SUBMISSION

ISA Response to Productivity Commission Draft Report

PRODUCTIVITY COMMISSION:
SUPERANNUATION COMPETITIVENESS AND EFFICIENCY

12 September 2016

Industry Super Australia

ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia (ISA) is an advocacy organisation for the industry super movement. ISA manages collective projects on behalf of a number of Industry SuperFunds with the objective of maximising the retirement savings of five million industry super members. Please direct questions and comments to:

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ISA RESPONSE TO PC DRAFT REPORT

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EXECUTIVE SUMMARY

The Productivity Commission (the Commission) has been tasked with assessing the competitiveness and efficiency of Australia's superannuation system.

As a cornerstone of Australia's economic and social policy framework, the efficiency of the superannuation system profoundly impacts the standard of living for Australia's current and future retirees. Any improvements in efficiency will raise aggregate and individual retirement income adequacy and, in doing so, will reduce future outlays on aged pension expenditure.

Industry SuperFunds are dedicated to developing efficient superannuation funds which have strong and sustained investment outperformance, delivering products which represent good value in terms of product features and services including insurance, and which boost members returns through making long-term investments directly into the Australian economy through infrastructure, property and private capital assets as part of diversified portfolios. This wholesale approach has paid off for our members and for the superannuation system.

In responding to the Commission's Draft Report, ISA offers the following key points:

- We commend the Commission for applying the lessons of behavioural economics to both the proposed assessment approach and the development of policy settings. The advent of a compulsory super system has prudently used system settings to overcome cognitive and psychological barriers to rational consumer decision-making on saving for retirement. However, given the comparatively poorer outcomes achieved by members who leave the default system, ISA remains skeptical of the extent to which demand-side pressures can enliven competitive pressure to improve system efficiency and member outcomes, and overcome documented conflicts in retail products particularly in the choice segment. As such, we urge the Commission to ensure that its assessment is focused on measuring consumer outcomes (including retirement income). Clearly there is a need for stronger consumer protections for those who leave the default sector, who remain reliant on ineffective and outmoded disclosure-based protections.
- On methodology, the Commission has proposed five system-level objectives which frame the assessment process. In order to ensure consistency with the Government's (yet to be legislated) objective for the super system, the objectives and assessment should give priority to the key system outcome – the level of retirement income delivered to Australians. Aggregate adequacy provides the most coherent and meaningful metric of improvements in system efficiency and competitiveness.
- In particular, we would urge the Commission to modify its second objective on the system "meeting member preferences and needs" to refocus it on the delivery of maximised and stable retirement income. Our view is premised on:
  - the fact that delivery of retirement income is the social and economic policy rationale for the super system and provides the most coherent and tractable metric for assessing system efficiency;
  - a focus on "needs and preferences" is less appropriate as a system efficiency objective, and difficult to objectively measure; and
  - an objective which emphasises features which improve the quality of retirement income – level, longevity, certainty and stability – will expedite innovation in this area.
- We also propose a separate additional objective focusing on improved system-level transparency and disclosure.

- Any assessment of competitiveness and efficiency must investigate the drivers of underperformance in retail funds, and so we endorse the focus on vertical and horizontal integration, related party arrangements and cross-selling of super to customers and employers.
- Looking forward, it is clear that the system-based protections for those who choose are inadequate. At the very least, system architecture should not continue to be built on outmoded disclosure-based regulatory protections. Members should be encouraged to understand the significant financial costs of departing the wholesale default sector. System settings must set a higher level of protection for those leaving higher performing default funds.

1. Superannuation – A Unique System

Superannuation is unique in two important respects.

First, superannuation is a cornerstone of Australia's economic and social policy framework. Superannuation arises from government mandates, including substantial direct and indirect fiscal expenditure, and is an integral component of our retirement security system.

The key objective of the system is to improve standards of living for Australia's current and future retirees through steadily building retirement income adequacy and, in so doing, assisting in reducing future aged pension expenditure.

Ensuring that the superannuation system is operating as efficiently as it can will assist in meeting the challenges of an ageing population and the diminishing ratio of employed to retired Australians.

Second, and as noted in the Commission's Draft Report, superannuation does not operate as a typical market due to the:

- policy-driven demand for superannuation services (the compulsory nature of super, its concessional tax treatment)[1];
- passivity and disengagement of members;
- challenges for members in making informed and rational decisions; and
- prevalence of principal-agent relationships that span the supply-demand interface.[2]

The challenges associated with consumer interaction in superannuation have been accepted in all recent major reviews of the superannuation system, including the Cooper Review, the 2012 Productivity Commission Review Inquiry into Default Superannuation Funds in Modern Awards and the Final Report of the Financial System Inquiry. Both in Australia and internationally, insights from behavioural economic research have led to a rethinking of policy settings around retirement income frameworks and financial systems regulation. It has now been widely recognised that demand-side pressures are often insufficient to ensure sound consumer or system outcomes.

Retailisation and 'choice' hasn't enlivened competition

The Draft Report correctly identifies the need to absorb the findings of behavioural economics into both its assessment approach and the broader policy settings in superannuation. The Commission accepts that strong protections, in the form of default arrangements, are needed for those who do not choose a super fund and that traditional indicators to assess demand-side pressures are unlikely to be meaningful.

[1] How to Assess Superannuation Competitiveness and Efficiency, Draft Report, Productivity Commission, 2016, P 36

[2] How to Assess Superannuation Competitiveness and Efficiency, Draft Report, Productivity Commission, 2016, P 77

However, the Draft Report states that competition and member choice will remain institutionally entrenched in Australia's superannuation system, and that a reliance on demand-side pressures is warranted: "…member-level pressure is necessary to signal preferences and to ensure that the benefits of wholesale-level competition are passed through to the member."

ISA and Industry SuperFunds have a long track record of working to improve member disclosure and education, but we are skeptical of the extent to which consumer engagement can enliven competitive pressure to improve system efficiency and member outcomes, and overcome the documented conflicts in retail providers. Members face cognitive constraints and behavioural biases that traditional disclosure responses cannot overcome and that prevent choice from enlivening competition.

The initial design of the superannuation system prudently used *structural* policy settings to overcome behavioural biases and cognitive limitations, putting in place a broadly efficient, wholesale model for the delivery of super. While the establishment of Australia's superannuation system preceded the mainstream acceptance of behavioural economic thinking that member engagement on its own will not ensure system efficiency and competition, it was consistent with its lessons.

Policy interventions since, such as the Choice of Fund changes introduced in 2005, have been less successful. The rationale which underpinned the 2005 Choice of Fund legislation, that the *"choice of fund amendments will increase competition and efficiency in the superannuation industry, leading to improved returns on superannuation savings and placing downward pressure on fund administration charges…"*[3] was premised on an orthodox but now outdated understanding of the merits of consumer-led competition in superannuation. To the extent other reforms have improved system efficiency, they have resulted from changes to structural settings not demand-side pressures – the banning of commissions in FoFA and introduction of MySuper requirements.

The Commission must test consumer outcomes

The unique nature of the superannuation system makes it imperative that the Commission focuses on aggregate and individual member outcomes, particularly improvements in levels of retirement income, in undertaking its assessment of competitiveness and efficiency.

