SUPERANNUATION EFFICIENCY AND COMPETITIVENESS – RESPONSE TO PRODUCTIVITY COMMISSION ISSUES PAPER

SUPPLEMENTARY SUBMISSION

June 2016

The Association of Superannuation Funds of Australia

CONTENTS

1. EXECUTIVE SUMMARY

ASFA welcomes the opportunity to make a supplementary submission to the Productivity Commission's Study into Superannuation Efficiency and Competitiveness, following on from our initial submission lodged on 9 May 2016.

In our initial submission, ASFA advocated a 'balanced scorecard' approach be adopted in assessing the operational efficiency of the superannuation industry or superannuation system. In that submission we recommended 'net benefit' as one indicator in the scorecard, where *net benefit* is investment returns net of all investment and administration fees, operational costs, indirect costs and taxes. A single indicator, however, does not reveal the full picture.

A balanced scorecard approach would examine the full range of benefits that funds provide to their members (outputs), as well as the costs incurred by members for those benefits (inputs). In addition to the *net benefit* indicator proposed in our initial submission this should include the insurance cover for death and disability; the provision of advice, in particular intra-fund advice; and other services such as web-interactivity and mobile applications.

It is not feasible to measure operational efficiency with respect to these benefits with a single indicator – for instance it is not clear how the *net benefit* indicator could be aggregated with the benefit provided by insurance. Thus, a broad based assessment of efficiency necessitates analysing a range of possible indicators, focusing on different benefits, in a balanced scorecard approach. Some benefits – such as some member and employer services – are better suited to a qualitative assessment as opposed to quantitative analysis.

This supplementary submission outlines the other indicators and factors that should be included in a balanced scorecard approach.

Additional benefits – over and above *net benefit*

1 *Insurance*

Next to *net benefit*, insurance is the other significant, material, discrete benefit provided to members and their dependants. As identified in ASFA's initial submission, insurance in superannuation is crucial in ensuring broad coverage for death and disability insurance across the broader population.

2 Ancillary benefits

Ancillary benefits include benefits such as advice and innovations in products and services. These benefits are not captured in the *net benefit* indicator, whereas the indicator does include the costs of providing these benefits.

3 Improvements in member and employer servicing

Similarly, improvements in member and employer servicing, including measures to facilitate consolidation of accounts, have improved overall system wide efficiency. Again, these benefits are not captured in the *net benefit* indicator but the indicator does include the costs of providing these benefits.

Additional costs – beyond the control of the industry

Finally, the effect of regulatory settings on efficiency and costs are outside the control of the industry, yet have a material effect on industry (and system) efficiency. The costs of implementing regulatory changes, as well as on-going compliance costs, are included in the costs of delivering benefits to members, and are captured in the *net benefit* indicator. Thus, failure to take into account the effect of regulatory costs will result in an under-estimation of the efficiency of the superannuation industry.

KEY POINTS

Additional benefits - over and above *net benefit*

1. Provision of insurance

- After *net benefits* to members, the provision of insurance cover is the other significant, discrete, benefit provided to members of superannuation funds.
- For the majority of members death and TPD cover is provided on a default, opt out, basis.
- Insurance in superannuation provides valuable, cost effective, protection against the financial hardship which can be caused by disability or premature death.
- Underwriting of insurance in superannuation generally is performed on the basis of a 'group' of lives being insured and has the value of sharing the risk across as broad a population as possible.
- The provision of insurance through superannuation serves to reduce significantly the level of underinsurance in the economy and enhances allocative efficiency.
- Insurance in superannuation generally is significantly more cost effective than insurance provided outside of superannuation for an equivalent level of cover.
- The differing tax treatment of benefits inside and outside superannuation, resulting in different net TPD benefits and net death benefits (to non - dependants), has a distortive effect.

2. Provision of ancillary services such as advice

- Most Australian superannuation funds provide at least some advice options for members, ranging from general financial product advice through scaled personal advice (generally 'intra-fund' advice) to comprehensive financial advice.
- It is relatively uncommon for overseas pension funds to provide advice to members.
- As comprehensive financial advice can be costly there is consumer demand for lower-cost, scaled advice and, increasingly, for robo-advice. The majority of superannuation members want access to simple, lower-cost advice rather than comprehensive advice.
- The costs of intra-fund advice are very low – generally equivalent to around two basis points of assets.
- The provision of intra-fund advice by superannuation funds is part of the solution of making quality advice more accessible to Australians.
- Accessible, quality financial advice can bring significant benefits for consumers.
- Assessment of industry efficiency needs to account for the range and quality of products and services provided to members and employers.
- In recent years there has been substantial innovation with respect to superannuation products and services.

3. Improvements in member and employer servicing

- In recent years there have been substantial improvements with respect to servicing of members and employers.
- Over recent years there have been a number of initiatives to encourage members to consolidate their accounts and to reduce duplicate accounts.
- There have been a number of fund initiatives to reduce the number of lost and inactive accounts.
- The ATO has leveraged its unique position – it can positively identify taxpayers and has access to a database of all of the data reported by funds and taxpayers – to develop initiatives to assist members to consolidate their accounts and to re-unite them with their lost superannuation.
- The introduction of SuperStream has led to considerable efficiency enhancements in the processing of both contributions and roll-overs.

