ASFA/PwC CEO Report
November 2013

What is on the minds of CEOs in superannuation?

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Foreword

Pauline Vamos
Chief Executive Officer
The Association of
Superannuation Funds of Australia

Welcome to the second ASFA/PwC Superannuation CEO/ leaders survey. Time is scarce across the industry so I am particularly grateful to those that took the time to answer the survey questionnaire.

I am pleased to see that operational efficiency and post retirement products are within the top three priorities identified as these squarely fit into ASFA advocacy priorities. The most important strategic priority identified was member engagement. This means two things. That the super industry will continue to innovate in member communication and education tools and that the ASFA strategy of 'improving the stakeholder experience' is the right one. As the peak body for the collective industry, part of our role is to be the bridge between the industry and the community. As a compulsory system we have a greater obligation to the community and as such initiatives like www.superguru.com.au will continue to be developed.

One of the biggest pieces of work for ASFA over the coming months is preparing for the financial system enquiry. The identification in the survey of specific matters that should be covered is particularly helpful. As an industry we need to take a proactive as well as a defensive approach to the enquiry. The core of the review will be the assessment of role and movement of capital in the economy, ASFA's research to date and that in train will stand us in good stead.

The survey results also indicate that there is a lot of pride across the industry and a real understanding of the privilege we have of 'looking after other people's futures'. We need to remember this as we receive more and more scrutiny and the regulatory net tightens. It is not our system, it is the community's system and as leaders across the industry they are looking to you to deliver on the public good. One step in that process is to agree to work together on what we should, and compete openly, fairly and transparently on the rest.

Executive Summary

David Coogan
Superannuation Industry Leader
PwC

Welcome to the second annual ASFA/PwC CEO Survey. This survey captures the views of 26 CEOs from across the superannuation industry, including industry, retail, corporate and public sector funds.

This survey covers the matters on the minds of CEOs in relation to:

1. strategic priorities over the coming years
2. investments
3. operational matters including the impact of regulatory reform, data quality and member advice

Member engagement is now at the forefront of CEOs' strategies. Operational efficiency and post retirement products are also high priorities. CEOs are over all the regulatory changes and want time now to improve the level of member engagement and to use current returns to help rebuild the level of trust in their fund, the industry and the superannuation system.

When it comes to investment governance, CEOs are mainly focussed on the monitoring of investment managers with outsourcing anticipated to remain more popular than insourcing. It is also interesting that since the results of the 2012 survey CEOs believe that significant progress has been made in negotiating investment manager fees.

CEOs are feeling confident over compliance with Stronger Super but have some concerns over the link between cost and benefit. The expectation is that costs will not increase as much as they have in recent years, but they will not go down. This is because the costs of technology, regulatory and member engagement strategies are greater than the actual savings through SuperStream and MySuper.

Most organisations are in agreement that the bar is being raised by members in expectation of governance and product offerings.

Similarly to last year, CEOs remain proud of their delivery to members and the dedication of their teams to this end.

CEOs are over all the regulatory changes and want time now to improve the level of member engagement.

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Strategy

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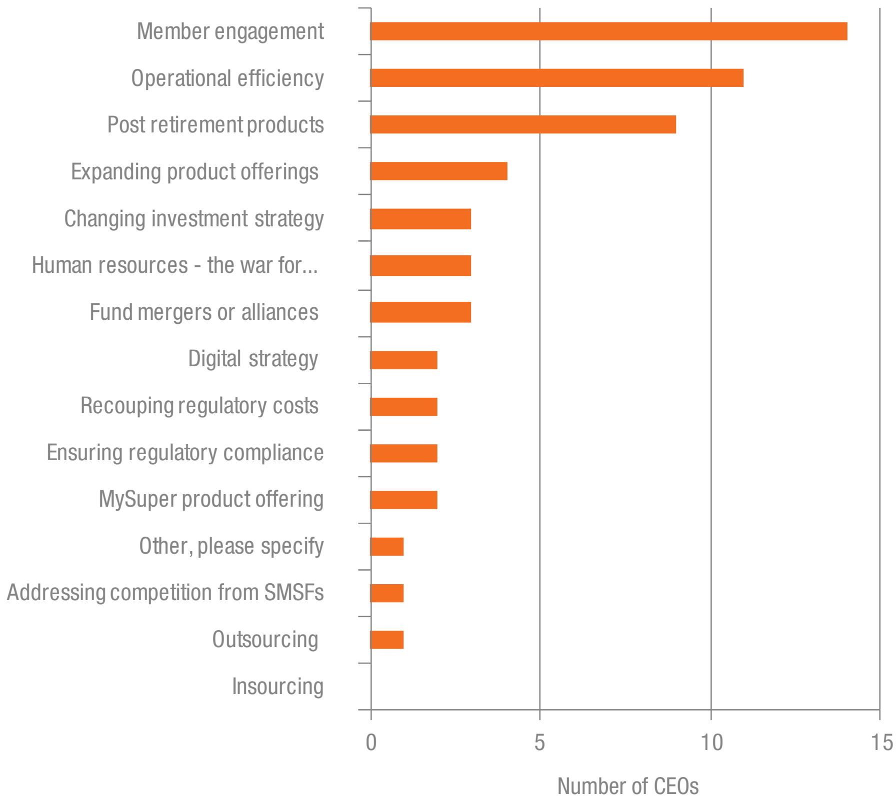
Strategic priorities in the next 3 years