In light of the evidence showing that choice does not equate to better outcomes, it is ISA's view that the Study should test the extent to which choice arrangements and decision making in superannuation have "improved returns and placed downward pressure on administration charges". The competition indicators to assess competitive effects proposed in the Draft Report should test consumer outcomes which result from choice against the more efficient wholesale default sector. The evidence presented by ISA in its initial submission to this Study shows that the choice sector is a drag on aggregate performance, with sustained and significant underperformance, throughout all market conditions. This means that the underperformance of the choice retail sector cannot be explained by lower risk allocations. Average underperformance over the past 19 years by the retail sector when compared to the industry super sector adds up to over $100 billion. Without intervention this underperformance will continue to be a drag on system efficiency.

ISA strongly supports the Productivity Commission's proposal to closely examine supply-side issues, including vertical and horizontal integration, terms of engagement for related parties, realising and passing on of economies of scale and performance outcomes.

Structural differences between sectors and segments

[3] Thursday, 27 June 2002, Slipper, Peter, MP, Second Reading Speech, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 Superannuation, p 4543

The superannuation sector is sharply segmented, reflecting fundamentally divergent views about policy settings and how to respond to consumer behavior. This has resulted in significantly different structures and product offerings between not-for-profit fund segments and for-profit/SMSF fund segments.

The not-for-profit or “all profits to member” funds are concentrated in the default sector and operate on a more wholesale basis. They have a track record of sustained outperformance off the back of higher unlisted investments that exploit liquidity premiums and long-term strategies, and superior investment governance. They use wholesale workplace distribution strategies, have avoided commission-based remuneration, have better realised and passed on economies of scale, and have maintained arms-length engagement of related parties for the benefit of members. This not-for-profit wholesale model is inherently efficient and drives improved member and system outcomes.

Whereas, the choice sector is comprised of mainly retail and bank-owned funds and the SMSF sector. Retail business models are premised on a more tailored approach, with significant evidence of ongoing agency issues within vertically and horizontally integrated structures, atomised approaches to asset allocation which compromise risk and liquidity optimisation across the portfolios, inferior investment strategies and sustained sectoral underperformance.

Similarly, comparable data being published on the SMSF sector has shown poorer diversification and investment techniques, much higher average costs, a lack of scale, incentivised sales practices all translating into very poor average performance in this sector.

The evidence shows that not only are retail choice models inherently less efficient, but there is significant rent-seeking under the guise of satisfying member preferences.

Figure 1 – Comparison: Models for the provision of super

	WHOLESALE	RETAIL	INDIVIDUAL
SECTOR	Not-for-profit funds: Industry superannuation funds, corporate funds, public sector funds*	Retail superannuation funds run by vertically integrated financial services businesses including the major banks	Self managed superannuation funds
STRUCTURE	Economies of scale keep costs down: Average of 11 investment options*	Higher number of tailored investment options: Average of 349 - related party service providers add to cost*	Highly tailored structure based on tax incentives - no economies of scale
DISTRIBUTION	Focus on lower cost wholesale distribution through workplace EBAs, Awards and corporate tenders: 81% of assets in default*	Distribution through related party advisers and bank staff upselling to existing customers (individuals and employers) - also uses corporate tenders: 19% of assets in default*	Distributed through advisor and accountant networks
INVESTMENT APPROACH	Emphasis on diversified, long term, unlisted and direct investment through trustee directed portfolios that enable risk and liquidity optimisation	Higher allocation to listed assets with lower allocation to infrastructure, private equity and unlisted property - reliance on intermediated investment vehicles and individualised asset asllocation deprives optimal risk and liquidity management	Less diversified with high allocations to cash and property
GOVERNANCE	Operated on a 'run only to benefit members' basis by representative trustee boards	Run by for-profit parent to generate shareholder return by boards comprised of bank/wealth executives and independent directors	Member trustees supported by service providers (accountants, administrators, auditors, providers)
ADMINISTRATION FEE	$133 Industry super fund average[1]	$397 Retail super fund average[2]	$4250 Mid fee[3]
LONG TERM INVESTMENT PERFORMANCE (AV)	6.33% Not for profit sector 10 years to June 2015*	4.61% For-profit sector 10 years to June 2015*	3.09% SMSF sector 7 years to June 2014[4]

*APRA Annual Superannuation Bulletin 2015, APRA Fund-level Data 2015, ATO Self managed superannuation funds - A statistical overview 2013-2014
1 SuperRatings data (2014) asset weighted average administration fees on a $50,000 balance
2 SuperRatings data (2014) asset weighted average administration fees on a $50,000 balance
3 Based on a full admin fee (mid) on a $50,000 balance, Costs of operating SMSFs, ASIC, RiceWarner 2013
4 This is the longest period for which reliable data is available

The structural differences between the segments of the superannuation industry drive the significant and long standing differences in performance outcomes and, together with an outcomes-based assessment of consumer behaviour, signal the need for stronger protections for those who are considering departing, or have departed, the default environment.

The response

Policy settings in the default sector have functioned well to drive efficient outcomes, through the creation of default arrangements within the industrial relations system. The current arrangements in the Fair Work Commission have been successful in filtering high quality funds to serve as default funds. These settings ensure optimal returns for disengaged members as well as a safe harbour for engaged members who are at risk as a result of agency issues which compromise outcomes for members of for-profit funds. The Fair Work Commission is resistant to capture by the financial services sector, is transparent and adversarial, and appropriately reflects the nexus between superannuation, wages, and employment.

In contrast, financial services-oriented consumer protections have proved insufficient to protect members in retail choice fund options and SMSFs.

The assessments undertaken by the Productivity Commission, if based on consumer outcomes, should measure the system and member cost of choice, and test what the existing data points to: that the system-based protections for those who choose are inadequate. At the very least, system architecture should not continue to be built on outmoded disclosure-based regulatory protections. Members should be encouraged to understand the significant financial costs of departing the wholesale default sector. System settings must set a higher level of protection for those leaving higher performing default funds. Such changes are not intended to constrain the rights of individuals to exercise choice but to ensure that individual outcomes and systemic efficiency is not compromised by a lack of adequate consumer protections for those who leave the safety net of default funds.

2. Methodology

2.1 Methodological approach

The Commission has proposed an assessment framework in which high level system objectives are derived from the (yet to be legislated) primary purpose of the superannuation system, then formulating assessment criteria and performance indicators which serve to test the extent to which the system is meeting these objectives.

