9 September 2016

Productivity Commission
Level 12, 530 Collins Street
Melbourne VIC 3000

Submission to draft Productivity Commission report in relation to the competitiveness and efficiency of the superannuation system

Dear Commissioner

AMP appreciates the opportunity to provide a submission in response to the Commission's Draft Report. As the Commission would be aware, AMP is one of the largest providers of superannuation products and services and accordingly has a vital interest in the outcome of this review.

In brief, our submission argues:

- That an alternative objective for the superannuation system should be used to that set out by the Commission

- That not enough time has elapsed from the start of the *MySuper* reforms for the Commission (or any other body) to reliably assess the competitiveness and efficiency of the superannuation system

- That the proposed assessment methodology is problematic

- That an analysis of why individuals are not engaged with superannuation could prove useful

- That a strong case exists for insurance to be retained within superannuation.

System Objectives

The draft report sets out what the Commission believes ought to be the objectives of the superannuation system including that:

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

- The superannuation system meets member preferences and needs, in relation to information, products and risk management.

- The superannuation system provides insurance that meets members' needs at least cost.

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

- Competition in the superannuation system that drives efficient outcomes for members.

AMP believes that these objectives confuse means and ends, and are at best intermediate objectives.

We suggest instead that a simpler objective should be adopted.

AMP considers that the aspirational objective of superannuation should be to lift Australians out of the welfare safety net of the age pension. That is, we should aspire for as many Australians as possible to have dignified self-funded retirements. By self-funded, we mean that an individual's retirement income should be self-funded through the whole of their retirement, not just at its commencement.

Of course this is an aspirational target so the broader community needs to continue to ensure that there is an adequate safety net for individuals who cannot save enough to meet this objective. As we are all aware, at this stage, most Australians will not have adequate retirement savings until the system fully matures.

We therefore suggest the objective should reflect the need to provide an income to support a dignified retirement for all Australians, including encouraging the self-provision of retirement income, while maintaining a sound welfare system which provides a full or part-pension to achieve an adequate retirement income.

The distinction between the overarching aspirational objective that we propose and the Commission's intermediate objective approach is important.

The danger with the Commission's approach is that its intermediate objectives might not, in fact, be consistent with (what should be) the overarching objective of superannuation. There is a concern that these sub-objectives might take on a life of their own as objectives in their own right, with policy makers and politicians focussing on these subsets.

These intermediate objectives, in the final analysis, might also be inconsistent with each other. For example, competition and financial system stability, in some circumstances, might be in conflict.

The draft report makes numerous references to behavioural biases that can affect people's decision making, which by implication can limit the effectiveness of competitive forces.

This is true, up to a point.

Not all consumers are confused by superannuation – many are very well aware of the choices available to them and act accordingly.

However, it is important for the Commission not to get overly concerned with the idea of behavioural biases. Many of the problems, and impediments to competition, which flow from these biases can be solved if consumers receive appropriate financial advice from professionals who have the skills to navigate their clients through the system.

AMP would be deeply concerned if the Commission, out of a perceived need to "un-confuse" consumers by presenting them with fewer choices, jumps to premature and inappropriate policy recommendations, such as restricting the number of default superannuation products.

In any event, to the extent that behavioural biases are significant, this points further to the need for a simple objective for superannuation.

Timing of the Third Phase of the Inquiry

AMP agrees that the Productivity Commission is the right body to conduct an inquiry into competition and efficiency in the superannuation system, but we do not believe that next year is the time to do it.

Our misgivings with the timing of the inquiry arise because it is only three years since the *MySuper* reforms began to be implemented. It will be only four years when the Commission begins to measure efficiency and competitiveness of the superannuation system (July 2017, according to the Draft Report). We note that the transition of existing account balances to MySuper will be completed by 1 July 2017.

The *MySuper* reforms were introduced to provide people with relatively easy choices amongst superannuation products in terms of key characteristics like investment options, insurance cover, fee structures and financial advice.

These reforms were intended to foster competition between superannuation funds and by implication also to foster efficiency, with APRA tasked with publishing data on fees and other indicia of competition. The reforms were probably the most important changes to super since the introduction of the Superannuation Guarantee in 1992.

As the then-Government made clear at the time, *MySuper* was intended as simple, cost-effective superannuation product that would replace – not complement – existing default products.

However, *MySuper* was not introduced on a 'big bang' basis. Superannuation funds were given time to comply with the associated regulations (such as moving default balances to a *MySuper* product over time) and funds have moved at variable speeds in introducing *MySuper* products.

As a result of the *MySuper* reforms, the superannuation system is continuing to evolve. It is in a state of flux, and has not yet reached the kind of 'equilibrium' needed to properly assess its efficiency and competitiveness. The table below, sourced from APRA data, shows how the total assets in *MySuper* products grew from zero (by definition) as at 30 June 2013 to around $470 billion as at 30 June 2016. This was around 22% of all super assets and 32% of super assets excluding SMSFs.

MySuper Assets (as at 30 June 2016, ($'000))

	retail	industry	corporate	public sector	Total
2014	$15,451	$244,003	$16,990	$84,987	$361,430
2015	$31,801	$278,795	$17,054	$97,182	$424,831
2016	$49,250	$297,023	$19,210	$103,898	$469,381

Source: APRA statistics

The table also shows the current dominance of industry funds in *MySuper* assets.

Industry funds account for 63 per cent of *MySuper* assets, which is roughly double their share of total non-SMSF super assets. Retail funds account for just 10 per cent of *MySuper* assets, which is more than double their share as at 30 June 2014, but still well below their share of total non-SMSF assets (47 per cent).

