30 July 2018

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Submission – Superannuation: Assessing Efficiency and Competitiveness – Productivity Commission Draft Report

By David Bell

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***** The views expressed are solely those of the author and should not be assigned to any of the above-listed groups. *****

Summary

Credit to the Productivity Commission for completing such a broad piece of research. I am certain that a number of the initiatives, if implemented, would deliver significant benefits to working Australians, present and future.

While respecting the quantity and breadth of work undertaken by the Productivity Commission, it doesn't mean that I agree with all of the recommendations. However I am writing as a sole person, so I'm sure there are areas where I am outflanked from a knowledge perspective by the Productivity Commission – I certainly hope this to be the case!

My submission proceeds to a collection of short reflections / essays (as short as possible) on a number of topics relevant to the Draft produced by the Productivity Commission. Some of these may represent mild critiques, others an alternative way of thinking, and some may be a topic not considered in depth by the Productivity Commission. It is possible that some of these are "elephant in the room issues" that haven't been considered or are in the too hard basket.

My overall reflections are that there are many ways to remove the issue of multiple accounts and to rid the superannuation industry of a tail of high fee, poor performing funds. Improving defaults and member engagement are far more complex issues. The model proposed by the Productivity Commission has much to credit but I also have many concerns. The themes of these concerns can be drawn from the reflections below.

Very happy to catch up and help in any way possible.

Short Reflections / Essays

1. What Preferences does the Productivity Commission Assume on Behalf of the Australian Population?

Lifecycle theory considers the working, spending, saving, and investment behaviours of individuals. Lifecycle theory is supported by a life cycle model; such frameworks have existed in academia for around fifty years. And at the heart of every life cycle model is an objective function.

The Productivity Commission has not chosen to go down the life cycle framework path as a cornerstone of its review. This is unfortunate as a lifecycle framework could provide insight into a number of issues, such as the appropriate degree of risk for a default fund, the value of lifecycle strategies, and the benefits of areas such as personalised defaults, future innovations, and financial advice.

Nonetheless it is relevant to consider the preferences implied on behalf of the population. Though not clear, the language throughout the Draft Report (April 2018) suggests implied preferences described as follows:

- Focus on lump sum outcomes (the primary alternative being lifetime income), a "to" rather than "through" focus
- Constant relative risk aversion (broadly, the investor tends not to change the percentage of his/her wealth invested in risky assets when his/her wealth increases)
- Silent on the degree of risk aversion, though there are some hints that the Productivity Commission consider the risk of a Balanced Option to be appropriate

My interpretation of the Productivity Commission's implied preferences is represented by the following formula:

$$u(w) = -e^{-\gamma_w w}$$

where *u(w)* is the utility of accumulated superannuation wealth at retirement, and γ_w is an undefined measure of risk aversion (but one which is consistent with the Productivity Commission's view that a Balanced or Growth option is broadly appropriate throughout life).

For more information on developing utility functions, refer to the Working Paper included in the MDUF (Member's Default Utility Function)[1] website materials (http://www.aist.asn.au/media/995162/mduf_working_paper.pdf).

2. The Productivity Commission Focuses on Accumulation and Not Directly on Retirement Outcomes

[1] Member's Default Utility Function version 1 (MDUF v1) provides a framework for holistically capturing many of the important elements of retirement. This work was produced over 18 months by a 14-strong group of leading industry and academic researchers and is freely available to the public through the support of the joint custodians of this work, industry bodies AIST and ASFA.

The Productivity Commission specifically focuses on the accumulation phase for their efficiency measures. Is it appropriate to separate the accumulation phase from the post-retirement phase? Is this a distinction for convenience or merit?