4. Additional costs beyond the control of industry – effect of regulatory settings

- APRA-regulated funds pay for the public cost of prudential supervision by APRA, consumer regulation by ASIC and services provided by the ATO through the payment of an APRA levy.
- The cost per member of the APRA levy increased markedly in 2012 with the advent of the SuperStream levy ($467 million over 7 years) and since then has remained around that level.
- To compensate victims of fraud in APRA-regulated funds resulting from the collapse of Trio Capital Limited the industry paid two financial compensation levies totalling over $71 million.
- Policy and regulatory amendments over recent years have resulted in providers incurring significant costs in implementing necessary changes.
- The current stock of regulatory obligations and requirements imposes material ongoing compliance costs on the various entities in the superannuation system.

2. PROVISION OF INSURANCE

KEY POINTS

- After *net benefits* to members, the provision of insurance cover is the other significant, discrete, benefit provided to members of superannuation funds.
- For the majority of members death and TPD cover is provided on a default, opt out, basis.
- Insurance in superannuation provides valuable, cost effective, protection against the financial hardship which can be caused by disability or premature death.
- Underwriting of insurance in superannuation generally is performed on the basis of a 'group' of lives being insured and has the value of sharing the risk across as broad a population as possible.
- The provision of insurance through superannuation serves to reduce significantly the level of underinsurance in the economy and enhances allocative efficiency.
- Insurance in superannuation generally is significantly more cost effective than insurance provided outside of superannuation for an equivalent level of cover.
- The differing tax treatment of benefits inside and outside superannuation, resulting in different net TPD and death benefits (to non - dependants), has a distortive effect.

3.1 Provision in superannuation

As identified in ASFA's initial submission, insurance within superannuation is crucial to ensure broad coverage for death and disability cover. After the provision of *net benefits* to members, insurance cover can be considered to be the other significant, discrete, benefit provided to members of superannuation funds and their dependants.

Importantly, for the majority of members, death and Total and Permanent Disablement (TPD) lump sum cover is provided within superannuation on a default, opt out, basis. MySuper products must offer a minimum level of default death and TPD cover to members on an opt-out basis. Many funds offer members the ability to increase or decrease their level of death and TPD insurance, with increases being subject to varying degrees of underwriting.

Insurance in superannuation provides fund members and their dependants with valuable, cost effective, protection against the financial hardship which can be caused by disability or premature death. There is an old adage to the effect that insurance is not bought, it is sold, which reflects a tendency in the behaviour of most consumers to fail to take action to effect appropriate insurance cover without some form of 'nudge'.

In addition, a number of funds offer cover in the event of temporary disability, such as income protection or salary continuance insurance. In some instances this is offered as default, 'opt-out' cover while in other cases it is offered on an 'opt-in' basis. After a specified period after ceasing work (temporarily) due to the disability the member is paid a replacement income stream by the insurer, generally a percentage of their pre-disability income up to a cap, for such period as the member remains unable to work.

Historically the inability of funds to claim a tax deduction for premiums for temporary disability insurance in excess of two years acted as an impediment to the provision of long-term (e.g. until pension age) disability income benefits within superannuation. This, coupled with temporary disability cover being relatively expensive, resulted in funds tending to favour as default cover the provision of a TPD lump sum benefit.

The limited, somewhat 'all or nothing', nature of the regulatory definition of total and permanent disablement has led to difficult, and sometimes protracted, decision-making for trustees. In order to determine whether the member meets the regulatory definition the trustee must be reasonably satisfied that the member's ill health makes it unlikely they will ever again engage in gainful employment for which they are reasonably qualified. This is not a straightforward decision, especially with respect to younger members and/or relatively soon after the disability has occurred, and necessitates the assessment of conflicting reports from medical and occupational specialists.

In particular the regulatory definition does not provide for the possibility of subsequent rehabilitation or recovery, or for future changes in technology, that may permit a member to return to work. There is evidence that framing a person's medical condition in terms of their 'disability', as opposed to their 'ability', can have a deleterious effect on their psychological condition. Furthermore, the 'one time' assessment as to disability can, in some circumstances, act as a disincentive for a member to recover some ability, as this may cause them to miss out on being paid a lump sum TPD benefit. In response to this phenomenon some funds are looking to introduce a TPD benefit paid in instalments, where after an initial assessment as to the member's disability the trustee makes a part-payment of the TPD sum insured and a further assessment is made prior to a second or subsequent instalment being paid.

As stated in our initial submission, in Australia more than 70 per cent of death cover, 88 per cent of TPD cover and 59 per cent of temporary disability cover is provided through superannuation funds.

Group insurance means that the underwriting is performed on the basis of a 'group' of lives being insured, as opposed to underwriting each individual on a case by case basis. Operationally this provides significant cost savings and has the additional value of sharing the risk across as broad a population as possible. This can correct for potential market failures in insurance, where higher-risk individuals may be unable to obtain appropriate insurance cover.

As noted in the main submission, the provision of insurance through superannuation enhances allocative efficiency by correcting for market failures in the broader insurance market and reducing the level of underinsurance. Ultimately, this leads to a better allocation of resources within the broader economy.

