



**Australian Government**  
**Productivity Commission**

How to Assess the  
Competitiveness and Efficiency  
of the Superannuation System

Productivity Commission  
Research Report  
*Executive Summary*

November 2016

© Commonwealth of Australia 2016



Except for the Commonwealth Coat of Arms and content supplied by third parties, this copyright work is licensed under a Creative Commons Attribution 3.0 Australia licence. To view a copy of this licence, visit <http://creativecommons.org/licenses/by/3.0/au>. In essence, you are free to copy, communicate and adapt the work, as long as you attribute the work to the Productivity Commission (but not in any way that suggests the Commission endorses you or your use) and abide by the other licence terms.

### **Use of the Commonwealth Coat of Arms**

For terms of use of the Coat of Arms visit the 'It's an Honour' website: <http://www.itsanhonour.gov.au>

### **Third party copyright**

Wherever a third party holds copyright in this material, the copyright remains with that party. Their permission may be required to use the material, please contact them directly.

### **Attribution**

This work should be attributed as follows, *Source: Productivity Commission, How to Assess the Competitiveness and Efficiency of the Superannuation System.*

If you have adapted, modified or transformed this work in anyway, please use the following, *Source: based on Productivity Commission data, How to Assess the Competitiveness and Efficiency of the Superannuation System.*

### **An appropriate reference for this publication is:**

Productivity Commission 2016, *How to Assess the Competitiveness and Efficiency of the Superannuation System*, Research Report, Canberra.

### **Publications enquiries**

Media and Publications, phone: (03) 9653 2244 or email: [maps@pc.gov.au](mailto:maps@pc.gov.au)

#### **The Productivity Commission**

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

---

# Contents

<b>Executive summary</b>	<b>1</b>
About this report	1
The Commission's approach	2
Criteria to assess competition	5
Criteria to assess efficiency	6
Data needs	9

The full report is available from [www.pc.gov.au](http://www.pc.gov.au)



---

# Executive summary

The Australian superannuation system has grown rapidly since the introduction of the Superannuation Guarantee in 1992, both in terms of funds under management and coverage. Almost all employed Australians contribute to superannuation. Collectively, Australians have over \$2 trillion of assets in superannuation funds, comprising about 20 per cent of total household assets. In relation to the financial system as a whole, superannuation will continue to increase in relative importance as the system matures by the 2040s.

The sheer size of the superannuation system, combined with its compulsory and broad nature, makes the efficiency of the system paramount. Even small changes in efficiency can have significant impacts on the wealth and wellbeing of Australians. Competition is often a key way of promoting efficiency.

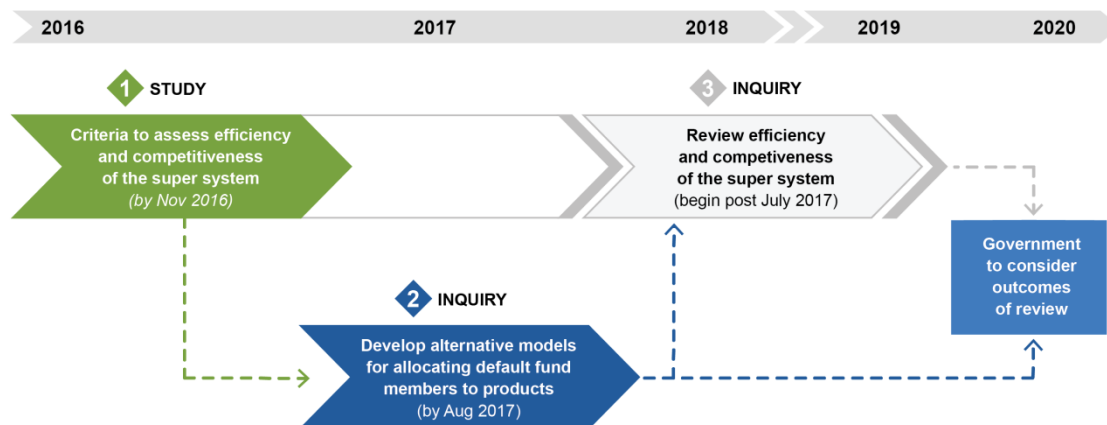
## About this report

In this report, the Commission has developed criteria to assess whether, and the extent to which, the superannuation system is efficient and competitive in delivering the best outcomes for members. The publication of these criteria is intended to provide transparency and certainty to the superannuation industry about how it will be assessed in the future review of the efficiency and competitiveness of the superannuation system. The Australian Government has stated that the Productivity Commission will be asked to undertake this system-wide review following the full implementation of the MySuper reforms (after 1 July 2017) (figure 1).