Three examples highlight the connections between accumulation and drawdown, thereby highlighting the need for a whole-of-life focus:

(1) Risk: Risks to the drawdown phase can often be hedged with accumulation assets. An example is annuity purchase price risk (detailed in many textbooks and academic papers). The purchase (full or part) of a life annuity at retirement represents a substantial investment in a long-dated fixed income security. Effectively there is a large single point of risk event, namely the yield of the annuity / benchmark fixed income security at the time of retirement. To hedge this risk one can ladder into longer-dated bonds during the later years of the accumulation phase. This is one of the justifications of a lifecycle strategy. This example also highlights how one super fund's accumulation strategy may not mix well with another fund's post-retirement strategy.

(2) Funding: For many funds the percentage (by number of people and by assets) in post-retirement versus accumulation is small. The Productivity Commission's focus on accumulation efficiency may contribute to a silo focus within super funds. Specifically funding for post-retirement solution design most likely needs to be subsidised by accumulation assets (which is acceptable as they will ultimately benefit from this research). A focus on accumulation efficiency may mean less spent on post-retirement solutions, hence inferior retirement outcomes.

(3) Legislative recognition: Through Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017 there exists legislative recognition that connects post-retirement solutions into the accumulation phase. The Amendment specifically allows for retirement income stream solutions which are purchased during the accumulation phase (typically on a staggered basis). This extends the accumulation phase far beyond the relatively simple (existing) accumulation account concept which would support the Productivity Commission's view of separating the accumulation and post-retirement stages. Leading practice retirement solutions of the future are most likely to be designed from a whole-of-life perspective.

The Productivity Commission raises valid points around the varied use of superannuation account balances at retirement (retirement income, one-off purchases, debt reduction, bequests).

3. How Well Equipped is the Productivity Commission to Assess System Outcomes?

By not formalising a degree of risk aversion, the Productivity Commission restricts itself to "in-expectation" type analysis. This limits the ability of the Productivity Commission to provide guidance on issues which impact variability (e.g. appropriate risk level for defaults, balanced versus lifecycle approaches etc.).

By considering accumulation rather than full lifecycle outcomes the Productivity Commission cannot produce fully formed views on the value of whole-of-life products and the benefits of risk management strategies which extend across the accumulation / post-retirement categories.

4. A Broader Definition of Efficiency

The superannuation industry spends fees on behalf of its members and takes investment risk on behalf of its members. Thus efficiency should be viewed through two lenses:

(1) The efficiency of how fees have been spent;
(2) The efficiency for how risk has been translated into investment performance.

Even once we acknowledge the many different contexts in which the word “risk” is used in the Draft Report (and also acknowledging that the word “fee” is used in multiple contexts), a quick word count of the Draft Report reveals:

- “Risk” appears 357 times
- “Fee” appears 946 times

5. How Well Does the Productivity Commission’s Approach Align with the Government’s Objectives for Superannuation?

There are two relevant considerations for Government to consider:

(1) Is the Productivity Commission’s focus on accumulation strongly aligned with the Government’s own views of superannuation, broadly (though not yet enshrined) as *“to provide income in retirement to substitute or supplement the age pension”*[2]? This is considered in Reflections (1), (2), and (3).

(2) Should the term “efficiency” consider both efficiency of fees and also the efficiency of transferring risk into outcomes? This is considered in Reflection (4).

6. How Much Risk Should a Default Super Fund Target?

Little guidance is provided by the Productivity Commission as to what degree of risk is appropriate for default superannuation funds to target. Broadly the level of risk, if efficiently managed, will be the primary driver of long-term investment outcomes.

If not addressed then the ability to compare funds will be difficult and there will be a likelihood of large performance differentials between super funds with equivalent underlying quality.

The operation of an expert panel will be constrained without clear direction on the appropriate level of risk that should populate a default fund.

As discussed in Reflection (1) the Productivity Commission appears to reflect preferences over accumulation balances at retirement but is silent on the degree of risk aversion.

[2] Superannuation (Objective) Bill 2016

7. Will Effective Engagement be More Difficult Under the Proposed "Best in Show" Assisted Employer Choice Model?

In a number of industries engagement models are collaborative. A fund will work with the relevant union and the employer to provide relevant and tailored engagement and education. I have seen this model work in the coal mining industry, resulting in good outcomes for members.

