FINANCIAL
SERVICES
INSTITUTE
of Australasia

4 May 2017

Online submission

Dear Commissioner,

Re: Superannuation: Alternative Default Models Draft Report

FINSIA welcomes the opportunity to comment on the Productivity Commission's draft report, *Superannuation: Alternative Default Models*.

FINSIA is a membership association that represents 10,000 professionals across the Australasian financial services industry. Our members are employed in the capital markets, retail and business banking, funds and asset management, and financial advice sectors.

FINSIA is committed to professionalising the industry, and by so doing, raising levels of trust and improving community outcomes.

In making this submission, FINSIA consulted with senior members in the funds and asset management sector including retail and industry superannuation funds.

Previous research

A chief concern of FINSIA members is whether the superannuation system is meeting its mandate by ensuring adequate standards of living in retirement. Commencing in 2012, FINSIA commissioned a three part investigation into the challenges for creating and maintaining sustainable retirement income.

This research, which focused on asset allocation through the life course, found that:

- Sequencing risk — the realised sequence of investment returns, and the very real possibility of receiving the *worst possible investment returns in their worst order* — is the single most important factor in determining the size of a superannuant's retirement savings. Defined contribution schemes leave investors vulnerable to fluctuations in asset values when their portfolios are at their largest, in the years immediately preceding retirement.[1]
- Post-retirement, the conventional wisdom that a retiree can withdraw 4% of their savings per annum and expect their savings to last the course is challenged by data revealing the annualised performance of different investments in five international markets in the past century. In Australia a 4% withdrawal rate over 30 years on a 50:50 growth/defensive asset allocation is associated with a 20 per cent chance of financial ruin.[2]

[1] Basu A, Doran B, and Drew M, 2012, *Sequencing Risk: A Key Challenge to Sustainable Retirement Incomes*, FINSIA, Sydney.
[2] Drew M, and Walk A, (2014), *How Safe are Safe Withdrawal Rates in Retirement? An Australian Perspective*, FINSIA, Sydney.

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- Dynamic asset allocation strategies, both in the lead-up and through the retirement phase, can nudge the balance of probablities in favour of the retiree. This research, while concerned with asset allocation approaches across the lifecycle, proposes an approach for securing sustainable reitrement income.[3]

Member consultation

FINSIA consulted with senior members in the funds management sector, including industry and retail superannuation funds. This consultation confirmed that there are differing views across the industry on the most appropriate allocation mechanism for default funds. The nature of these differences has been captured by the Commission in earlier stages of the inquiry.[4]

There was, however, agreement on the need to find common ground on reforms, and that the filter for determining this should be what works best for the superannuant. This view coincides with the support that the Commission previously has found for member benefit as a primary criteria for assessing default models.

As FINSIA members pointed out, superannuation is not a normal market and competition should not be pursued for competition's sake. Superannuation is both compulsory and complex. For this reason it is crucial that the superannuation system assist consumers in making choice by addressing information asymmetries.

As has previously been reported, two thirds of employees stay with their employer-nominated default underscoring the likely continuing need for a default model.

Striking a balance between choice and paternalism was acknowledged to be a necessary element of model design. While preservation of choice is important, it's equally important to help people who are either ill-equipped, or disinterested, in making a decision.

While defaults, by their nature, provide an incentive for consumers to be disengaged the complexity of superannuation products and their focus on accumulation over the long term are also significant hurdles to engagement. For this reason, FINSIA members agreed that education should sit above any alternative default model implemented.

Assisted employee choice or assisted employer choice models are most workable for the superannuant

Taking the points of convergence and the Commission's analysis together, the optimal models proposed are the assisted employee choice or assisted employer choice.

Both models address the complexity challenge faced by employees and provide suitable protections for those who do not nominate a superannuation product. These are the essential features for a system that works in the best interests of the superannuant. However, FINSIA acknowledges, as the Commission does, that the assisted employer choice model may raise principal–agent issues and that the capacity of employers to choose appropriate default products will vary.

The Commission's focus in the design of the four models is on the accumulation phase. FINSIA draws attention to the Drew, Walk and West research cited by the Commission in the draft report that identifies the transition phase between accumulation and retirement. Managing risks in this phase can make a sizeable difference to retirement outcomes and should be considered in default product design.

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[3] Drew, ME, AN Walk and JM West, 2015, *The Role of Asset Allocation in Navigating the Retirement Risk Zone*, FINSIA, Sydney.
[4] Productivity Commission, 2017, *Superannuation: Alternative Default Models* p 38–9.

Members assigned to a default product only once

There was general acknowledgement from FINSIA members that account proliferation is a source of inefficiency that erodes end date balances for superannuants.

FINSIA members also noted that individuals may have multiple funds for reasons other than switching jobs because the current system does not give meaningful choice to all employees.

On this basis, FINSIA supports recommendation 3.1 that any allocation model works on the premise that employees are assigned to a default product only once.

Centralised online service for members

FINSIA also supports recommendation 3.2 to assist employees and employers in the carry-over and maintenance of accounts, and to address the information gaps identified by the Commission about member behavior in respect of default allocations, product switching and account consolidation.

FINSIA welcomes the opportunity to contribute to further policy development in this area.

Please refer any future enquiries to Caroline Falshaw, Head of Industry Affairs and policy:

With kind regards,

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CEO and Managing Director