The Commission has developed assessment criteria and corresponding indicators for the superannuation *system*. The system is bigger than just the superannuation funds (the industry). It encompasses many horizontal and vertical relationships on the supply side, decisions of members and their intermediaries on the demand side, and actions of regulators on both the supply and demand sides.

There is little precedent (including internationally) for what this study has done, or for the ultimate assessment itself. The broader efficiency and system-wide perspectives are both unique and make this a challenging task. Importantly, they mean that the Commission will not be assessing the performance of individual products or funds. The Commission's analysis will, at times, examine the performance of various segments of the superannuation system — such as the default, self-managed superannuation fund (SMSF) and retirement segments — but only where this will meaningfully inform the system-wide assessment.

Figure 1 Three-stage superannuation review



## The Commission’s approach

The Commission’s approach in this stage 1 study involves three steps (figure 2):

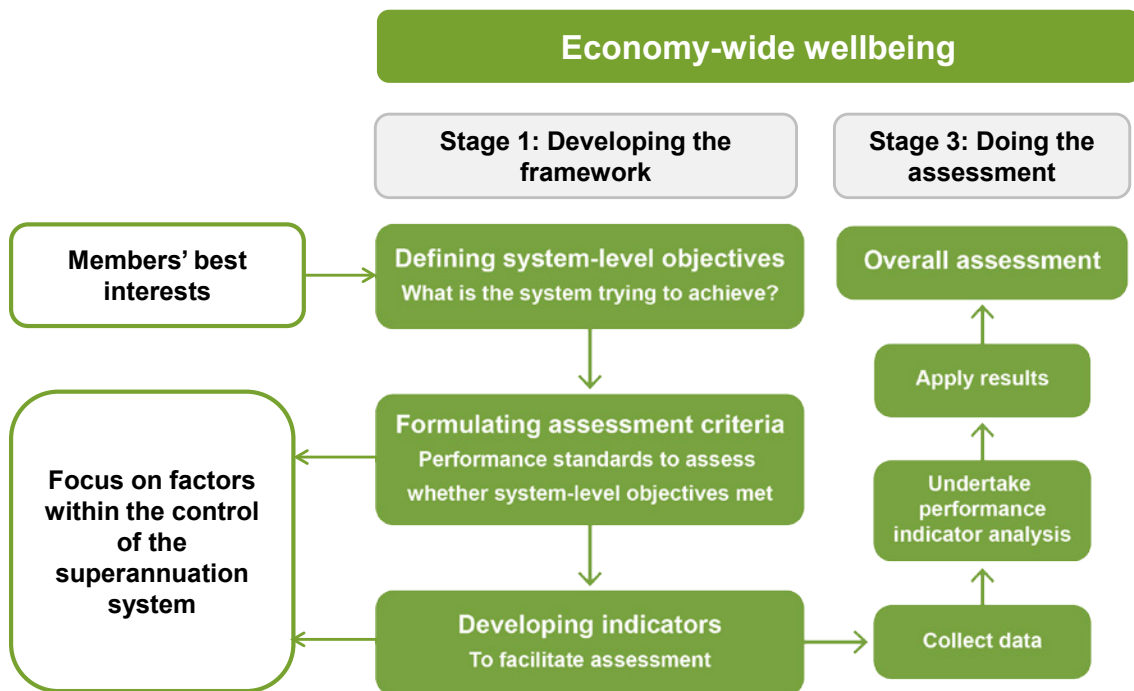
1. defining *system-level objectives* — what is the superannuation system trying to achieve?
2. formulating *assessment criteria* based on these objectives — that is, the performance standards by which to assess if the system-level objectives have been achieved
3. identifying corresponding *indicators* to facilitate the assessment.

