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| The Productivity Commission |
| The Productivity Commission is the Australian Government’s independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.  The Commission’s independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.  Further information on the Productivity Commission can be obtained from the Commission’s website ([www.pc.gov.au](http://www.pc.gov.au/)). |
|  |

# Opportunity for further comment

You are invited to examine this draft report and comment on it by written submission to the Productivity Commission by **Friday 28 April 2017**. Further information on how to provide a submission is included on the inquiry website at [www.pc.gov.au/inquiries/  
current/superannuation/make-submission](http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency/report)

The final report will be prepared after further submissions have been received and public hearings have been held, and will be forwarded to the Australian Government by 17 August 2017.

Public hearing dates and venues

| Location | Date | Venue |
| --- | --- | --- |
| Melbourne | 3 May 2017 | Productivity Commission  Level 12, 530 Collins Street |
| Sydney | 8 May 2017 | The Grace Hotel  77 York Street |

Commissioners

For the purposes of this inquiry and draft report, in accordance with section 40 of the *Productivity Commission Act 1998* the powers of the Productivity Commission have been exercised by:

|  |  |
| --- | --- |
| Peter Harris | Chair |
| Karen Chester | Deputy Chair |

# Terms of reference

**EFFICIENCY AND COMPETITIVENESS OF THE SUPERANNUATION SYSTEM**

I, Scott Morrison, Treasurer, pursuant to Parts 2, 3 and 4 of the Productivity Commission Act 1998, hereby request that the Productivity Commission conduct: a study to develop criteria to assess the efficiency and competitiveness of the superannuation system; and an inquiry to develop alternative models for a formal competitive process for allocating default fund members to products.

### Background

An efficient superannuation system is critical to help Australia meet the economic and fiscal challenges of an ageing population. The superannuation system has accumulated over $2 trillion in assets. Given the system’s size and growth, the system is of central importance to funding the economy and delivering retirement incomes.

MySuper has been a strong step in the right direction but more needs to be done to reduce fees and improve after‑fee returns for fund members. The Financial System Inquiry noted that fees have not fallen by as much as would be expected given the substantial increase in the scale of the superannuation system, a major reason for this being the absence of consumer‑driven competition, particularly in the default fund market.

These Terms of Reference follow from the Government’s response to Financial System Inquiry Recommendation 10 on efficiency in superannuation. The Government committed to tasking the Productivity Commission to develop and release criteria to assess the efficiency and competitiveness of the superannuation system, including the choice and default markets and to develop alternative models for allocating default fund members to products.

This work will inform a review of the efficiency and competitiveness of the superannuation system, which the Productivity Commission will be asked to undertake following the full implementation of the MySuper reforms (after 1 July 2017).

### Process

The Productivity Commission is to develop criteria to assess the efficiency and competitiveness of the superannuation system and release the criteria within nine months of receiving these Terms of Reference. The release of these criteria is intended to provide transparency and certainty to the superannuation industry about how it will be assessed ahead of the full implementation of MySuper.

The Productivity Commission is to develop alternative models for a formal competitive process for allocating default fund members to products. In developing alternative models, the Productivity Commission should be informed by the criteria it develops to assess the efficiency and competitiveness of the superannuation system. The Productivity Commission should report on alternative models within 18 months of receiving these Terms of Reference.

For both elements, the Productivity Commission should consult widely and undertake appropriate public consultation processes, including inviting public submissions and conducting industry roundtables. The Productivity Commission is to provide both draft and final reports and the reports will be published.

#### Scope of study: development of criteria to assess efficiency of super system

The Productivity Commission should develop criteria to assess whether and the extent to which the superannuation system is efficient and competitive and delivers the best outcomes for members and retirees, including optimising risk‑adjusted after fee returns. In determining the criteria to assess the efficiency and competitiveness of the superannuation system, the Productivity Commission may have regard to:

* operational efficiency, where products and services are delivered in a way that minimises costs and maximises value, which can be enhanced by competition and innovation from new entrants and incumbents;
* allocative efficiency, where the system allocates resources to the most productive use and optimally allocates risks;
* dynamic efficiency, including services to members, where the system induces the optimal balance between consumption and saving over time; and
* the extent to which the system encourages optimal behaviour on the part of consumers, including consideration of the learnings from behavioural finance.