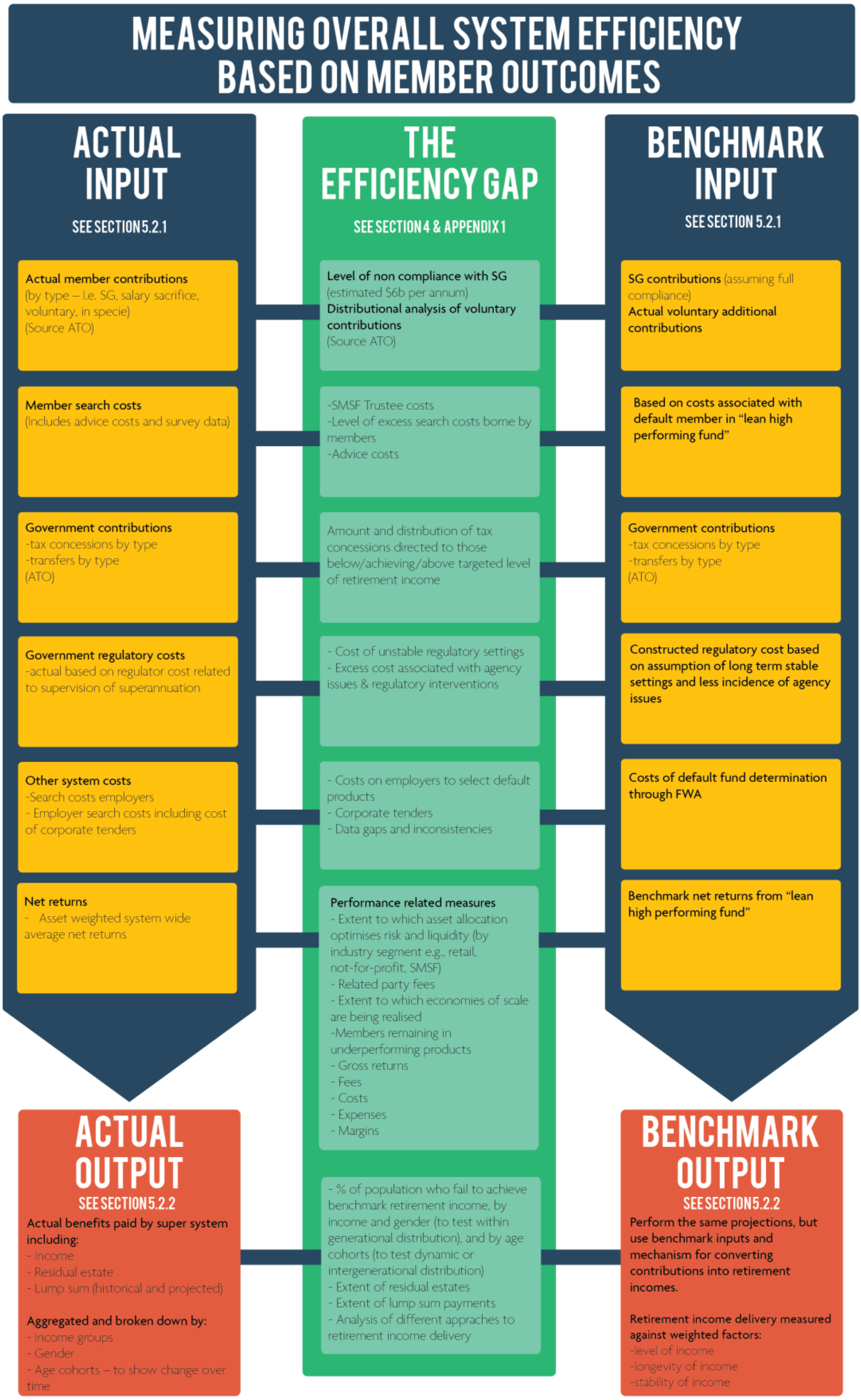
In our initial submission, ISA proposed a top-down approach to measuring super system efficiency, which identified and created benchmarks for each component of system input (for instance, member contributions, fund net returns, government concessions and transfers) and assessed the “efficiency gap” between actual and benchmark system performance. The approach also provided a necessary condition for the analysis - a framework for a more granular analysis of the functioning of different components of the super system – for instance, fund operational efficiency, SG coverage and compliance and ensuring members, funds and the system allocate resources to the most efficient use.

One of the key benefits of ISA’s proposed top-down approach is that it ensures that the assessment framework gives priority to the key system outcome – the level of retirement income delivered to Australians. Whatever methodology is adopted, we would urge the Commission to consider the impact on retirement income when assessing system competitiveness and efficiency. As noted in the Draft Report, the “size and significance of the … superannuation system mean that its efficiency and competitiveness materially impacts the wellbeing of Australians”, with even “small improvements [having] a large impact”.[4] ISA would completely endorse this assessment – the long-term compounding of improved efficiencies would substantially improve individual and aggregate levels of retirement income over coming decades. Furthermore, modelling of retirement incomes drawn from the system will be necessary in the second stage of this Inquiry, as the Terms of Reference request analysis of fiscal impacts of default arrangements. The modelling of fiscal impacts first requires establishment of levels of income drawn from the system, including some distributional segmentation.

A top-down methodology would also provide a basis for analysis of efficiency and equity of policy settings in the future, were it required.

[4] How to Assess Superannuation Competitiveness and Efficiency, Draft Report, Productivity Commission, 2016, P 43,

Figure 2 – Measuring overall system efficiency – ISA's proposed methodology



Note: The references in this chart are from ISA's initial submission to the Productivity Commission which can be accessed here: http://www.pc.gov.au/__data/assets/pdf_file/0008/199205/sub038-superannuation-competitiveness-efficiency.pdf

A number of stakeholders have expressed concern regarding the complexity and granularity of the proposed approach, which will generate a significant quantity of data which will be challenging to collect, verify, contextualise and interpret. In our view, a more focused set of clear benchmarks to test the efficiency of the super system will be more effective in highlighting areas in which the system is performing more or less efficiently and in establishing clearer criteria of expected outcomes to nudge industry participants, regulators and policy makers to improved outcomes. For instance, the Commission's proposed indicator of an 'efficiency frontier' for benchmarking long term net performance could be converted into both a regulatory and consumer tool to place pressure on funds which have underperformed over the long term.

2.2 Data

The Draft Report acknowledges that assessing the efficiency and competitiveness of the superannuation system will involve data and that not all of the necessary data is publicly available or exists at all. ISA agrees with this. However, the Draft Report states that the Commission's guiding principle is to draw on data that is already collected from the system, including from the regulator and private sector, and that new data will be sought only where it is feasible to collect within the short-to-medium term and the benefits of collection are likely to exceed the costs. This approach is problematic.

As noted in ISA's first submission, APRA's current statistical collection is comprehensive for MySuper products (albeit for a limited time period in terms of performance), but does not include equivalent data about non-MySuper products and options. This is a fundamental gap which the Commission must address, especially given the poorer long-term net performance of large elements of this sector.

It is unlikely however that the Commission will be able to rely on the private sector to overcome this problem. The various private sector research houses do not themselves hold a comprehensive suite of data about non-MySuper products. Not all funds actually provide data about non-MySuper products to research houses, and funds are not even required to produce Product Disclosure Statements for legacy products which are no longer open to new members.

APRA is in the process of expanding its statistical collections on non-MySuper products. However, this will not provide historical data and as noted in our earlier submission, there are significant deficiencies in the way fees and costs (including indirect costs) are disclosed in Product Disclosure Statements under the existing law as modified by ASIC and in changes effective from 1 February 2017 under ASIC Regulatory Guide 97. For example, platform-based products do not have to comply with the fees and costs disclosure regime for superannuation in a manner which is consistent with the rest of the superannuation industry. Therefore, ISA recommends that APRA's data collection for these products should not be based on data reported in Product Disclosure Statements.

ISA recommends that the Commission work with APRA to undertake a one-off data collection exercise. This exercise should capture comprehensive data about non-MySuper products and options over the past 10 years (including net returns, fees and underlying costs, asset allocations, FUM and member statistics). We acknowledge that there will be costs associated with this exercise. An assessment of the system would be compromised without more and better data about non-MySuper products.