### What are the objectives of the superannuation system?

What is efficient ultimately depends on what you are trying to achieve: the objectives of the superannuation system. The Australian Government has announced that the objective of superannuation is ‘to provide income in retirement to substitute or supplement the Age Pension’.

The Government’s policy objective is framed within the principles of fairness, adequacy and sustainability, and casts superannuation as only one part of the broader retirement income system. Retirement incomes are a function of many factors outside the influence of the superannuation system (such as government policy). The Commission has therefore developed system-level objectives that are *within the scope of influence* of the superannuation system and *specific to the principles of competitiveness and efficiency*, but link back to the overarching objective set by the Government (table 1). The Commission’s consultation with study participants has informed the refinement of these system-level objectives, along with the corresponding assessment criteria and indicators.

Figure 2 The Commission’s approach to assessment<sup>a</sup>



<sup>a</sup> The stage 2 work (figure 1) will also be informed by the criteria developed in stage 1, and stage 2 work itself will similarly inform the stage 3 review.

Broadly speaking, the system-level objectives target the best interests of members, in both the accumulation and retirement phases. Competition in the superannuation system is therefore not an end in itself, but an intermediate objective insofar as it drives more efficient outcomes for members.

The best interests of members also affords a direct focus on long-term net returns — which are a key driver of superannuation balances and therefore retirement incomes for members. The objectives also reflect the obligations and constraints on superannuation trustees, such as providing useful insurance to members while protecting their retirement balances.

### Developing the assessment criteria and indicators

Formulating assessment criteria involves identifying attributes that a competitive and efficient superannuation system would be expected to possess. As such, the assessment criteria are closely linked to the system-level objectives.

The Commission has taken current policy settings as given when developing the assessment criteria. This is done either by omission (the Commission is not proposing to assess the system on what is outside its influence, such as the overall adequacy of

---

retirement incomes) or by recognising the influence of external factors when proposing criteria.

The Commission's assessment approach relies heavily on benchmarking. The term 'benchmarking' is used broadly. Performance will be benchmarked:

- against others (for example, investment costs by asset class can be benchmarked to other countries)
- against stipulated objectives (for example, net investment returns can be benchmarked to the net returns from a reference portfolio)
- over time (for example, trends in the number of lost accounts can be examined).

In some parts of the assessment, the Commission will complement its benchmarking with a 'negative test' — an examination of the barriers that may be impeding the efficiency and competitiveness of the superannuation system (such as barriers to entry).

The Commission will rely on a comprehensive suite of indicators to facilitate collective assessment, along with evidence-based interpretation and judgment. This will include input and process indicators, output indicators, behavioural indicators and outcome indicators. Some indicators will be quantitative while others will be qualitative.

Some of the proposed indicators are ambiguous and cannot be interpreted in isolation. Robust evidence and judgment will be required to interpret the meaning of each indicator. In some cases, this meaning may only surface in the presence of other indicators. The indicators therefore need to be considered and interpreted collectively to inform the assessment. It also means that a large indicator set is unavoidable for this kind of exercise, and the Commission has erred on the side of being comprehensive.

## **Summarising the assessment framework**

In response to feedback on the draft report, the Commission has consolidated and refined its assessment criteria and rationalised some of its indicators — namely those that have the least interpretive value or those most difficult to measure. In other areas, especially insurance and dynamic efficiency, the Commission has bolstered the number of indicators.

In summary, the Commission's assessment framework has 5 system-level objectives and 22 assessment criteria, supported by 89 unique indicators. There is unsurprisingly a significant overlap between the competition and efficiency indicators, as the two often go hand in hand. The criteria are summarised in table 1 below, while the full set of criteria and indicators can be found at the end of chapter 7.

Importantly, and as detailed further below, the lion's share of the indicators primarily rely on data that are already collected or can be constructed from existing information sources.



---

## Criteria to assess competition

The Commission is proposing two complementary approaches to assess the nature and extent of competition in the superannuation system:

- a ‘structural’ assessment of the market, which evaluates whether the conditions within the market are conducive to competition
- an ‘outcomes’ assessment, which focuses on actual conduct and outcomes, and tests whether these are consistent with what is expected in a competitive market.