The Productivity Commission should consider the nature of competition in the superannuation industry, the effect of government policy and regulation on the competitiveness and efficiency of the system and relevant international experience.

#### Scope of inquiry: development of alternative models

The Productivity Commission is to examine alternative models for a formal competitive process for allocating default fund members in the superannuation system to products and to develop a workable model, or models, that could be implemented by Government if a new model for allocating default fund members to products is desirable. These model(s) would provide viable alternatives for the Government’s consideration, depending on the outcomes of the review of the efficiency and competitiveness of the superannuation system, which the Productivity Commission will be asked to undertake following the full implementation of the MySuper reforms.

The developed model(s) should enhance efficiency in the superannuation system in order to improve retirement incomes, including through optimising long‑term net returns to members, and build trust and confidence in funds regulated by the Australian Prudential Regulation Authority (APRA). The models developed should consider default fund selection across the superannuation system as a whole.

The Productivity Commission may consider auction, tender and other types of competitive processes. The Productivity Commission should consider the merits of different approaches, the metrics for conducting them and their frequency. This should include consideration of:

* the strengths and weaknesses of competitive processes used internationally, such as Chile, New Zealand and Sweden, as well as those used in large corporate tenders by the Northern Territory Government and in other jurisdictions;
* the costs and benefits of different mechanisms, including:
* optimising long‑term after fee returns;
* the administrative, fiscal, individual and complexity costs;
* and in examining different processes, consider:
* the robustness of the process, including against gaming and collusion;
* whether the structure achieves efficient outcomes and facilitates ongoing innovation over the long run;
* the effect on system stability and market concentration;
* who should run the process; and
* the extent to which the process promotes the interests of consumers.
* regulatory impediments to optimal competition under the preferred model(s).

Principles for designing a model for a competitive process should include:

* **Best interests:** ensure incentive compatibility with meeting the best interests of members, encourage long‑term investing, and encourage a focus on expected after‑fee returns based on asset allocation and investment strategy.
* **Competition:** drive pressure on funds to be innovative and efficient, diversify asset allocation and optimise long‑term after‑fee returns by rewarding best performers. Facilitate new superannuation fund entrants to the market.
* **Feasibility:** ensure the process is low‑cost and easy to administer and minimises regulatory costs on industry, including business and employers.
* **Credibility and transparency:** make relevant information public; avoid room for gaming the process; and ensure metrics are clear, simple, difficult to dispute and difficult to manipulate.
* **Regular assessment and accountability:** regularly conduct a repeat process that requires default funds to earn their right to receive new default members, and ensure funds are accountable for the outcomes they deliver members.
* **Fiscal implications:** the extent to which the process can reduce reliance on the Age Pension and/or give rise to other risks or costs to Government.

The Productivity Commission should draw on expertise in the field of competitive models.

**S. MORRISON**

**Treasurer**

[Received 17 February 2016]

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# Abbreviations

|  |  |
| --- | --- |
| AFP | Administradoras de Fondos de Pensiones (Chile) |
| APRA | Australian Prudential Regulation Authority |
| ASIC | Australian Securities and Investments Commission |
| ATO | Australian Taxation Office |
| BOOT | Better off overall test |
| CPI | Consumer price index |
| FSI | Financial System Inquiry |
| FWC | Fair Work Commission |
| NEST | National Employment Savings Trust (United Kingdom) |
| PC | Productivity Commission |
| RSE | Registrable superannuation entity |
| SG | Superannuation Guarantee |
| SG Act | *Superannuation Guarantee (Administration) Act 1992* (Cwlth) |
| SIS Act | *Superannuation Industry (Supervision) Act 1993* (Cwlth) |
| SMSF | Self‑managed superannuation fund |
| SPA | Swedish Pensions Authority |
| TPD | Total and permanent disability |