CEOs appear to have shifted their focus away from regulatory reform and onto member-focused strategies, with the most common strategic priorities in the next 3 years being member engagement, operational efficiency and post retirement products.

Perhaps surprisingly given the level of industry discussion, addressing competition from Self Managed Super Funds was ranked comparatively low. Perhaps this objective is already implicit in CEOs' strategies around member engagement and expanding product offerings.

What are your key strategic priorities in the next 3 years?



What should be done to improve member engagement?

CEOs are adopting a variety of approaches to improving member engagement, though most identified lobbying for cessation of changes to superannuation or for simplification of super as being key. There was a call to reduce industry jargon and incomprehensible or irrelevant information. Some CEOs said that media and government could do their part in promoting a positive profile for superannuation.

Other ideas identified by CEOs included making superannuation more visible to members. Some suggestions included an increasing number of touch points, packaging of superannuation with other services and projecting balances on statements. Other examples included making superannuation available through online banking platforms or improved educational offerings.

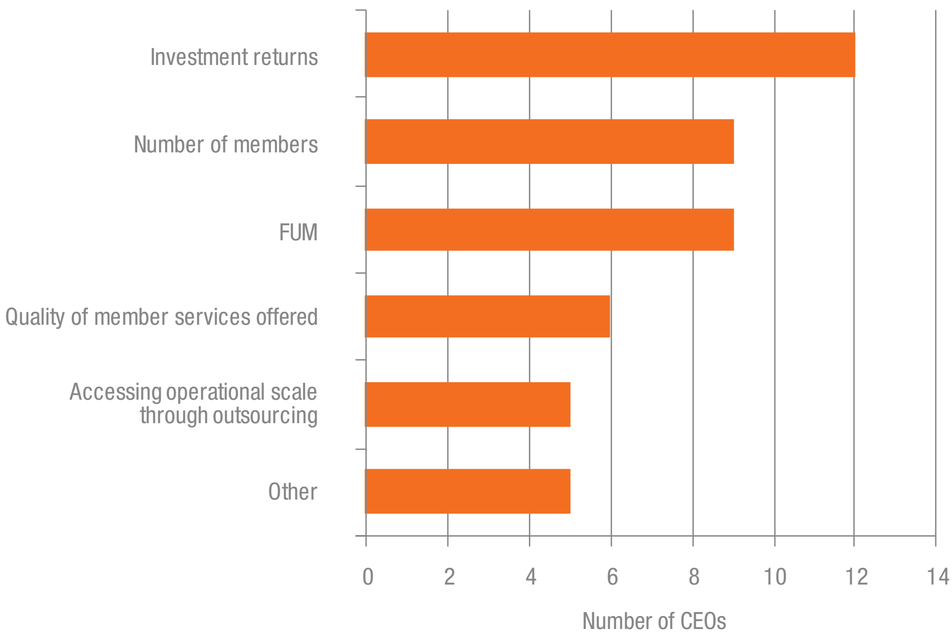
> "*Make super relevant to people early in the accumulation phase rather than just before the pension phase.*"
> *~ Fund CEO*

APRA's annual declaration of scale.

APRA has introduced an annual declaration of scale. Most CEOs expect to consider investment returns, member numbers and funds under management when assessing scale.

