



FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

9 September 2016

Superannuation
Productivity Commission
Level 12, 530 Collins Street Melbourne
VIC 3000, Australia

By email: super@pc.gov.au

Dear Sir / Madam

Re. Study of superannuation efficiency and competitiveness – Draft Report

The Financial Planning Association of Australia (FPA) welcomes the opportunity to make a submission to the study in response to the Draft Report.

The FPA acknowledges the depth of the Draft Report and the Commission's consideration of the issues in identifying how to assess the competitiveness and efficiency of the superannuation system.

As such, the FPA has limited its submission to areas that would add benefit to the Commission's thinking and the vital role well-being metrics and financial planners offer in facilitating and assessing competition and efficiency in the superannuation system.

The FPA would welcome the opportunity to discuss with you the issues raised in our submission.

If you have any questions, please contact me on 02 9220 4500 or dimitri.diamantes@fpa.com.au.

Yours sincerely

Dimitri Diamantes

Policy Manager

Financial Planning Association of Australia¹

¹ The Financial Planning Association (FPA) has more than 11,000 members and affiliates of whom 9,000 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
 - In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
 - We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
 - The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
 - We have built a curriculum with 17 Australian Universities for degrees in financial planning. All new voting members of the FPA are required to hold, as a minimum, an approved undergraduate degree.
 - CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
 - We are recognised as a professional body by the Tax Practitioners Board
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HOW TO ASSESS THE COMPETITIVENESS AND EFFICIENCY OF THE SUPERANNUATION SYSTEM – DRAFT REPORT

FPA submission to:
Productivity Commission

9 September 2016

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INTRODUCTION

The superannuation system consists of assets of \$2,032 billion (\$2 trillion rounded)² and over 14.8 million Australians account holders³. It is a significant contributor to the economy and importantly, holds the retirement savings and aspirations of many Australians.

The FPA's submission focusses on member needs and well-being in relation to the superannuation system and as such we have suggested additional elements to include in the Commission's methodology and assessment framework and criteria.

We have also articulated the function of financial planners, acting in the best interest of members, as influencers of the competitiveness and efficiency of the system.

² <https://www.superannuation.asn.au/resources/superannuation-statistics> - at the end of the March 2016 quarter

³ www.ato.gov.au – 30 June 2016. Approximately 43% of these people have more than one super account.

A. THE COMMISSION'S SCOPE OF THE REVIEW

The Commission has a very broad remit, which covers most of the system supporting superannuation including funds, members, employers, wholesale providers, intra-fund advice and regulators. However, it excludes financial advice (other than intra-fund).

The FPA strongly urges the Commission to reconsider its position on bespoke financial advice. Such advice is well within the scope of influence of the superannuation system. This is because the system influences whether (and to what extent) bespoke advice is obtained through:

- ***funds providing education about the value of advice and allowing certain fees to be debited from member balances***
- ***tax benefits of paying for advice from superannuation***
- ***fund relationships with advisers through referral programs***

As such, we believe bespoke advice is within the Commission's Terms of Reference.

The Draft Report states:

“⁸ In developing the criteria for competitiveness, the study will consider intrafund financial advice (an ancillary service provided by superannuation funds) as part of the core services provided to members. The broader market for financial advice is outside the scope of this review.”

However, the Commission also acknowledges the decision making role and influence of financial planners as members of the supply chain, in determining the level of competition in the superannuation system (p. 67).

The Commission acknowledges that the inherent complexity of the system can limit the availability of information or obscure its understanding, leading to suboptimal outcomes for participants (p.274). The FPA supports the Commission's summation that “Regulators, particularly APRA and ASIC, have a role to make information in the superannuation system transparent and easy to understand”⁴ in relation to disclosure requirements and reporting standards. However, research shows that disclosure may result in client awareness of issues and processes, but not necessarily understanding.⁵

Financial planners help members understand disclosure and product information in relation to their personal circumstances. This critical function of financial advice supports both the regulators and funds to maintain these policy mechanisms, to improve transparency and accountability of trustees and service providers, and help drive efficiency in the system through increased member understanding and engagement.

The Commission has concluded that “the level of member engagement can have important implications for the competitiveness and ultimately efficiency of the superannuation system” (p.36). Linking these summations together demonstrates the role of financial planners in the principal-agent relationship, their function within the superannuation system, and the resulting influence on competitiveness and efficiency.

⁴ p.274

⁵ Value of Financial Planning Advice: Process and Outcome Effects, QUT Business School, 2014

In its Draft Report, the Commission recognises the challenge of making sound superannuation decisions that align with member needs and preferences, even for financially literate and engaged members, creating a high risk of suboptimal decision making (p.69). As stated above, increasing understanding can impact on member engagement and reduce the possibility of poor decision making.

Approximately 20 per cent of the population, or 4,834,720 Australians, currently seek personal financial advice.⁶ The number one topic consumers seek financial advice for is retirement planning including superannuation. Importantly, Elder & Rudolph found that planning for retirement positively correlates with retirement satisfaction (1999).⁷ Financial planners embrace the responsibilities in this principal-agent relationship as they are experts in both the superannuation system and understanding member needs.