Corporate funds are slightly over-represented in *MySuper*, comprising 4.1 per cent of *MySuper* assets compared to 2.6 per cent of all non-SMSF assets.

Clearly, retail funds got off to a relatively slow start in *MySuper* which was largely because many industry funds immediately rebadged their products as *MySuper* products and most retail funds could not.

However, the more significant point is that the Commission cannot possibly undertake an analysis of competition between types of funds - at least not an analysis which could be used as a basis for future policy reform - when retail funds are still catching up on the *MySuper* reforms, and the data that the Commission will have will only reflect this transition period.

A related point is that, inevitably, an analysis of competition will look at rates of return, both gross and net of fees.

However, to be meaningful, this can only be done over a full investment cycle. The length of investment cycles varies by asset class, amongst other factors, and this makes like-for-like comparisons, in terms of gross returns, costs and fees very difficult.

For example, as is well-known, for a variety of reasons, industry funds invest a much larger proportion of their assets in infrastructure and unlisted property than retail funds. According to APRA statistics, as at 30 June 2016, industry funds had 8.3 per cent of their assets in unlisted property and 6.7 per cent in unlisted infrastructure. For retail funds, the proportions were just 5.5 per cent and 1.4 per cent, respectively.

Also (as is well-known), there is an illiquidity premium attached to unlisted assets.

This premium, together with the different asset composition of industry funds, largely accounts for their apparent out-performance, in the short run, and makes short-run performance comparisons between industry funds and other funds highly problematic.

Furthermore, while unlisted assets are revalued every quarter, these revaluations (at least in the short run) are smoother than the market-based revaluations of listed assets, so funds that are overweight in unlisted assets are likely to have less variance in their returns, further complicating competition and efficiency analysis.

Over the long run – the relevant time frame for superannuation – these factors will be much less of an issue and so which investment strategy is superior, over all dimensions of performance, and whether competition is strong enough to drive consumers towards superior performing funds, will become apparent.

However, the Commission, at this time, has only short runs of data to assess.

At very best, this will be useful for the analysis of the short-run dynamics of competition and efficiency, but this will be of very limited usefulness for an assessment of the superannuation system, where people have investment horizons of 40 years or so when they are in the workforce, and the 20 years or so when they are retired.

Assessment Methodology

The difficult task that the Commission has been set is evident in the assessment methods and evidence sources that it will use to assess competition and efficiency.

For example, in Table 5.1, the draft report lists 23 indicators of demand side competition and efficiency. The great majority are to be assessed using "trend analysis".

It is not altogether clear what this means, but presumably this will mean plotting data points on a chart and seeing whether they are going up or down.

But there are only going to be three or four annual post-*MySuper* data points.

This will be insufficient to identify a short term cycle, much less a trend. The Commission also won't be able to reliably make any observations on the very important trade-offs between the benefits of more competition and the benefits of economies of scale and scope, or to draw robust conclusions on a host of other issues.

The sources of evidence that the Commission proposes includes surveys.

If superannuation fund members are going to be surveyed, their responses are only going to be useful if members are at least reasonably well-informed about the industry, and the features of alternative products and prices.

But, as is well known consumers (of superannuation products) are not, on the whole, well-engaged, so it is hard to know what surveys will achieve, other than to confirm what we already know, which is that people are not as engaged as they could be, and should be, with their superannuation.

Accordingly, AMP is sceptical of the claim in the Draft Report (p199) that "there is scope for more robust analysis of survey data using econometrics".

More generally, AMP doubts that the Commission will be able to reliably estimate, using econometric methods, the determinants of price-cost margins using econometric techniques (p102), whether fees reflect scale economies (p102), investment performance (p118) and other ambitious tasks it has set for itself.

AMP is particularly sceptical about the use of data envelopment analysis for estimating efficiency frontiers (p117), due to problems of data (non) comparability.

Superannuation products and services are not commodities, and the data comparability issues, between different providers, and even between different products from the same provider, are formidable.

Individual Engagement in Superannuation

One useful thing the Commission could inquire into is why people are not engaged. There are many possibilities – perhaps people are not engaged because superannuation is compulsory and not a form of saving they would undertake if it were voluntary, or, relatedly, perhaps they think the Age Pension will always be there for them in any event, so it doesn't much matter if their superannuation investments perform poorly.

This would be a very useful hypothesis for the Commission to test, which would not require a long run of time series data.

Insurance in superannuation

AMP considers that opt-out insurance provided through superannuation is a positive and appropriate feature of our system. Without it, many Australians would have no insurance to assist in times of prolonged illness, disability or in the event of the early death of a member.

Insurance should not simply be evaluated on price as proposed by the Commission. While price is an important consideration, so is coverage and service, particularly at time of claim.

The previous Government clearly considered that the benefits of insurance through superannuation merited an opt-out system in the *MySuper* reforms, and AMP considers that these arrangements should continue.

Summary

In summary AMP proposes that:

- the Commission recasts the objective of the superannuation system to be to lift Australians out of the welfare safety net of the age pension. The system objectives detailed in the draft report should be set as intermediate objectives.

- that 2017 is too soon after the full introduction of the *MySuper* reforms to assess the competitiveness and efficiency of the superannuation system, which is still in transition. Ideally, the Commission's work should be delayed by (at least) five years. If not, the conclusions of the inquiry will need to be clearly marked as preliminary, incomplete and certainly without any necessary implications for further changes in policy.

- That a potential fruitful analysis for the Productivity Commission to pursue could be to determine why individuals largely are not engaged with their superannuation. After all, in most cases it is the second largest asset that most individuals have.

We would be pleased to discuss insurance related issues with the Commission and I can be contacted

Yours sincerely,

(Alastair Kinloch)