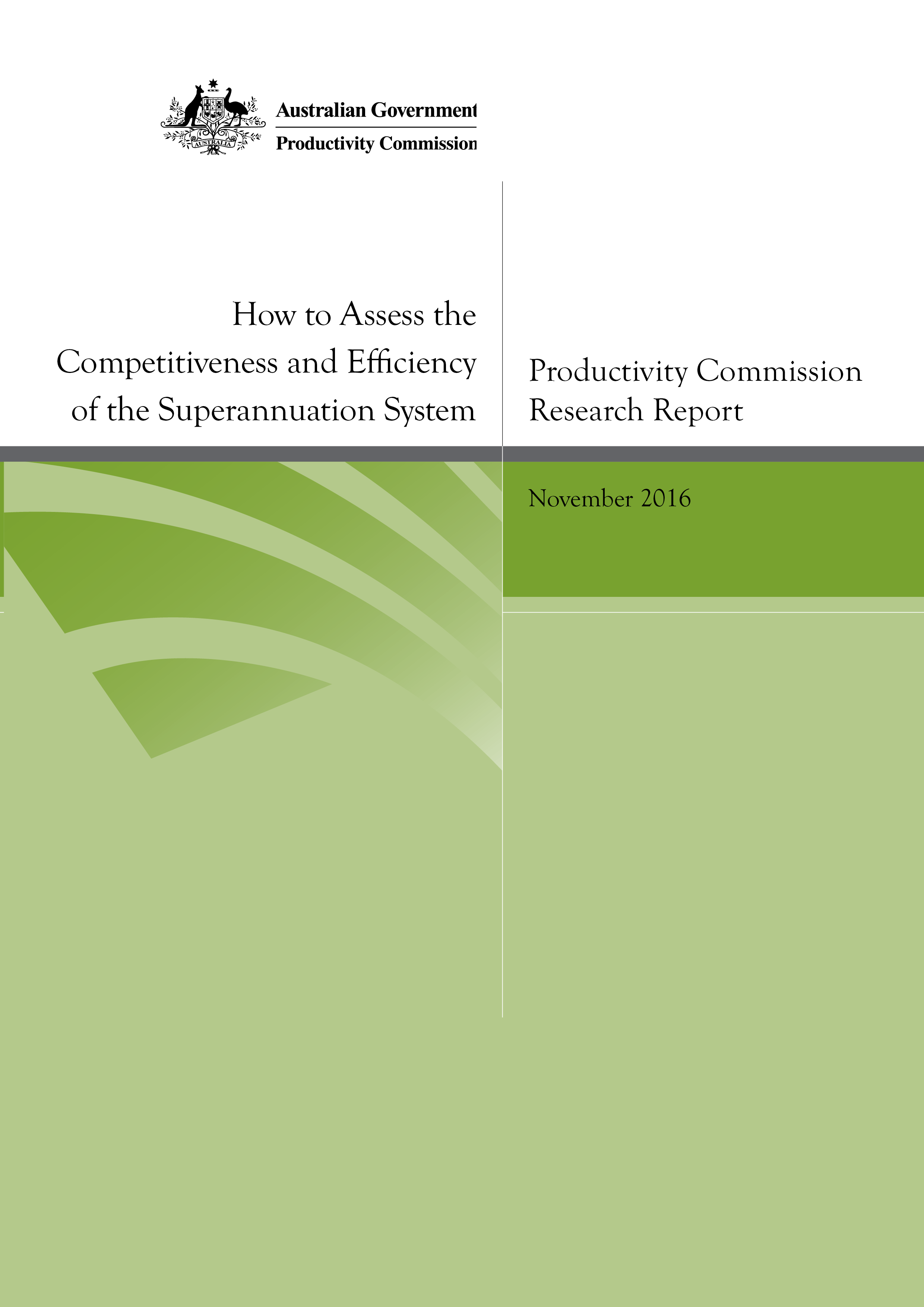
# How to Assess the Competitiveness and Efficiency of the Superannuation System

Productivity Commission Research Report

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Commonwealth of Australia 2016

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Publications enquiries

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

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|  |

# Foreword

Superannuation is an important, albeit often neglected, part of the lives of most adult Australians. Almost all working Australians contribute to superannuation and the superannuation system already accounts for about 20 per cent of household assets. The sheer size and compulsory nature of superannuation makes it paramount that the system is efficient and delivers good outcomes for members.