Financial planners also have a requirement under the law to act in the best interest of their clients and put their client's interests above their own.⁸ Representing the member's best interest in the superannuation system supply chain, financial planners play a role in seeking fee discounts and optimal services to meet each member's needs. They assist members to identify and select the most appropriate fund and preferences for their circumstances. With approximately 4,834,720 Australians seeking financial advice, financial planner influence on demand-side competition may be a significant driver of efficiency in the system and should not be ignored.

"Well informed and highly engaged consumers make decisions in their own best interest, driving demand for goods or services they value" (p. 36). Low levels of member engagement can reduce net returns, and ultimately reduce competition in the market. The less engaged members are, the less they expect from their fund and super product, the less members shop around and compare, the less need there is for product providers to be innovative and competitive in their product and service offering, which reduces competition in the market. This in turn, reduces the outcomes for members and hinders the efficiency of the system.

The role financial advice plays in facilitating active and engaged financial decision making, has been recognised by the Australian Government, ASIC, industry and consumer groups who are seeking ways to improve access to financial advice.⁹

Further, those individuals who engage in comprehensive planning experience an 85% higher financial well-being over those who have engaged in limited planning such as intrafund advice.¹⁰

Financial planners also act as a conduit between members and funds, providing superannuation funds and service providers with an informed source of member information and detailed insights into member needs and preferences. Funds and service providers should work with the financial planning profession to identify optimal ways of working together to continually improve the efficiency of the system in the best interests of members.

The Commission's study should include measures that facilitate this working relationship, utilise the function of financial planners as contributors to demand-side competition in the members best interest, and monitor the efficiency of provision of financial advice to members (not limited to

⁶ Regulatory Guide 255 - Providing digital financial product advice to retail clients, Australian Securities and Investment Commission, August 2016

⁷ Elder, H & Rudolph, P 1999, 'Does retirement planning affect the level of retirement satisfaction?', *Financial Services Review*, vol.8, pp117–127.

⁸ Corporations Act s 961J

⁹ Report 224: Access to financial advice in Australia, Australian Securities and Investment Commission, 2010

¹⁰ The value of financial planning, Financial Planning Standards Council (Canada), 2013

intrafund advice). Financial planners should be a source of information and data for the review and equally their performance measured.

The existence of this study demonstrates the risk that the superannuation system is not delivering the member outcomes it needs to as a pillar of the retirement income system. The value financial planners offer to improving member engagement and ultimately member outcomes, influencing competition and driving efficiency should be recognised by including financial advice within the scope of the Commission's review.

It should be noted that the financial planning industry has undergone significant reform. For example, the Future of Financial Advice reforms have been implemented and legislation to mandate an uplift in professional and ethical standards is expected to come into effect soon. For this reason, it is important that any assessment is forward looking.

A1 Recommendations:

The FPA makes the following recommendations:

1. The scope of the Commission's study into the competitiveness and efficiency of the superannuation system should include bespoke financial advice.
2. Measures should utilise the function of financial planners as contributors to demand-side competition in the members' best interest - such as:
 - maximising financial planners as a source of information and data for the review
 - facilitating the working relationship between financial planners and superannuation funds
 - monitoring the efficient provision of financial advice to members (not limited to intrafund advice), and
 - assessing the value of retirement planning and superannuation advice for members.
3. By comparing members receiving advice¹¹ and those who are not, the Commission should isolate the value of bespoke financial advice when assessing relevant criteria for competitiveness, such as whether:
 - there is sufficient member engagement to exert competitive pressure
 - members are able to make informed decisions
 - there is low segmentation along member engagement lines;and when assessing relevant criteria for efficiency, such as whether:
 - member preferences and needs are being met by the system providing high-quality information and financial advice to members to help them make decisions (the proposed indicators would need to be broadened to include members acting on bespoke financial advice)
 - net investment returns are being maximised over the long term, taking account of service features provided to members

¹¹ Members who have had an adviser service fee charged to their account within a certain timeframe could be taken to be receiving bespoke financial advice.

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- the system is effectively managing tax for members
 - the system is providing products and information to help members optimally consume their retirement incomes
 - member balances are being allocated in line with their risk preferences
 - trustees are acting in the best interests of members
 - funds offer insurance products that meet members needs
 - the costs of insurance are being minimised given the type and level of cover

B. THE ASSESSMENT FRAMEWORK

B1 Member outcomes

The Draft Report attaches many of its considerations and aspects of the assessment framework to 'member outcomes'. For example:

- the weighting (to be developed in stage 3) attached to each criterion will depend on how significant each is likely to be in terms of member outcomes (p.50)
- competition in the superannuation system is not an end in itself, but an intermediate objective insofar as it drives more efficient outcomes for members (p.4)
- competition drives efficient outcomes for members (p.72)
- improving governance practices and structures is key to improving member outcomes (p.140).

However, the Draft Report is based on a narrow conception of 'member outcome'.

As previously stated, from a member's perspective superannuation is a compulsory vehicle that is designed to encourage them save for retirement – that is: it is the member's superannuation account and the member's money that will help them achieve a certain quality of life in the future. This desired quality of life will vary from member to member depending on their beliefs, values, interests, circumstances and aspirations. Hence, a member outcome is very subjective.