Under a "Best in Show" model these collaborative engagement opportunities will be far less likely to occur. An employer would find it difficult to engage with a large number of funds, and there would be less union involvement.

The Productivity Commission may consider that this opportunity cost only impacts a small proportion of Australia's population. The Productivity Commission may consider this cost small relative to the overall benefits delivered by the "Best in show" model.

8. What Outcomes are Being Targeted from Engagement?

Has the Productivity Commission sufficiently distinguished between the good and bad outcomes of engagement?

Clearly one targeted outcome is for people to switch away from "poor" funds. But "poor" itself is only really categorised in the Productivity Commission as expensive funds which have delivered low performance.

But given the poor financial literacy levels in Australia (I use the word "poor" because the questions used by Lusardi and Mitchell are to assess basic levels of financial literacy, not moderate or advanced), what other outcomes are targeted by the Productivity Commission's focus on engagement?

This question is asked given the Productivity Commission's view that:

"Informed members are those who know the basic details of their superannuation (or outsource this knowledge to a reliable financial adviser) such as (in approximate) their balance, their projected retirement income, the fees they pay (including premiums for insurance) and how their current fund and product compares to other broadly comparable options."

- Choosing between moderate, good, and very good funds is a difficult task.
- It needs to take a long-term focus.
- It needs to account for risk.

Can we really lift consumers to be able to make decisions on this basis?

Possible adverse outcomes are:

- "False positives": members incorrectly identifying a fund as poor
- Fund turnover: time, member fees, and industry expense of higher turnover
- Mis-understanding of investment risk resulting in a poor choice of investment option within a fund

9. Is this a "Top of the Cycle" Review and Would this Impact the Analysis?

The post-GFC bull run has now extended into its 10th year. Funds with the largest asset allocation to growth assets have enjoyed a healthy tailwind.

Meanwhile, the last 10 years has been a golden period for private assets. Using the table below I estimate that a simple collection of unlisted growth assets (1/3 each to private equity, unlisted property, and unlisted infrastructure has returned 8.33% pa) has outperformed a simple collection of listed growth assets (40% Australian shares, 40% unhedged international shares, and 10% each to Australian and global listed property has returned 7.5%) by nearly 1% pa.

Table 2: Asset Sector Performance (Results to 30 June 2018)

	1 Mth (%)	Qtr (%)	1 Yr (%)	3 Yrs (% pa)	5 Yrs (% pa)	7 Yrs (% pa)	10 Yrs (% pa)	15 Yrs (% pa)
Australian Shares	3.2	8.4	13.2	9.1	10.0	9.0	6.3	9.5
International Shares (Hedged)	0.2	3.4	10.8	8.6	11.1	10.5	7.3	7.9
International Shares (Unhedged)	2.3	5.5	15.4	10.0	14.9	15.0	9.2	7.4
Private Equity	0.1	2.2	17.6	12.7	16.1	13.4	9.1	-
Australian Listed Property	2.3	9.8	13.2	10.0	12.2	13.6	6.1	5.8
Global Listed Property	2.0	7.3	6.4	6.9	8.8	9.8	6.8	-
Unlisted Property	1.9	2.4	10.4	11.4	10.6	10.0	6.8	-
Global Listed Infrastructure (Hedged)	2.9	6.1	4.2	9.3	11.7	12.8	-	-
Unlisted Infrastructure	1.7	1.6	12.6	15.1	12.9	11.9	9.1	-
Australian Bonds	0.5	0.8	3.1	3.4	4.4	5.3	6.1	5.5
International Bonds (Hedged)	0.2	0.1	1.9	3.8	5.0	5.8	6.9	6.6
Cash	0.2	0.5	1.8	1.9	2.2	2.7	3.3	4.2

Source: Chant West

Will these trends continue into the future? Of course not indefinitely – markets oscillate to (an unfortunately) unpredictable degree.