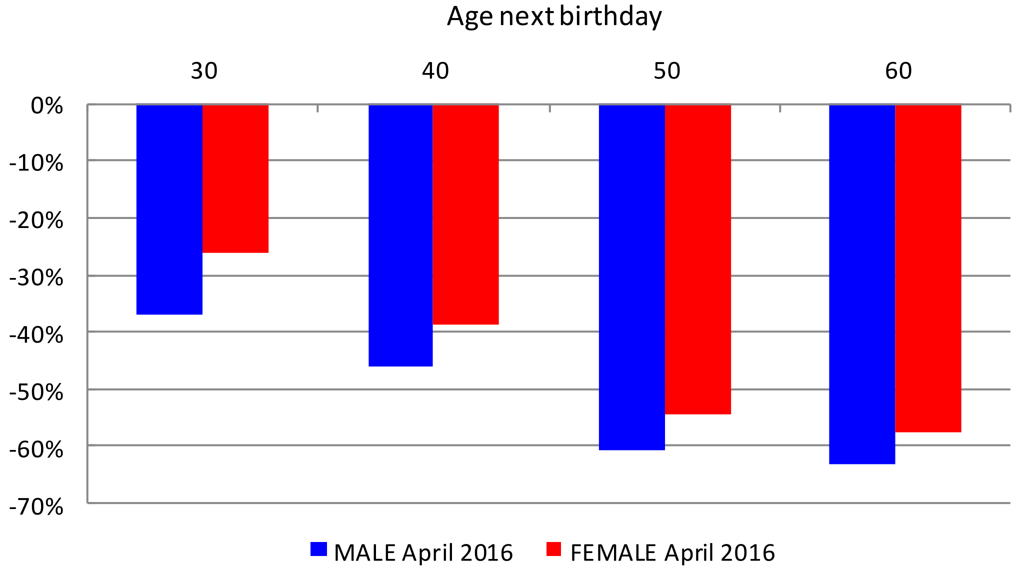
3.2 Efficiency measure - premium for given amount of cover

The indicator which best reflects efficiency with respect to the provision of insurance is a measure of the benefit that insurance provides members for a given cost – cover per dollar of premium paid, or the inverse – dollars of premium paid for a given level of cover.

In order to determine the relative efficiency of insurance provided within superannuation, as opposed to insurance provided directly to consumers outside superannuation, an indicator of premium per amount of cover inside superannuation could be benchmarked against the equivalent indicator for insurance provided outside of superannuation.

Chart 1 compares the price of insurance (premiums), for a given level of cover, for different age cohorts. The chart shows that insurance in superannuation generally is significantly more cost effective than insurance provided outside of superannuation for an equivalent level of cover.

Chart 1: Price of superannuation life insurance relative to retail life insurance* (%)



** For the same level of cover/sum insured. This does not take into account the effect of tax on the end benefit received by the member.*
Note: The data is sourced from a sample of ten, mostly very large, superannuation providers and thirteen insurers. The scenario is for an accountant (professional occupation) with $1,000,000 sum insured for death and TPD 'any' occupation.
Source: Rice Warner.

It is important to note in this context the distortive effect of the regulatory settings with respect to the taxation of insured benefits inside and outside superannuation. While, as evidenced by Chart 1, it is more cost efficient to provide death and TPD lump sum insurance through superannuation, the differing tax treatment of benefits paid out can lead to significant differences in the amount of the net benefit received by the member/beneficiaries.

Part of lump sum TPD benefits (before age 60) and all of death benefits (to non-dependants) paid from superannuation funds are subject to tax at a rate up to 32 per cent, whereas death and TPD insurance payouts made outside superannuation are tax free in the hands of the recipient.

As a consequence of this disparity, while provision of insurance in superannuation is generally more cost-effective, depending on their circumstances some members may receive advice to obtain insurance outside superannuation because of the reduction of the amount of a benefit received from a superannuation fund due to the effect of tax.

3. ANCILLARY BENEFITS SUCH AS ADVICE

KEY POINTS

- Most Australian superannuation funds provide at least some advice options for members, ranging from general financial product advice through scaled personal advice (generally 'intra-fund' advice) to comprehensive financial advice.
- It is relatively uncommon for overseas pension funds to provide advice to members.
- As comprehensive financial advice can be costly there is consumer demand for lower-cost, scaled advice and, increasingly, for robo-advice. The majority of superannuation members want access to simple, lower-cost advice rather than comprehensive advice.
- The costs of intra-fund advice are very low – generally equivalent to around two basis points of assets.
- The provision of intra-fund advice by superannuation funds is part of the solution of making quality advice more accessible to Australians.
- Accessible, quality financial advice can bring significant benefits for consumers.
- Assessment of industry efficiency needs to account for the range and quality of products and services provided to members and employers.
- In recent years there has been substantial innovation with respect to superannuation products and services.

In recent years there have been substantial increases in the ancillary benefits provided to members, in particular the provision of advice. Whereas the benefits are not captured in the *net benefit* indicator, the indicator does reflect the costs involved in providing such benefits.

4.1 Advice

Most Australian superannuation funds provide at least some advice options for members, which can range from general financial product advice, through scaled personal advice (generally 'intra-fund' advice, a limited form of personal advice confined to matters relating to superannuation) to comprehensive financial advice. It is relatively uncommon for overseas pension funds to provide advice to members, especially intra-fund advice.

Assessment of the benefit to members of the provision of advice, especially intra-fund advice, is best suited to qualitative analysis. This could be assessed by considering the availability of and access to advice, how funds are tailoring advice options to best suit member preferences and needs and the difference that the receipt of advice can make to the final financial outcomes for a member.

3.1.1. General financial product advice

Superannuation funds have always maintained sizeable call centre operations to provide assistance to members and employers. A number of funds also employ relationship managers who visit employers and members to provide information and assistance to them.