The Commission appears to limit its definition of 'member outcomes' to fees, net returns or better quality service:

“ to be able to draw any conclusions about competition for the benefit of members, analysis needs to link the evidence on growing economies of scale (irrespective of source) to improvements in member outcomes in the form of lower fees (for equivalent returns) or better service quality.”(p.97)

While these deliverables of the system are important, this is a very limited view of a member outcome. Member outcome also encompasses member values, member satisfaction and, importantly, member well-being.

The FPA recognises the system-level objectives and some indicators relate to member outcomes however, we suggest that the framework should reflect this broader conception of member outcomes.

B2 Objectives

In its Draft Report, the Commission proposed the following system-level objectives:

- Objective 4.1 - Competition in the superannuation system that drives efficient outcomes for members through:
 - a market structure and other supply and demand-side conditions that facilitate rivalry and contestability

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- suppliers competing on aspects of value to members across the accumulation, transition and retirement phases
 - Objective 4.2 - The superannuation system maximises net returns on member contributions and balances over the long term.
 - Objective 4.3 - The superannuation system meets member preferences and needs, in relation to information, products and risk management, over the member's lifetime.
 - Objective 4.4 - The superannuation system provides insurance that meets members' needs at least cost.
 - Objective 4.5 - The superannuation system complements a stable financial system and does not impede long-term improvements in efficiency.

The system-level objectives are specific to the principles of competitiveness and efficiency, and link back to the overarching objective set by the Government (p.3) - "to provide income in retirement to substitute or supplement the Age Pension"¹².

The Draft Report also states that the system-level objectives are designed to focus on the best interests of members (pg. 66).

The FPA questions how the review can truly assess the competitiveness and efficiency of the system, be in the members' best interest, and link to the Government's definition, if its system-level objectives ignore the critical measures of success for the industry and the system – retirement adequacy, which measures a member's projected income throughout their retirement relative to a standard such as a defined modest or comfortable standard of living or as a percentage of pre-retirement income.¹³

Retirement adequacy reflects a composite of the indicators of competition and efficiency. The more efficient the allocation of resources among the investment function, ancillary benefits and member engagement (including education and advice), for example, the greater the adequacy of projected superannuation payments (and probably projected retirement receipts after adjusting for risk differences inside and outside super). ***Adequacy therefore captures important elements that risk-adjusted net returns alone cannot, and brings those elements together.***

We appreciate that many people have retirement savings outside the superannuation environment. However, we would expect that the ranking of adequacy (by occupation class) from superannuation wouldn't be materially if assets outside super were also taken into account. This is because we'd expect level of assets outside super to be positively correlated with adequacy from super. We acknowledge this is an empirical question that can only be resolved by a broader study than the Commission's terms of reference for the present study allow.

B3 Indicators

We acknowledge both the need to measure the performance of the superannuation system and the enormity of such a task. However, with 56 indicators under competition and 59 under efficiency, the

¹² A more sustainable superannuation system, Treasurer Scott Morrison, May 2016

¹³ For a broad discussion of approaches to measuring retirement adequacy, see <http://actuaries.asn.au/Library/Phil%20Gallagher.pdf>. Pre-retirement income might be assessed along demographic lines corresponding to information held by funds, e.g., occupation. Pre-retirement income for each cohort could, potentially, be estimated from ABS data.

FPA has concerns about the logistics of managing the high number of measures to investigate including:

- which regulatory body will be responsible for the management of sourcing, collating, analysing and reporting of the data, and how will it be funded?
- approximately half the indicators rely on surveys as the evidence source. With such a heavy reliance on surveys,
 - who will fund the surveys?
 - who will determine source/s of truth?
 - how will the surveys be funded?

The FPA is also concerned that the amount of data required is likely to create a significant additional impost on funds and wholesale level providers, which may have a negative impact on member outcomes.

These concerns are amplified by the existence of different product segments (e.g., MySuper, Choice and SMSFs). Each segment may need to be tracked separately to reflect structural differences. For example, fees and engagement levels for MySuper and SMSFs would be expected to be materially different based on the degree of customisation of investment strategies and the required level of member involvement in decision-making.

Recommendations

The FPA makes the following recommendations:

1. To ensure the superannuation system maintains a focus on what is in the best interest of members including member-wellbeing, the following additional criteria should be included under the efficiency objective of meeting 'member preferences and needs, in relation to information, products and risk management, over the member's lifetime': are member preferences and needs being met by members achieving (or being on track to achieving) an adequate retirement income for their cohort?
 - cohorts could be based on occupation and age
 - variables would include: projected contributions and net returns based on historical data
 - analysis should involve comparison of different product segments and advised/non-advised members
 - it may be appropriate to adjust the relative adequacy of different cohorts to take into account excess risk (or a shortfall of risk) relative to the relevant passive benchmark portfolio

C. ASSESSING THE SYSTEM USING WELL-BEING METRICS

The concept of measuring well-being is not new. It has informed policy development in Australian and globally for well over a decade.

The Australian Bureau of Statistics believes well-being can be measured using people's subjective evaluation of themselves, based on their feelings, or by collating any number of observable attributes that reflect on their well-being; and that well-being might best be assessed subjectively, as it is strongly associated with notions of happiness and life satisfaction.¹⁴

“While such measures can be difficult to interpret, subjective measures, as with other statistics, can be aggregated and monitored over time, and, in theory, provide a picture of the nation's view”¹⁵ which would be an invaluable aspect of measuring the competitiveness and efficiency of Australia's compulsory superannuation system.