We also note that there continues to be deficiencies in the statistics published on the SMSF sector: see ISA's first submission to this Study (Pages: 6, 20, 56).

3. Proposed System-Level Objectives

The Draft Report sets out five system-level objectives that are intended to expand upon the proposed objective for the superannuation system and provide a framework for creating assessment criteria to facilitate the measurement of its efficiency and competitiveness.

ISA has advocated for the inclusion of a concrete mention of adequacy within this proposed legislative objective for the superannuation system. Notwithstanding our preference for a more tractable form of wording for the system objective, it is clear that the key system outcome within the Government's proposal is <u>provision of retirement income</u> and it is our view that this should be reflected in the system-level objectives used in the Commission's Study.

ISA is supportive of much of what the Commission proposes in terms of the objectives.

Figure 3 sets out ISA's submissions on the wording and rationale for system level objectives:

Figure 3 – ISA response to system-level objectives

PC Proposed System-Level Objective	ISA Response
The superannuation system maximises net returns on member contributions and balances over the long term.	ISA agrees that this is a key element of system efficiency and that it should be an area of focus in the Commission's Inquiry. Maximising net returns is arguably a subset of maximising retirement income and so is a subset of ISA's amended version of the second objective – however given the importance of maximising net returns, we are supportive of it remaining a standalone objective.
The superannuation system meets member preferences and needs in relation to information, products and risk management, over the member's lifetime. ISA version: The superannuation system delivers retirement income over the member's lifetime that is maximised and stable, and meets reasonable member preferences and needs ~~in relation to information, products and risk management~~.	ISA believes that, given the compulsory nature of super and the significant government support provided through tax concessions, the system should impute a more expansive objective for efficiency in retirement income provision. **In a mature system, the system-level objective should be focused on the defining aspects of pension provision, namely a retirement income that (1) is for life, (2) which is maximised, (3) stable, (4) is reasonably predictable as members approach retirement, and (5) meets reasonable member needs and preferences (to the extent consistent with system objectives).** All individuals have idiosyncratic needs and preferences. Satisfying these is not, however, the economic or social policy basis for the superannuation system. An objective which prioritises the delivery of superior financial outcomes in terms of pension provision will also ensure that policy makers, institutions and system participants including consumers are better able to assess the tradeoff involved between higher pension payments and choice/optionality. Broadening this objective to include more objective financial metrics for efficient income delivery will also be important looking ahead to the second stage, where the Commission has been requested to consider the fiscal implications of default fund processes. Reasonable member preferences and needs would extend to the provision of financial advice, online tools and disclosure of and ready access to information and education.

PC Proposed System-Level Objective	ISA Response
The superannuation system provides insurance that meets members' needs at least cost. ISA version: The superannuation system provides insurance that is good value and is tailored to the reasonable needs of members ~~meets members' needs at least cost~~.	ISA agrees that this should be a discrete area of system assessment but proposes a revision to the wording of the objective and additional indicators. The review should acknowledge the role of group insurance in addressing the extent of underinsurance in Australia and the ability for insured members to access competitively-priced insurance through group rates, providing financial protection should a member suffer an unfortunate event during their working life. There is currently a deficiency within life insurance and superannuation sectors as to how to measure 'value' in insurance. We believe that there is an opportunity to develop and define benchmarks to assess the 'value' and quality of insurance offered under a group life policy including any limitations and policy restrictions preventing or limiting the value of claims.
The superannuation system complements a stable financial system and does not impede long-term improvements in efficiency.	ISA agrees with this criteria, but will offer additional ways to assess how super can contribute to system stability.
Competition in the superannuation system that drives efficient outcomes for members.	ISA agrees that competition is not an end in itself but an intermediate objective insofar as it can drive more efficient outcomes for members. ISA supports a focus on measuring conduct and outcomes associated with horizontal and vertical integration that impede efficient outcomes for members. However, consistent with our above comments, measuring the impact of any changes on retirement income adequacy provides the most meaningful indicator that competition is driving better outcomes for members.
ISA additional objective: The superannuation system is transparent and accountable and provides useful information to members about their superannuation and/or retirement income.	ISA proposes a separate additional objective which addresses system-level (rather than just product level) transparency and accountability. This should seek to address inequities in fee disclosures and promote a level playing field across all sectors of the industry.

ISA will provide more detailed submissions on the Commission's proposed approach to assessment criteria and indicators. Except for the competition objective, we will comment by exception only.

3.1 Commission Objective 1: Maximising net returns

ISA strongly supports the Commission's proposal to develop a system-level objective focusing on maximising net member returns on member contributions and balances over the long term.

While this is a subset of the objective of maximising retirement income, we agree that it merits being expressed as a discrete system objective.

The Draft Report observes that various factors contribute to net returns - differences in performance, the impact of costs and asset allocation.

As noted in ISA's first submission and above, there are highly divergent long-term trends in terms of net performance in the industry. In our view these trends are driven by structural factors – profit orientation, governance arrangements, investment philosophy and wholesale product design. The Commission's assessment criteria and indicators should be focused on interrogating these structural drivers of outperformance and underperformance, necessitating deeper segmentation than is proposed in the Commission's Draft Report.

3.1.1 Segmentation

The Commission proposes to analyse net investment returns by using three key indicators:

- Long-term historical system and segment net returns, compared to benchmark;
- Long-term historic net returns to specific asset classes at system-level compared to asset class benchmarks;
- Dispersion of funds and products from a frontier of the best-performing funds and products (based on historical net returns).

We support this approach.

Given the significant performance differences between different sectors and the impact of this on member outcomes, we suggest that the Commission should segment each of these long-term net return indicators as follows:

1. Default funds vs funds distributed through retail channels (including APRA regulated funds and self-managed super funds)
2. Industry super fund / retail fund / corporate fund / government fund / self-managed superannuation fund
3. For-profit fund vs not-for-profit fund
4. My Super products vs non-My Super products
5. Accumulation vs retirement
6. Legacy products (which are closed)

In relation to the third indicator (the dispersion of funds/products from the efficient frontier) we would encourage the Commission to also include member accounts and assets in their analysis, as it will be critical to understand the numbers and location of members impacted by underperformance. It is imperative for this process to quantify the number of members or assets residing in products which exhibit long-term poor performance outcomes.

3.1.2 Costs

The Commission notes that fees and costs detract from net returns. We support many of the proposed indicators which seek to quantify fee and cost trends, including segment analysis of costs relative to return/services, margins and economies of scale. Examination of fees and costs must cover hidden costs including embedded costs and the costs of non-arms' length, related party transactions.

However, as noted in ISA's first submission, while we are supportive of the inclusion of an assessment of fee and cost trends in the Study, reliance on fees alone to gauge efficiency can sometimes lead to a false economy in which net performance is compromised to achieve lower fees. We would strongly counsel the Commission to ensure measurement of fees and costs is secondary to analysis of net returns. A ratio of returns to fees/costs is also recommended.

3.1.3 Asset allocation

Asset allocation is a key driver of performance. Approaches to asset allocation differ markedly between the not-for-profit, retail and self-managed superannuation sectors.

Not-for-profit funds have a higher allocation to unlisted asset classes, including unlisted property, infrastructure and private equity than other sectors. This has been an important factor in the higher net returns achieved by the not-for-profit sector compared with the retail sector over the long term.