Words such as *"highest net returns to members"* (page 24 of Draft Report) potentially suggest a focus on returns without an equivalent consideration of risk. I'm sure this is not the case.

However it is a behavioural trait for people to focus more on returns and less on risk in markets which have conditioned people to ongoing strong market performance.

10. Reflections on Lifecycle Strategies

I feel like lifecycle strategies have been dealt an unfairly harsh assessment by the Productivity Commission. There is the potential that three issues, which should be separated, are being treated jointly:

(1) The appropriate amount of risk appropriate for a member's retirement account balance;
(2) The Productivity Commission's focus on accumulation outcomes rather than retirement outcomes;
(3) The relatively infant design of existing lifecycle strategies.

The Productivity Commission provide a basic example (which I have not verified) considering the expected opportunity cost of a lifecycle strategy ("$130,000"), along with a basic description of the range of downside scenarios. However it is the experience / impact of the full range of scenarios

which is important. The Productivity Commission do not undertake such an analysis, which can be readily accommodated by applying stochastic analysis and using a utility function (Reflection (1)).

The Productivity Commission uses the lens of accumulation balance at retirement rather than retirement outcomes. They may be assessing products designed for a purpose (retirement outcomes) different to the one they are assessing (accumulation outcomes). This ties back to Reflections (1) and (3).

Lifecycle strategies currently have basic design, predominantly age-based. There are exceptions, notably the leadership role taken by QSuper. This is at a time when data and technology provide the opportunity for giant advancements in the design of personalised lifecycle strategies. Such strategies could account for:

- Age
- Balance
- Contribution rate (which entails non-contribution due to career breaks etc)
- Gender
- Expected returns
- Risk

From personal experience I know that the algorithms for these strategies have already been designed and the improvement to member outcomes is significant. In my view these innovation-led improvements to outcomes exceed the competitive grind of investment management – they represent the lowest hanging fruit because it is where the least focus has been applied.

Yet the Productivity Commission is unable to assess this potential (Reflection 3). Because if its own limitations the Productivity Commission's Draft appears uncomfortable and lacking in authority in its wording around lifecycle strategies, and the potential for more advanced personalised lifecycle strategies. Faced with the inability to readily compare lifecycle strategies and balanced strategies on a formalised risk-adjusted basis, the Productivity Commission has recommended only lifecycle strategies be used for MySuper options. This represents a major foregone efficiency opportunity.

Providing some further clarity on lifecycle strategies:

- One of the drivers was a more constant dollar risk profile – in theory (i.e. without leverage constraints) this can lead to a lower distribution of accumulation outcomes with no reduction in expected outcome.

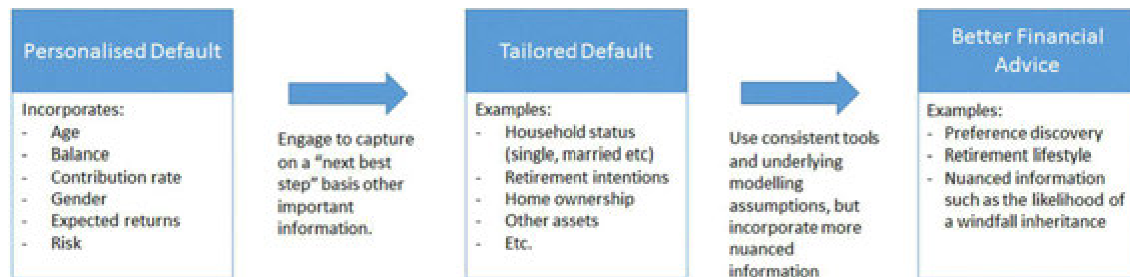
- Historically, and particularly in the US, one of the motivations of lifecycle strategies was to transition from growth assets into long-dated bonds to manage annuity purchase price risk (the risk of making a one-off purchase of a life annuity at a time when the yield is very low). Australian's do not annuitise to the same degree (at present) so this design element is less relevant. The dispersion in outcomes amongst US lifecycle strategies was more a result of poor agent based product management issues (these products were benchmarked and taking more risk pre-GFC was an outperformance strategy).

