12 February 2014

Manager, Superannuation Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuationconsultation@treasury.gov.au

Dear Sir/Madam

Submission on the Government's Discussion Paper – Better regulation and governance, enhanced transparency and improved competition in superannuation

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,100 members, including more than 2,200 actuaries. Our members have had significant involvement in the superannuation industry and the development of superannuation regulation, reporting and disclosure, interpreting financial statistics, risk management and related practices in Australia for many years.

The attached submission sets out the Actuaries Institute's response to the Government's superannuation discussion paper released for consultation on 28 November 2013.

Please do not hesitate to contact the Chief Executive Officer of the Actuaries Institute, David Bell (phone 02 9239 6106 or email david.bell@actuaries.asn.au) to discuss any aspect of this paper.

Yours sincerely

Daniel Smith
President

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Submission on the Government's Discussion Paper released on 28 November 2013
Better regulation and governance, enhanced transparency and improved competition in superannuation

PART 1: A better approach to regulation

Question 1: The Government has committed to identifying (in dollar terms) measures that offset the cost impost to business of any new regulation. What suggestions do you have for how the regulator compliance burden can be reduced?

The Institute has been concerned for some time about the potential additional regulation of actuarial services via the Tax Agent Services Act 2009. On 5 August 2008, the Institute sent a submission to Treasury in response to the Tax Agent Services Bill 2008 Exposure Draft. The Institute was concerned that, in the absence of a broad exemption applying to actuarial services, which typically involve the certification of amounts that are required to calculate a tax liability and are often required by legislation, the legislation may severely limit the existing scope of services that can be provided by actuaries without registering as tax agents. Further, it was (and still remains) our understanding that, in the framing of the draft legislation, there was no specific intention to introduce further regulation of actuarial services. We believe that it would be appropriate to exempt actuaries from the Tax Agent Services legislation, in particular in respect of services that are specified in tax legislation that require actuarial advice and/or certification.

As you would be aware, the "Sustaining the Superannuation Contribution Concession" legislation passed in June this year imposes an additional 15% tax on the concessional superannuation contributions of individuals with relevant incomes of $300,000 or more. Implementation of this new tax requires regulations to be issued which specify the method of determining notional defined benefit contributions for this purpose. We strongly recommend that the Notional Taxed Contributions (NTCs) already in use for concessional contribution limit purposes also be used for the new tax. NTCs are already available for the vast majority of defined benefit arrangements - that is, all except a small number of public sector funds. Further, this approach would avoid the considerable confusion that is sure to arise if two different notional contribution amounts are required for each defined benefit member for tax purposes. Use of the 'surchargeable contributions' methodology would impose substantial additional compliance costs on (effectively) the employer sponsors of defined benefit funds – including many funds which may have no members affected by this new tax. In our view, it is unnecessary and inappropriate to impose these additional costs, given that NTCs could be used.

PART 2: Better governance

We do not have any comments on this Part.

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

PART 3A: Enhanced transparency – Choice product dashboard

Question 13: Should a Choice product dashboard present the same information, in the same format, as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what should it include and why?

Yes, it is the Institute's view that Choice dashboards should have the same principal sections as the MySuper product dashboards. However, as noted in the remainder of our responses we believe that there are aspects of the current information required on the MySuper dashboard which should be changed. These changes are summarised below and further explained in the Appendix which also provides reasons for these changes.

1. The Net Return and Net Return Targets as currently defined by APRA should not be disclosed on MySuper and Choice dashboards.

2. The Net Investment Return Target and historical Net Investment Returns should be disclosed on the MySuper and Choice dashboards.

3. Net Investment Return Targets should be based on AWOTE rather than CPI. Since it is impossible to change investment objectives from CPI to AWOTE 'overnight", it might be desirable for the Government to give notice that the change will not be compulsory for at least say two years.

4. A second metric to measure long term investment risk should be included with the current short term volatility risk measure. It should be based on the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.

5. Risk Labels (i.e. High, Medium, Low) should not be included on MySuper and Choice dashboards, just Risk Measures (i.e. number of negative net investment returns over a 20 year period).

6. A liquidity metric, equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation), should be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.

7. MySuper and Choice dashboards should **compulsorily** include standardised administration, advice and investment fees and costs for two representative members in a simple table such as the following:

Statement of annual fees and other costs		
	Member with a $10,000 account balance	Member with a $50,000 account balance
Administration	**$xxx**	**$yyy**
Advice	**$ccc**	**$ddd**
Investment	**$aaa**	**$bbb**
Total	**$TTT**	**$SSS**

The amounts $aaa and $bbb should be included on the dashboard for all investment options.

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

8. MySuper and Choice dashboards, where the fund does not fully pass on the benefit of tax deductions on administration or advice fees and costs to members, should **compulsorily** include an explanation of the impact of this on the above table. While it would be preferable for all funds to pass this tax benefit on to members on a consistent basis, even though it is quite a technical issue members should be warned about the impact of this different tax treatment on their accounts.

9. If fees and costs for a Choice product depend on contributions (or salary) then information must be added to explain that the statement of annual fees and other costs also assumes that the member with a $10,000 account balance has annual contributions of $1,000 and the member with a $50,000 account balance has annual contributions of $5,000 (or to explain the salary assumption).

10. Dashboards should provide clear direction as to how members can find further information relating to the investment, administration and advice services provided.

11. Choice dashboards should **optionally** include additional information regarding the Net Investment Return and the investment, administration and advice fees and costs that the trustees believe is necessary to provide superannuation fund members with a proper understanding of these services. For example this might include information about different fees and costs for active and non-active members, different categories or optional services.

12. More development work and consumer testing needs to be done with regard to how the dashboard is integrated into websites, PDS's and member statements. Our preliminary views are set out below:

    a) Websites: It is feasible to have a dashboard for each investment option assuming the member is 100% invested in that option (subject to 10. above). The website dashboard should make it very clear that it has assumed a member is invested this way.
    b) PDS's: We suggest that a full choice dashboard for each investment option is unnecessary and impractical. In a PDS, funds should be able to show the administration and advice fees and costs once for each product and then show the target net investment return, return history, risk metrics and investment fees and costs for each investment option separately.
    c) Member's statements: The provision of a choice dashboard that is member specific is impossible to produce and therefore should not be sent to members. The member may have multiple investment options with different amounts in each option. The total return and fees and costs will be virtually impossible to calculate as this will depend on the mix of investment choices. The member's statement should include the information in 7 above and have a statement in it which directs the member to the relevant sections of the website where the information at the investment choice level is available.

