

A competitive superannuation system: will efficiency gains follow?

Written by The Conversation

Will competition in the superannuation system improve efficiency, or is this an ideological argument extended beyond its usefulness? If more competition would promote efficiency, what design and policy issues need to be addressed to accommodate the changes?

The Productivity Commission's [draft report on superannuation's efficiency and competitiveness](#) seeks to address whether increased competition will, in fact, drive efficiency, or whether this proposal is ideologically driven by either a belief in the free market or a desire to weaken the role of the unions in industry superannuation funds.

The Commission confronts this, saying that the role of competition is to drive efficiency, and is not an end in itself. Competition is justified only if it drives funds to become more innovative and efficient. An increase in the number of funds could lead to inefficiencies as smaller, potentially more innovative, funds would not have the economies of scale of bigger funds.

A number of participants in the consultation process made the case that competition may not lead to greater efficiency: the [ACTU raised the concern](#) that competition could weaken the superannuation system, noting failures when other services, specifically technical education, were opened to the market.

Other submissions discussed whether consolidation of the existing range of providers would improve efficiency; [Fiduciary's Friend](#) thought this would detract from innovation, while the [Financial Planning Association](#) and [Financial Services Council](#) thought that competition could incentivise underperforming funds to consolidate with more efficient funds.

Another perverse effect of competition could be to change the investment policies of superannuation trustees. If members were encouraged to switch funds, this could place stress on the liquidity of the fund. If funds retained more investment in liquid assets this would not only flow through to capital markets but would affect the returns of the fund.

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The draft report does make the point that superannuation is a unique environment, so the usual frameworks for assessing efficiency need to take that into account. Specifically, superannuation is an instrument for government policy, and is compulsory. Member disengagement continues to be relatively high, as shown by the number of members who accept the default options both of their fund and of investments within their fund.

Although the introduction of MySuper with the [Stronger Super Reforms](#) was intended to increase efficiency and reduce costs, the behavioural effect could well be to further reduce member engagement with the superannuation system.

Since 2005 most employees have been able to choose their fund, but according to the PC report, about two thirds of employees remain in their default fund and less than one third switch their investment options within their fund. There are also about 20% of employees who are not able to choose a fund other than the default fund nominated in their award or enterprise bargaining agreement (EBA).

This contributes to a large number of agency relationships in the system: the employer acts as an agent for the members when nominating a default fund; there is a fiduciary relationship between the trustees of the fund and the members in respect of managing the fund; and many trustees outsource functions to external service providers.

Given the combination of member disengagement and the agency relationships, competition needs to be considered more broadly than facilitating member choice.

The report also discusses the relationships that arise at the wholesale level, including a range of services provided to the superannuation sector. Insurance is particularly in the spotlight here as many members are entitled to insurance benefits through their superannuation fund.

Superannuation trustees are able to obtain policies at far better rates than most individuals – although [this has been under the spotlight recently](#) as members find exclusions in their policies. The effect of competition in this area could be less efficient than the current system.

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The Productivity Commission sets out a series of objectives for the superannuation system, that sit below the policy objective that the superannuation system is [“to provide income in retirement to substitute or supplement the Age Pension”](#);

. These objectives include:

- Competition that drives efficient outcomes through facilitating rivalry and contestability in supply and demand conditions and allowing suppliers to compete on adding value to members
- Maximising net returns over the long term
- Meeting member preferences and needs over the member’s lifetime
- Providing insurance that meets members needs at the lowest cost
- The Superannuation system complements a stable financial system

The development of these objectives is the first stage: the report goes on to refine the objectives into assessment criteria and indicators.

It is important that the superannuation sector operates efficiently as it is becoming an increasingly important retirement policy instrument and a major component of household wealth. This report has articulated a set of objectives that would strengthen the superannuation system and the faith that members have in their superannuation fund.

Helen Hodgson receives funding from AHURI. Helen is a member of the Tax and Superannuation advisory panel for ACOSS and the Social Policy Committee of NFAW. She is a member of the WISER research group at Curtin Business School. Helen was a member of the WA Legislative Council from 1997 to 2001, elected as an Australian Democrat. She is not currently a member of any political party.

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