With the advent of the Financial System Regulation reforms most superannuation funds acquired an Australian Financial Services Licence (AFSL) in order to be able to provide at least general financial product advice about their superannuation product(s) to members and employers. General financial product advice is advice about the superannuation product generally but which does not take into account any of the recipient's relevant circumstances (objectives, financial situation or needs), nor does it make any recommendations.

The majority of general financial product advice is provided by call centre staff or client relationship managers. In order to be able to provide such advice under the AFSL the trustee/licensee must ensure that the individuals providing the advice meet the requirements of ASIC's Regulatory Guide 146 (RG 146). While desirable from a consumer protection perspective, complying with the requirements of RG 146 has imposed considerable additional training and compliance costs onto superannuation funds.

3.1.2. Personal advice

3.1.2.1. Scaled personal advice, in particular intra-fund advice

Scaled personal advice is limited in scope, by agreement between the adviser and the consumer, to one or more specific topics. Intra-fund advice is a form of scaled advice, confined to matters relating to a member's interest in their superannuation fund, the costs of which can be covered in whole or in part by the administration fee charged to all members of the fund. Any direct fees levied in respect of scaled advice are, at the member's direction, able to be deducted from the member's account.

The Investment Trends 2015 Direct Client Report revealed that there are still 14.5 million Australians who are not using, and do not intend to use, a financial planner, and 86% of them have concerns about their finances. In general, the majority of superannuation members want access to simple, lower-cost advice rather than comprehensive advice. Research undertaken by ASIC indicates that most demand for financial advice (with respect to superannuation) is at the simpler end of the advice spectrum.[1]

Accordingly, this suggests a significant need for the provision of scaled, personal advice to members, often with respect to only one or two issues relevant to their circumstances at the time. Superannuation funds have responded to this demand from members. ASFA research suggests that the majority of funds provide advice to members; most funds offer personal advice that is scaled; and the majority of scaled personal advice is provided as intra-fund advice.

The costs of intra-fund advice are very low – generally equivalent to around two basis points of assets.[2] Deloitte research found the estimated cost of providing intra-fund advice ranges from $8 per member per annum (for funds with more than 800,000 members) to $18 per member per annum (for funds with less than 4,000 members).[3] In our view this does not impose an excessive cost burden on funds or represent an unreasonable cross subsidisation between members.

[1] ASIC 2010, *Access to Financial Advice in Australia*, Report 224, December 2010.
[2] ASFA research.
[3] *Superannuation System Review; Final Report, Appendix D.*

The provision of intra-fund advice by superannuation funds is part of the solution of making quality advice more accessible to Australians. Access to advice can make a significant difference to member financial outcomes.

3.1.2.2. Comprehensive advice

At the other end of the spectrum, the provision of comprehensive advice, based on adviser knowledge of a range of financial products and options, can greatly assist consumers to make appropriate decisions, in particular with respect to retirement income stream products. The increasing number of fund members approaching retirement age, with growing levels of assets and improvements in life expectancy, means access to superannuation advice is ever more important. In contrast with intra-fund advice, members who receive comprehensive advice are charged a fee which, in some circumstances, can be deducted from their account.

3.1.2.3. Robo-advice

Superannuation funds are embracing new technologies that will better service member needs. 'Robo-advice' is automated advice which utilises technology and algorithms to provide advice, without direct involvement of a human advisor at the point of delivery of the advice.

The Investment Trends 2015 Direct Client Report survey data suggests that there is substantial member demand for robo-advice. The survey suggested that there are 1.5 million Australians who would use robo-advice services for investment recommendations and 2.6 million who would use those services to receive a detailed recommendation on how to achieve their financial goals. It also found that 36% of people prefer their superannuation fund to provide these tools. Accordingly, it is likely that robo-advice tools will become increasingly popular.

4.2 Other products and services

Assessment of industry efficiency needs to account for the range and quality of products and services provided to members and employers. If not, measured efficiency will under-estimate the benefits funds provide to members and therefore under-estimate efficiency. For example, the *net benefit* indicator incorporates the cost to funds of improving their products and services but does not incorporate the benefits to members and employers of those improved products and services.

The benefits of improved service and product quality are difficult to quantify, so assessment is best suited to qualitative analysis that assesses the nature, extent and pace of innovations to products and services.

In recent years there has been substantial innovation with respect to superannuation products and services. Innovations over recent years include: -

- More targeted, bespoke products. Ongoing developments in data analytics and associated technologies is enabling product issuers to build and distribute financial products in a more segmented, targeted way to better meet consumers' needs. Examples of this include lifecycle MySuper products, where the investment strategy is tailored to particular cohorts, generally a function of age and sometimes other factors such as account balance.
- Web-based tools, such as calculators; web-based education, such as webinars and videos; and easier electronic access to accounts – including the use of mobile applications linked to superannuation accounts. This has served to enhance member awareness of, and engagement with, their superannuation.

4. IMPROVEMENTS IN MEMBER AND EMPLOYER SERVICING

KEY POINTS

- In recent years there have been substantial improvements with respect to servicing of members and employers.
- Over recent years there have been a number of initiatives to encourage members to consolidate their accounts and to reduce duplicate accounts.
- There have been a number of fund initiatives to reduce the number of lost and inactive accounts.
- The ATO has leveraged its unique position – it can positively identify taxpayers and has access to a database of all of the data reported by funds and taxpayers – to develop initiatives to assist members to consolidate their accounts and to re-unite them with their lost superannuation.
- The introduction of SuperStream has led to considerable efficiency enhancements in the processing of both contributions and roll-overs.