The Australian Government has stated that it will task the Commission to review the competitiveness and efficiency of the superannuation system after 1 July 2017. This study — in establishing the assessment approach — is the first step in that process. This report provides transparency to system participants, by formulating the system–level objectives, supporting assessment criteria and corresponding indicators (along with the anticipated data needs) for the future review.

There is little precedent (including internationally) for the work presented in this report, and for the ultimate assessment itself. The Commission, and thus the study, benefited from discussions and submissions from many participants from the superannuation industry, academia and government, as well as from the users of the system. We are grateful for the valuable contribution of all those who participated.

|  |  |
| --- | --- |
| Karen Chester Deputy Chair | Angela MacRae  Commissioner |

November 2016

# 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

|  |  |
| --- | --- |
| ABP | Account‑based pension |
| ABS | Australian Bureau of Statistics |
| ACCC | Australian Competition and Consumer Commission |
| AFS | Australian financial services |
| APRA | Australian Prudential Regulation Authority |
| ASIC | Australian Securities and Investments Commission |
| ASX | Australian Securities Exchange |
| ATO | Australian Taxation Office |
| CAPM | Capital asset pricing model |
| CFR | Council of Financial Regulators |
| CIPR | Comprehensive income product for retirement |
| CPI | Consumer price index |
| DAA | Dynamic asset allocation |
| DB | Defined benefit |
| DC | Defined contribution |
| DHS | Department of Human Services (Australian Government) |
| EPSSS | Exempt Public Sector Superannuation Scheme |
| FSI | Financial System Inquiry |
| FUM | Funds under management |
| GDP | Gross domestic product |
| GFC | Global financial crisis |
| HHI | Herfindahl-Hirschman index |
| IMF | International Monetary Fund |
| MC | Marginal cost |
| MMGPI | Melbourne Mercer Global Pension Index |
| NBNI | Non bank, non insurer (entity) |
| OECD | Organisation for Economic Co-operation and Development |
| PAIRS | Probability and Impact Rating System |
| PC | Productivity Commission |
| PDS | Product disclosure statement |
| PSI | Pension Sustainability Index (Allianz) |
| RAVA | Risk‑adjusted value added |
| RBA | Reserve Bank of Australia |
| RG | Regulatory guide |
| ROA | Return on assets |
| RSE | Registrable superannuation entity |
| SAA | Strategic asset allocation |
| SCT | Superannuation Complaints Tribunal |
| SG | Superannuation Guarantee |
| SIS Act | Superannuation Industry (Supervision) Act 1993 (Cwlth) |
| SMSF | Self-managed superannuation fund |
| SOARS | Supervisory Oversight and Response System |
| SPS | Superannuation Prudential Standard |
| SRM | Standard risk measure |
| SRS | Superannuation Reporting Standard |
| TPD | Total and permanent disability |