11. The Potential for Personalised Lifecycle Strategies

As outlined in Reflection (10) I believe the outcome benefits of personalised lifecycle strategies are significantly large. However this is only one step down an alternative path which would release significant benefits to members. Two additional steps include:

(1) An engagement model to capture the "next most important" pieces of information which can be incorporated into an updated lifecycle design;
(2) An uplift in financial planning tools and risk profiling practices, which in my opinion, are below where they need to be.

These two points are reflected in the diagram below:



12. Is There Any Reason to Excuse the Inability to Invest in Unlisted Assets?

As outlined in Reflection (9) it appears that unlisted asset exposure has been a large driver of outperformance. The Productivity Commission has addressed this issue by creating two benchmarks, BP1 and BP2. These allow the Productivity Commission to estimate operational value-add of retail and not-for-profit funds.

There is a more fundamental question however: if the focus is on member outcomes should retail funds be excused from a system-wide performance assessment?

There is a suggestion that retail funds do not invest into unlisted assets due to their lack of stable cashflow. However the operational complexities of investing in unlisted assets is another reason why retail funds have not invested in illiquids. Distinguishing between constraints and capability is an important issue.

Members will not excuse weaker overall returns on the basis that their default fund didn't invest in unlisted assets.

Of course there is a reasonable chance that unlisted assets will not outperform listed assets in the future. Nonetheless it cannot be disputed that profit-for-member funds have an additional capability, and operationally, an additional degree of freedom by which to construct portfolios: they have exposure to more investment opportunities which could enhance returns and provide diversification. This would surely be valued as an advantage by any expert panel…

13. Liquidity Risk – The Concept of a "Best in Show" Model Introduces Fund Level Risks and Reduces Overall Sector Opportunity to Invest in Illiquid Assets

Should there be liquidity limits on funds? Not-for-profit funds have invested to varying degrees in unlisted assets, partly based on their fund cashflow profiles. Presumably (though I have not seen an

assessment of this) fund exposures to unlisted assets are proportional to their cashflow profiles and their confidence in their future profile.

The "Best in show" model could change this. What happens to a fund with a high allocation to unlisted assets based on a strong cashflow profile, which then doesn't make it on to the "Best in show" list? Their cashflow position has changed but they have no ability to readily (in a timely and cost effective manner) reduce their exposure to illiquid assets. Remaining members are now exposed to a potentially inappropriate liquidity mismatch.

One solution, to assist in managing this risk, would be the imposition of industry-wide liquidity limits.

Those funds which find their way on to the "Best in show" list also have no long term certainty around the inflow of new default members. They would then need to be prudent around their decision regarding illiquid asset exposure.

The overall impact is potentially a system-wide reduction in exposure to illiquid assets, which effectively means less diversified, and potentially lower returning portfolios (though this second claim is not certain).

14. Forecasting Potential Outcomes of a "Best in Show" Model

What would be some of the potential practical outcomes of a "Best in show" model?

- Unions may strongly encourage their members to actively select their former award nominated fund. This may not be a bad thing, but it may reduce the targeted outcomes of the Productivity Commission's modelling.

- There may potentially be an even greater degree of advertising, amongst those on the list (maximise the prominence of being on the top 10 list when a person goes to choose), and amongst those not on the list (advertising is an alternative organic growth model).

- Peer focus – though the Productivity Commission identifies this as a bad outcome, it remains a likely outcome under the "Best in show" model. Some of the behaviours that peer grouping discourages are:

    - Strategies to diversify a portfolio
    - Portfolio protection strategies
    - Risk-driven asset allocation decisions

- Focus on fees – fee savings are good to a degree, but at a certain point of efficiency, lower fees means a lower quality portfolio in terms of the potential mix of assets and the active manner in which those assets are managed. A case in point in Mine Super is that we were prepared to raise our investment expenses to accommodate a switch from lower cost bonds into higher fee alternatives (based on our long term low return forecasts for bonds).