In recent years there has been substantial improvements with respect to servicing of members and employers. These represent a benefit to members and employers which is not captured in the *net benefit* indicator, whereas the indicator does reflect the costs involved in making such improvements.

In particular, considerable efforts have been made with respect to account consolidation and lost accounts, while the advent of SuperStream has markedly improved the employer experience.

5.1 Members - consolidation of accounts

Over recent years there have been a number of initiatives to encourage members to consolidate their accounts and to reduce duplicate accounts. Members generally benefit from account consolidation through a reduction in the overall level of fees which they pay. These initiatives can also represent improved efficiency at a fund level.

The majority of funds have made considerable efforts to engage members to consolidate their accounts, including educating members about the effect of fees on multiple accounts and facilitating consolidation. A number of funds also regularly undertake activities to identify duplicate accounts and, once satisfied they are for the same member, to merge the accounts together.

A potential indicator of the success of funds' initiatives in consolidating accounts is the number of accounts per member, which is trending downwards – from around 2.1 accounts per member in 2005 to 1.86 per member in 2015.

Of course there are a number of legitimate reasons why consumers consciously retain more than one superannuation account – the primary reason being to maintain a particular level of insurance cover. Other reasons include people with a deferred defined benefit or who wish to access different product features or services available in different funds. As such, there is a limit to the extent that consolidation can occur – while the number of accounts per member may trend towards one, due to the above reasons it will never reach one account per member.

As a result of the success in consolidating accounts, one factor to be taken into account when consideration is being given to any indicator which is on a 'per account' basis is that any reduction in the number of accounts will have the effect (ceritus paribus) of making those indicators look worse.

5.2 Members - lost and inactive accounts

5.1.1 Background

Historically the majority of new members were enrolled in a fund by their employer adding them to their 'contribution return' for the period they commenced. This, together with the fact that Tax File Numbers have only started to be provided consistently over the last decade or so, saw accounts created with varying degrees of data quality and in some instances duplicate accounts for the same member were created.

The risk of accounts being opened with sub-optimal data or of duplicate accounts being created was exacerbated by the increasing casualisation of the workforce and by the rate at which Australians tend to change jobs (especially those in younger demographics).[4] Commencing employment with a new employer frequently would result in the new employer enrolling the member in a fund as well, with contributions to the old fund often ceasing.

Added to this is the frequency of moving house (especially those in younger demographics), sometimes as the result of a relationship breakdown, which increases the likelihood that, eventually, mail is returned to the superannuation fund as unclaimed. Given that superannuation is not a day to day transactional account, but instead a long-term investment, members, especially younger members, are more likely to take longer, or forget altogether, to advise their superannuation fund of their new address.

Over time all of these factors combined to produce a number of accounts which were considered to be 'lost' (due to returned mail) or 'inactive' (due to contributions not being received).

5.1.2 Fund initiatives

There have been a number of fund initiatives, aimed at members, that work to reduce the number of lost and inactive accounts. A significant number of funds also utilise data verification services to update details on member accounts – in particular the current address of the member but occasionally other data as well. In addition, the increased availability of web-based, secure, access to accounts has made it much easier for members to update details on their member records.

For some time now a number of funds have also participated in 'cross fund matching' with Eligible Roll-over Funds (ERF) whereby a fund has an agreement with an ERF to share information for the purpose of identifying accounts in the ERF which belong to one or more of the members of the fund. As a matter of general principle the trustee of a fund must obtain consent from a member to roll-over their benefit to another fund. As part of the 2016-17 Budget the Government has finalised changes to the regulatory regime. With effect from 10 May 2016 ERFs are permitted to transfer member account balances to an active account in a superannuation fund without the member's consent, on the condition that the active account has received at least one contribution or rollover within the previous 12 months.

[4] The proportion of casual employees increased steadily over the 1990s, from 21.5 per cent in August 1992 to 25.2 per cent in August 2000. The proportion has since declined slightly, to 23.9 per cent in August 2013 (Parliamentary Library 2015, *Casual employment in Australia*, Research Paper Series, 2014-15). RBA research suggests that the average tenure for all workers is around 7 years (RBA 2012, *Labour Market Turnover and Mobility*, RBA Bulletin, December quarter).

ATO initiatives

The ATO has leveraged its unique position, in that it is able to: -

- positively identify taxpayers; and
- access the databases comprised of all of the data reported annually by funds and taxpayers to the ATO

to develop initiatives to assist members in consolidating their accounts, to re-unite members with their lost superannuation and to advice funds of updated member details, such as addresses.