Question 14: Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product returns?

No, the Institute does not believe that a single standard benchmark is appropriate for all choice products. Where an "inflation plus percentage return" is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Question 15: Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard? In considering this question, you may wish to consider:

- ***If including an additional measure for a product's investment return would add unnecessary complexity.***
- ***If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.***
- ***Whether it is appropriate to use a single time horizon, for example 10 years, when calculating target net return and net return for the range of possible choice products.***

No, only the Net Investment Return should be disclosed on both the MySuper and Choice dashboards. The Institute has indicated previously that we strongly believe that administration and advice fees and costs should **not** be deducted from investment returns when calculating net investment returns for the purposes of comparing the investment outcomes and capabilities of different superannuation funds (see the Appendix for a summary of our reasons).

The Institute therefore believes that the Net Return as defined by APRA should not be disclosed on either the MySuper product dashboard or the Choice product dashboard. We understand that this is also the view of the Association of Superannuation Funds of Australia (ASFA) and we strongly endorse that view. The only metric that is suitable for comparing the investment performance of different product providers is the Net Investment Return where only the fees and costs and taxes associated with the investment service are deducted from the investment return.

Therefore it is this Net Investment Return and only this return that should be disclosed on both the MySuper and Choice product dashboards. This would remove the issue of disclosure of two returns introducing unnecessary complexity in the dashboard. It will also remove the misleading aspect of the current proposals and support the Government's aim to reduce regulation and compliance costs. In any case, the disclosure of administration fees on the dashboard (as suggested in the summary of proposed changes on pages 1 and 2) achieves the same goal as deducting administration fees in the net return without distorting investment returns.

The Institute believes that ten years is a reasonable period to show actual past investment performance. It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is, however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Question 16: Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question, you may wish to consider:

- ***Is the SRM model the best measure of short-term investment risk?***
- ***What would be the most suitable measure of long-term risk to include on the product dashboard?***
- ***Is it possible to present a long-term risk measure in a similar format to the short-term risk measure (that is High/Medium/Low)?***
- ***Would including an additional risk measure add unnecessary complexity to the product dashboard?***

Yes, the Institute believes that the dashboard should disclose two metrics that measure investment risk. We believe that metrics relating to short term and long term investment objectives must be included. This is necessary to reduce the potential for members to make choices that reduce their final retirement benefits.

We agree that the Standard Risk Measure as proposed in the FSC/ASFA guidance note is an appropriate metric for the short term investment risk.

We propose that the metric to measure long term investment risk should be *the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.*

This will mean there will be two risk measures. We acknowledge that this will increase the complexity of the dashboards. But we believe they can co-exist on the dashboard as long as a simplifying label such as high/medium/low is not used for each as, for a particular option, the label for the short-term measure may be quite different to the label for the long-term measure. The estimated number of negative net investment returns over a 20 year period and the probability of not meeting a reasonable long-term return over wage inflation should provide a good indication of risk, perhaps with some explanatory comments to guide members as to what certain ranges of these measures may indicate about each risk.

The dashboards currently must include a "Risk Label" as well as a "Risk Metric". The Institute does not support this. We are concerned that members will only focus on the Risk Label when choosing their investment option. If they did this, it is possible that members will choose options that have less risky short term risk labels. For superannuation fund members with long term investment horizons, it is likely that this will mean that they will achieve lower long term investment returns and therefore lower final retirement balances.

If two risk measures are included, Risk Labels should not be shown for each risk measure as it would confuse members since many investment options will be labelled as both more risky and less risky.

We note that our comments below apply equally to MySuper and Choice dashboards. However, they are particularly relevant to Choice dashboards as it is expected that members who select Choice products will base their choices on an examination of the material provided by the superannuation fund. This will include information disclosed on the dashboard. It is therefore vital that the information on the dashboard not be misleading.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Question 17: Are additional carve outs from the choice product dashboard obligations required? If so, why are these additional carve outs required? In considering this question, you may also wish to consider identifying where the gaps in the current carve out provisions are.

No, we do not recommend any additional carve outs, but we suggest a slight change to clarify the intention of the first carve out (see page 22).

Question 18: Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?

Yes, there should be a measure of liquidity included on both the MySuper and Choice dashboards.

There is merit in the Cooper review's recommendation to include a measure of projected liquidity on the dashboard. Members should be alerted that the risk of not being able to access their money is substantially higher in certain options, especially if there is a material risk they may not be able to access their money within 30 days without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) in some circumstances. It would also be desirable for members to be made aware if there was an option for withdrawals to be frozen and the general circumstances where this could occur.

Further, the liquidity of assets within an investment option which has a mix of different assets is important as the rebalancing that may be required when relative values of different asset classes change may generate investment losses when illiquid assets have to be sold.

However, it is difficult to construct an appropriate liquidity measure, as the liquidity of different assets can rapidly change, as occurred with mortgage-backed securities during the GFC. Nevertheless, it is still important to include some indicator of the level of illiquid assets. If an investment option is supported by a high level of illiquid assets, it is important that a member (particularly one selecting a Choice product) is alerted to the possibility that access to capital may be restricted in some circumstances.

On balance, the Institute recommends that a liquidity metric, equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation), be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.

Question 19: Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

Yes, the commencement date should be delayed until at least 1 July 2015 to allow for revision of the MySuper dashboard and the finalisation of Choice product dashboard requirements (which will take some time after the consultation period finishes) and then implementation by product providers.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

The main issue the dashboard is trying to address is to provide the least engaged MySuper members with a simple way to evaluate and compare default options, which is where the vast majority of superannuation money is held. There is a need to extend this to the wider universe of Choice options but it is not as pressing as the MySuper dashboard and it is more important to get it right the first time to avoid unnecessary re-work costs.
Subject to these modifications, we believe the dashboard can become a useful source of information for superannuation fund members.

PART 3B: Enhanced transparency – Portfolio holdings disclosure
We do not have any comments on this Part.