Self-managed superannuation funds have higher allocations to cash and property, but tend to be poorly diversified compared to the APRA regulated sector. This contributes to self-managed super funds underperforming APRA-regulated funds over the long term.

The Commission proposes to include a comparative indicator of asset allocation between the APRA-regulated and SMSF sectors. We submit that this should be expanded to include segment analysis of asset allocation differences within the APRA-regulated sector to illuminate the way in which asset allocation differences drive the relative performance of each segment.

We also suggest that comparison of returns, fees and costs, asset allocation and liquidity of the Future Fund would make an interesting point of comparison, cognisant of its entirely wholesale nature.

In the context of a system which is founded on long-term savings, optimising the benefit of illiquidity is a key driver of efficiency and improved returns. Accordingly, we also recommend that the Commission include an indicator which assesses levels of liquidity at both system and fund level. It would be appropriate to test liquidity against an appropriately framed benchmark.

3.1.4 ISA Comment on Assessment Criteria for Objective 1:

The superannuation system maximises net returns on member contributions and balances over the long term

Assessment Criteria	Indicators by exception
Are net investment returns being maximised over the long term, taking account of service features provided to members?	▪ For specific asset classes at system and market segment level compared to asset class benchmarks ▪ Liquidity measure – by segment, fund vs benchmark ▪ Dispersion of funds and products (by segment, with assets and members) from efficient frontier of best performing funds and products

Are costs incurred by funds and fees charged to members being minimised, taking account of service features provided to members?	▪ Measure exempted and grandfathered commissions, including orphaned commissions ▪ Include an indicator to track grandfathered and exempted commissions
Do all types of funds have opportunities to invest efficiently in upstream capital markets?	▪ Include an indicator to compare asset allocation within the segments of the APRA-regulated funds

3.2 Commission Objective 2 – Maximise retirement income rather than meet member preferences

The key system objective relevant for this Study should be focused on maximising stable retirement income, rather than "meeting member …preferences".

Orienting this objective towards the delivery of superior financial outcomes is appropriate for a system-level objective because:

Income is the key system outcome

The key system outcome is delivery of retirement income, and this provides the most rational, objective, tractable and coherent metric for measuring improvements in system efficiency (and assessing whether competition is usefully contributing to this outcome). While other indicators can provide a proxy for enhanced member outcomes, measuring adequacy levels shows actual outcomes, and is easier to measure and interpret.

An increased level and security of retirement income is more consistent with the direction of the Government's objective, which is focused on income provision. Implicit in the notion of "supplement or substituting the age pension" is an expectation that the system will maximise the level and stability of retirement income and in doing so reduces long term fiscal outlays on the aged pension.

Broadening this objective to include more objective financial metrics for efficient pension delivery will also be important looking ahead to the second stage, where the Terms of Reference request the Commission to consider the fiscal implications of default fund processes. In order to model fiscal impacts of various default arrangements, the Commission will need first to understand how improved efficiencies translate into increased levels of retirement income, including distributional analysis across gender, income and age cohorts. ISA is in the process of preparing such an analysis using the ISA/ RiceWarner retirement income model, and will make a further short submission to the Commission to share its findings.

As noted in the Draft Report, while other policy settings have a significant bearing on whether the system is able to deliver improvements in the adequacy of retirement income, their effect can be isolated and do not negate the appropriateness of using levels of adequacy as the most meaningful way of measuring improved industry and system efficiency.

An objective of needs and preference could produce inefficient outcomes

Creating an objective which targets the meeting of member needs and preferences promotes more tailored and atomised approaches to product and service delivery, which are inherently more costly and risk promoting unhealthy competition on non-priced (net return) based features, under the guise of "responding to preferences". Such an approach might be more appropriate if assessing the retail wealth management industry or perhaps the third pillar of retirement security. It is not appropriate for the second pillar, which is a compulsory and subsidised retirement income system formed to achieve a public and social policy objective.

While it is often said that members' needs are heterogeneous, there is no evidence to demonstrate the extent to which more tailored choice options are requested rather than sold, nor of the extent to which consumers understand the high direct and indirect costs of individualised approaches. It would be impossible for consumers today to understand the cost of individualised approaches because retail offerings are not required to be benchmarked against a more wholesale approach.

The introduction of choice of fund arrangements in the accumulation phase were premised on the assumption that active consumer decision making would drive lower costs and improved returns. Yet the evidence shows that the reverse has occurred - the proliferation of expensive, underperforming and tailored retail choice accounts has retarded system efficiency. The choice and SMSF sectors are characterised by higher fees, an extraordinary proliferation of choices and evidence of agency issues with less disclosure and transparency of fees, as recently highlighted by ASIC's actions against "no fee" and "low fee" product claims.

In addition, there are system costs associated with the facilitation of choice, with funds having to increase their expenditure on marketing, product development, IT and administration.

Whilst we continue to support transparency and disclosure of fees in default products, we also support a level playing field across non-default products.

An objective framed around income delivery can assist the system's transition to a mature 2nd pillar

ISA noted in its original submission that there is likely to be significant change and innovation in the development of retirement income approaches or products in Australia. Establishing metrics which place value on the key features which maximise member outcome – level, longevity, stability and certainty - will arguably expedite that innovation.

Members can (and often do) have preferences which are at odds with the Government's key objective for the system: for instance, to 'hoard' their savings as a form of self-insurance, to use superannuation for estate planning or to provide a bequest. While these 'preferences' are not proscribed, they certainly reduce the efficiency of the system, and a number of reform initiatives are in train to address these inefficiencies – including altering tax concessions to start to close off the capacity of superannuation to be used for wealth accumulation and improving system settings for delivery of retirement products which improve the stability, longevity and certainty of income as well as creating better default arrangements.

ISA has also proposed to remove the references to information provision from this objective and add them to a broader objective around system transparency, which is expanded in Section 3.6 below.

ISA therefore strongly urges the Commission to adopt a system-level objective focused on the defining aspects of pension provision, namely a retirement income that (1) is for life, (2) which is maximised, (3) stable, (4) reasonably predictable as members approach retirement, and (5) meets reasonable member needs and preferences (to the extent consistent with system objectives).

We also offer some views about the assessment criteria and indicators which are proposed under this objective. An overarching concern for ISA is that many measures are insufficiently connected to member outcomes, and that all key areas should be assessed against improvements in retirement income provision (aggregate, distributional and cohort adequacy), and the long run fiscal impacts of improved efficiency.

In keeping with our submission above regarding an efficiently operating system, a key assessment criteria should be determining the extent to which the system is ensuring that members' retirement savings are located in funds which will maximise their net returns and thus their retirement income.

We support the inclusion of indicators related to SG compliance and minimising of lost accounts. However, we would also build upon the measurement of system elements to include a measure of retirement income provision. While we are supportive of using development of retirement income products as a measure, products must be tested against the extent to which they improve the level, longevity, certainty and stability of income provision.

The Commission proposes to measure the extent to which funds allocate member asset allocations by age, which implies that lifecycle investment products are in members' best interests. Many industry super funds have undertaken detailed modelling which demonstrates that their members' best interests are not served by lifecycle products which de-risk asset allocations as members approach or commence retirement. There are other approaches which can be taken to address the seemingly competing needs of maximised and stable income provision in retirement – for instance through the pooling of risk among members through group self-annuitisation and collective defined contribution product design.