The second element in particular is necessary to keep the focus of competition on improving outcomes for members.

### Structural assessment of the market

The Commission will assess whether the current market structure is conducive to rivalry between incumbent providers of services. Measures of market concentration are often used to assess the degree of rivalry. However, such measures can be ambiguous (for example, high concentration can be a positive consequence of economies of scale realised due to competition, or a sign of potential market power). Therefore, indicators of market concentration need to be accompanied by robust empirical evidence on how outcomes have changed following changes in market concentration.

The Commission plans to assess the contestability of the market by looking at barriers to entry and exit. There are two main barriers to entry that can give rise to incumbency advantages in superannuation: default fund status and vertical/horizontal integration.

- Defaults are an important policy feature of the superannuation system, and will be taken as given. The relevant assessment therefore is whether the *process* of selecting defaults is contestable, competitive and undertaken by those who are best placed to make the decision in terms of expertise and incentives.
- Vertically and horizontally integrated entities often benefit from access to well-developed distribution channels and economies of scope. While being a barrier to entry, this may not necessarily be inefficient. Concerns would arise, however, if this integration led to anticompetitive behaviour.

The effectiveness of the regulatory regime in promoting competitive outcomes, and in ensuring that fund governance is aligned with this objective, will provide useful context for the assessment. Two issues in particular — the MySuper scale test and bulk transfer rules — are commonly cited as having an influence on the ease and extent of fund exit and consolidation.

Traditional assessments of competition tend to end here (the supply side). However, the Commission’s assessment will extend to the demand side (the member side, including their intermediaries). The Commission considers that some level of member engagement is

---

required to signal preferences, and to ensure that the benefits of wholesale-level competition flow through to the member.

Several study participants contested the Commission's focus on member-driven competition. The Commission acknowledges that measures of member engagement need to be interpreted carefully, and in the context of actual outcomes for members. Informed engagement and high-quality decision making are the ultimate goals. The Commission has proposed criteria to assess whether there is informed member engagement and whether members (and their intermediaries) are exerting material competitive pressure. Informed by draft report consultation, the analysis will delve into the default and choice member segments (including SMSFs and retirement), in recognition of their different engagement dynamics.

## **Assessment of conduct and outcomes**

In a market where competition is facilitating efficiency, funds would compete on factors that are relevant to members, which are most often fees and returns. There would also be innovation and quality improvement over time, including in retirement products. In contrast, competition on irrelevant non-price (non-fee) aspects, product proliferation, high advertising expenditure and high search costs could be symptoms of unhealthy and wasteful competition.

The Commission plans to assess whether there is a high degree of competition on fees, and whether there is a decline in costs and subsequently fees charged to members over time. Several study participants cautioned the Commission against a strong focus on fees. The Commission acknowledges that fees need to be considered in tandem with other features that members value (such as returns and service quality). Nonetheless, examining *trends* in costs, fees and margins is an obvious and objective indicator of competitiveness. And in the long run, as other markets have consistently demonstrated, it is possible to achieve both lower prices (or in the case of superannuation, lower fees) and higher quality.

Economies of scale have been identified as a potential source of efficiency in the superannuation system, and competition is a key way to realise economies of scale. (Scale can also be achieved from exogenous growth in the system due to regulatory fiat.) The Commission will assess (in stage 3) the *magnitude of unrealised* scale economies and the *extent of pass-through* of the benefits of economies of scale to members.

## **Criteria to assess efficiency**

The Commission has developed criteria that span all three aspects of efficiency: operational, allocative and dynamic. They also cover the pre-retirement (accumulation) and retirement phases of superannuation. Standalone criteria have been developed for insurance within superannuation.

---

## Net returns

Maximising net returns (after fees and taxes) is the most important way in which the superannuation system contributes to adequate and sustainable retirement incomes. The Commission will focus on assessing system-wide long-term net returns, and benchmark them to reference portfolios and CPI + X benchmarks. The assessment will also be applied to particular segments (for example, institutional superannuation funds, SMSFs, accumulation phase and retirement phase) where these can provide insights about system-wide performance. The Commission also intends to look at the distribution of net investment returns of default products over time, and the prevalence and extent of persistent underperformance. The Commission is focusing on default products because they provide a form of system safety net, because trustees make the investment decision and because they are relatively comparable products.