PART 4: Enhancing competition in the default superannuation market

Question 27: Does the existing model (which commences on 1 January 2014) meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape?

No. It does not meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape.

The industrial relations system was extremely important in the development of meaningful retirement savings for all Australians through superannuation. However, with the passage of subsequent legislation, and in particular the Superannuation Guarantee, APRA governance and MySuper, we believe that having named default superannuation funds determined through the Fair Work Commission is now an additional and unnecessary level of red tape and complexity.

The first stage of the default fund selection process for awards is complex and time consuming. It sees an Expert Panel of the Fair Work Commission (FWC) select a Default Superannuation List which is a sub-set of funds with authorised MySuper products. At today's date, there are only about 80 funds with authorised generic MySuper products (excluding single employer MySuper products), all of which have already been reviewed by APRA against a set of criteria to ensure they meet certain standards. The value add of the Expert Panel's List is questionable.

The second stage of the default fund selection process lacks full contestability and transparency. It sees the Full Bench of the FWC decide which 2 to 15 funds are selected to be named in each particular award from the Default Superannuation List. The selection process allows prescribed persons to make submissions to the Full Bench for funds to be named in each award. Prescribed persons excludes superannuation funds, but includes the unions and employer associations which established many of the industry superannuation funds competing for a place on the awards, causing other funds to be concerned about full contestability. The process will also lack full transparency as it will be extremely difficult for the FWC to justify the sub-set of funds named in each award given the increased similarity between superannuation funds with MySuper products.

The outcome of the review process will constrain competition and contestability, and will very much advantage the growth of funds which are named in awards as compared to other funds with MySuper products.

It will increase the red tape to which employers are subject, and cause disruption not only to employers but also to members as it potentially creates:

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

- the need for a large number of employers to review their current default superannuation arrangements, even when they may recently have been through a review process;
- the requirement for employers to pay superannuation to several default funds for different groups of employees if their workforce is covered by multiple awards; and
- reduced retirement outcomes for default members, with more duplicate member accounts, confusion regarding insurance coverage, and the potential for increased fees and costs.

Question 28: If not, is the model presented by the Productivity Commission the most appropriate one for governing the selection and ongoing assessment of default superannuation funds in modern awards or should MySuper authorisation alone be sufficient?

No. As stated in the Actuaries Institute's submissions of 13 April 2012 and 1 August 2012 to the Productivity Commission, we believe that MySuper authorisation alone should be adequate to determine whether a fund should be able to qualify as a default fund in an award. If they are not considered adequate, then we believe it would be preferable to strengthen the MySuper standards in an appropriate way rather than adding an extra set of criteria for qualification as a default fund.

Having said this, the model presented by the Productivity Commission does have several advantages over the existing model which commenced on 1 January 2014, including:

- the Expert Panel is involved right through until the end of the naming process of specific default funds on Modern Awards, providing a greater degree of transparency;
- all parties, including superannuation funds, have the opportunity to make submissions to be included under specific Modern Awards, improving contestability;
- the number of named funds under a specific Modern Award is not limited (the Productivity Commission recommended the Expert Panel have a longer list rather than a shorter list where a decision about whether or not to list a product is marginal).

The recommendation by the Productivity Commission that a filter (over and above MySuper authorisation) should be applied when selecting a default fund was based on the views that:

- MySuper authorisation alone may not ensure that the funds selected would meet the best interests of employees covered by the award; and
- there is an administrative burden for employers (particularly new employers) being required to choose from a potentially large number of diverse MySuper products.

We would argue that both views have been sufficiently addressed now that there is a list of authorised MySuper products, and the number of authorised MySuper products is significantly less than the number envisaged when the Productivity Commission delivered its report.(refer pages 189 and 190 of the report). The Productivity Commission acknowledged that MySuper authorisation could form an appropriate filter in due course, stating (page 190) *"The Commission agrees that industry consolidation over time will mean that the number of MySuper products will decrease, and considers that this would potentially make Option 1 (use of any authorised MySuper product) a more appropriate solution over time."*

Given all existing employers will already have a nominated default fund, permitting choice for new employers (or existing employers reviewing their default fund) from a list of approximately 80 funds does not appear too great an administrative burden, certainly as

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

compared to the greater red tape and administrative burden created if employers with existing defaults are required to select a new default fund when the existing named fund is removed, or when the grandfathering terms can no longer be applied.

Question 29: If the Productivity Commission's model is appropriate, which organisation is best placed to assess superannuation funds using a 'quality filter'? For example, should this be done by an expert panel in the Fair Work Commission or is there another more suitable process?

Our view is that the Productivity Commission model is no longer the most appropriate model (refer response to question 28. above). However, if the Productivity Commission model were to be introduced, an expert panel of the Fair Work Commission would appear as suitable an organisation as any to apply a quality filter.

Question 30: Would a model where modern awards allow employers to choose to make contributions to any fund offering a MySuper product, but an advisory list of high quality funds is also published to assist them in their choice, improve competition in the default superannuation market while still helping employers to make a choice? In this model, the advisory list of high quality funds could be chosen by the same organisation referred to in focus question 29.

No, because the criteria that used to establish high quality funds would likely lead to a long list of high quality funds, given analysis of the 80 authorised MySuper products. As a result, the limited assistance potentially provided by having the high quality list would fail a cost-benefit analysis test.

Question 31: If changes are made to the selection and assessment of default superannuation funds in modern awards, how should corporate funds be treated?

If changes are made to the selection and assessment of default superannuation funds, we would recommend that an employer can automatically use any authorised employer MySuper product as a default fund.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Appendix: detailed responses and comments to Part 3A

This Appendix contains our detailed analysis and conclusions regarding our responses to Part 3A of the discussion paper. For clarity, we have retained the headings and sub-headings from the discussion paper.

The format of each response includes a further 'comments' section which sets out the reasons behind our response and in many cases further explanation of the matters which we believe should be taken into consideration

CHOICE DASHBOARD VERSUS MYSUPER

Question 13: Should a Choice product dashboard present the same information, in the same format, as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what should it include and why?

Yes, it is the Institute's view that Choice dashboards should have the same principal sections as the MySuper product dashboards. However, as noted in the remainder of our responses we believe that there are aspects of the current information required on the MySuper dashboard which should be changed. These changes are summarised in our Response to Question 13 at pages three and four of this submission.

