns while managing risk. The indicator should be long-term investment returns.

Assessing allocative efficiency requires information about the preferences of the users of the system. In circumstances where many members (in all superannuation sectors) are uninterested, disengaged and/or uninformed, this can be difficult to ascertain. This will remain largely aspirational while the system is still gaining maturity, account balances are increasing and the tipping point on consumer engagement and financial literacy is still to be reached.

AIST agrees with the illustrative criteria for benchmarking allocative efficiency in the decumulation stage, benchmarked across post-retirement income standards. As lifestyle and consumption patterns change markedly in retirement, and taxation operates in different ways, this is more appropriate than just benchmarking against pre-retirement income.

#### 5.4.4 Taxation treatment of super

Notwithstanding the significant taxation benefits applying to superannuation, some aspects of the existing taxation of superannuation operate to impede the efficient operation of superannuation.

Many of these were commented on by the Financial System Inquiry and include:

- Lack of certainty. There have been at least 25 major changes to the taxation arrangements of superannuation since 1983. The lack of a stable and predictable taxation environment has impeded long-term improvements in efficiency. For example, the introduction of the Division 293 contributions tax (very high earner contributions tax) was associated with uncertainty about eligibility, collection and administration by both super funds and the ATO.
- Lack of reasonable time for implementation. In the extensive experience of the authors of this submission, the implementations of taxation changes have tended to be hurried, expensive and inefficient. For example, this has been the case with changes to contributions caps and to the excess contributions tax regime.
- Complexity. The high degree of complexity of taxation arrangements creates confusion and uncertainty about operation of the system, and results in disengagement and increased reliance on intermediaries.
- Retirement date. Throughout this submission, we have drawn attention to the pitfalls of focusing on account balances at a target retirement date, rather than retirement incomes. This distorts decision-making and obstructs a whole-of-life view of retirement savings. This distorted and inefficient focus is also a feature of the taxation system.
  - Superannuation benefits (and earnings) are tax-free after age 60, regardless of whether benefits are taken as a lump sum or an income stream. This does not encourage retirees to take an income stream.
  - Generally, moving from a superannuation accumulation product to an income stream product involves crystallising a member's financial position at date of retirement. This may incur tax, and may cause a member to delay retirement.

Also, AIST strongly supports that the taxation of superannuation should promote the key objectives of adequacy, fairness, and sustainability. Each of these issues are assessed through the AIST-Mercer Super Tracker.

#### 5.4.5 Dynamic efficiency

AIST agrees that innovation and technological change, including upgrades to operational infrastructure, are challenging constraints imposed by current technologies, and delivering improved outcomes for members. Innovation and technology should be a key feature of assessing dynamic efficiency. The criterion should be

more clearly and explicitly linked with achieving optimal outcomes for members through the implementation of change. Change that is not linked to members' interests and the objective of superannuation is not a contributor to system efficiency.

### ***Alignment of investments with risk-return preferences***

AIST does not agree that, all other things being equal, alignment of investments with risk-return preferences should be a single assessment criterion for dynamic efficiency. As an alternate measure, we propose the alignment of investments with the optimisation of retirement income.

Many individuals may prefer to have their retirement savings in cash, on the grounds of security and low volatility, not realising that this preference will lead to a significant loss of purchasing power of their savings over time. If this preference is acted on a widespread basis, it will result in the diminution of retirement savings and reduced individual retirement incomes and increased reliance on the Age Pension. The system will therefore be less efficient.

AIST does not agree with the inclusion of reflective asset allocation on the grounds that it assumes greater homogeneity within age cohorts than actually exists. Factors including account balance, working patterns, gender, home ownership, age of retirement, health and marital status also play a significant role in levels of future income.

A focus just within the accumulation stage also ignores the lengthy period that most members will spend in retirement. The indicator "changes in system-wide asset allocations relative to broader demographic change" also seems to ignore the period in retirement, and the need to focus on retirement income rather than account balance at the point of retirement.

