Discussion Paper
Strategic planning and member outcomes: Proposed enhancements

Submission

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About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, The Institute is supported by the insights of a high-quality advisory board, whereby each member's involvement is on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Research is generally made open source to create transparency and accountability. The Conexus Institute exists with no commercial relationships. Further information here.

About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio here.

***** The author is willing and able to participate in further consultation. *****

1. Summary and recommendations

APRA's strategic planning and member outcomes assessment is fundamental to a healthy, progressive superannuation system. The existing framework is strong, and we are sure much has been achieved through its introduction.

However, we think it can be further progressed. The change we advocate for most strongly is a fundamental one: funds should be required to self-assess their key capabilities. This progresses the framework from one which ensures minimum standards to one which strives for improved member outcomes.

In this submission we touch on a range of challenges for funds and the associated assessment of outcomes. Most prominent is the incorporation of retirement outcomes. This creates challenges such as ex-ante analysis and the need for more advanced quantification. Hopefully these are viewed as positive opportunities rather than burdensome challenges.

Establishing a framework which directs industry to face into these challenges, while being cognisant of an appropriate timeframe to implement well, is an important balancing act for APRA to achieve.

2. Structure of this submission

Many of the questions posed in the Discussion Paper are directed at a super fund respondent. The author does not work for a super fund.

The author takes the liberty to simply raise the issues considered to be important. The key issue is the concept of self-assessment of key capabilities. We then progress through a range of related and distinct topic areas where we thought it useful to share our views.

2.1. Self-assessment of key capabilities should be fundamental to member outcomes assessment

Our view is that an assessment of capabilities is paramount to any assessment of a fund's strategic planning and member outcomes. It should consider all areas relevant to the delivery of member outcomes. The priority here should be on areas that have direct impact on member outcomes, so investments, retirement, advice and guidance are highly relevant.

To acknowledge this we propose that Figure 1, lifted from the Discussion Paper could be re-framed as per Figure 2.