Our views on disclosure relating to investment performance, investment risk and liquidity are set out below under the detailed responses to each focus question. We are also of the view that the section on Fees and Costs should be changed.
It is our view that MySuper and Choice dashboards should compulsorily include standardised administration, advice and investment fees and costs for two representative members in a simple table such as the following:

Statement of annual fees and other costs		
	Member with a $10,000 account balance	Member with a $50,000 account balance
Administration	**$xxx**	**$yyy**
Advice	**$ccc**	**$ddd**
Investment	**$aaa**	**$bbb**
Total	**$TTT**	**$SSS**

The amounts $aaa and $bbb should be included on the dashboard for all investment options.

We also believe that the dashboards should provide clear direction as to how members can find further information relating to the investment, administration and advice services provided.

Further, we believe that funds should be given the flexibility to include additional information that they believe will help superannuation fund members better understand the particular Choice product or option the member is considering and that more development work and consumer testing needs to be done with regard to how the dashboard is integrated into websites, PDS's and member statements.

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Comments

The Institute believes that the first step that a member considering a Choice product will take will usually be to compare their default MySuper product with a comparable Choice product. It is therefore important that, at a minimum, any Choice product has information comparable to that provided by the MySuper dashboard in a format that allows the two sources of information to be compared easily.

However, as indicated in our response to Question 14 below, we do not believe that a totally standardised content and format should be specified for all Choice products. Although all Choice products should be required to provide a Target Net Investment Return and historical Net Investment Return information, the product provider should be able to tailor this information to the specifics of each investment option.

Further, we expect that Choice products will offer a range of different administration and advice services. Choice dashboards should be required to provide information relating to the fees and costs of their administration and advice services. However, funds should be able to tailor this information (i.e. add to the specified minimum information) to provide superannuation fund members with a proper understanding of the options available and the cost of these options.

Fee and cost disclosure

The Institute believes that administration and advice fees and costs of one fund can only be properly compared to the fees and costs for another fund **separately from investment fees** and must take into account the level of the administration and advice services provided and the quality and timeliness of these services. We recognize that it is difficult to compare administration service (and the quality) of these services. However, if a service provider wishes to differentiate their product by adding different services or ensuring higher service levels (e.g. by providing a more personal website experience) it is important that dashboard reporting requirements do not reduce the possibility that members will have access to these additional services. Similarly it is only possible to compare investment options if investment fees and costs are separately disclosed from total fees and costs.

We note that our suggested table above discloses the **total** of the fees and costs. We have included the totals because we believe that it is currently the view of APRA that total fees and costs must be shown. However, the Institute believes that, at least for Choice products, the total of administration, advice and investment fees and costs has little comparative value for a member and should not be a compulsory inclusion in the table. We believe the total of these fees and costs is likely to mislead members unless they pay close attention to all the specific administration, advice and investment features which underlie the total fees and costs, to ensure they are comparing like-with-like.

Excluding the total fees and costs also reduces and simplifies the volume of information disclosed, particularly for Choice products with many investment options - for most Choice products (which have the same administration and advice fees for all investment options) it also can avoid unnecessary repeats of the administration and advice and total fees for every investment option.

A member, particularly a member considering a Choice product, should consider the relative value and costs of the administration, advice and investment services separately.

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Experience since the latest fees and costs template was introduced in 2004 has also highlighted that market competition has been affected by the inclusion of passive, indexed based, investments. These assets will normally attract lower total fees and costs. In these cases, where currently only the total of all fees is quoted on the Dashboard, the total fees disclosed is reduced substantially because of the lower fees incurred with passive investments. Members, who can only compare total fees, may select lower cost funds without considering the impact of passive investments on their overall net investment return.

Further, if the administration and advice fee component is "standardised" for only a $50,000 balance, it will still be potentially misleading for the vast majority of "non-standardised" members. Calculations made by the Institute have demonstrated that deducting administration and advice fees and costs from the investment return may mislead members who expect to have low account balances throughout their membership. As the Net Return is based on a $50,000 balance, this Return may incorrectly indicate the attractiveness of some funds for members with lower account balances. If this is the case, these funds may unfairly attract members who expect to have lower account balances prior to their retirement. A related problem arises with the "Statement of [total] fees and costs" displayed on the MySuper dashboard because only one [total] standardised result is shown.

The problems addressed in the two preceding paragraphs arise primarily because Australian accumulation-based superannuation funds express their administration fees and costs in one of the following formats:

A. Solely as a dollar amount per member (11 out of 100 Funds), or
B. Solely based on account balances (34 out of 100 Funds), or
C. Partly as a dollar amount per member and partly based on account balances (54 out of 100 Funds), or
D. Zero, because administration fees and costs are payable by the employer (1 out of 100 Funds).

[The above numbers are sourced from the August 2013 Chant West Super Fund Fee Survey, adjusted for known changes in late 2013].

The impact of administration fees and costs on the overall return to a member depends on the member's account balance. A simple way to alert members to this is to illustrate the annual administration and advice fees and costs for two representative members with, we suggest, account balances of $10,000 and $50,000 (and annual contributions, if relevant for Choice products, of $1,000 and $5,000 respectively).

Why do we suggest two representative members?

1. For Type A funds the administration fee and costs for the two representative members will be the same,
2. For Type B funds the administration fee and costs for the second representative members will be five times the first.
3. For Type C funds the administration fee and costs for the second representative members will be between one and five times the first.
4. For Type D funds the administration fee and costs will be (or should be) zero if paid by the employer.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Further, **the growth in the impact of administration and advice fees and costs is important.** The growth in administration and advice fees and costs of a Type A member is significantly different to that of a Type B member. **To properly address this requires a projection but having two representative members will help to indicate that further information, and perhaps a projection, might be desirable.**

We also note that the investment fees and costs are typically a percentage of assets. Disclosing these fees and costs for only one balance may mislead a member with larger account balances if they do not read the "small print" relating to the $50,000. Disclosing these fees and costs for two members with different account balances will immediately highlight the impact of the size of a member's balance on the investment fees.

SINGLE BENCHMARK

Question 14 Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product returns?

No, the Institute does not believe that a single standard benchmark is appropriate for all choice products. The reasons for our view are set out below.
Where an "inflation plus percentage return" is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI (see our response to Question 16).