The Organisation for Economic Co-operation and Development believes that for well-being measures to start making a real difference to people's lives, they have to be explicitly brought into the policy-making process:

*“Subjective well-being data can provide an important complement to other indicators already used for monitoring and benchmarking performance, for guiding people's choices, and for designing and delivering policies.”*¹⁶

The OECD suggests that being able to measure people's quality of life is fundamental when assessing the progress of societies, and has produced Guidelines which outline why measures of subjective well-being are relevant for monitoring and policy making.¹⁷

From a members' perspective superannuation is a long term 'nest egg' which each Australian hopes will help them to fulfil a desired quality of life in retirement. According to the Australian Centre on Quality of Life, quality of life includes subjective perceptions of well-being, which can be measured though questions of satisfaction directed to people's feelings.¹⁸

The Commission on the Measurement of Economic Performance and Social Progress recommends quantitatively measuring subjective aspects of individuals' well-being via evaluations of one's life, happiness, satisfaction, positive emotions of pride and joy, and negative emotions of pain and worry.¹⁹

The Draft Report states that “in keeping with the Productivity Commission Act 1998 (Cwlth), the Commission has conducted this study using transparent and public processes, with an overarching concern for the well-being of the Australian community as a whole” (p.13). “The size and significance of the Australian superannuation system mean that its efficiency and competitiveness materially impacts the well-being of Australians” (p.43).

However, the Draft Report indicates a reluctance to embrace well-being as a measure of the success of the system, rather than competition leading to reduced prices and improved service quality is a measure of well-being (p.61). Further, the Draft report states:

¹⁴ Measuring Wellbeing: Frameworks for Australian Social Statistics, 2001 (updated 2006), Australian Bureau of Statistics

¹⁵ Measuring Wellbeing: Frameworks for Australian Social Statistics, 2001 (updated 2006), Australian Bureau of Statistics

¹⁶ <http://www.oecd.org/statistics/oecd-releases-first-comprehensive-guidelines-on-measuring-subjective-well-being.htm>

¹⁷ <http://www.oecd.org/statistics/oecd-releases-first-comprehensive-guidelines-on-measuring-subjective-well-being.htm>

¹⁸ <http://www.acqol.com.au/>

¹⁹ Sen, A., Stiglitz, J. E., & Fitoussi, J.-P. (2009). Report by the Commission on the Measurement of Economic Performance and Social Progress. Paris, France: The Commission on the Measurement of Economic Performance and Social Progress.

“Meeting the needs and preferences of members is another key objective of the system (and aligned with a consideration of allocative efficiency). However, assessing this at a system level is challenging due to the diversity of member preferences and needs. The assessment criteria and indicators focus predominantly on inputs to the system, observed member behaviours and potential impediments to efficient outcomes.” (p.107)

Findings in the numerous relevant well-being studies already undertaken demonstrate the benefits of overcoming any perceived challenges of using such metrics at a system level. Existing well-being studies include (to name a few):

- BT's Australian Financial Health Index
- WSSA Financial Well-being Index
- Mercer Superannuation Sentiment Index Study
- Australian Unity
- PriceWaterhouseCoopers Employees financial wellness survey
- ING Direct Financial Well-being Index

The superannuation system is compulsory for all working Australians. The Government's objective for this compulsory system was framed within the principles of fairness, adequacy and sustainability. However, to truly understand if a system is fairly and adequately assisting its members to save for their retirement, member assessment of the performance of the system is paramount.

The FPA strongly recommends the Commission's assessment framework be expanded to include well-being indicators for assessing the competitiveness and efficiency of the superannuation system.

C1 Well-being indicators for assessing competitiveness and efficiency

Information request

What is the best outcome-based indicator of effective competition in the superannuation system and why? To what extent could growth in voluntary consumption of superannuation services be an indicator for such assessment?

Outcome-based indicator(s) of effective competition and efficiency in the superannuation system should include well-being-based indicators.

The Government's objective of superannuation is to provide income in retirement to substitute or supplement the Age Pension (p.3). Hence, its purpose is to contribute to the well-being of Australians in retirement. It is evident that this purpose is clearly understood by the Commission through its desire to measure the alignment of competition with member demands or what members want from the system.

“In this context, high and growing levels of member satisfaction and trust in the system is an indicator that would be both less challenging to measure and more directly linked to the objectives of competition in superannuation.”(p.105)

The FPA agrees with the indicator of “Member satisfaction and trust* (outcome)” (p.105) as a well-being measure of both competition and efficiency. When examining satisfaction it is important to identify the drivers of member satisfaction.

- In addition to low fees and net returns, drivers of member satisfaction could include

- perceived value for money
- fund communication – should be meaningful and help members understand how they are tracking in terms of their retirement savings needs / preparedness;
- useful member education and availability of effective online help on superannuation issues and planning for retirement
- understanding of services available to them

Similarly, there are considerations when assessing trust:

- perceptions of trustworthiness
 - is the system responding to members' needs?
 - member confidence in the financial stability of the super system
 - do members seek information and assistance from their superannuation fund directly?
 - do members feel confident in, comfortable with, and supported by the super system as a way to save for retirement
- members understanding of the system and comfort in making decisions
 - do members' have confidence in their own understanding and abilities?
 - do members seek help with super decisions either from an adviser or accountant?