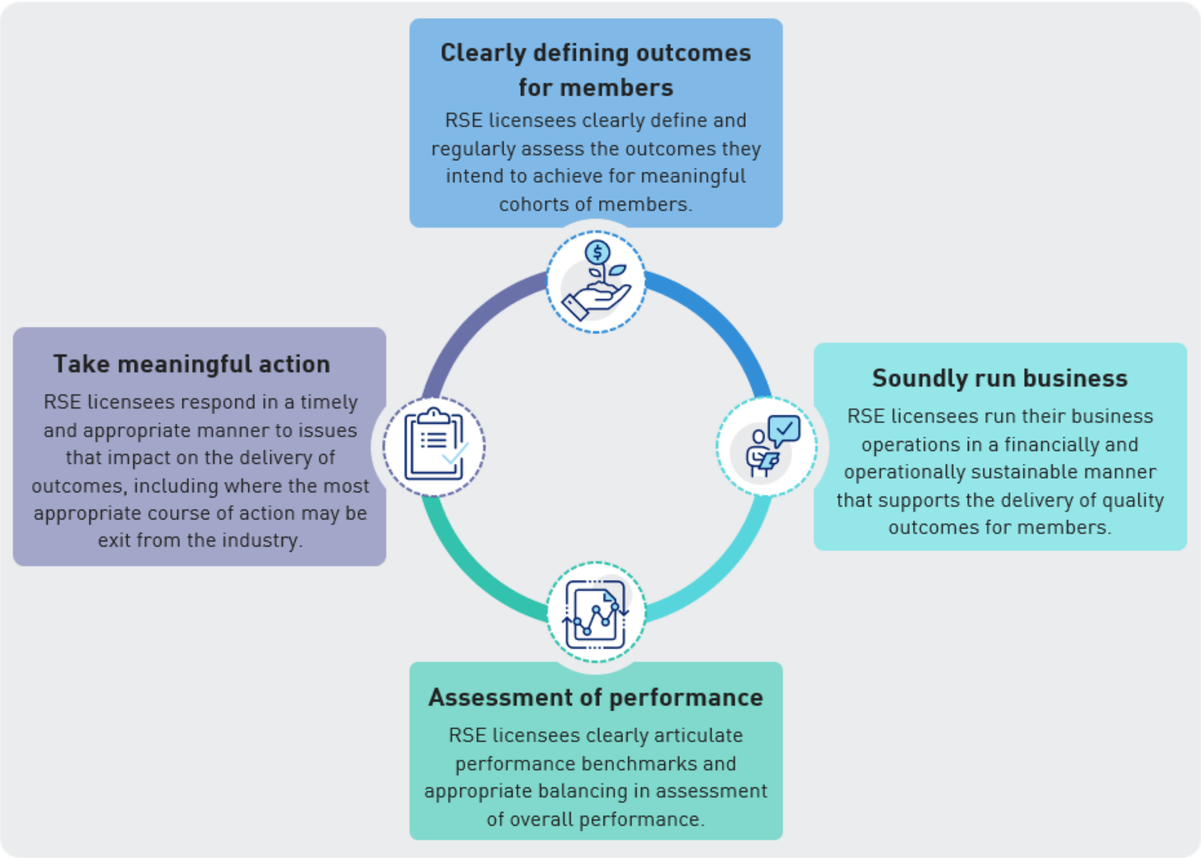

Figure 1: APRA's focus on four key actions that drive RSE licensee decision-making and delivery of outcomes for members.

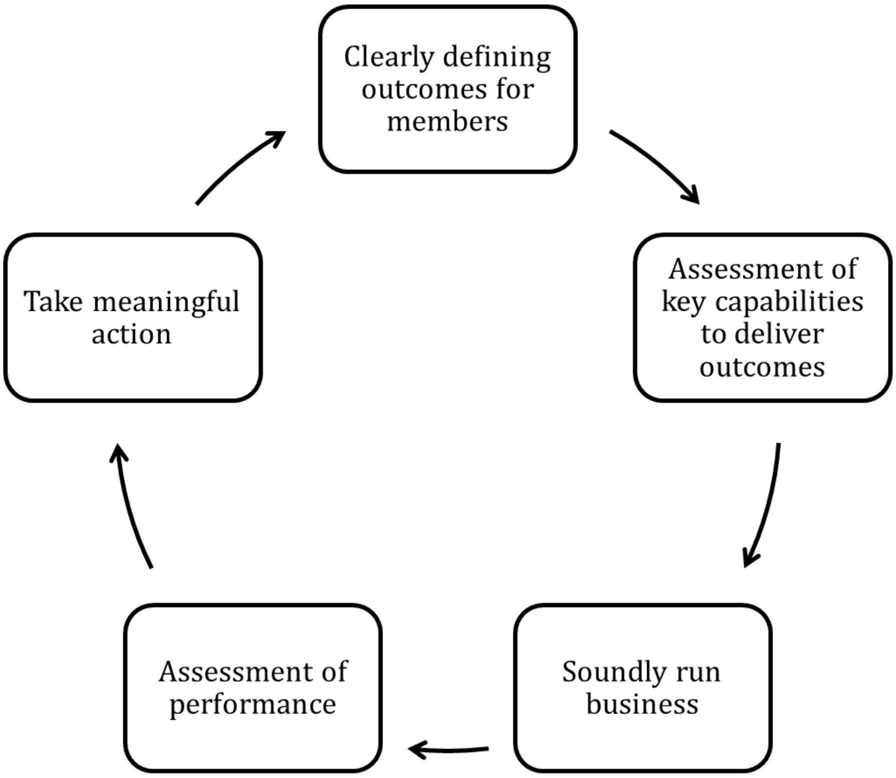

Figure 2: Alternative framing: five key actions that drive RSE licensee decision-making and delivery of outcomes for members.

We make the following reflections in comparing the frameworks proposed in Figure’s 1 & 2:

1. Simple examples which could populate the assessment of key capabilities:
    a. Investment capability: very strong capability in private assets, the development of internal asset allocation frameworks, the healthy portfolio tension created by being able to implement directly and via external managers.
    b. Retirement: leading collection of retirement modelling experts, product offering in this space.
    c. Advice and guidance: sizable advice service offering, leading provider of digital assistance tools integrated with a concierge service.

    There would need to be an acknowledgement that key capabilities in areas such as investments is subjective. But the foundations for any positive self-assessment should be documentable (e.g. philosophy, process, people, systems etc.).