A better substitute indicator would be the introduction and widespread use of new cost-effective products and services that are tailored to individual needs, and this is recommended by AIST. An example of this is online-advice services ('robo-advice'). However, the indicator should not just be the availability of such services but their use on a mass market basis to meet member needs.

### ***Technological neutrality***

AIST submits that technological neutrality and a regulatory system that encourages innovation and quality improvement should be added as assessment criteria, with the accompanying indicator being the audit of and then removal of regulatory constraints to innovation and technological change. Because technological neutrality impacts on system efficiency, AIST believes that a suitable criterion and definition should be set.

Significant regulatory barriers to dynamic efficiency remain. Reporting to various arms of government may involve different, inconsistent and overlapping requirements, different and inefficient governmental portals, and different delivery mechanisms (including some remaining requirements for paper-based lodgements).

The Financial System Inquiry recommended the legislated objective of technological neutrality, and the imbedding of the technological neutrality principle in future legislation and regulation-making. The Government accepted this recommendation and indicated that it would action this from the end of 2016.

## 5.4.6 Regulatory stability

AIST submits that a stable regulatory system that does not impede improvements in efficiency should be added as an assessment criterion. The accompanying indicator should take into account legislated objectives against which policy proposals are tested. As the Government's discussion paper on the objective of superannuation and this Issues Paper make clear, stability, predictability and certainty in the regulatory and policy environment to accommodate long term decisions, will improve system efficiency over time.

## 5.4.7 Demographic efficiency

This submission has articulated AIST's view of the need to ensure that long-term returns to members after investment and administration fees are maximised within the context of a retirement income. We have also written about the imperative to ensure that fees are minimised in order to achieve this result.

However, we also wish to raise the important issue of funds' appropriateness to their membership demographics – specifically, how funds best serve the occupational groups that they are designed for.

Funds that have a membership profile which reflects a specific demographic are best able to tailor their MySuper option in a way that reflects that profile. For example, a fund servicing the retail sector may hold a younger membership and therefore may tailor their MySuper asset allocation to ensure that it includes a higher portion of growth assets to reflect the longer timeframe to retirement.

On the other hand, funds may have a membership which is predominantly older, which may require a different approach to be taken in regards to the fund's MySuper option.

A more tailored approach may also be undertaken in respect of members of a fund's default insurance coverage, or group insurance arrangements generally. The occupational group in a fund predominantly servicing the legal industry, the construction industry or the health industry will necessarily lead to differences in the way that insurance is constructed.

This is perhaps a stronger criterion for inclusion as a default fund than long-term returns to members, as it demonstrates that trustees are considering their unique membership characteristics when constructing the features of not only their MySuper option, but their overall product features.

We submit that if a fund services a specific occupational group and can demonstrate that this delivers benefits in the best interests of those members, it follows that such funds are more appropriate to be listed as a default fund in an industrial instrument than a fund that does not.



## Recommendations – assessment of efficiency

- AIST agrees with the illustrative criteria for benchmarking operational efficiency listed in Table 2 of the Issues paper but recommends that these should not be given equal priority and weighting.
- The primary criterion for benchmarking operational efficiency should be the maximised value of retirement income – all other criteria should be subsidiary to this objective.
- MySuper investment returns should be assessed on a rolling ten-year net-net return basis. This timeframe could be extended as the super system matures.
- The Standard Risk Measure in the Product Dashboard should not be used to assess maximised return criteria on a risk-adjusted basis. AIST recommends use of the Sharpe Ratio or some variant.
- Administrative efficiency should be an explicit assessment criterion for examining operational efficiency.
- The Productivity Commission should assess the benefits that administrative efficiencies bring to consumers.
- Given that AIST does not agree with the assessment criteria for benchmarking allocative based on optimal risk, return trade off as this is based on an unsupported assumption that a strategy is preferable, AIST recommends that the proposed reference to optimal investment allocation addresses this issue.
- The dynamic efficiency criterion should be more clearly linked with achieving optimal outcomes for consumers.
- Technological neutrality and a regulatory system that encourages innovation and quality improvement should be added as a criterion.

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