Additional indicators should examine members' sense of security and members' comfort in the system's performance and ability to achieve its purpose:

- do members' feel confident in their ability to fund a comfortable lifestyle beyond retirement
- member comfort in investment of funds given global and Australian economy/sharemarket fluctuations
- member understanding of the role of super and how members plan to fund their retirement

Recommendations:

The FPA recommends the use of well-being indicators to measure both the competitiveness and efficiency of the system such as:

- member comfort in legislative, and other changes in the system and how they may impact them
- do members feel financially prepared for retirement?
- members' confidence in the super system as a way to save for retirement
- member understanding of the role of super
- how confident do members feel about their understanding of the how the superannuation system work, options within the system, and financial literacy more broadly?
- member understanding of terminology within the super system – this indicator will provide evidence of member accessibility to the system and limitations for members' to engage with the system, which could be restricted if terminology makes it difficult for members to understand. It will also identify variables for satisfaction of services.
- is fund communication meaningful for members?
- member confidence in their ability to make decisions in their own best interest and that will meet their retirement needs

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- how confident do members feel about their understanding of the link between share market performance and the balance of their super?

D. DEMAND SIDE CONDITIONS AND BARRIERS TO COMPETITION (Report Chapter 5)

Response to Table 5.1 - Demand-side characteristics: criteria and indicators

Information request

What other indicators do the industry and researchers use to assess member engagement? How could those indicators be applied in a system-level assessment of competitiveness and efficiency?

Member well-being

Member engagement is dependent on understating and trust, key attributes of well-being. Refer to section – C1 Well-being indicators for assessing competitiveness and efficiency - above for a detailed discussion and recommended indicators to assess member engagement.

Member education

The Draft Report states that “product proliferation, high advertising expenditure, competition on irrelevant non-price (non-fee) aspects and high search costs are potentially signs of unhealthy competition” (p.6).

The Commissions acknowledges member engagement should not be examined in isolation from measures of financial literacy and cognitive capacity (p.78). Therefore, the FPA recommends the inclusion of an indicator that measures fund expenditure on member education to improve financial literacy and engagement relative to the overall marketing expenditure of the fund (input).

Superannuation changes

We acknowledge the desire of all sides of politics to minimise changes in superannuation policy. However, given the changes proposed in the 2016 Federal Budget, and the economic significance of the superannuation system, it is likely that changes will occur.

The current considerations of the life insurance industry may also result in policy changes that impact the superannuation system, particularly the provision of insurance through super.

Such changes will ultimately impact the fees, insurances and services offered by superannuation. Similarly, changes in technology, market consolidation and other business operations, as well as consumer behaviour and bias, can also influence fees and service offerings.

Hence, consideration should be given to the value of measuring member awareness of and activity in response to changes to fees, insurance, superannuation services, or government policy changes, as an indicator of member engagement.

Principal-agent influence on competitive pressure

As discussed above, financial planners embrace the responsibilities in the principal-agent relationship as they are experts in both the superannuation system and understanding member needs.

A key feature of financial planning is the identification of client financial and lifestyle goals assisting clients to plan for the future; and planning for the future implies engagement.²⁰ “The level of member engagement can have important implications for the competitiveness and ultimately efficiency of the superannuation system” (p.36).

With approximately 4,834,720 Australians seeking financial advice, measures should utilise the function of financial planners as contributors to demand-side competition acting in the members’ best interest.

Member awareness of superannuation features

Superannuation is a long-term investment structure. Members engage with the system at different timeframes and frequency, and for different reason. As discussed in the Draft Report, member behaviour and engagement is influenced by member need – for example, a 20 year old in their first job would not have an interest in or the foresee the economic need to engage with the system as often or as deeply as someone approaching retirement age. As engagement may intensify when decisions are necessary, such as moving from the accumulation to retirement phase, member engagement may vary throughout the lifespan of investment.

Given the length of time a member has a superannuation account, it is also reasonable to expect a member’s recollection of information about their superannuation may wain, particularly outside of key decision making times. Therefore, measuring “member awareness of key features of their superannuation” (Table 5.1) may not provide a true representation of member engagement or indicate the existence of demand-side competition.

An alternative indication of demand-side competition could be measuring how members selected their fund. For example: did they shop around? What did they look for in a fund? What were the driving factors in selecting their fund? Was it easy to access information about various funds? Was it easy to compare funds?

Examining the process members undertake to select a new fund could indicate the level of engagement. This research would need to focus on new members. A similar approach could be taken to assessing how (if at all) members respond to fees, insurance, superannuation services, or government policy changes.

Member account monitoring activity

The FPA acknowledges and agrees with the challenges of using member activity as a measure of engagement and therefore an indicator of competition, as discussed in the Draft Report. For example, a high level of activity by members could mean they are engaged and make active decisions, or that there are issues with the product or fund, or that they have changed jobs. However, low levels of member activity could also mean the member is engaged and has made an active decision. As discussed above, the level of member activity can change throughout the life-span of the superannuation investment based on the needs and life-stage (among other factors) of the member.