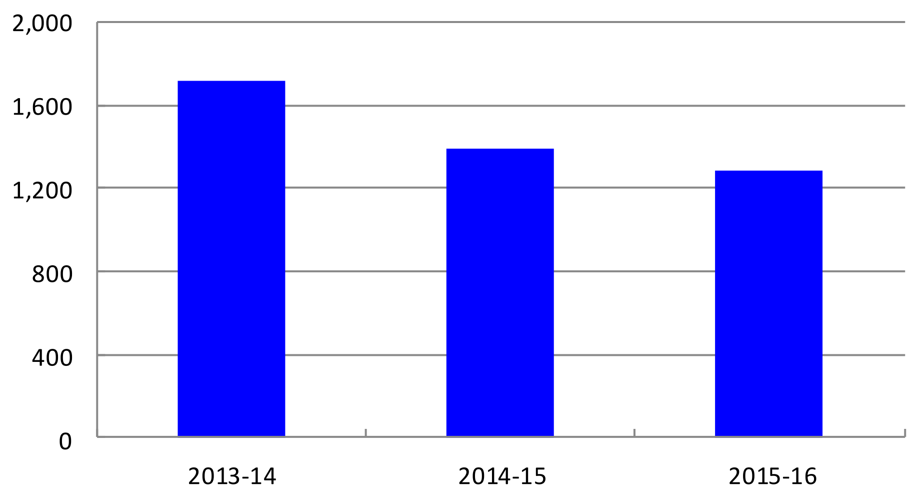
These initiatives have included: -

- SuperStream – which has markedly improved the quality of data being provided by employers when enrolling new employees;
- MyGov/SuperSeeker – which has facilitated members: -
    - locating all of their superannuation accounts;
    - rolling-over benefits via the MyGov web-site, as opposed to having to provide paperwork and certified copies of identification documentation to the fund; and
    - identifying amounts of lost and unclaimed superannuation reported or paid to the ATO.

Currently the ATO must obtain consent from a member to transfer any amounts of lost/unclaimed superannuation back to an active account. ASFA has consistently advocated for the ATO to be able to transfer an amount of lost/unclaimed superannuation to an active account without the member's consent, on a similar basis to the recent exemption created for ERFs (outlined above).

A potential indicator of the success of such initiatives is the number of lost or inactive accounts. Chart 2 shows that the number of lost accounts has fallen by 25% since 2013-14.

Chart 2: Lost superannuation accounts (number, '000s)



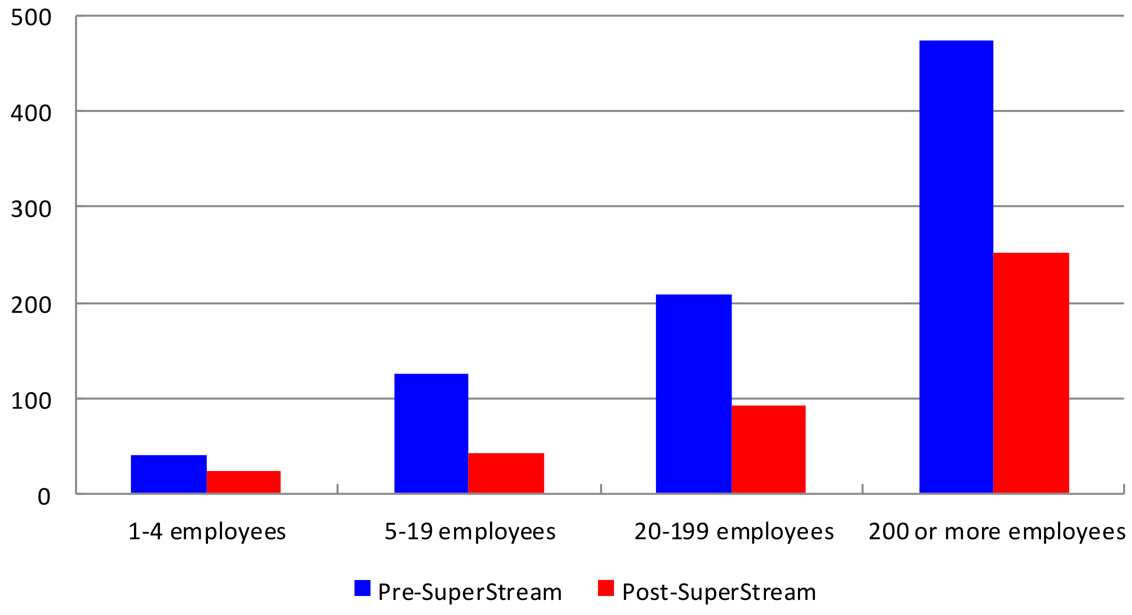
Note: The figure for 2015-16 is at 31 December 2015.
Source: APRA, Super accounts data overview, https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/Super-accounts-data/Super-accounts-data-overview/?page=1#Number_of_super_accounts_held_by_each_Australian, accessed 20 May 2016.

5.2 Employers – compliance costs

The introduction of SuperStream has led to considerable efficiency enhancements in the processing of both contributions and roll-overs. SuperStream facilitates the transmission of data in a standardised format – contribution data between employers and fund and roll-over data between funds. For employers SuperStream provides a single, electronic channel for interacting with multiple super funds. For funds, the standardised data allows for faster allocation of contributions and reduces the incidence of errors.

One potential indicator of the efficiency benefits of SuperStream is the reduction in time taken for employers to process superannuation contributions. The ATO found that employers who implemented SuperStream and had completed more than one payment cycle experienced between a 65% (small employers) and 47% (large employers) reduction in time spent in processing their superannuation contributions (Chart 3).

Chart 3: Average time for employers to manage contributions (minutes)



Source: ATO Super Reform Final Report, Colmar Brunton, 2 Dec 2015.