15% of CEOs identified only one criterion that would be considered as part of their scale assessment. It will be interesting to see whether having just one criterion results in a higher risk of funds failing their own assessment of sufficiency of scale. However, if the criterion is strongly aligned with the fund strategy, then CEOs focus on the selected area may mitigate this risk.

What factors do you expect you will consider in assessing the adequacy of your scale?



What superannuation matters would you like the Financial Services Inquiry to cover?

CEOs would like to see a clear goal for long term retirement income policy that embeds sustainability in the system. Nonetheless, CEOs are keen to ensure that the Financial Services Inquiry is not a wholesale revisit of the Cooper or Henry reviews.

Some of the specific matters that CEOs identified to be covered by the Financial Services Inquiry include:

- **Adequacy** - For example, as members transition through accumulation to post retirement – what is the appropriate system design and appropriate risk mitigation? What should be considered in relation to contribution levels for members with broken periods of employment?
- **Regulatory matters** - How should the roles between regulators be split to minimise duplication while maintaining appropriate oversight? What is the appropriate scope of regulatory powers? How should costs of regulation to the overall community be assessed? What is an appropriate level and mechanism of disclosure of the use of levies?
- **Prudential matters** - How should the industry assess capital adequacy, particularly given the massive increase in assets being held in trust for others?
- **Economic matters** - What should superannuation's contribution be to the macro-economy? How do we export our capacity and expertise in a way that benefits members? What is our role on the global stage, particularly in the Asian region? How can competition and structural neutrality be achieved across the industry?
- **Social security** - What is the appropriate relationship between superannuation and social security?
- **Tax** - What are the appropriate tax policy settings for superannuation? How should post retirement products be taxed? How can the complexity of the current tax regime be reduced?
- **Advice** - How can impartiality be achieved?
- **Transparency** - Will the focus on fees detract members from focusing on the best long term investment returns? Will the increased transparency on investment holdings disadvantage funds and impact returns to members?
- **Infrastructure** - What is superannuation's role in this area?
- **Offshore investments** - What is the impact of increased offshore investment on currency stability?

How should funds, industry associations and service providers work collaboratively to achieve strategic outcomes at an industry level?

Most CEOs were of the view that there should be a united industry view on strategic and regulatory issues. Paramount to CEOs is to ensure members' best interests are top of mind not only with CEOs but with the government and regulators.

To achieve a united industry CEOs said it was vital to have an agreed vision industry and compromise where feasible, while recognising agreement will not always be reached.

A way forward, as suggested by one CEO, is to focus effort on principles of good policy that can be supported across the industry. For example find the areas of agreement then build trust and earn credibility in the eyes of the government and opposition.

> *"Work hard to publically agree most issues and then let sectors make their own statements on areas that they cannot agree upon.*
> *~ Fund CEO"*

> *"Focus on influencing, educating and assisting government, regulators, superannuants and other stakeholders to optimise retirement outcomes.*
> *~ Fund CEO"*