There are also different levels of member activity. For example, member activity in response to an email sent by a fund could range from a member opening the email, versus clicking through to their

²⁰ Irving, Kym, The Financial Life Well-Lived: Psychological Benefits of Financial Planning, Australasian Accounting, Business and Finance Journal, 6(4), 2012, 47-59.

account on the website, versus spending time reading additional information on the website, versus acting on a call to action.

Assumptions

When considering member engagement as a measure of competition, it would be necessary to apply assumptions to cater for behavioural differences of member segments, such as members with high account balances versus those with low account balance; and must consider correlations such as those between engagement and age, home ownership, members with children, and type of employment (for example).

Variables across numerous market segments should be carefully considered when examining sources of evidence.

Recommendations

The FPA recommends:

- the use of well-being indicators to measure the competitiveness and efficiency of the system (see section C1 above)
- measuring fund expenditure on member education to improve financial literacy and engagement relative to the overall marketing expenditure of the fund (input).
- measuring member understanding of and activity in response to changes to fees, insurance, superannuation services, or government policy changes, as an indicator of member engagement (behaviour)
- utilising the function of financial planners as contributors to demand-side competition acting in the members' best interest (as above for detailed recommendations).
- assessing whether members can opt-out of services they do not use or need.
- examining the process new members undertake when selecting a new fund, as an indicator of member engagement (rather than measuring "member awareness of key features of their superannuation").

Response to Table 5.2 - Supply-side characteristics: criteria and indicators

Information request:

What is the best way to measure the height of barriers to entry arising from the inability of prospective entrants to access the distribution channels available to incumbent funds, including through being afforded default status? Is there case study evidence of new entry being prevented by those barriers?

Default arrangements

The Draft Report states:

"A more sophisticated assessment [of a fund] will typically consider issues such as the asset allocation strategy, the quality of underlying assets within each category, the asset diversification strategy as a means of improving risk-adjusted returns over time, and how adjustments to the strategy may be made over time."(p.205)

As previously stated, financial planners have an obligation in the Corporations Act to act in the best interest of their client²¹. In relation to product recommendations, such as superannuation, this requires financial planners to compare funds and assess the products' ability to meet their client's (short, medium and long term) needs, the appropriateness for their client's circumstances, and make a recommendation that is in the best interest of their client. This involves financial planners identifying and examining (for example):

- product risks and their client's risk appetite – discussing product risks with their client to determine whether they are comfortable with any risks associated with the fund such as investment performance and how these meet client needs
- features, such as services, investment options including asset allocation (and management of those investments), additional offerings within the product, transparency of information, fund performance, etc, and how they may or may not assist their client to meet their needs and achieve their goals
- insurance component and services within each product, ensuring they are comparing 'like with like'
- quality of the fund such as potential product performance and returns, strength and stability of the product provider, and how these may assist in achievement of goals
- any disadvantages to the client such as impacts on insurance and liquidity and how these impact on client needs in the short, medium and long term
- costs including switching fees (if applicable), ongoing fund fees.
- compare funds within each phase of the product – accumulation, transition to retirement and pension phases.

Importantly financial planners consider the benefits and disadvantages, risks and costs with alternative solutions (both inside and outside the superannuation system) that may meet their client's needs and appetite for risk.

As previously discussed, financial planners play an important role in the superannuation system, particularly as an active participant in the principal-agent relationship and member engagement. The best interest obligations in the law govern the delivery of financial advice to superannuation members and should be considered when developing a formal competitive process for allocating default fund members to products.

A potential policy issue arising out of the 'best interests' duty is that, where the client is an employer, the duty doesn't apply to the employer's employees and associates. This means that advice provided to employers in respect of default fund arrangements for employees isn't necessarily in the best interests of employees and their associates.

Recommendation:

The FPA recommends that the development of alternative models for a formal competitive process for allocating default fund members to products must consider how it interacts with the best interest obligations for the provision of financial advice in the Corporations Act. Specifically, consideration should be given to legislating that when obtaining advice in respect of default fund arrangements for employees and their associates, the employer acts in a fiduciary or similar capacity. Further, consideration should be given as to whether the employer and adviser should have a positive duty to act in the best interests of the employees and their associates as a whole (including, possibly, future employees and associates) rather than the employer.

Response to Table 5.4 Cost and price-based competition: criteria and indicators

²¹ Corporations Act 2001, s961B

Transparency

As discussed in the Draft Report, “with respect to the product dimension, the end product that reaches members comprises of a bundle of distinct administrative, investment and ancillary services (p.75).

However, the services offered by funds vary greatly in both scope and quality, even within distinct services. This can result with apples and oranges offered under each service type.

When identifying funds that meet their clients’ needs, financial planners are required to compare and assess, among other components, fees and services.

The effectiveness of fee disclosure is often hampered by the lack of useful and in-depth information regarding the relevant service offering, making it challenging to identify ‘like’ offerings for fee and service comparisons. The Commission’s view is that:

“The complexity of the underlying decisions and information asymmetries for members create scope for superannuation funds to differentiate their products on multiple characteristics to further complicate the comparison of products across providers.” (p. 103)

The FPA also agrees with the Commission’s findings that there are significant quality issues in the currently available data from both APRA and funds. Therefore, when considering the ‘transparency and efficacy of fee disclosure by funds, including for distinct services as an indicator of competition, care needs to be given that evidence sources compare products on a ‘like-for-like’ basis.