The emphasis on *system-wide long-term* net returns provides one straightforward approach the Commission will take to account for risk. Long-term net investment returns will collectively reflect the impact of diversification and average market volatility. In other words, this metric effectively captures the impact of most risk on returns such that the Commission considers it to be robust for a system-wide assessment. Other complementary approaches to considering risk include benchmarking net returns at the asset-class level and benchmarking the *variance* of system-wide net returns, including for balances in the retirement phase.

A related criterion is whether the system minimises costs and fees, since higher fees will reduce net returns, all else equal. The Commission also intends to assess whether there are any institutional or market impediments to investment in upstream capital markets (for example, is fund size or type an impediment to investing in certain asset classes?) that may be leading to higher costs and/or lower returns.

Taxes are the biggest item to detract from net returns and ultimately member balances. While taxation policy is outside the control of the superannuation system — and hence outside the scope of this study — the Commission will assess how effectively the system manages tax. This is relevant to all phases of a member's life cycle, including as they transition to retirement.

Finally, the Commission will examine trends in the more egregious leakages in the superannuation system, including unpaid Superannuation Guarantee contributions and lost accounts. These can have a material impact on member balances and particularly affect those with low incomes, irregular work patterns or low financial literacy.

## Member needs

Assessing whether the superannuation system achieves allocatively efficient outcomes is impossible, given the wide variation in individual members' circumstances and needs.

---

However, the Commission will assess whether *inputs* and *behaviours* in the system are consistent with allocative efficiency.

Meeting member needs means providing them with the right information and products to help them make optimal decisions about risk and retirement incomes. This is an area where it will be important for the assessment to distinguish between the accumulation and retirement phases. For example, the former would benefit from product consolidation to aid comparability and decision making, whereas the latter would benefit from new products that help members (with disparate and changing needs in retirement) to manage sequencing and longevity risks.

Finally, in a system characterised by compulsion and high levels of disengagement, meeting member needs means minimising principal–agent problems. The Commission will assess this by examining data on governance practices (which are largely qualitative). The Commission will also examine the extent to which funds target short-term performance relative to their peers (such as by adopting similar investment strategies to minimise their ‘peer risk’), because this may run counter to trustees investing in their members’ best (long-term) interests.

## **Efficiency over time**

Dynamic efficiency — that is, improving efficiency over time — is an important foundation for improving long-term member outcomes. The Commission will consider changes in operational and allocative efficiency (using indicators geared towards these) over time to assess dynamic efficiency. The Commission will also consider how participants in the system overcome impediments to improving long-term outcomes — for example, how funds use the lessons from behavioural finance to improve information provision or product design, and the impact of regulatory impediments on product and service innovation. The assessment will rely significantly on qualitative and case study information.

In the long term, the stability of the superannuation system is also important. In that regard, the Commission intends to assess the extent of systemic risks in the superannuation system.

## **Insurance**

The cost of insurance held through superannuation detracts from members’ retirement balances and ultimately retirement incomes. Policy dictates that trustees provide a default level of life and total and permanent disability insurance in MySuper products on an opt-out basis, and that the cost of this insurance does not unduly erode member balances. These competing objectives mean that it is unrealistic for default insurance in superannuation to meet all member needs. The Commission has therefore set a lower

---

hurdle in its assessment criteria: are funds offering value-for-money insurance products, and is the cost of insurance being minimised for the level and quality of cover?