2. As it stands (Figure 1) there is little at the fund level to promote innovation, identification and creation of key capabilities. Aggregating this to a system level can result in a system with little innovation.

3. When it comes to key capabilities, assessment should acknowledge strengths and weaknesses.

4. The assessment of key capabilities needs to be undertaken on both an absolute and relative basis. It should be incumbent upon funds to identify if their offering is inferior to the outcomes which could be delivered by other funds. The combination of this assessment step alongside the absolute assessment creates a strong accountability framework.

5. Best practice assessment of key capabilities would entail estimating the net benefits to members of each key area of activity. Quantification of estimated benefits allows an overall fund-level assessment.

6. Assessment of key capabilities forces funds to think ex ante (forward-looking). Otherwise funds can rest on the laurels of past performance and are vulnerable to confirmation bias. This is discussed further in (2.2).

7. The assessment of key capabilities needs to account for issues of fund sustainability. For example, consider a fund which identifies its investment capabilities in unlisted assets as a strategic advantage. If the fund is in net outflow then the value of that advantage is diminished.

8. We contend that the minimum standard created by being a soundly run business needs to be lifted. By introducing assessment of key capabilities the industry is directed to focus on improving outcomes to members in a competitive environment. The aggregate insight would provide APRA with the basis for feedback where no strength in key capabilities exist. This feedback process is framed in Figure 3.

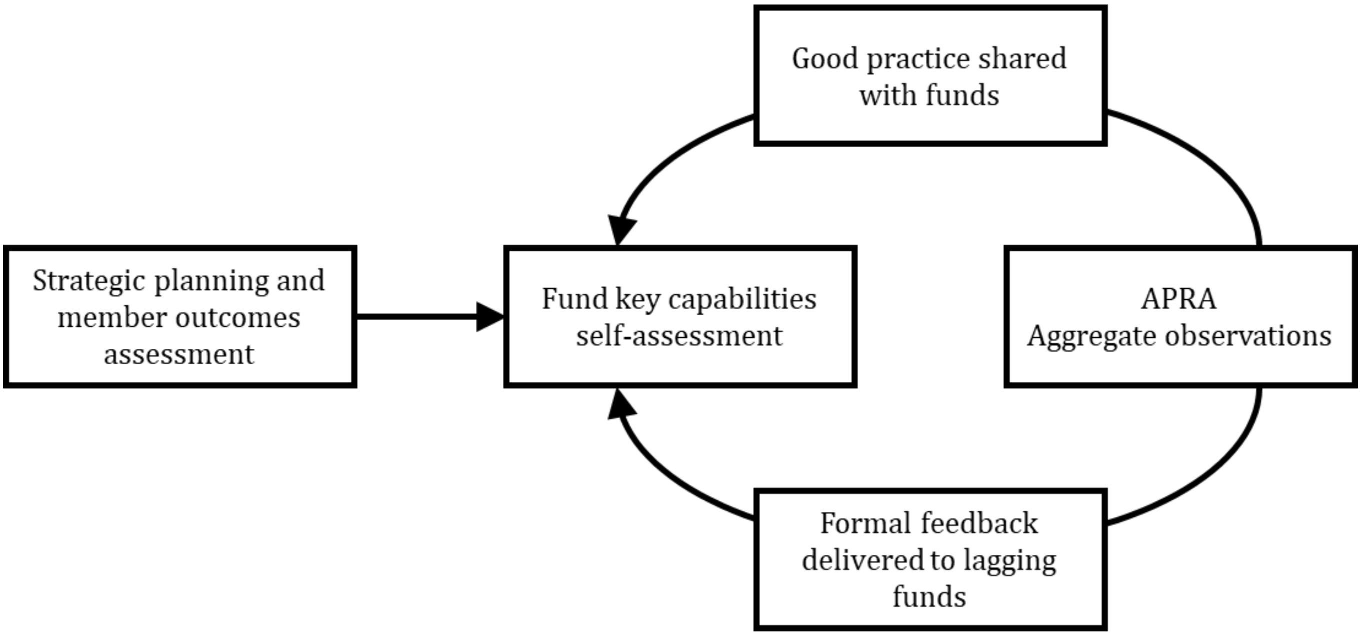

Figure 3: Multiple ways that the strategic planning and member outcomes assessment can be used to improve fund and industry-level outcomes.