Comments

The primary issue is whether a single standard benchmark should be set for all choice products. The secondary issue is if a single standard benchmark is to be set, what should it be.

Choice products have been introduced to enable funds to develop superannuation products that meet a range of different member needs. It is our expectation that these products will provide a wide selection of different investment options, some of which will have return and risk objectives that will be significantly different to any one benchmark. If a single benchmark has to apply to every investment option, the Institute believes that this would stifle innovation and ultimately disadvantage those superannuation members who are looking for specialist investment options.

A fundamental characteristic of a member who is investigating a Choice product is that the member is not willing to take the default option offered by a MySuper product. These members will be willing to, and will want to, obtain more detailed information about the Choice products they are considering. This will mean that these members will be willing to make the effort to investigate what investment products with different benchmarks really offer. These members are less likely to be confused by the additional complexity introduced by having more than one benchmark. They will see it as an opportunity to tailor their superannuation fund to their specific investment objectives. Examples of different objectives might include 'Cash plus 3%' or 'the ASX200 + 2%'.

Where an "inflation plus percentage return" is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI.

The reasons for using a wage-based inflation measure follow from a consideration of how the stakeholders in a superannuation fund will use this target.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

We believe that, for accumulation style funds, the net investment return target will be used for two purposes:

1. Members will use the stated level of the investment return target to compare the expected returns that different investment options (both in the same product or in different products) will potentially provide for the member; and
2. Members will use a comparison of actual investment performance with the net investment return target to assess whether the goals established by the members are likely to be achieved.

For accumulation style funds, the final benefit payable to the member is directly affected by the level of investment return achieved. The Institute believes that the investment goals of these members should be to achieve a retirement benefit equal to a nominated proportion of their wage at or close to retirement. It is important to note that the rate of wage increase over time includes the impact of general productivity increases in the economy. Therefore, the rate of increase in wages over the long term is normally higher than increases in prices as increases in productivity feed through to wages.

To assess the impact of using CPI or AWOTE as the base for the Net Investment Return Target, consider a person aged 25 whose goal is to achieve an income of 65% of their final wage on retirement at 65. If we assume net investment earnings of 7% pa, wage increases of 4% pa and the income conversion factor set out in Class Order 11/1227, net contributions (after taxes, fees, costs, insurance etc) of 15% of wage every year for 40 years would achieve this goal. This final benefit is achieved with an investment target of 3% above the rate of wage increases. If we assume that CPI price inflation is 2.5% pa (i.e. 1.5% less than wage inflation), the equivalent price inflation target is 4.5% above CPI.

Now consider how each of these targets would meet the two purposes of the Net Investment Return Target set out above.

The first purpose of the investment target could be achieved if either of these investment targets were used as each option (in the same product or different products) is compared on the same basis.

However, what happens if the gap between wage increases and price inflation is greater than 1.5% because productivity increases are higher than assumed in the original assumptions?

If, in the above example, wages increased by 5% pa rather than 4% pa with the same net investment return and price inflation, the net investment return would be only 2% above wage inflation and the income produced in retirement would be only 52% of final wages, a substantial reduction on the 65% goal established by the member. If the price inflation investment target has been used, the investment would still have achieved its target of 4.5% above price inflation. However, if the investment target is based on wage increases, the actual investment return is 1% below target. If the dashboard provides information on actual investment returns based on the wages increase base, the member will be able to see that this performance is below their long term target. The member will also be able to see that, if this trend continues, they will not achieve their long term goals. This information would not be provided if the price inflation target of CPI was used.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

It is therefore clear that an investment return target based on AWOTE will provide more relevant information for members of accumulation funds than a comparable target based on price inflation.

We also have to consider whether members will understand what AWOTE represents and the implications of using AWOTE rather than CPI. Because most members will not be familiar with AWOTE it will be important that material be made available to members that explains what AWOTE is and how an investment return target based on AWOTE differs from one based on CPI. In the main target return disclosure, it could simply be described as 'wage inflation' and then a separate note can disclose that this means AWOTE (which is similar to what was suggested in the results of consumer testing of the dashboard). We expect that members considering a Choice product will be willing to take the time to understand this explanatory material.

The Institute believes that the results that are included in the dashboard (the target and the actual performance relative to this target) will therefore achieve the two objectives discussed above even if the member does not fully understand the fine details relating to the target.

NET INVESTMENT RETURN VERSUS NET RETURN

Question 15: Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard? In considering this question, you may wish to consider:

- ***If including an additional measure for a product's investment return would add unnecessary complexity.***
- ***If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.***
- ***Whether it is appropriate to use a single time horizon, for example 10 years, when calculating target net return and net return for the range of possible choice products.***

No, only the Net Investment Return should be disclosed on both the MySuper and Choice dashboards.

The Institute has indicated previously that we strongly believe that administration and advice fees and costs should **not** be deducted from investment returns when calculating net investment returns for the purposes of comparing the investment outcomes and capabilities of different superannuation funds.

The Institute therefore believes that the Net Return as defined by APRA should not be disclosed on either the MySuper product dashboard or the Choice product dashboard. The only metric that is suitable for comparing the investment performance of different product providers is the Net Investment Return where only the fees and costs and tax associated with the investment service are deducted from the investment return. Therefore it is this Net Investment Return and only this return that should be disclosed on both the MySuper and Choice product dashboards. This would remove the issue of disclosure of two returns introducing unnecessary complexity in the dashboard. It will also remove the misleading aspect of the current proposals and supports the Government's aim to reduce regulation and compliance costs.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

The Institute believes that a ten year period is a reasonable period to show actual past investment performance. It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is, however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.

Comments

The Institute strongly believes that the Net Return as disclosed on the MySuper product dashboard should never be used "to measure a product's investment return". The deduction of administration and advice fees and costs is technically unsound and may lead members to make incorrect conclusions about the investment capabilities of a superannuation fund.

Consider for example two funds which have exactly the same past investment performance after investment fees and costs and taxes but where the first fund provides a greater level of general member services than the second fund and therefore charges a higher administration fee to all members. If these administration fees are deducted from the investment return to obtain the net return, the second fund will have a higher net return. Members comparing the two net returns could conclude that the investment capabilities of the first fund are inferior to those of the second fund. This is obviously incorrect.

