Submission to Productivity Commission
Draft Report – Superannuation: Assessing Efficiency and Competitiveness

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We thank the Productivity Commission for the opportunity to make a submission on the Draft Report, Superannuation: Assessing Efficiency and Competitiveness. Our approach is to comment briefly on selected Draft Recommendations and, where appropriate, refer the Commission to relevant academic papers which we include in an attachment.

Default model (Draft Recommendations 1, 2, 3)

We support the aim to bring greater competitive pressure to the superannuation market and agree that fund members should not bear the risk of default into a poorly performing fund or paying multiple administration fees and insurance premiums (as under the current arrangements).

The proposal for 'active' choice from a limited menu of 'selected' superannuation products (supplemented by random allocation to a 'selected' product in the absence of active choice, and free choice from all superannuation products if that is preferred) could initiate 'interest' in superannuation at the beginning of one's working life. However, we emphasise that most people will need guidance when making this 'active' choice. New hires, particularly the young who are unfamiliar with superannuation, will need clear, comparable, easy to find information on key superannuation product/fund features and access to online and face-to-face support. This will need to be facilitated by government, employers and superannuation funds.

In relation to the default model and elsewhere the Draft Report mentions dashboards as a source of information. We have strong reservations about using the current MySuper (and proposed Choice) dashboard as the starting point. Over the past decade we have investigated the effectiveness of a number of Australia's financial product disclosure provisions – specifically the MySuper dashboard, short form product disclosure and the standard risk measure. Our studies broadly conclude that the current summary disclosure formats information are

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ineffective, that simplicity *per se* is not always beneficial and that the current approach to pre-testing of presentation formats is inadequate (see further comments under Draft Recommendations 9, 10).

We strongly support the recommendation that a centralised online service should be established to allow members to start, change or leave jobs without adding superannuation accounts. However we recommend that the online service is integrated with standardised and relevant fund comparison information. Since members are more likely to reconsider their choices during these transitions, it is the right time to offer summary information (Fernandes et al. 2014).

Members with multiple jobs could have their accounts consolidated to the fund where they hold their highest balance, subject again, to giving them access to relevant summary information on the features and performance of the funds where they now hold accounts (as in Draft Recommendations 9 and 10). (Studies of engagement show that people become more engaged with retirement saving as their balances rise, so the fund where a member holds their highest balance is likely to be the fund with which they are most engaged e.g., Bateman et al. 2014.) Moving inactive or redundant accounts into the account with the highest balance would mitigate crystallised investment losses in many cases. We also support the collection of member choice information at the time these choices are made.

We support in principle the proposed online standard choice form (SCF) with a consolidation facility – this would greatly help members manage their superannuation – but we would also recommend thorough testing of the format and function of any SCF. A well-designed consolidation process that is integrated with standardised, comparable information about superannuation funds is likely to help members understand where their savings are, and how they are managed, and so to encourage engagement. It is also possible that the online SCF will decrease the incidence of unpaid Superannuation Guarantee contributions since members are likely to notice unpaid contributions because they i) have only one account; ii) renew or change that account when starting or changing jobs; iii) are more likely to update address and email details. Indeed, cross-checking of SG contributions by the ATO might be possible through this system.

How the changes proposed in Draft Recommendations 1-3 would affect rollovers and fund investment strategies is unclear. Initially, one would expect high rates of rollovers as more inactive and multiple accounts are consolidated. This could mean that funds need to maintain higher allocations to liquid assets, at least in the short term, to cover possibly higher, or at least less predictable, outflows. Thus in the short term, higher holdings of liquid assets could mean lower investment returns. On the other hand, as the Draft Report notes, individual members who close or consolidate redundant accounts will realise long term gains. After a transition to the new default structure, one would expect the system as a whole to converge towards a steady rate of account creation, closure and rollover, subject to labour market conditions. Over time, a lower proportion of inactive accounts and longer member tenure with the one fund could allow trustees to manage liquidity for higher long run returns. The same outcomes could also allow trustees to better understand the experiences and preferences of longer-tenured members.

Financial product disclosure and dashboards (Draft Recommendations 9, 10)

We have reservations about the increased role proposed for product dashboards as a decision tool and source of comparable superannuation fund information, and the suggestion to base these on the current MySuper dashboard. Far more work is required by policymakers and regulators to design effective formats. In this context we draw the Commission's attention to our research findings on the design, implementation and effectiveness of several current approaches to financial product disclosure.

In the paper 'Flicking the Switch: Simplifying Disclosures to Improve Retirement Plan Choices' (Thorp et al. 2018), we investigated whether and to what extent the summary fee and returns information on the MySuper dashboard help super fund members compare MySuper products and make competent choices. Using incentivised experiments we found that people respond quickly to fee information but are confused by the returns information. A simplified information disclosure format we designed considerably reduced confusion about returns information. Our findings raise concerns about the effectiveness of the MySuper dashboard as currently designed.