02

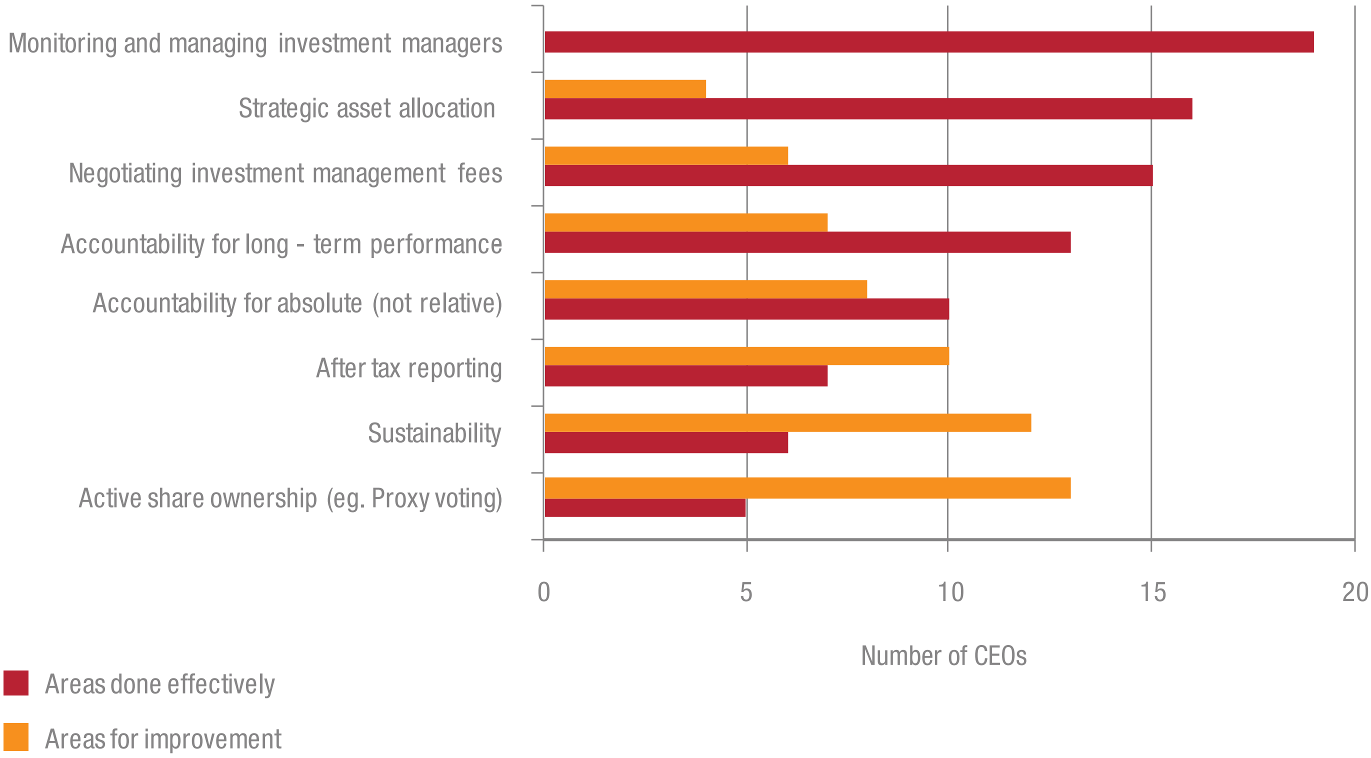
Investments

Investment governance

Investment governance is clearly paramount to maximising members' retirement outcomes. The CEOs believe that the area of investment governance that is done best by the industry is monitoring and managing investment managers. This is consistent with output from our survey in the previous year. This is important given the continuing preference for outsourcing as noted on the next page.

Negotiating investment management fees also scored highly and represented an improvement compared with the previous year. This is a reflection of funds focussing on costs and operational efficiency.

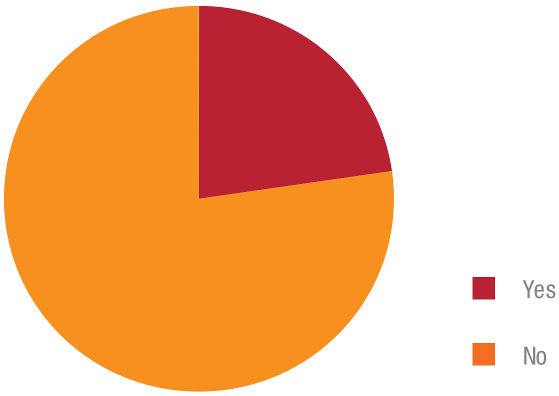
What are the areas of investment governance that you do very effectively? What areas of investment governance could you improve significantly?



77%

of CEOs do not intend to insource their investment management over the next 3 years.

Will you increase the extent of investment management performed in-house in the next 3 years?



Investment management

77% of CEOs do not intend to insource their investment management over the next 3 years. The main reasons for this are cost and scale. In addition, some organisations do not have the skills necessary or the risk appetite.

Those that do intend to bring investment management in-house referred to control and fee management as key reasons. Interestingly, the ability to make investment decisions was cited both for and against the insourcing of investment management. While one respondent said that insourcing would increase their capacity to be more flexible, another said it would lead to less flexibility and the risk of being captive to their internal investment team.

In addition to maximising member retirement outcomes, what other key factors are you considering in setting your investment strategy?