This will be particularly relevant for Choice products where the level or quality of administration and advice services and the cost of these services can vary from product to product and potentially from member to member. Although there may not currently be significant variation, funds should not be inhibited from adding services because of dashboard reporting requirements.

The deduction of administration and advice fees and costs from the investment return will discourage funds from providing additional services if the additional cost of these services decreases the return disclosed on their product dashboard and this places them at a competitive disadvantage.

An area where this could have an important impact is on the provision of advice. For many superannuation fund members the cost of specific financial advice provided by a financial planner will prevent these members from obtaining even basic levels of advice.

Superannuation funds can however provide scaled financial advice that will have relevance to these members. It would be highly undesirable for the way that investment performance is reported to inhibit the provision of this important service. This will be particularly important where the scaled advice is tailored to the personal circumstances of the member and the member will receive a specific recommendation and statement of advice (SOA) as we expect that these services will involve additional costs. General advice is provided by all funds but scaled advice, where a member can get a recommendation and SOA is a more valuable service that will be provided by most but not all funds. It is the main battleground on the advice side. Scaled advice teams are growing rapidly for most funds and will probably continue to do so.

If the net return as currently defined by APRA is disclosed on the Choice product dashboard, it will mean that the fees and costs for three, totally unrelated, services - investment,

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

administration and advice – have to be deducted. Therefore, the comparison of the investment capabilities of two funds will be distorted by the level and type of the administration and advice services offered by different Choice products and the fees and costs charged for these services.

The Institute also believes that if the Return Target disclosed on the dashboard has administration and advice fees and costs deducted it will not be the Investment Return Objective used to actually manage the fund's assets. Funds have never set investment objectives (or targets) net of administration and advice fees and costs. The use of the Return Target disclosed on the dashboard would be particularly inappropriate given that the administration and advice component of the Return Target is set for a "representative" member who may, or may not be, indicative of the actual membership of the fund. The Return Targets will therefore have less relevance to the way that the assets of a superannuation fund are invested.

Further, investment professionals (and investment consultants) analyse and compare investment capabilities by considering Net Investment Return. The introduction of the Net Return calculated as specified will simply complicate and not simplify this analysis.

It has been argued that the dashboard should disclose a Net Return which has administration and advice fees and costs deducted from the investment return as this represents the "overall return" a member receives in their accounts. The Institute believes any discussion on this issue is not relevant to what should be disclosed to members to allow them to assess the investment capabilities of superannuation funds. As discussed above, the Net Return, as currently defined by APRA, measures (misleadingly) the impact of three services. It does not provide information on the investment capabilities of a fund. It also only relates to a "representative" member and can therefore potentially mislead the majority of "non-representative" members.

We also refer to the separate issue as to whether a single time horizon should be used when calculating the target investment return.

With respect to what period should be used when reporting actual historic returns, one must choose a period that can be expected to show the longer term relative performance of superannuation funds. It is important that this comparison should not be overly dominated by one year of superior performance. One must, however, choose a period that will be relevant to most superannuation funds. The Institute believes that a ten year period is a reasonable period to show actual past investment performance.

It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.
In considering this issue we must differentiate between the historical net return and the future target net return.

When calculating the future target net return it is necessary to make assumptions about the level and volatility of future investment returns. The Institute believes that the only practical basis on which to make these assumptions relate to what is expected over the long term. This means that current market conditions will not be taken into account. If current market

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

conditions were to be taken into account then the target return will have to be changed on a regular basis as it will change as market conditions change. Therefore the target will not be the expected return over any specific ten year period.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

MEASURING A PRODUCT'S INVESTMENT RISK

Question 16: Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question, you may wish to consider:

- ***Is the SRM model the best measure of short-term investment risk?***
- ***What would be the most suitable measure of long-term risk to include on the product dashboard?***
- ***Is it possible to present a long-term risk measure in a similar format to the short-term risk measure) that is High/Medium/Low)?***
- ***Would including an additional risk measure add unnecessary complexity to the product dashboard?***

Yes, the Institute believes that the dashboard should disclose two metrics that measure investment risk.

We believe that metrics relating to short term and long term investment objectives must be included. This is necessary to reduce the potential for members to make choices that reduce their final retirement benefits.

We agree that the Standard Risk Measure as proposed in the FSC/ASFA guidance note is an appropriate metric for the short term investment risk.

We propose that the metric to measure long term investment risk should be *the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.*

This will mean there will be two risk measures. We acknowledge that this will increase the complexity of the dashboards. We believe they can co-exist on the dashboard as long as a simplifying label such as high/medium/low is not used for each.

The estimated number of negative net investment returns over a 20 year period and the probability of not meeting a reasonable long-term return over wage inflation should provide a good indication of risk, perhaps with some explanatory comments to guide members as to what certain ranges of these measures may indicate about each risk.

The dashboards currently must include a "Risk Label" as well as a "Risk Metric". The Actuaries Institute does not support this. We are concerned that members will only focus on the Risk Label when choosing their investment option. If they did this, it is possible that members will choose options that have less risky short term risk labels. For superannuation fund members with long term investment horizons, it is likely that this will mean that they will achieve lower long term investment returns and therefore lower final retirement balances.

If two risk measures are included, Risk Labels should not be shown for each risk measure as it would confuse members since many investment options will be labelled as both more risky and less risky.

We note that our comments below apply equally to MySuper and Choice dashboards. However, they are particularly relevant to Choice dashboards as it is expected that members who select Choice products will base their choices on an examination of the material

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

provided by the superannuation fund. This will include information disclosed on the dashboard. It is therefore vital that the information on the dashboard not be misleading.

Comments

The Institute believes that it is desirable for the product dashboard to include an indicator of the investment risk of the product. In assessing the potential investment return that any product can achieve, it is always important to consider the level of investment risk associated with that product. However, it is entirely inappropriate for only a measure of short-term risk to be included in the dashboard, particularly if a risk label is included with the risk metric.

The Actuaries Institute believes that "Investment Risk" should be defined as the risk that a particular investment product does not achieve the investment goals of a member. The difficulty of providing members with investment risk metrics in respect of a specific investment product is that investment objectives vary between members and will depend on their personal circumstances. Notwithstanding this difficulty, we believe that there are two principal goals that a superannuation fund member may have.