Short-term market signals

The FPA supports the Commission’s view that undertaking an assessment of costs should not be conducted in isolation of other relevant factors, such as quality of service and other aspects of value to the consumer. However, we would caution against using an assumption that no member response to market signals, particularly pricing signals, as an indicator of poor competition.

As previously stated, superannuation is a long-term investment structure. Hence, there would be reduced motivation or benefit for members to respond to short term changes to the relative returns of (a) individual funds (b) different investment options within funds. We would argue that making superannuation decisions based on short-term competition drivers of funds, may not be in members’ interests and could be detrimental to long term member outcomes.

Response to Table 5.5 Aligning competition with demand: criteria and indicators

As discussed in section – C1 Well-being indicators for assessing competitiveness and efficiency - above, the FPA recommends well-being indicators as a vital measure of competitiveness of the system.

In addition, awareness does not equate to understanding of the system. A lack of understanding of the system, reduces member trust in the system and satisfaction with its performance. This can reduce member engagement and motivation to use the system, which in turn impacts the efficiency and competitiveness of the system and potentially member adequacy and well-being in retirement.

Therefore, the FPA recommends the following amendment to Table 5.5 indicators:

Member awareness understanding of key features of their superannuation, including insurance* (input)

One approach to assessing understanding is undertaking diagnostic testing of a sample of members through surveys.

Indicators on-price dimensions

As discussed in section above - Response to Table 5.1 - Demand-side characteristics: criteria and indicators: Member account monitoring activity - the FPA recommends:

- the inclusion of an indicator that measures fund expenditure on member education to improve financial literacy and engagement relative to the overall marketing expenditure of the fund (input).
- measuring member awareness of and activity in response to changes to fees, insurance, superannuation services, or government policy changes, as an indicator of member engagement (behaviour)

Innovation and quality improvement

As discussed throughout the Draft Report, there are numerous services offered to members by superannuation funds. The costs of these service offerings are either covered under the product fees charged to members or on a fee-for-service basis (such as with insurance).

The FPA recommends the following indicator to measure quality improvements in the system aligning services with member demand - a reduction in the service offerings that are underutilised by members.

E. ASSESSING EFFICIENCY (Report Chapter 6)

Response to 6.1: The system maximises net returns on member balances over the long term

Information request:

What reference portfolio should be used to benchmark long-term net returns in the system and particular segments of the market?

What other benchmarks should be used to supplement the analysis? If a CPI + X benchmark was used what is the appropriate level of 'X'?

The FPA suggests that the Commission consider the procedure used by Liu for constructing benchmarks.²² This procedure involves working out funds' average asset allocations across the sample period and using relevant indices,²³ such as the S&P/ASX200 Merged Accumulation Index, to construct benchmark returns.

This procedure could be adapted to construct benchmark portfolios, where each corresponds to a different 'risk bucket'. Deciding on the limits of each risk bucket would, we think, involve a measure of judgement.

Response to Table 6.3 Costs and fees: criterion and indicators

The FPA agrees with the Commission's intent to "take account of service features provided to members" when measuring if costs incurred by funds and fees charged to members are being minimised. Cost efficiency should not be determined on fee minimisation alone.

Superannuation funds supply many different services to their members tailored to the membership base. Fees must be weighed up against the services provided. The trade-off between fees and services must be measured by the value members place in those services. This can only be measured seeking members' views using well-being indicators (as discussed above).

As previously discussed, the service features provided to members may vary in scope and quality across providers making it challenging to determine the "maximising of value" needed from the system. This may be reflected in fee anomalies in industry and Regulator data.

Recommendation:

The FPA recommends well-being indicators to measure member satisfaction and trust that fees are reasonable and reflect the value members place in the services provided.

Response to Table 6.5 - Managing tax: criterion and indicators

To determine whether the system is "effectively managing tax for members", the assessment must come from the members themselves using well-being indicators, such as:

- member understanding of the tax elements of the superannuation system
- member satisfaction and trust in the tax effectiveness of the system.

²² Liu, K.Y., *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD thesis, June 2013), http://ses.library.usyd.edu.au/bitstream/2123/9264/1/Liu_K_THesis_2013.pdf pp 198-209 (accessed 9 September 2016)

²³ *Ibid.* Table 5.8, p 204

Response to Table 6.8 - Provision of information and advice: criterion and indicators

Are member preferences and needs are being met by the system providing high-quality information and financial advice to members to help them make decisions?

As discussed above, fund communication is a key determinant of member satisfaction and understanding, and can significantly reduce member engagement and investment in the system.

Determining the helpfulness to members of fund communication and financial advice is a question for members themselves. Hence, well-being indicators are crucial in measuring the provision of information and advice.