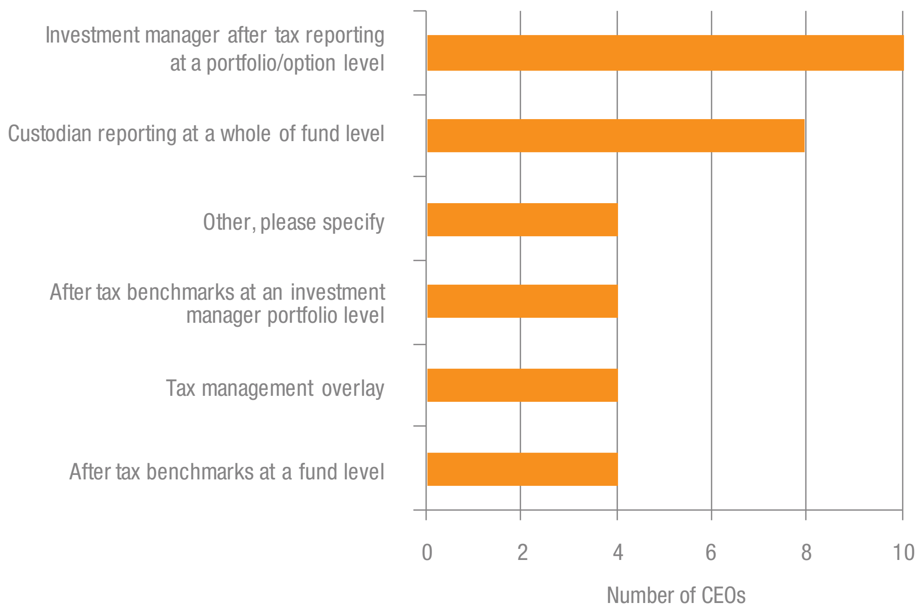
There were a large variety of factors provided by CEOs in response to this question. Areas of influence included member feedback, employer attitudes, member demographics and capability.

The most common thread was around risk and the need to avoid volatility in performance. There was acknowledgement of the importance to set a risk profile suitable for the majority of members while offering investment choice options which are attractive to members.

With the current economic climate impacting on returns, CEOs noted the need for flexibility and diversification. This included a scenarios approach to stress testing and consideration of more sophisticated downside management options.

Another factor in setting investment strategy was Stronger Super and its focus on simplicity and cost-effectiveness. Some CEOs warned that to focus only on costs and short-term strategy could lead to lower returns or even negative investment outcomes.

Which of the following do you use in your after-tax strategy?



Most CEOs use multiple measures in setting and assessing their after-tax strategy, with option level reporting and custodian whole of fund reporting being used. After tax reporting is likely to increase in prominence given the MySuper reporting requirements for investment returns and performance fees and the need for Trustees to consider “tax consequences” in formulating investment strategies.

> *“The current environment is dominated by ‘financial repression’ and central bank policy. This means lower returns can be expected for some time, plus risk of bubbles. Therefore there is a greater need for dry powder, flexibility, diversification and medium term asset allocation tilts.”*
>
> *~ Fund CEO*

Operational matters

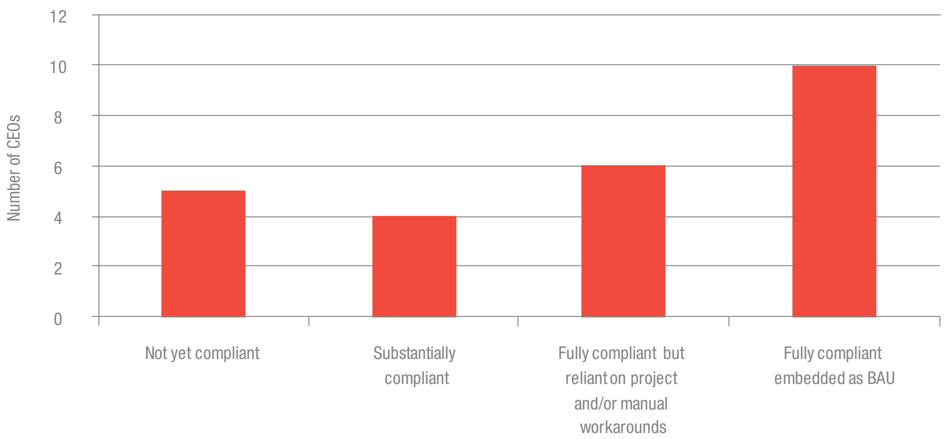
03

The primary operational focus of organisations over the past 12 months has been the implementation of the Stronger Super reforms, particularly the reporting requirements. CEOs have diverse views in relation to the challenges and benefits of the new reporting regime. However, most are in agreement that their data quality is improving and that members are more engaged.