1. A member may have a short term investment horizon and therefore wish to protect the capital value of their superannuation balance or part of their balance. For such members, the investment risk is that the investment product will suffer negative returns.

2. Other members may have long term investment horizons and therefore may wish to ensure that their final superannuation balance will allow them to achieve a required standard of living in retirement. For such members, the investment risk is that the investment product does not produce a specified real rate of return.

Addressing each of these needs in turn:

1. Measuring the risk of capital loss

The Institute accepts that the metric that measures the risk of a negative return in any twelve month period is an acceptable metric for this investment risk. This metric is the "Standard Risk Measure" defined in the joint 2011 FSC/ASFA guidance paper.
We would, however, stress that the methodology used in that paper calculates the risk of a negative return over a one year period and then re-expresses this as a number of negative returns over a twenty year period. It is important to understand that it is not the number of negative returns that are expected over any specific twenty year period. The calculation of this metric would require the impact of the investment return in one year on the next year's return to be taken into account. The FSC/ASFA approach effectively assumes that each year's return is independent of the previous year's return. Notwithstanding this issue, we are generally in agreement with the metric developed by FSC/ASFA.

However, there are a number of technical issues that need further consideration. The Institute has written to ASFA outlining these issues and would be happy to participate in a review of this standard.

2. Measuring the risk of not achieving an adequate long term return

The Actuaries Institute suggests that the metric to measure this risk should be the probability that the investment return will be less than a specified margin over the rate of salary increases over a twenty year period.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

We believe that members with long term investment horizons will want their retirement benefit to enable them to maintain a predetermined standard of living in retirement. Typically this will be represented by a specified proportion of their salary at, or close to, their retirement.

Over time, salaries tend to increase at a faster rate than price inflation (i.e. inflation measured by changes in the CPI) as the impact of productivity increases is shared between capital and labour. Without these "productivity" increases the income produced by a member's account balance would gradually fall behind increases in community living standards. We therefore prefer long term investment objectives to be based on wage inflation rather than price inflation (Refer to our answer to Question 14 as to why.)

One option would be to make the margin equal to zero i.e. simply use AWOTE as the benchmark rate of net investment return. However, our investigations indicate that this margin will not differentiate between the long term risks for a wide range of investment strategies. For example, the probability of the net investment return exceeding the rate of increase in AWOTE over say twenty years for a capital stable investment strategy would not be significantly different to the probability for a growth oriented balanced fund. This means that a positive margin is required.

To determine the level of this margin we need to consider what an appropriate investment strategy would be for a member with a long term investment horizon. It is generally accepted that a growth orientated balanced investment strategy is the most appropriate for such members (i.e. options with about 70% growth assets). Our analysis indicates that a margin of 3% is reasonable for this type of investment strategy. Our analysis also indicates that this margin is required to ensure acceptable differentiation between the various investment options available to members. If lower margins are used, then most investment options will all have the same risk metric.

We note that in Class Order 11/1227 a margin of 3% above AWOTE has been used as the net investment return for long term projections. It can therefore also be argued that our proposed long term risk metric is the probability that a member will not achieve the projected retirement benefit calculated in accordance with this class order (assuming that all other assumptions are borne out in practice).

We have suggested that a twenty year period is an appropriate length of time over which to measure this metric for the following reasons:

- Although most members will be in the work force for a much longer period than twenty years, most members will have already been working for a number of years and twenty years for the average member's remaining working life time is reasonable.

- Underperformance in the last twenty years of a superannuation fund member's working life has a greater impact on the final benefit than underperformance in the first twenty years.

- During the first twenty years of a member's working life time, the effect of promotions, job changes, etc will have as much, if not more, impact on the final benefit of that member as investment return. In the last twenty years of a member's working life time the investment return will, in most cases, be the most important driver of the member's final benefit.

Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446

e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

We also note that the investment return target of each investment product is to be disclosed in the dashboard. As it is expected that this investment return target will be based on a targeted real rate of return, it is important that the long term investment risk measure be based on the same measure (i.e. if the investment return target is based on AWOTE then the long term risk measure should be based on AWOTE).

Assumptions used in calculating the metrics

We believe that the assumptions used in calculating the risk metrics should be best estimates of the long term return and risk characteristics of the assets included in each investment product assuming that all assets are at "fair value". These assumptions will remain constant over time unless there is a significant change to the fundamental factors that determine the return and/or the risk characteristics of any asset class. This will mean that the risk information set out in the dashboard will not need to be changed regularly.

It is, however, important for superannuation fund members to understand that a metric calculated on this basis does not necessarily provide an indication of the risk of an investment product over the next ten or twenty years.

If, alternatively, the return and risk assumptions used to calculate the metrics were to reflect the current position of markets from time to time, the risk metrics would change frequently. The return characteristics of asset classes (even over a ten to twenty year period) are affected significantly by whether the asset class is overvalued or undervalued at the start of the period. Further, the correlations between the returns of asset classes vary over time and will depend on the level of risk in the markets generally at the start of the period. This would mean that if the current state of investment markets had to be taken into account in determining the level of risk disclosed on the dashboard, the information disclosed would change frequently. It would also potentially mean that the relative risk of different investment products would change over time. This would increase the cost of providing this information and would be very confusing for members.

ADDITIONAL CARVE-OUTS

Question 17: Are additional carve outs from the choice product dashboard obligations required? If so, why are these additional carve outs required? In considering this question, you may also wish to consider identifying where the gaps in the current carve out provisions are.

No, we do not recommend any additional carve outs but we suggest a slight change to clarify the intention of the first carve out (see below).

Comments

The currently proposed carve outs from the choice dashboard are shown in Section 1017BA(4) (a)-(c) of the Corporations Act 2001.

The first set of carve outs, S1017BA(4)(a), covers options where negative investment performance does not reduce members' benefits. These carve outs are warranted as the performance of these options has little relevance to the member, as long as the providing institution has the necessary reserves to support the guarantee. Levels of such reserves are monitored by the product actuary and reviewed by APRA and would not be appropriate to show on a dashboard.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

The first carve out includes the following: ‘an investment account contract that is held solely for the benefit of that member, and relatives and dependants of that member – to cover legacy products such as endowment and whole of life policies’.