5. EFFECT OF REGULATORY SETTINGS ON COSTS

KEY POINTS

- APRA-regulated funds pay for the public cost of prudential supervision by APRA, consumer regulation by ASIC and services provided by the ATO through the payment of an APRA levy.
- The cost per member of the APRA levy increased markedly in 2012 with the advent of the SuperStream levy ($467 million over 7 years) and since then has remained around that level.
- To compensate victims of fraud in APRA-regulated funds resulting from the collapse of Trio Capital Limited the industry paid two financial compensation levies totalling over $71 million.
- Policy and regulatory amendments over recent years have resulted in providers incurring significant costs in implementing necessary changes.
- The current stock of regulatory obligations and requirements imposes material ongoing compliance costs on the various entities in the superannuation system.

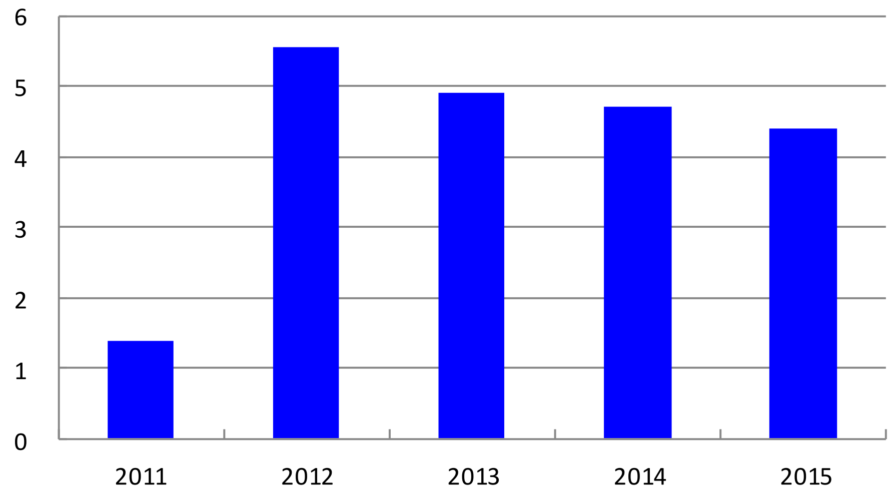
As noted in our initial submission the superannuation system operates under a highly prescriptive regulatory regime, which has been subject to significant change over recent years. Ultimately, the cost of regulation – the payment of regulatory levies; the cost of implementing regulatory change and the costs involved in on-going regulatory compliance are borne by superannuation members in the form of higher fees.

6.1 APRA levy - recovery of APRA, ASIC and ATO costs

APRA-regulated funds pay directly for the public cost of prudential supervision by APRA, consumer regulation by ASIC and services provided by the ATO through the payment of a levy to APRA.

In the 2012-13 Budget the Government announced the introduction of a $467 million SuperStream levy. The levy will be imposed over seven years, with $121.5 million levied in the 2012-13 financial year. The cost per member of the APRA levy increased markedly in 2012 with the advent of the SuperStream levy and since then has remained around that level (Chart 4).

Chart 4: APRA Levy per member ($)



Source: Rice Warner.

6.2 Financial compensation levy

In early 2012 a grant of around $55 million was provided to compensate victims of fraud in APRA-regulated superannuation funds resulting from the collapse of Trio Capital Limited. This compensation was funded via a levy imposed on the superannuation industry in 2011. Later in 2012 the Government agreed to provide a further grant of $16.7 million to compensate members and to recoup a shortfall of $2.2 million in relation to the 2011 levy. Ultimately the cost of paying these levies was borne by superannuation fund members.

6.3 Cost of implementing regulatory change

The regulatory regime has been subject to significant amendment over recent years.

It is important to note that regulatory amendments necessitate considerable changes being made to an already complex and automated superannuation system. Multiple amendments, which need to be implemented at the same time, further complicate matters.

Trustees need a great deal of certainty in relation to the details of regulatory changes in order to be able to make strategic and/or discretionary decisions. Following these 'threshold' decisions there is a variety of tactical determinations which need to be made.

Implementation of new regulatory obligations and requirements involves the identification of, and agreement upon the approach to, considerable and extensive alterations to IT systems; processes/procedures; fund documentation such as governing rules; member communication materials such as product disclosure statements and training materials.

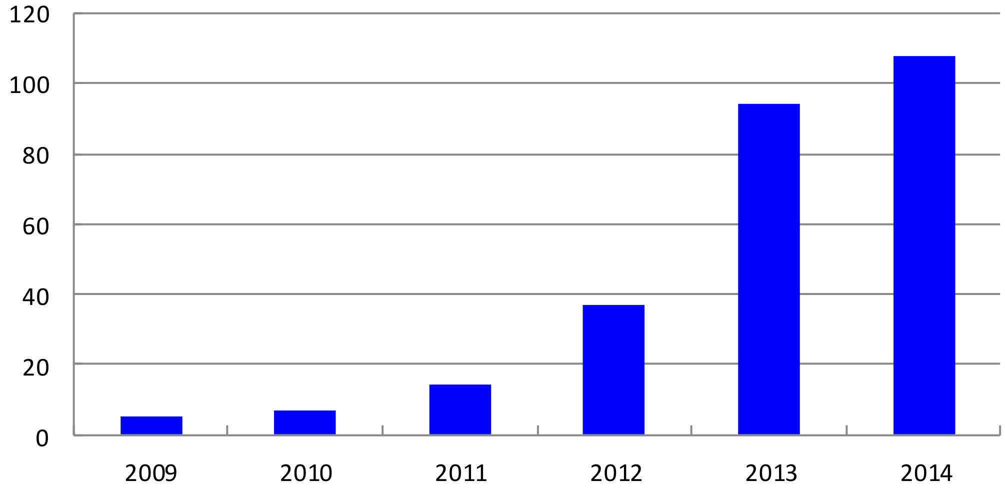
Funds often maintain a number of separate IT systems, such as a member registry; accounting system; statements and letters system and client relationship management. These systems need to interact with each other, with various databases and with interfaces such as the web-site and mobile applications. Prior to IT systems work commencing, business requirement documents, and functional and technical specifications, must be agreed upon and signed off. The complexity of IT system design frequently necessitates complex regression testing to mitigate the risk of unintended consequences, which can take longer to perform than the initial coding of the changes to the system.