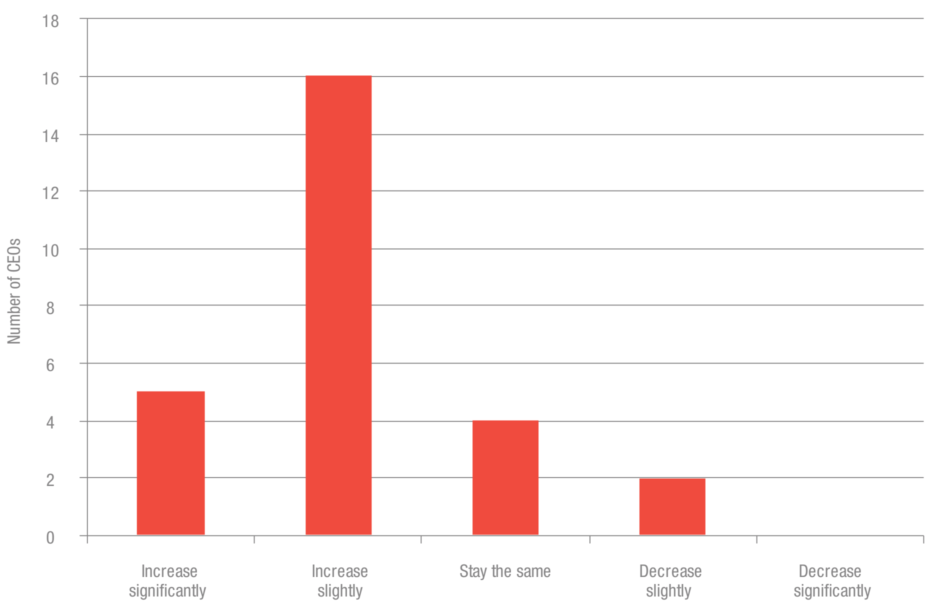
Stronger Super

The majority of CEOs are confident their organisations are fully compliant with the new prudential standards. It will be interesting to see over the next 12 months how fund trustees monitor compliance with these new standards, for example through quarterly compliance reporting.

How successful has your organisation been in adopting APRA's prudential standards?



How do you anticipate that your operating costs will change in 3 years time (i.e. after Stronger Super implementation)?



Superstream and MySuper were introduced with an expectation of a significant reduction in operating costs across the industry and a corresponding reduction in member fees.

Despite this objective most CEOs said they expected that their ongoing operating costs would increase after Stronger Super is implemented.

While there has been a rise in straight-through processing across the industry and a corresponding reduction in manual handling of paperwork and cheques, the savings arising from these appear to be more than offset by the ongoing investment in technology (and its subsequent amortisation) together with additional costs, including increased disclosure obligations and levies payable to regulators.

What are the strategic implications of increased reporting to APRA?

There were mixed responses to this question. Some CEOs did not see strategic benefits behind the increased reporting. Other CEOs were more positive and cited benefits such as greater transparency, increased peer awareness and demonstration of good governance.

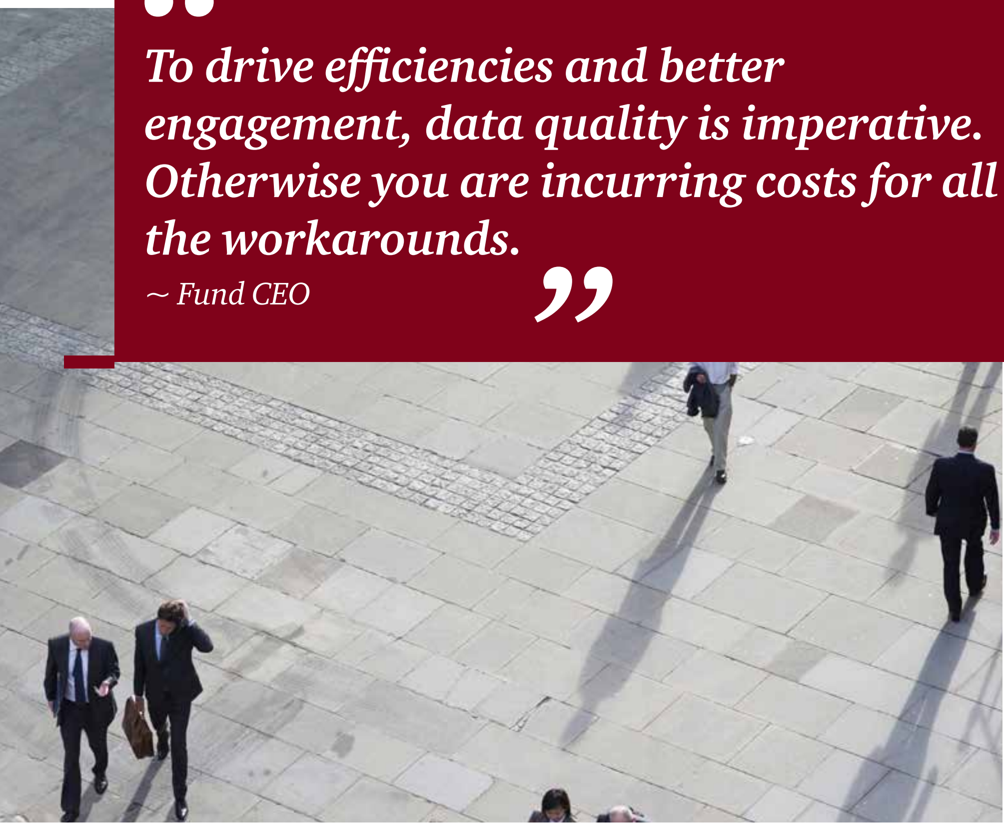
While many CEOs identified benefits there was also some caution around the long term implications such as competitive disadvantage. CEOs said members will raise the bar of expectation across the industry and funds will need to find new ways to differentiate themselves. For example, investing time educating and engaging members to believe that value can be derived by different investment approaches. Another concern was about risk of misinterpretation of comparative data by the average member.