15. Other Models Potentially Left Aside

There are other product-types the Productivity Commission may not have considered. The most notable example is:

- Collective DC / Target DC funds – broadly a non-guaranteed DB fund, these structures enable intergenerational risk sharing which can lead to higher and smoother retirement outcomes across population cohorts. I presume UniSuper has provided more detail on the benefits of such a structure.

To properly assess the benefits of such as strategy would require a lifecycle framework (Reflection (1)) combined with overlapping generations modelling.

The main driver of additional efficiency is sharing and then fairly re-distributing risk across the population rather than treating each individual as a standalone unit.

16. Insurance and Superannuation

There exists a complex issue of the appropriate level of insurance and whether it should be funded from superannuation. The two issues can be partly separated but then practically come back together again (because many people won't reduce consumption to choose insurance, but superannuation is compulsory).

A life cycle framework (Reflection (1)) could be extended to assess the benefits of insurance – since it a utility function is designed to consider and scale the experience of a large adverse event.

17. Reducing Dispersion of Outcomes Within (Age / Time based) Population Cohorts versus Dispersion of Outcomes Across (Age / Time based) Population Cohorts

A focus on fees and the dispersion amongst fund performance outcomes addresses the dispersion of outcomes within age cohorts of the population.

Constant risk targeting versus lifecycle type approaches will increase the dispersion of outcomes across population cohorts – the dispersion in average end balances amongst cohorts will be larger (a balanced fund approach results in more end-period point-in-time risk).

18. How Conclusive is the Fees Debate Once we Move Beyond the Tail?

The evidence outlined, asides from the tail of very high fee products, did not appear overwhelming. All would agree that there is a tail of very high fee funds and that this has impaired the returns of those funds.

A period where diversification hasn't particularly mattered – the key drivers, in addition to fees, have been exposure to growth assets and unlisted assets.

Once the data is conditioned for exposure to growth assets and exposure to illiquid assets, and the tail of extremely high fee products removed, is the evidence resoundingly strong enough to confirm that lower fees drive performance?

My residual concern remains that outlined in the bottom of Reflection (14) – once a point of efficiency is reached, lower fees represent lower portfolio quality.

19. The Role of Paternalism

It is interesting to observe that the word "paternalism" is not mentioned once. Hopefully paternalism is not viewed as a dirty word (https://cuffelinks.com.au/paternalism-is-not-a-dirty-word/).

It is far from assured that effective engagement will be achieved under the proposed default "Best in show" model (see Reflection (8)).

Paternalism means being prepared to manage risks to retirement outcomes, potentially to the detriment of peer-relative performance. It could also mean spending more in certain environments to implement initiatives which significantly benefit member outcomes. There is a risk that the "Best in show" type model will reduce paternalism amongst not-for-profit funds.

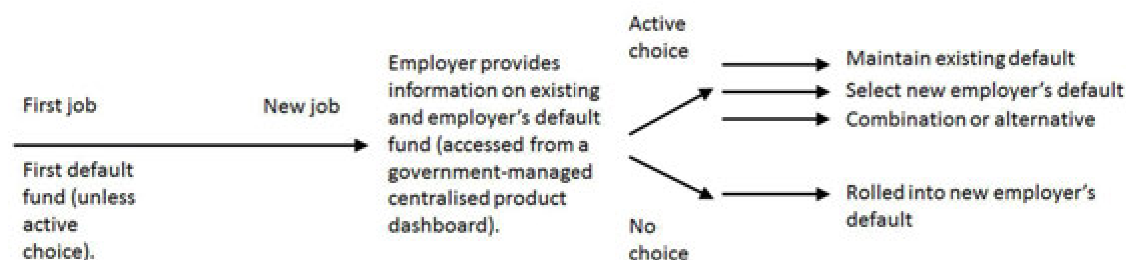
20. Reiterating an Alternative Version of the Single Default Model