## Data needs

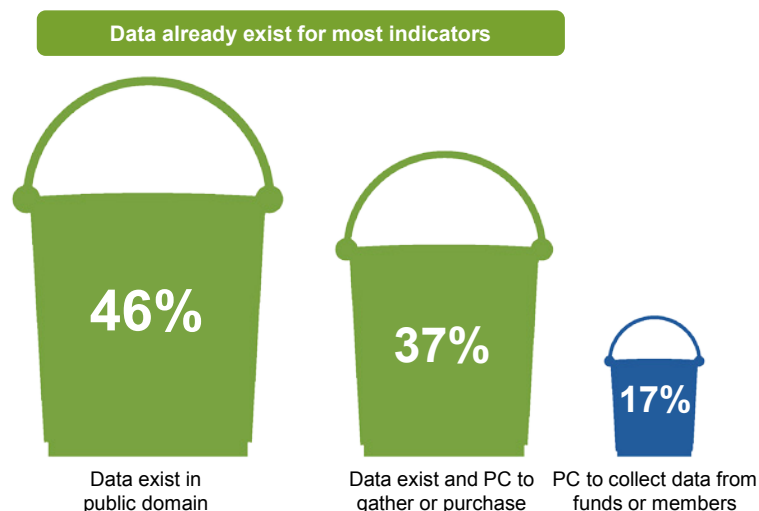
Assessing the efficiency and competitiveness of the superannuation system will be data intensive. This arises from the inherent complexity of the task — the need to consider and weigh up many factors — but also from data constraints. Issues of data availability, quality and comparability mean that the Commission may have to rely on multiple indicators and data sources, each of which only paints a partial picture, to form a considered view.

The Commission’s guiding principle for the ultimate assessment in stage 3 will be to draw on existing data as much as possible. This includes regulator data as well as data that can be obtained from the private sector. The Commission also intends to construct some data itself from published information (such as annual reports or product disclosure statements).

The Commission is mindful of not creating unnecessary burdens on system participants. Only a minor share of indicators will rely on new data collections, and these will be via surveys (of funds and members) and case studies. Participation will be voluntary. The Commission will also invite input from inquiry participants and draw on submissions and other relevant evidence in the stage 3 inquiry. Figure 3 summarises the status of the primary data sources the Commission intends to use for the proposed indicators.

---

Figure 3 **Stage 3 data needs: primary sources for our indicators<sup>a</sup>**



<sup>a</sup> Some indicators draw on multiple sources of data. In this figure, each indicator has been classified into a single category representing the primary expected source of data.

**Table 1 Superannuation system-level objectives and criteria to assess efficiency and competitiveness**

<i>Assessment criteria</i>	<i>Number of indicators<sup>a</sup></i>
<b>The superannuation system contributes to retirement incomes by maximising long-term net returns on member contributions and balances over the member's lifetime, taking risk into account</b>	
• Are long-term net investment returns being maximised over members' lifetimes, taking account of risk?	4
• Are costs incurred by funds and fees charged to members being minimised, taking account of service features provided to members?	10
• Do all types of funds have opportunities to invest efficiently in upstream capital markets?	4
• Is the system effectively managing tax for members, including in transition?	3
• Are other leakages from members' accounts being minimised?	5
<b>The superannuation system meets member needs, in relation to information, products and risk management, over the member's lifetime</b>	
• Is the system providing high-quality information and intrafund financial advice to help members make decisions?	7
• Is the system providing products to help members manage risks over their life cycles and optimally consume their retirement incomes?	7
• Are principal-agent problems being minimised?	7
<b>The efficiency of the superannuation system improves over time</b>	
• Does the system overcome impediments to improving long-term outcomes for members?	6
• Are there material systemic risks in the superannuation system?	3
<b>The superannuation system provides value for money insurance cover without unduly eroding member balances</b>	
• Do funds offer value for money insurance products to members?	10
• Are the costs of insurance being minimised for the level and quality of cover?	7
<b>Competition in the superannuation system should drive efficient outcomes for members</b>	
<i>Market structure</i>	
• Is there informed member engagement?	8
• Are active members and member intermediaries able to exert material competitive pressure?	7
• Is the market structure conducive to rivalry?	2
• Is the market contestable at the retail level?	3
• Are there material anticompetitive effects of vertical and horizontal integration?	6
<i>Conduct and outcomes</i>	
• Do funds compete on costs/price?	6
• Are economies of scale realised and the benefits passed through to members?	5
• Do funds compete on member-relevant non-price dimensions?	5
• Is there innovation and quality improvement in the system?	3
• Are outcomes improving at the system level?	2

<sup>a</sup> Many indicators are used multiple times. In total there are 89 unique indicators.