We are less supportive of the focus on surveying member preferences, except as a secondary area of focus and to the extent that member preferences are consistent with the core objective. However, we query whether it is a worthwhile area of focus, given that member preferences should be accorded significantly less weight than member outcomes.

We would also urge the Commission to measures specific gaps or leakages:

- Residual estates, detailing aggregate, cohort and segments analysis;
- SG gaps, including detailed analysis of the demographics most impacted;
- SG non-compliance including detailed analysis of the industries and demographics most impacted;
- Lost accounts;
- Advice and member engagement – need to assess cost and value; and must include external advice paid for out of super; and
- The long tail of choice investment products which hold very little by way of assets and are a drain on system efficiency.

We would also suggest that the Commission measure the outcomes of corporate tenders, with analysis including both large and SME sectors.

3.2.1 ISA Comment on Assessment Criteria for Objective 2:

The superannuation system delivers retirement income over the member's lifetime that is maximised and reasonably stable ~~in relation to information, products and risk management~~.

Assessment criteria	Indicators by exception
Is the system delivering retirement income which is stable and maximised?	▪ Aggregate, cohort and distributional analysis of retirement income delivery ▪ Long-term analysis of fiscal impacts of improved efficiency ▪ Residual estates, detailing aggregate, cohort and segments analysis ▪ Comparison to a relevant retirement income index ▪ Extent to which LISC/LISTO and government co-contribution contribute to an improvement in outcomes for low income participants, including women

Are member preferences and needs being met by: minimising unpaid contributions and lost accounts	▪ Unpaid Superannuation Guarantee contributions (input) including details of demographics and industries most affected ▪ Delayed Superannuation Guarantee contributions (input) ▪ Number and value of lost accounts (output) ▪ Number of lost accounts reunited with members
Are funds collecting relevant information to ensure their product offerings are suitable for their diverse member bases? We question whether this criteria and accompanying indicators are sufficiently objective and outcome focused, and would exclude for the purpose of this system level study.	▪ Information collection by funds on key member characteristics* (input) ▪ Response rates to funds' member surveys (behaviour)
~~The system providing high-quality information and financial advice to members to help them make decisions?~~ We would include in our additional system transparency objective, below.	▪ Availability, cost and quality of information on fees and investment risks at product level* (input) ▪ Members acting on intrafund financial advice (behaviour) ▪ Member account monitoring activity (use of websites, call centre enquiries)* (input, behaviour~~)~~ ▪ Cost of funds' member engagement activities (input) ▪ Take-up rates of co-contributions and offsets (input)
The system providing products and information to help members optimally consume their retirement incomes?	▪ Introduction of new retirement income products and development of ~~more tailored~~ default products* (output) which enhance stability/longevity/level of retirement income streams are offered. ▪ Take up of different retirement income products which enhance stability/longevity/level of retirement income. ▪ Drawdown rates in transition and retirement phases. ▪ Unclaimed superannuation (output) ▪ Standard definitions for active & inactive members to be adopted industry wide
member balances being allocated in line with their risk preferences and needs	▪ Introduction of new retirement income products and development of ~~more tailored~~ default products* - which enhance stability/longevity/level of retirement income ▪ Asset allocations by age cohort (across different market segments and products) (output) – we strongly disagree that lifecycle investment should always be presumed to improve member outcomes ▪ Member awareness of investment sequencing and longevity risk (query whether this is too subjective)
Is the system using lessons from behavioural finance to design products and 'lean' against well-known biases in how people make decisions?	▪ Dispersion of members in high quality products ▪ Impact of switching - track members who switch within or between products to determine outcomes ▪ Indicators to assess basis of decision-making in the SMSF sector

Are trustees acting in the best interests of members?	▪ Existing ratings of system-wide quality of governance* (input) ▪ Accurate disclosure of trustee directors' and investment committee members' qualifications and relevant skills/experience, remuneration structures and potential conflicts of interest due to related-party dealings and competing duties* (behaviour) ▪ Contraventions of regulator governance standards by trustees, employers, service providers and financial advisers* (behaviour) ▪ Level of skills and standard of performance for trustee boards and investment committees, including review processes* (input) ▪ Member satisfaction and trust

3.3 Commission Objective 3 – the superannuation system provides insurance that meets members' needs at least cost

The Commission has proposed that the superannuation system provides insurance that meets members' needs at least cost.

ISA strongly supports the provision of insurance that is good value and is tailored to the needs of members. However ISA caution against the use of 'least cost' as this will not always result in better outcomes for members.

ISA agrees with the Commission's proposed assessment criteria. However, we recommend additional indicators to assess the value of default insurance cover and the impact of commissions.

3.3.1 Industry SuperFunds' experience

The Commission's description of the bundling of insurance on an opt-out basis in default products as a "constraint"[5] is problematic as it has enabled many Australians to access default insurance that is affordable and in many cases tailored to their demographic. According to Rice Warner, more than 70% of Australian life insurance policies (more than 13.5 million separate policies) are held through superannuation funds. Yet despite this coverage, Rice Warner estimate that the median level of life cover meets about 60% of the basic needs for average households – and a much-lower proportion of needs for families with children.

The rationale for the inclusion of base-level group insurance cover through superannuation in retirement income policy is to provide financial protection for individuals who retire early due to disability or death.

Without the inclusion of base-level group insurance through superannuation, the cost of disability during people's working lives will fall to the government as evidence suggests that it is unlikely that individuals will actively take out insurance cover.

Delivering good value group insurance that meets members' needs is a complex task which involves balancing the insurance needs of members during the accumulation phase against their financial needs in retirement and the interests of different cohorts of fund members. ISFs have rigorous processes for assessing the most appropriate insurance cover for members and minimising the cost of default insurance.

[5] How to Assess Superannuation Competitiveness and Efficiency, Draft Report, Productivity Commission, 2016, P 8

In assessing value and benefits provided, the role of reinsurers should also be considered as they strongly influence pricing outcomes. Consideration should be given to arrangements with reinsurers and whether further disclosure and transparency would assist in meeting objectives.

3.3.2 Recommendations

ISA supports the Commission's proposed indicators, however recommends two additional indicators.

In assessing whether funds offer products that meet members' needs, it is important that the Commission considers the value and benefit of default insurance that is offered to members of a fund. This should enable comparison between sectors, as it is widely acknowledged that default insurance varies between sectors.

In assessing whether the costs of insurance are being minimised, an indicator which assesses the impact of commissions in life insurance sales is relevant to this objective, particularly between related parties.

We recommend that the Commission includes an indicator which quantifies the level and incidence of commission payments in relation to life insurance in super. Commission structures do not just lead to biased advice, they result in excessive churn of life insurance policies, with clients often recommended to change cover to attract the more generous level of commissions in the first year of cover.

3.3.3 ISA Comment on Assessment Criteria for Objective 3:

The superannuation system provides insurance that is good value and is tailored to the needs of members ~~meets members' needs at least cost~~.