While the text provides the example of endowment and whole-of-life policies, the description is not sufficient to make that clear without the example. We suggest that the wording of this part of the first carve-out be changed to make it more clearly apply to such policies. The current wording could possibly be used to exempt a number of different types of product, depending on the definition of ‘investment account’ contract.

The second carve out, S1017BA(4)(b), relates to pension only options. This carve out is also warranted as the purpose of the dashboard is to provide transparency and comparability between superannuation products in the accumulation phase, not the pension phase. The returns of pension options are not comparable with accumulation options as they have a different tax structure. Any side-by-side comparison of returns that includes both accumulation and pension options would be misleading.

The third carve out, S1017BA(4)(c), has the greatest impact on the number of options requiring a product dashboard. It specifically excludes options invested in a single asset, which is intended to exclude options available on a wrap platform. Such an exclusion is warranted, as wrap platforms are simply providing access to investment products already available in the market – the platform provider is not constructing a new investment option/product. Most wrap platforms include several hundred options and there would seem to be little value in having a dashboard for each one. Also such wrap platforms are sophisticated financial products that provide a similar level of flexibility to SMSFs. They require a high level of sophistication from adviser and/or client and therefore the same high degree of consumer protection appropriate for MySuper options is not necessary.

The third carve out does not exempt traditional master trust platforms that employ a mandate structure for each option. This is where the product provider, often under instructions from an investment manager, invests in a number of different assets to create a portfolio that may be diversified across asset classes or focussed on one asset class. It is not appropriate to exempt such options from the product dashboard as such options do not generally exist separately outside the product but are constructed by the product provider. It is helpful for members invested in these options to have access to information on these options on the dashboard. The number of such options in traditional master trusts is generally much less than the number of wrap options, making it feasible to produce product dashboards for these options.

No doubt other carve outs will be considered such as closed options, legacy products etc. But even if an option/product is not open to new money, if a member has money invested in the option/product, they should be provided with easy-to-access information on these options/products. We do not recommend additional carve outs for closed options and legacy products (except for whole-life and endowment assurance products and unbundled life products based on notional accumulations).

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

A LIQUIDITY MEASURE

Question 18: Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?

Yes, there should be a measure of liquidity included on both the MySuper and Choice dashboards.

There is merit in the Cooper review's recommendation to include a measure of projected liquidity on the dashboard. Members should be alerted that the risk of not being able to access their money is substantially higher in certain options, especially if there is a material risk they may not be able to access their money within 30 days without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) in some circumstances. It would also be desirable for members to be made aware if there was an option for withdrawals to be frozen and the general circumstances where this could occur.

Further, the liquidity of assets within an investment option which has a mix of different assets is important as the rebalancing that may be required as the relative values of different asset classes change may generate investment losses when illiquid assets have to be sold.

However, it is difficult to construct an appropriate liquidity measure, as the liquidity of different assets can rapidly change, as occurred with mortgage-backed securities during the GFC. Nevertheless, it is still important to include some indicator of the level of illiquid assets. If an investment option is supported by a high level of illiquid assets, it is important that a member (particularly one selecting a Choice product) is alerted to the possibility that access to capital may be restricted in some circumstances.

On balance, the Institute recommends that a liquidity metric equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.

Comments

A measure could be used that showed the ability of the product provider to pay x% (perhaps 50%) of the option's assets if overall listed markets fell by, say, 20%. However this would remain a difficult exercise as a range of assumptions would need to be made on the impact of falling markets on the value and liquidity of the underlying assets of the option. It would also be difficult to standardise these assumptions across all Choice products to ensure the results were comparable. In any case, this will not solve the rebalancing issue.

A potential danger with a liquidity measure is that, depending on how it is formulated, it may discourage some members from investing in funds with high quality diversified investment options that have significant unlisted assets but where the fund has sufficient assets and cash flow to warrant it – and where investment choice does not cause equity problems between different options. This is the case in most of the major industry funds that tend to have 20-35% in unlisted assets. Highlighting that a fund has, say, 30% illiquid assets and therefore a medium liquidity measure, may scare off some members, while this allocation to illiquid assets may be entirely appropriate and unlikely to cause a significant liquidity problem.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

The most critical options for which liquidity should be highlighted are single asset sector options with a material liquidity risk in adverse conditions. Such options may include unlisted property options, options investing in mortgage-backed securities etc. The liquidity measure should focus on these types of options without causing undue concern over diversified options with a reasonable level of unlisted assets.

IMPLEMENTATION ISSUES

Question 19: Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

Yes, the commencement date should be delayed until at least 1 July 2015 to allow for revision of the MySuper dashboard and the finalisation of Choice product dashboard requirements (which will take some time after the consultation period finishes) and then implementation by product providers.

The main issue the dashboard is trying to address is to provide the least engaged MySuper members with a simple way to evaluate and compare default options, which is where the vast majority of superannuation money is held. There is a need to extend this to the wider universe of Choice options but it is not as pressing as the MySuper dashboard and it is more important to get it right the first time to avoid unnecessary re-work costs.

Comments

Too often product providers have been required to report certain information (to APRA, ASIC or the public) based on draft standards, only for those standards to be materially altered. This means product providers need to engage in significant re-work, the costs of which are ultimately passed on to members.

It would be better for ASIC and APRA to consult widely with industry on the Choice product dashboard, produce a draft for discussion, finalise the reporting requirement and then allow enough time for product providers to build the tools required to produce the reporting.

The lead-time for such reporting projects is invariably several months and product providers need to be allowed the time to do it properly, especially given that some providers will have a large number of options (with some across several different products) requiring a Choice dashboard. If some aspects of the revised dashboard suggested by ASIC's consumer testing of the MySuper dashboard are added, such as the ability to choose from a range of a balances and a link to an asset allocation chart, it will take considerable time for each provider to add these elements to its dashboard reporting. It is in the interests of ASIC, APRA and product providers to get the Choice dashboard right the first time and to avoid a series of re-works brought about by changing requirements. Likewise, not allowing enough time for implementation will mean a rushed implementation that is likely to lead to the need for re-work for many product providers.

There should be a period of at least three months between passing of the final regulations and the commencement dates of the revised MySuper dashboard and finalisation of Choice product dashboard requirements.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 7, 4 Martin Place, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 **f** +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au