In my previous submission I proposed an alternative to the Productivity Commission's single default model. It is re-presented below:

I propose that it would work as follows:

(1) An individual only has one super fund unless they make an active decision to have multiple funds;
(2) As an individual changes jobs / industries they are prompted to choose between their existing fund and their new employer's default fund. I recommend no change (at current time) to the existing processes of selecting default funds (reasons discussed in further detail below);
(3) The individual will be provided with comparisons of the two funds (carryover and employer default) via the employer's access to a government-managed centralised product dashboard which allows easy access for companies and individuals;
(4) If the individual makes no choice their existing default fund is rolled into the company's default fund.

This proposed process is summarised in the diagram below:



Reflecting further on the work of the Productivity Commission I recognise that the focus is on linking defaults to the member and not the job. While acknowledging this I still have residual concerns:

- Some occupations may not be able to get insurance (i.e. outside of existing scales).

- Industry level defaults provide for coordinated engagement, education and financial wellbeing sessions based on collaboration between fund, employer, and on occasion the relevant union (Reflection (8)).

There may be a large impact to affected members in some sectors such as mining but this may be viewed as a small cost overall versus the broader system benefits as assessed by the Productivity Commission.

21. Trends in the Future

It may be valuable for the Productivity Commission to reflect on some of the trends I see in investment management:

- Greater internalisation
    - The benefits of internalisation have been much publicised (lower fees, greater control, and greater ability for large funds to effectively manage capacity).
    - However the risks of internalisation (cultural and governance stress tests when an internal team underperforms) remain untested.
    - Due to agent issues associated with the retail business model, greater internalisation is more difficult for a retail fund to implement

- Technology, particularly around data, and personalisation.

- Private assets – not only the existence of but the ability for some funds to develop outperformance opportunities within these sectors (take CBUS Property and Sunsuper private assets as case studies).

- Reduction in niche opportunities for large funds may become an opportunity for small to mid-sized funds provided they have the requisite skills to implement and manage at a portfolio level.

- Increasing focus on ESG as risks to outcomes, and as a social expectation.

22. Alternative Views on a Government-Owned Monopoly Fund

The Productivity Commission was not supportive of a Government default. Some of the reasons include (along with my reflections):

- Reduction in innovation – there would remain many choice funds which would need to compete on the basis of innovation. The concept of a Government default fund could foster significant innovation partnerships with universities and the private sector, confident in the knowledge that the innovation could be outcomes focused and doesn't need to win through the lens of choice.

- No engagement strategy – this could readily be developed and could indeed become more coordinated with other government regulatory bodies such as ATO, ASIC MoneySmart etc.

23. Forward versus Backwards Looking

An interesting case study which could provide some direction to any future expert panel: if an underperforming fund lifts out the entire investment team from a fund with strong performance, would the underperforming fund now, all else equal, be a strong candidate to make a "Best in show" list?

24. Asset Categorisation Remains a Large Challenge

One of the most frustrating challenges faced by industry participants is the self-categorisation of assets into growth and defensive. This (mis)information is then used to compare the performance of funds, and is used by financial planners for portfolio construction purposes (financial planners generally use growth / defensive splits rather than more advanced measures of risk).

Some examples where clarity of categorisation would benefit the industry include:

- Core property versus development property
- Different forms of credit

See https://www.pwc.com.au/consulting/assets/publications/comparing-super-funds-15.pdf for a good summary of this issue.

25. Is the Performance Analysis Good Enough?

The Productivity Commission has undertaken significant efforts to assess performance of funds. It is difficult to assess the quality of the work undertaken because we have restricted insight.

One technique to self-assess, given the importance of the research and associated recommendations, is to assess whether this research would meet the standard required to be published in a top level international academic journal. There may be some leading academics in the field who can provide some assessment of the data sources and techniques.