Recommendation:

The FPA recommends well-being indicators to measure the impact of fund communication on members:

- is fund communication and advice meaningful for members?
- how confident do members feel about their understanding of the how the superannuation system work, options within the system, and financial literacy more broadly?
- member understanding of terminology within the super system
- member understanding of services available to them
- member understanding of and comfort in legislative, and other changes in the system and how they may impact them.
- member understanding of the role of super
- how confident do members feel about their understanding of the link between share market performance and the balance of their super?

Response to Table 6.9 Retirement income: criterion and indicators

As discussed above, financial planners embrace the responsibilities in the principal-agent relationship as they are experts in both the superannuation system and understanding member needs.

Financial planners work with clients to identify their needs, goals and preferences, and develop solutions to help them plan for the future and adequacy in retirement.

With approximately 4,834,720 Australians seeking financial advice, measures should utilise the function of financial planners acting in the members' best interest, as contributors to the efficiency of the superannuation system.

Response to Table 6.10 - Allocating member balances: criterion and indicators

“The system is compulsory, complex, and members can disengage in the face of cognitive constraints and restrictions on choice.” (p.36)

The complexity of the system that members are faced with is exacerbated by industry jargon and terminology which is a significant barrier to member engagement with and investment in superannuation.

The Commission states that the “diverse range of fund and product types increases complexity and requires a flexible approach to the development of assessment criteria and indicators (p.23)”. Whether a preference or need has been met can only truly be determined by evidence about members.

The FPA suggests the proposed indicator - “member awareness of investment, sequencing and longevity risk” – is based on technical terminology that members may or may not be familiar with and is an unreliable measure of efficiency.

Recommendations:

The FPA recommends well-being indicators to measure member trust, comfort and understanding about the investment of their account balance, such as:

- members’ level of comfort to take on risk to grow their superannuation account balance
- alignment of balance allocation and members’ level of comfort to take on risk and best interests
- members’ feelings, reaction to, and understanding of incurring losses in the short term to maximise long term opportunities

Response to Table 6.12 - Trustees acting in member interests: criterion and indicators

Financial planners are required by law to act in the best interest of their clients. By helping members make an informed decision about their superannuation, in turn, facilitates trustees to act in the best interests of members.

The role they play in the principal-agent relationship enables financial planners to assist members to understand and monitor the allocation of account balances to ensure they are being invested in line with their risk preferences and needs.

Financial planners are an ‘informed source’ of member information and detailed insights into member needs and preferences which could assist superannuation funds and service providers to ensure their product offerings are suitable for their diverse member bases.

The FPA agrees with member satisfaction and trust as an indicator of whether trustees are acting in members’ best interest. Happiness is another well-being indicator that may be useful. Evidence of member happiness could be derived from the existing superannuation complaints handling system.

Recommendations

The FPA recommends the Commission include

- indicators that maximise the contribution financial planners offer the review of the competitiveness and efficiency of the system, both in their capacity of advice provider to members and information source for funds.
- member happiness about fund decisions that impact on the member outcomes, with evidence sources from the existing superannuation complaints handling system.

Response to Table 6.13 - Systemic risks: criterion and indicators

Information request:

Are there any other indicators of systemic risks in the superannuation system that should be incorporated into the assessment of this criterion? Are there any useful indicators that capture the impact of regulation and regulators on systemic risk?

Are there any other ways the Commission could assess dynamic efficiency in the superannuation system (in addition to looking at changes over time in operational and allocative efficiency)?

Do regulators significantly influence the scope for dynamic efficiency? How can this be measured and assessed?

Systemic risks in the superannuation system include sub-optimal diversity in operations or investment across the system. Indicators might include over-concentration of a single risk management framework (e.g. software system); or investment philosophy (e.g. index).

Response to Table 6.14 - Insurance products: criterion and indicators

Well-being indicators relating to insurance should include member satisfaction and trust that they will be covered should the need arise. Understanding that the superannuation fund offers insurance, particularly in the default environment, and the features of the insurance cover, are vital to satisfaction and trust.

As previously discussed, when considering whether competition and efficiency align with member needs, it is more effective to use diagnostic testing to measure member understanding of the system and fund features, rather than member awareness. Awareness does not equate to understanding of the system or product. A lack of understanding can reduce member trust in the system and satisfaction with its performance. This can reduce member engagement and motivation to use the system, which in turn impacts the efficiency and competitiveness of the system and potentially member adequacy and well-being in retirement.

F. BRINGING IT ALL TOGETHER (Report Chapter 7)

Response to Table 7.1 Evidence needed for the stage 3 review: summary

As discussed throughout this submission, the Commission's framework and criteria for assessing the competitiveness and efficiency of the superannuation system would be enhanced by using well-being metrics.

The evidence required to support the inclusion of well-being indicators would need to be investigated.

As stated in section D - Assessing the system using well-being metrics - of this submission, the concept of measuring well-being is not new. There have been numerous well-being studies undertaken including (to name a few):

- BT's Australian Financial Health Index
- WSSA Financial Well-being Index
- Mercer Superannuation Sentiment Index Study
- Australian Unity
- PriceWaterhouseCoopers Employees financial wellness survey
- ING Direct Financial Well-being Index

An assessment would be required to determine if the methodology and parameters of existing studies would provide the necessary evidence for effectively assessing the competitiveness and efficiency of the superannuation system based on determined well-being indicators.

The FPA recommends the Commission examine the usefulness of existing well-being research.