Assessment criteria	Indicators by exception
Do funds offer insurance products that meet members' needs?	▪ The value and benefit of default insurance ▪ Assessment of definitions and policy conditions
Are the costs of insurance being minimised given the type and level of cover?	▪ The impact of commissions in life insurance sales ▪ Transparency of reinsurance arrangements

3.4 Commission Objective 4 - System Stability

The Commission has proposed applying two indicators to assess whether there are material systemic risks in the superannuation system: market concentration in upstream service provider markets and leverage within the SMSF sector.

On the latter, the Draft Report proposes that the Commission will consider the rate of growth in the borrowing activities of SMSFs in its assessment of systemic risk. This will be supported by a qualitative assessment of the potential for this activity to generate risks for other parts of the financial system, an assessment of the materiality of those risks and an assessment of the quality of reported data relied on by regulators to understand and monitor the levels of these risks.

ISA strongly supports including a measurement of risks to system stability associated with leveraging by SMSFs.

The Draft Report acknowledges that the stability of the policy and regulatory environment may have implications for dynamic efficiency and that policy and regulatory changes are a potential source of uncertainty and instability that could impact the longer term outcomes of the system.

ISA agrees that policy changes and their frequency are outside the control of the superannuation system. However, while acknowledging this, it nevertheless remains important to measure the impact of such changes on system efficiency. ISA therefore recommends that the Commission develop a specific indicator to measure the impact of policy and regulatory instability on system efficiency.

As noted above, not-for-profit funds consistently make higher allocations to unlisted asset classes, including unlisted property, infrastructure and private equity, than other sectors. As well as contributing to the outperformance of the not-for-profit sector over the long term, the long-term countercyclical nature of these investments also contributes to system stability. Assessment of the efficiency of the system requires measurement of this impact.

The Commission proposes to look to market concentration measures as an indicator of systemic risk. Market concentration is not the same as systemic risk. Fortunately, the measurement of systemic risk has been a matter of significant interest to a number of regulatory institutions around the world. The Commission could instead look to the measures developed for systemic risk. The Financial Stability Board has proposed an assessment methodology for identifying systemically important non-bank financial institutions. The factors in this methodology may be an appropriate starting point for the Commission's work.[6]

The high level factors considered when assessing the global systemic risk posed by an institution include the following. These would need to be modified for domestic application, but this is likely to be a relatively straightforward task:

(i) Size: The importance of a single entity for the stability of the financial system generally increases with the scale of financial activity that the entity undertakes.

(ii) Interconnectedness: Systemic risk can arise through direct and indirect inter-linkages between entities within the financial system so that individual failure or distress can have repercussions throughout the financial system.

(iii) Substitutability: The systemic importance of a single financial entity increases in cases where it is difficult for other entities in the system to provide the same or similar services in a particular business line or segment in the global market in the event of a failure.

[6] Although pension funds are proposed to be excluded from the FSB's assessment, this is because they pose a low risk due to their long term perspective, and because the asset management activity of pension funds is considered to be where the potential risk could lie, and these would be included. If applying these principles, the Commission should only exclude pension funds that satisfy the FSB's rationale, i.e., they have a demonstrable long-term investment approach or their activities are captured in the Commission's assessment by asset managers.

The FSB explained its proposed exemption for pension funds: "Based on this review, the FSB and IOSCO are considering excluding public financial institutions (e.g. multilateral development banks, national export-import banks), sovereign wealth funds, and pension funds from the scope. The FSB and IOSCO are considering excluding public financial institutions and sovereign wealth funds from the scope as they are owned and fully guaranteed by a government. Regarding the proposed exclusion of pension funds, one rationale is that they pose low risk to global financial stability and the wider economy due to their long-term investment perspective. Pension funds are in general also covered indirectly through contractual relationships with asset managers or use of investment funds." FSB-IOSCO consultative document (2d) Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions: Proposed High-Level Framework and Specific Methodologies, 4 March 2015.

(iv) Complexity: The systemic impact of a financial entity's distress or failure is expected to be positively related to its overall complexity, i.e. its business, structural and operational complexity. That is, in principle, the more complex a financial entity, the more difficult, costly and time-consuming it will be to resolve the failing institution.

(v) Global activities (cross-jurisdictional activities): The global impact from a financial entity's distress or failure should vary in line with its share of cross-border assets and liabilities. The greater the global reach of a financial entity, the more widespread the spill-over effects from its failure.

With more than $ 2 trillion in assets, the superannuation sector is a significant contributor to the economy through employment opportunities, investment in real assets and also taxpaying entities. In August 2016, the Australian Prudential Regulatory Authority (APRA) released its quarterly update report on the superannuation system and MySuper products to June 2016. Of note, retail funds were the only APRA-regulated sector not to pay tax, receiving over $5.6 billion in tax refunds over 11+ years. This is partly due to the dividend imputation credits arising from their investments, and to some extent member demographics. We would expect a similar outcome with SMSFs. Therefore, in assessing financial system stability, consideration should be given to the contribution that superannuation funds make to the broader economy including taxation receipts.

3.4.1 ISA Comment on Assessment Criteria for Objective 4:

The superannuation system complements a stable financial system and does not impede long-term improvements in efficiency

Assessment criteria	Indicators by exception
Are there material systemic risks in the superannuation system?	▪ ~~Market concentration (Herfindahl-Hirschman Index and market shares of largest providers) in upstream service provider markets (input)~~ ▪ Review systemic risk from entities based on an appropriate assessment methodology (i.e. the FSB's Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions ▪ Capacity of superannuation funds and the system as a whole to invest counter-cyclically ▪ Capacity of superannuation funds and the system as a whole to make investments based on long-term outcomes, rather than short-term risk management, including liquidity risk ▪ Tax receipts by superannuation funds, by segment

3.5 Commission Objective 5 – Competition that drives efficient outcomes

ISA supports the Commission's focus on improving member outcomes in its examination of competition.

The Draft Report acknowledges the need for caution in assessing member engagement, on the basis that engagement does not equate with sound decision making or member outcomes. ISA strongly agrees with this caution.

Consistent with ISA's point of view throughout this submission, we would urge the Commission to focus on outcomes-based indicators that ensure competition is leading to enhanced member outcomes, rather than seeking to measure engagement or fund insights into member activity. We have provided detailed feedback below on proposed indicators to test demand-side pressures. The Commission has rightfully noted that it is necessary to examine the quality of member engagement and decision making rather than traditional indicators of demand-side pressure – for instance, activity and switching. We would urge the Commission to take a further step and ensure that the assessment takes into account the outcomes of choice.

We have provided detailed feedback below on proposed indicators to test demand side pressures.

The Draft Report identifies evidence of competition concerns relating to the use of vertical and horizontal integration by bank owned superannuation funds. These include evidence that retail funds use banking relationships to cross-sell superannuation products and outsource functions to related parties.

ISA strongly supports the Commission's view that assessment of the efficiency of the system requires an understanding of the impact of competition problems arising from vertical and horizontal integration.

Fees paid for outsourced investment management services are a significant cost to all APRA-regulated superannuation funds. Anecdotally, there is evidence that investment management fees are very high. Also, they have not necessarily decreased as expected in line with system growth and that efforts of individual funds to attempt to negotiate lower fees have not been successful due to the market power of the funds management industry.

Assessment of the efficiency of the system requires an understanding of the impact of investment management fees on member outcomes.

3.5.1 ISA Comment on Assessment Criteria for Objective 5:

Competition in the superannuation system that drives efficient outcomes for members

Note that comment on indicators in other sections is by exception only, but we have provided more detailed commentary in relation to this objective.