26. Is the Post-Retirement Product Range Sufficiently Broad?

At present the majority of solutions are guaranteed, which means they do not offer high returns and create the potential for over-insuring (when viewed in conjunction with the protection provided by the Age Pension).

Non-guaranteed pooled solutions, from my modelling, have much greater application – they offer a higher expected return (as they do not incur capital charges and can invest in a riskier asset mix) and blend better with the Age Pension (by hedging risk well but not perfectly).

A DGSA (Deferred Group Self-Annuitisation) additionally is more capital efficient (only a small proportion of retirement savings needs to be allocated to the product). I believe this is the key missing member of the post-retirement product range.

In the absence of a quality DGSA, it will be beneficial when deferred life annuities come to market.

27. Update on CIPR

The Retirement Income Covenant Position Paper should update the Productivity Commission's working knowledge on CIPRs – the framework changed significantly from a prescriptive rules based framework to a principles based approach.

28. Productivity Commission has Recommended Little to Improve the Ability to Compare Funds

The challenges for professionals to choose between super funds, for instance at fund tenders, are difficult. How could we possible expect the retail public to be able to make such difficult decisions?

Issues around risk are difficult to understand, especially when the industry has struggled to define risk itself, and cannot consistently self-asset growth and defensive asset splits (Reflection (24)). If professionally trained financial advisers rely heavily on such basic information, yet the industry does not provide it consistently, then what hope is there for providing a framework to enable the public to compare funds?

The most realistic goal would be to help members switch out of "poor" funds (high fee, poor returns); beyond that, and highlighted in Reflection (8) I am bearish on the prospects of truly informed choice.

29. The Case Study of the Standard Risk Measure

Page 192 of the Draft Report references (without name) the Standard Risk Measure (SRM). This is a poorly misunderstood measure of risk – it identifies the expected number of negative years in a 20 year period without consideration of the potential size of those negative returns.

At present assets like bonds have a high SRM – by my calculations they have a low expected return but have some volatility; the probability of a negative return is reasonably high but the possible size of those negative returns is constrained against another asset such as equities.

I am aware that a number of financial advisers struggle with this risk measure – it is the only compulsory investment risk measure. What chances does a consumer have of understanding?

Investment risk is a complex area which requires a mosaic of information to gain an understanding. An effective comparison of funds requires an understanding if return and risk. However there appears little appetite to explain risk in detail. This limits the realistic outcomes of engagement, as discussed in Reflection (8).

30. Insufficient Number of Quality Advisers

The Productivity Commission raised concerns about the quality of financial advisers. In additional there must be concerns about the number of quality advisers in an environment where the population is ageing.

Given the Productivity Commission has effectively separated accumulation and post-retirement, and given my concerns about the realistic likelihood of informed decision making by engaged members of the population (Reflection (8)), the importance of a sizable number of quality advisers is critical.

If this piece is missing then the Productivity Commission needs to identify this as an area which requires attention, or alternatively consider the roles of paternalism (Reflection (8)), and personalised defaults (Reflection (11)).

31. Opt-in from Defaults will Stunt Innovation and Limit its Impact

The Productivity Commission readily acknowledges the importance of innovation and views its "Best in show" model as encouraging innovation.

I am concerned that the Productivity Commission's measures will cap innovation. This comes through a number of sources:

(1) The business cases for some innovations will collapse if the benefits of the innovation cannot be applied to all members of the default. As it stands many innovations, particularly in the exciting area of personalised defaults, cannot be applied within the existing default.

(2) In the complex area of superannuation members may not be able to readily identify the benefits of some innovations (consider personalised default accounts as an example). Relying on member choice as the test for innovation is potentially a poor quality filter, and also an unreliable one from a business case perspective.

(3) Finally the Productivity Commission has flagged the need to develop strategies for dealing with the risk of upselling out of defaults. This is a further deterrent to innovation in any areas which reside outside of defaults.

(4) Innovation can often be best achieved through collaboration. Will funds collaborate as readily in a "Best in show" environment?