Change management with this scope, scale and degree of interrelatedness is not only expensive but, more importantly, making significant alterations to IT systems and member databases poses a considerable risk of lost or corrupted data or functionality, which at worst could result in inaccurate or incomplete member records. The most effective means of mitigating such a risk is by utilising robust project management methodologies to determine timelines; identify interdependencies; produce a staged project plan; include sufficient time for regression and user acceptance testing, and then execute in accordance with the plan. All of this takes skilled resources and sufficient time.

When it comes to implementing system changes often there are capacity constraints – especially access to skilled/knowledgeable resources – and interdependencies. Rushing to meet unrealistic regulatory deadlines increases the risks to a project and can increase costs materially, which are ultimately born by the members of the fund. There is a 'project triangle' which is commonly referred to – the three parameters of a project are scope; timeframe and cost. Any increase in scope or reduction in time frame leads to an increase in costs – in particular in obtaining the services of highly skilled, and scare, resources such as programme managers and analysts. Accordingly, any delays in finalising changes to regulatory obligations significantly affects the ability of providers to implement the required changes in an orderly and appropriately risk-managed fashion.

Policy and regulatory amendments over recent years have resulted in providers incurring significant costs in implementing necessary changes to systems; processes and procedures; documentation and in delivering training. Recent examples have included the costs of implementing the Stronger Super changes, in particular SuperStream (over and above the SuperStream levy) and MySuper, and the changes necessitated to provide reporting of data to APRA. The Westpac Group, in its second submission to the Financial System Inquiry, revealed that the annual regulatory reform implementation costs of the BT Financial Group (BTFG) had increased markedly from 2009 to 2014, to be over $100 million in 2014.

Chart 5 BTFG regulatory reform implementation costs ($m)



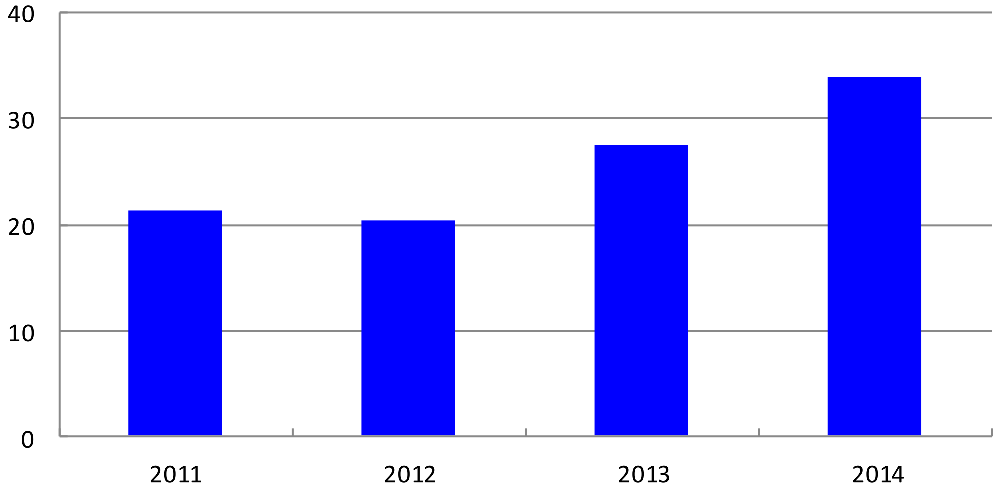
Source: Westpac Group, Second Submission to the Financial System Inquiry, August 2014, Page 55.
Note: Chart reproduced by ASFA.

There is also the effect of regulatory change and increased complexity on consumer confidence and member engagement. Increasing complexity can make superannuation difficult to understand, which can contribute to apathy and inertia on the part of consumers.

6.4 On-going cost of regulatory compliance

Complying with the various regulatory obligations and requirements imposes material ongoing compliance costs on the various entities in the superannuation system. Over recent years there have been significant increases in ongoing regulatory costs associated with policy and regulatory changes, including in particular the APRA data reporting obligations. At the industry level, compliance and trustee support expenses per member increased by almost 60% between 2011 and 2014 (Chart 6).

Chart 6: Compliance and trustee support expenses per member ($)



Source: Rice Warner.

There are also hidden costs of regulation that affect operational (as well as dynamic) efficiency. Regulation potentially inhibits innovation and product development in the system, as well as representing an opportunity cost whereby participants' resources are concentrated on implementing changes to comply with regulatory requirements rather than on product development. Though this is difficult to quantify, any assessment of efficiency should take these indirect costs of regulation into consideration as well.

Ultimately the above factors are outside the control of the industry, so any assessment of operational efficiency with respect to the superannuation industry should make allowance for the effect of regulatory costs – either quantitatively or qualitatively.