2.2. Ex-ante assessment needs to be more prominent

We believe that ex-ante (or forward-looking) assessment needs to be more prominent in the outcomes assessment framework. It better aligns with the challenge of delivering good future outcomes.

The need for greater ex-ante assessment is most relevant in areas such as retirement. Our recent research on the topic of assessing retirement income strategies[1] made the point that in retirement there will be limited ability to undertake meaningful ex-post analysis. In other areas such as investment, over-reliance on ex-post analysis can result in confirmation bias.

There is a risk that the framework provided in Figure 1 fails to sufficiently encourage funds to assess on an ex ante basis, and instead weighs too heavily on ex-post analysis. The additional consideration incorporated into Figure 2, assessment of key capabilities, provides the topic area where ex-ante analysis has strong resonance.

2.3. Industry a long way from best practice when it comes to quantification of member outcomes assessment

We have concerns that the industry in aggregate is weak at considering member outcomes in an advanced manner. What defines 'advanced'? Our thoughts are summarised in Figure 4.

[1] "*Assessing retirement income strategies… when outcomes are but a promise*" by Geoff Warren (ANU) and David Bell.

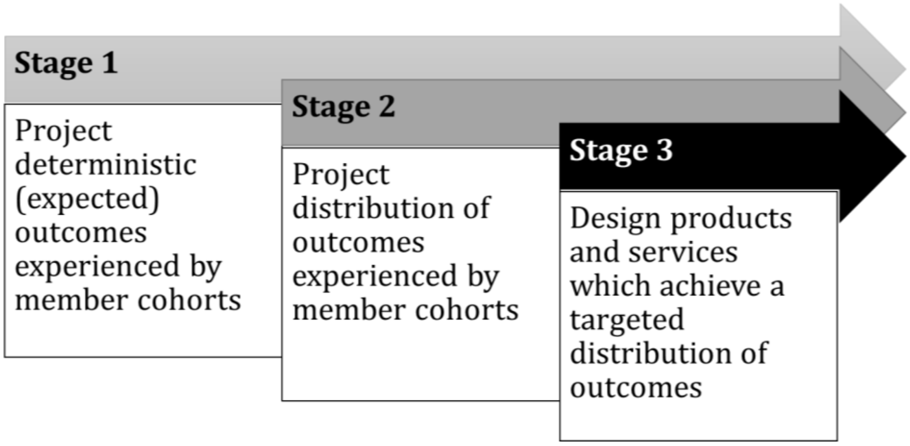

Figure 4: Advancement stages in member outcomes assessment.

We consider that a threshold minimum standard (Stage 1 in Figure 4) would be the projected deterministic (expected) outcomes experienced by member cohorts. We have seen some funds undertaking this type of assessment, similar to what was undertaken by the Productivity Commission in its analysis[2].

More advanced metrics, which we advocate that the industry needs to reach (Stage 2), include the distribution of outcomes experienced by member cohorts. We have seen little of this style of analysis.

The next progression is for trustees to design products and services which achieve a targeted distribution of outcomes (represented by Stage 3 in Figure 4) based on an informed trade-off between expected outcomes and the range of outcomes. There are only limited positive developments in this space. Funds need to reach this level of analytical capability to determine the appropriate accumulation default design (lifecycle versus constant risk approaches, where we think analysis could definitely be improved) and retirement income strategies.

It is worth noting that quantitative assessment of retirement income strategies is far more difficult. There are many reasons including the basis (balance versus income), drivers and risks. Further detail is provided in Appendix 1. However, we would also say that any fund which hasn't reached Stage 3 in Figure 4 will struggle to meet the challenges of high quality retirement income strategy design.

So while it is understandable that the journey to high quality ongoing assessment in the retirement phase will be a slow one, we consider that funds should be well-formed on the assessment of accumulation. This is an area where we encourage APRA to consider being more prescriptive around expectations, perhaps in the form of a good practice guide.