In the paper 'As Easy as Pie: How Retirement Savers use Prescribed Investment Disclosures' (see Bateman et al. 2016a) we examined how super fund members choose investment options using the five information items prescribed by regulators in the short-form product disclosure statement. We found that the asset allocation information presented as a pie chart (or table) had the largest impact on choices. In using this information people preferred options with more and more evenly weighted asset class allocations but used risk and return information in unexpected directions.

Finally, in the paper 'Risk Presentation and Portfolio Choice' (Bateman et al. 2016b) we investigated the extent to which alternative formats for the presentation of investment risk (including the standard risk measure) are associated with 'rational' investment choices. We tested nine different formats for presenting investment risk including textual range formats, probability tail formats, frequency formats (which included the standard risk measure - the expected frequency of a negative annual return in 20 years), and one graphical range format. The standard risk measure – which is mandatory in the short form financial product statement and the MySuper dashboard - was found least likely to lead to 'rational' investment choices.

Key lessons from all three studies is that information contained in prescribed disclosures might not be used in the manner intended, that simplicity *per se* does not necessarily assist consumer decision making and that the current approach to validating information disclosures is inadequate. At the very least the format and information content of 'dashboards' should be carefully pre-tested using quantitative methods to determine 'how' people use the summary information, and whether the information is used as expected by the disclosure architects.

In terms of our response to the Draft Report, we emphasise that the MySuper dashboard model should not be blindly followed in its current format. Furthermore, if dashboards are to be used they should be clearly accessible on a single website (hosted by the government or a government agency – such as the ATO or ASIC) and structured to allow comparison product-by-product and attribute-by-attribute.

Insurance (Draft Recommendations 14-19)

We agree that attention needs to be paid to insurance in superannuation. Super fund members should be aware of the existence of default insurance and be provided with 'guidance' to understand whether, and how much insurance they need.

Choice architecture around insurance should ensure that members who have made active choices relating to their insurance (i.e., opted out, raised or lowered cover) do not have those choices reversed through automatic account consolidation or other automatic processes, at least not without the active consent of the member. Further, members who have not opted out of insurance cover should not be left uncovered by automatic processes. In the event that a member has default cover in one account but has made an active choice in another account, so that settings seem inconsistent, it is not clear how an automatic process can resolve the problem.

In general, insurance is probably the least well understood feature of the superannuation system and we concur with the report that an independent review of insurance in superannuation is warranted.

Superannuation Data Working Group (Draft Recommendation 22)

We agree that a Superannuation Data Working Group be established. Improved fund-level data is essential, but this must be complemented by member data collection. Superannuation funds typically collect little data about their members, yet member-level data can enhance the ability of funds to design 'smart' defaults.

References

Bateman H, J Deetlefs, L I Dobrescu, B R Newell, A Ortmann and S Thorp (2014), 'Just interested or getting involved? An analysis of superannuation attitudes and actions', *Economic Record*, 90(289): 160-178.

Bateman H, I Dobrescu, B Newell, A Ortmann and S Thorp (2016a), 'As easy as pie: How retirement savers use prescribed investment disclosures', *Journal of Economic Behavior and Organization*, 121: 60-76.

Bateman H, C Eckert, J Geweke, J Louviere, S Satchell and S Thorp (2016b), 'Risk Presentation and Portfolio Choice', *Review of Finance*, 20(1): 201-229.

Bateman H, C Eckert, F Iskhakov, J Louviere, S Satchell and S Thorp (2018), 'Individual capability and effort in retirement benefit choice', *Journal of Risk and Insurance*, 85: 483-512. http://dx.doi.org/10.1111/jori.12162.

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Attachments

1. Bateman H, J Deetlefs, L I Dobrescu, B R Newell, A Ortmann and S Thorp (2014), 'Just interested or getting involved? An analysis of superannuation attitudes and actions', *Economic Record*, 90(289): 160-178.
2. Bateman H, I Dobrescu, B Newell, A Ortmann and S Thorp (2016a), 'As easy as pie: How retirement savers use prescribed investment disclosures', *Journal of Economic Behavior and Organization*, 121: 60-76.
3. Bateman H, C Eckert, J Geweke, J Louviere, S Satchell and S Thorp (2016b), 'Risk Presentation and Portfolio Choice', *Review of Finance*, 20(1): 201-229.
4. Bateman H, C Eckert, F Iskhakov, J Louviere, S Satchell and S Thorp (2018), 'Individual capability and effort in retirement benefit choice', *Journal of Risk and Insurance*, 85: 483-512.
5. Fernandes D, J G Lynch Jr, and R G Netemeyer (2014), 'Financial literacy, financial education, and downstream financial behaviors', *Management Science*, 60(8): 1861-1883.
6. Thorp S, H Bateman, I Dobrescu, B Newell and A Ortmann (2018), 'Flicking the Switch: How Prescribed Disclosures Drive Retirement Plan Choice'. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2783113

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