# 

# Glossary

|  |  |
| --- | --- |
| Account-based pension | A regular retirement income stream, purchased with money an individual has accumulated in their superannuation after they have reached the preservation age. |
| Alpha | The ‘excess’ return of a fund relative to a benchmark index, usually attributed to the performance of the individual fund manager. |
| Annuity | A retirement income product that provides a guaranteed stream of fixed payments made at regular intervals. |
| APRA‑regulated fund | Any large or small superannuation fund regulated by the Australian Prudential Regulation Authority (APRA), also known as a Registrable Superannuation Entity. |
| APRA‑regulated institutional fund | Any large (more than four members) superannuation fund regulated by APRA. |
| Asset allocation | The distribution of funds in an investment portfolio (for a fund or individual member) between different asset classes. |
| Asset class | A category of assets that a superannuation fund can invest in, such as cash, fixed interest, shares, property or unlisted infrastructure. |
| Beta | A measure of the volatility of an asset price or portfolio value relative to the market as a whole. |
| Bulk transfer | The process whereby multiple member accounts are transferred to a different superannuation fund without the member’s consent. This process follows ‘successor fund transfer’ rules set out in legislation. |
| Concessional contributions | Contributions drawn from an individual’s pre‑tax income that are made into a superannuation fund. |
| Condition of release | A prescribed event (such as retirement) a person must satisfy to be able to access superannuation payments. |
| Corporate fund | A superannuation fund sponsored by a single employer or group of usually related employers for the benefit of company employees. |
| Corporate tender | A tender for the right to become the default superannuation fund of a particular group of employees. |
| Default fund | A superannuation fund to which an employer’s Superannuation Guarantee contributions are paid if the employee does not choose an alternative fund. |
| Deferred annuity | An annuity where payments commence after a nominated period. |
| Defined benefit fund | A superannuation fund where contributions are pooled rather than allocated to particular members, and where retirement benefits are determined by a formula based on factors such as salary and duration of employment. |
| Defined contribution fund | A superannuation fund where the value of the final retirement benefit payable is based on contributions made plus investment returns less any fees and taxes. |
| Exempt public sector superannuation scheme | A superannuation fund providing benefits for government employees, or schemes established by Commonwealth, State or Territory law, that are not directly subject to the *Superannuation Industry (Supervision) Act 1993* (Cwlth) and APRA regulation. |
| Industry fund | Funds originally formed to provide access to superannuation for employees working within a particular industry. |
| Investment risk | One of a number of risks to the value of an investment, including market, interest rate, inflation, credit, liquidity and asset‑specific risk. |
| Legacy product | A superannuation product (held by some members) that is no longer available for issue to new members. |
| Lifetime annuity | An annuity payable over a recipient’s remaining lifetime. |
| Longevity risk | The risk of a person outliving their savings. |
| Money‑weighted return | A measure of the [rate of return](http://www.investopedia.com/terms/r/rateofreturn.asp) for an asset or portfolio of assets calculated using the rate of return that equates the [present values](http://www.investopedia.com/terms/p/presentvalue.asp) of all [cash flows](http://www.investopedia.com/terms/c/cashflow.asp) and [terminal values](http://www.investopedia.com/terms/t/terminalvalue.asp) to the value of the initial investment (internal rate of return). |
| MySuper product | A default defined contribution superannuation product. Superannuation funds must meet requirements set by APRA to be permitted to offer a MySuper product. All default products must be MySuper products from 1 July 2017. |
| Non-concessional contributions | Contributions drawn from an individual’s post‑tax income that are made into a superannuation fund. |
| Outsourcing | The process whereby a superannuation fund trustee contracts another entity to provide services to the fund, such as administration or investment management. |
| Peer risk | The risk of an individual superannuation fund performing below the market average. |
| Pooled superannuation trust | A trust in which the assets of a number of superannuation funds, approved deposit funds or other pooled superannuation trusts are invested and managed by a professional manager. |
| Preservation age | The minimum age prescribed by law at which a member can withdraw their superannuation benefits from the superannuation system. |
| Product dashboard | Product and performance information (specified by APRA) regarding MySuper products that must be made available on superannuation fund websites. |
| Registrable superannuation entity | An APRA‑regulated superannuation fund, an approved deposit fund or a pooled superannuation trust. |
| Retail fund | A superannuation fund that offers superannuation products on a commercial ‘for profit’ basis. |
| Retail level | The level of the superannuation market that provides services directly to members. |
| Self-managed superannuation fund | A superannuation fund with fewer than five members, all of whom are trustees or are directors of a corporate trustee. |
| Sequencing risk | The risk of experiencing poor investment returns just prior to drawing on funds in retirement. |
| Small APRA fund | Any APRA‑regulated fund with fewer than five members. |
| Small fund | Any superannuation fund with fewer than five members. |
| Superannuation Guarantee | Compulsory superannuation contributions paid by employers on behalf of employees, and equal to a percentage (currently 9.5 per cent per annum) of each employee’s ordinary time earnings. |
| Superannuation system | The collection of participants and activities involved in superannuation, including members, employers, funds, upstream suppliers, ancillary service providers (including insurers) and regulators. |
| SuperStream | An Australian Government package of measures designed to enhance administrative processes for superannuation, especially the way that Superannuation Guarantee payments are transferred from employers to funds. |
| Time-weighted return | A measure of the compound rate of growth in a portfolio. It is not directly influenced by contributions or withdrawals. |
| Trustee | A person or company holding property on behalf of another party with a fiduciary duty to the beneficiaries. |
| Unlisted asset | An asset for which there is no public exchange for listing, quotation or trading. |
| Wholesale level | The level of the superannuation market that involves the interaction between trustees/funds and other service providers. |