> *“Members are becoming more aware (or maybe just more concerned) and are therefore contacting us to obtain advice.”*
> *~ Fund CEO*

Is the level of data quality at your fund changing?

Most CEOS said that data quality had either increased or stayed the same. They are mindful of the strategic and operational benefits of good data. Consequently there is a continual focus on fixing issues and improving systems as part of a long-term strategy.

> *“To drive efficiencies and better engagement, data quality is imperative. Otherwise you are incurring costs for all the workarounds.”*
> *~ Fund CEO*



Is the number of members seeking advice changing?

More than 80% of respondents said the number of members seeking advice was increasing.

There is a strong correlation between increased member engagement and increased advice sought. The heightened awareness of areas such as market volatility and longevity coupled with enhanced access to channels that suit the consumer (for example online access) have been leading factors. Another influence is the combination of point in time advice at a reasonable cost.

Many CEOs also cited how the demographic of members is evolving with more members approaching retirement and therefore more concerned in relation to retirement outcome.

Another reason was the struggle by members to keep pace with legislative changes and their ability to interpret the requirements.

04

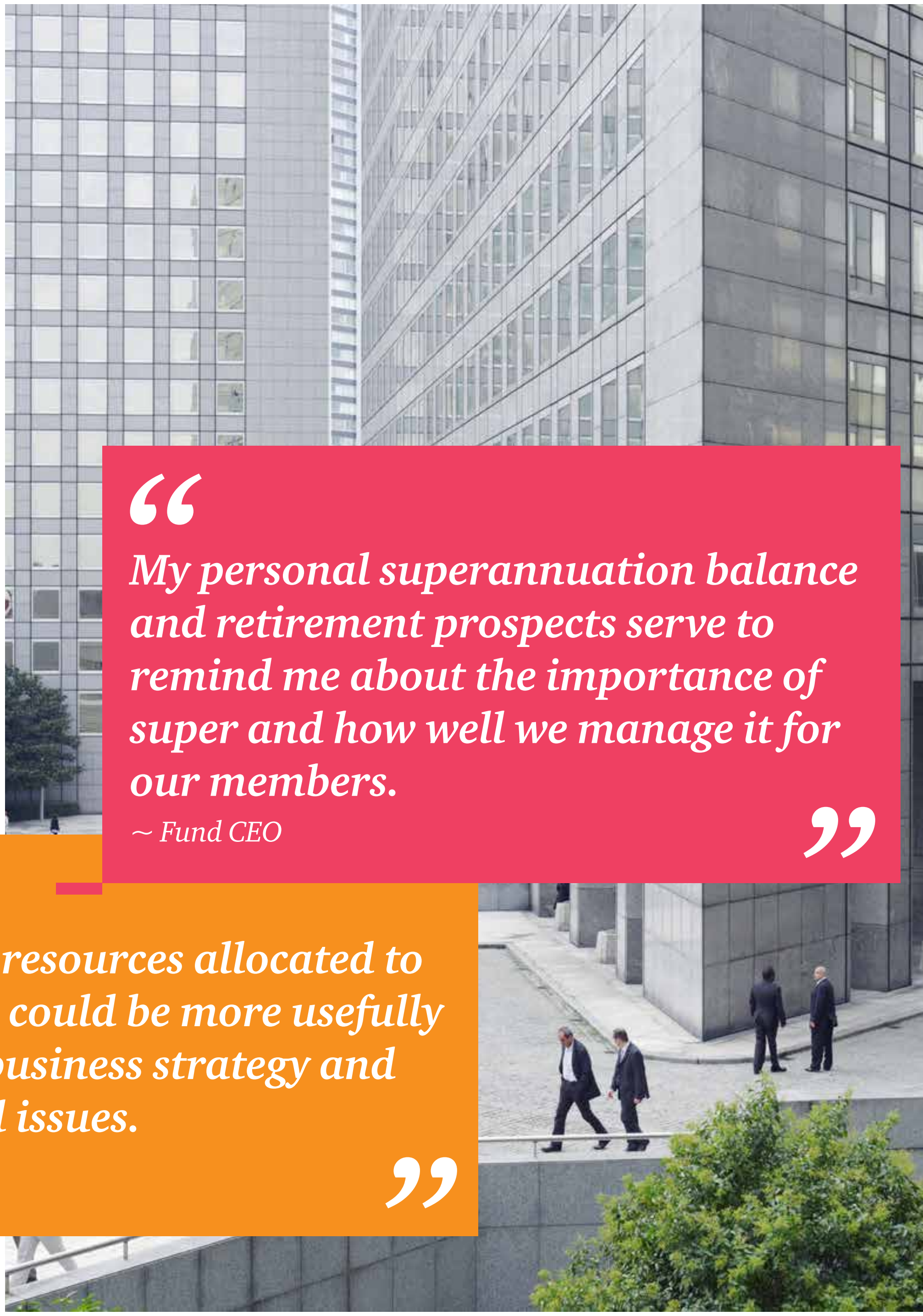
What keeps you awake at night?

CEOs are primarily concerned about regulatory change and the pressures it brings. They highlight the complexity of such regulation and the extent of change that has occurred within relatively short time-frames. There is also concern that such changes do not pay regard to established business practices, heritage products and systems. This all culminates in a detrimental impact on cost to members and the outcome for future generations.

There is also anxiety at government's lack of forward planning and use of superannuation as a tool to be manipulated for political gain.

Other CEOs are also worried about their capacity to continue to invest in the administration systems impacted by regulatory change.

Longer term concerns include funding levels of defined benefit plans and the possibility of another financial downturn.