Assessment criteria	Indicators
Is there sufficient member engagement to exert competitive pressure?	▪ ISA recommends including indicators to test the extent to which consumer activity leads to enhanced returns. ▪ ISA recommends including indicators to test the extent of up and cross-selling as a driver of choice. ▪ ISA does not disagree with the indicators proposed to track member activity and awareness, however query whether they demonstrate improved member outcomes.
Are members and member intermediaries able to make informed decisions?	▪ ISA supports the tracking of consumer literacy. ▪ ISA queries the tracking of use of intermediaries (advisers and employers) without analysis of consumer outcomes. In particular we urge detailed assessment of corporate tendering outcomes.

Is there low market segmentation along member engagement lines?	▪ ISA does not agree with these indicators as in our view system efficiency should favour more wholesale arrangements which can exploit scale efficiencies. ▪ ISA queries measurement of expenditure on retention vs marketing. It is difficult to capture this expenditure in a comparable manner due to vertical integration in the retail sector.
Do active members and member intermediaries have sufficient countervailing power?	▪ Analysis of SMSFs must focus on outcomes. ▪ The Commission should develop an indicator to assess the value of service providers to the SMSF sector.
Are principal–agent problems being minimised?	▪ ISA is generally supportive of these indicators, although are less supportive of member satisfaction surveys.
Is there rivalry among incumbent providers?	▪ Indicators related to the number of institutional funds should examine size and scale of funds and relationship to performance benchmark.
Is the market contestable?	▪ Proposed indicators regarding default funds will be difficult to reliably assess given the stalling of the FWC process. ▪ ISA queries the assumption that more default funds are desirable without an assessment of performance history and quality of contesting funds.
Are there material anti-competitive effects of vertical and horizontal integration?	▪ ISA supports the proposed indicators however would recommend that related party analysis also include fund managers.
Do funds compete on costs?	▪ ISA supports the proposed indicators subject to these being subordinated to net return indicators
Are economies of scale utilised and the benefits passed through to members?	▪ ISA is supportive of these indicators
Do funds compete on relevant non-price dimensions?	▪ ISA queries the reliability of member awareness surveys. ▪ We would urge the Commission to examine the dispersion of funds from an efficient frontier as a clearer indicator of non-price/return competition
Is there innovation and quality improvement in the system?	▪ ISA notes that the reduction in the number of products must be linked to the quality of products ▪ Innovation in retirement products must include assessment of whether new products enhance stability/longevity/level of retirement income

Are outcomes improving at the system level?	▪ ISA reiterates that unless the Commission undertakes an analysis of retirement income, it will not be possible to ensure that competition and efficiency result in improved consumer and system outcomes. For instance, is switching leading to enhanced returns?

3.6 Transparency and accountability

ISA proposes an additional system-level objective focused on system-level transparency and accountability. The objective could be worded as such: The superannuation system is transparent and accountable and provides information to members about their superannuation and/or retirement income.

Articulating accountability and transparency as an objective will allow the Commission to examine gaps in the regulatory framework which hinder the comparability of products at a system level, the provision of information to members, and the transparency of fees and payments which impact member returns. ISA considers this information essential to the assessment of system efficiency.

3.6.1 Industry SuperFunds' experience

ISA supports greater transparency by all super funds of data about fees, costs and long term net performance.

Consumer disclosure and engagement, while important, is not sufficient to enliven competition in the superannuation system or result in efficiency driven by consumer demand.

Disclosure and performance data and official statistics are therefore critical for government, regulators, analysts, and commentators to measure the efficiency of the superannuation system, compare the efficiency of different sectors, and identify areas of inefficiency. Comprehensive, accurate product-level performance data is also a crucial governance tool for funds themselves.

However, the existing disclosure regime and data published by regulators does not enable this to occur due significant data gaps and inconsistent disclosure and data reporting requirements. Some important examples include difference between:

- MySuper products and choice products - disclosure of fees and underlying costs, detailed statistics on performance, assets, member population at the investment option level.
- Retail funds and not-for-profit funds
- APRA-regulated funds and SMSFs.[7]

Historically, the retail superannuation sector has fiercely resisted accurate, consistent disclosure of performance. This is most recently demonstrated in the response of the sector to the long overdue implementation of product dashboards for choice products.

The fractured nature of the current disclosure regime has resulted in an uneven playing field for providers and consumers. ISA's key concerns are summarised in Figure 4 below:

[7] See ISA's first submission to this Study regarding SMSF data issues (Pages: 6, 20, 56).

Figure 4 – Gaps in disclosure

Issue	Explanation
Rules are inconsistent at both sector and segment level	▪ There is no universal requirement for collection and publication of official data on all products and options including assets, fees and costs and returns.
No requirement to disclose underlying costs	▪ There is no obligation on platform providers (which form the majority of the retail choice sector) to disclose underlying costs to consumers, the market generally or APRA. It is extraordinary that, given the amount of superannuation invested via platforms, there is no reliable, publicly available data about fees and costs for this sector.
Lower reporting requirements for SMSF segment	▪ The reporting requirements of the SMSF segments are not in line with the APRA-regulated segments, which hinders comparability and assessment of the efficiency of this sector. While availability of data has improved over time, there are still significant problems with the data which limit the ability to accurately measure the performance of this sector and compare this with the APRA-regulated segments.
Rules do not apply to legacy products	▪ The key disclosure requirements do not apply to legacy products, which hold around one third of retail choice members' assets. Therefore there is no publicly available data on the returns delivered by these products and exit fees are typically high. Independent analysis has demonstrated that legacy products are more costly than current products.[8]
Gaps in governance disclosure	Inconsistencies and gaps in the disclosure framework hinder the capacity to monitor the governance of funds. This is particularly the case in relation to disclosure of related party transactions where the key gaps include: ▪ No requirement that RSEs disclose significant information regarding each material professional and financial service provider it retains, including the fees paid to that service provider, and whether the service provider is a related entity of the RSE licensee. ▪ No requirement that material professional and financial service providers disclose their revenue from superannuation. ▪ No obligation on RSEs to ensure that all related-party transactions are conducted on terms no more favourable to the related party than would be reasonable if the fund were dealing at arm's length. ▪ Limited and inconsistent transparency in relation to the corporate tender process and outcomes.

[8] Rice Warner, Superannuation Fees, 2014

3.6.2 Suggested indicators

Based on the discussion above, ISA proposes the following key indicators for assessing whether the super system is transparent and accountable to enable comparability of products, to facilitate assessment of the system and to better inform consumers of matters related to fees and fund governance.

- Assessment of the extent to which official comparable data is published on all products/options including assets, fees and costs, returns, members etc.
- Assessment of whether SMSF statistics enable comparisons with APRA sector; identify gaps etc.
- Comparable and clear information about all underlying fees and costs across segments.
- Indicators to assess whether improvements in transparency of corporate tender process & outcomes.
- Indicators of required disclosures around fund and product governance.
- Provision of high quality financial advice and information:
  - Take up and value of intra fund advice;
  - Use of online tools;
  - Member activity metrics;
  - Take-up and value of external financial advice which is funded from super; and
  - Outcome based measure of member engagement – that is, measured against improvements in retirement income.