> *"My personal superannuation balance and retirement prospects serve to remind me about the importance of super and how well we manage it for our members."*
>
> *~ Fund CEO*

> *"The level of resources allocated to compliance could be more usefully applied to business strategy and operational issues."*
>
> *~ Fund CEO*

05

What are you most proud of?

CEOs are most proud of member engagement and the commitment and loyalty of their staff to deliver member service. The short term measures of success in this area are low complaint levels and trusted relationships with members.

CEOs said that the most important longer term objective is the provision of adequate retirement outcomes to members. While they are proud of their achievements to date, it will remain an area of focus

Another source of pride is the achievement to contain costs and drive efficiencies. An example of this is having an administration system that is error free and provides straight through processing. CEOs are proud when low costs can translate to lower fees to members.

Other factors that make CEOs proud include having a socially responsible investment strategy (for example excluding tobacco products), innovation for members and being part of an Australian model which is ranked high amongst the world's superannuation systems.

> *"Our superannuation system represents a secure, tax-effective investment environment that will ensure more Australians are able to enjoy a comfortable retirement."*
>
> *~ Fund CEO*

06

About the survey

The ASFA/PwC Survey 2013 was conducted from September to October 2013. Respondents are CEOs from a wide range of organisations across the superannuation industry including industry, retail, corporate and public sector funds. In total 26 CEOs took part in the survey.

This report provides an overview of the survey findings together with analysis and interpretation of the results. We have also included some direct quotes from CEOs throughout the report. These quotes reflect individual views and demonstrate the passion and/or breadth of CEOs' views and are not necessarily consistent with the overall survey findings.

We thank the CEOs who participated for their time and insight.

Thank you Thomas Green and Gennesee Rock for their assistance and contribution to the survey.

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