2.4. Whole-of-life outcomes difficult to assess

The Retirement Income Covenant and first round of retirement income strategies strongly progresses the focus on post-accumulation outcomes. Unfortunately, for understandable reasons of complexity, the quantification of retirement outcomes is lagging, despite attempts to introduce

[2] "*Superannuation: Assessing Efficiency and Competitiveness - Inquiry report*", Productivity Commission.

some advanced standardised metrics[3]. It is a difficult topic area and we forecast it will evolve very slowly.

This has ramifications for the assessment of member outcomes. Our broad understanding is that APRA would like funds to present whole-of-life retirement outcomes in their member assessments, thereby negating the need for a separate retirement outcomes assessment to accompany the Retirement Income Covenant. Funds face numerous difficulties addressing this challenge, including:

1. The general quantification challenge associated with assessing retirement income strategies is difficult. We explored this in recent work[4] and our conclusion was to recommend both qualitative and quantitative frameworks. Here, we left the quantitative framework largely undefined, in recognition that it is a difficult and subjective area where there is much more work to be done.

2. Industry feedback that accumulation and retirement cohorts don't match up well.

3. The greater weighting placed on the benefits of services (such as advice and guidance) relative to products in retirement phase. This compares with largely product-based outcomes in accumulation due to default settings (though not entirely, given our subsequent comments in (2.5)).

For these reasons we think it will take a lengthy period before the industry starts to produce a quality whole-of-life member outcomes assessment.

Further, the existence of the second point, cohorts not matching up well between accumulation and retirement, means that quantitative assessment of whole-of-life outcomes is more difficult than quantitative assessment of retirement income strategies. APRA should consider whether whole-of-life assessment is too difficult in the near term, thereby risking the slowing down of the quantitative assessment of retirement income strategies. Two possible solutions to this challenge are:

1. Requiring standalone assessment of retirement income strategies, perhaps in a separate framework.

2. Requiring funds to, as an interim measure, account for accumulation and retirement outcomes separately within the strategic planning and member outcomes framework. Funds could be encouraged to make an attempt to connect the two areas into a whole-of-life outcome. Over time, perhaps five years, whole-of-life could become the standard approach.

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[3] For instance *"MDUF – Member's default utility function"* – working group.
[4] Again, *"Assessing retirement income strategies… when outcomes are but a promise"* by Geoff Warren (ANU) and David Bell.

2.5. The challenge of incorporating engagement and behavioural elements into MOA

Industry is increasingly aware of behavioural and engagement-based impacts on member outcomes.

Member switching is a good example, where research[5] supports these concerns. Another example relates to member engagement and insurance selection.

We believe that, at some point in the future, leading practice will be to incorporate behavioural considerations into the assessment of member outcomes. This will likely be led by a small number of more advanced funds. A simple example could be the incorporation of member switching into member outcomes, accounting for the offset provided by specific member engagement and education activities.

A concern is that this type of analysis provides funds an opportunity to obfuscate their assessment. By being well-prepared, perhaps by engaging with experts in this area, APRA has the opportunity to welcome (and perhaps encourage) the incorporation of behavioural considerations and to ensure they are incorporated in a robust manner.

2.6. Acknowledgement of member inequities

We previously raised this issue in our submission on SPS 530 Investment Governance.

Trustees undertake many activities which create member inequities. Examples include cross-subsidisation activities (in areas like insurance and member fees) and investment strategy / product design issues (e.g. member liquidity mechanisms in funds which invest into illiquid assets).

We believe that many funds don't have formal frameworks for assessing member inequities. We believe trustee accountability needs to be improved in this area, but that a prompt may be required. Addressing this area would require a combination of subjective and objective techniques.

2.7. Organic growth projections

We consider the net inflow position of a fund to be an important competitive edge. It informs both investment (e.g. scale opportunities and illiquid asset budget) and corporate (e.g. capital for new initiatives) opportunities.

As such, we think funds should provide good detail on the breakdown of their net inflow projections. This is one area where APRA could possibly be more explicit (potentially via a template in a practice guide). By requiring funds to attribute the assumptions underpinning their projections, it would provide APRA an aggregated dataset which could be compared against a

[5] For instance *"Portfolio choice for retirement savings: The impact of market volatility during the COVID-19 pandemic"* by Shang Wu (Aware Super).

sensible forecast of system growth. This analysis would provide a good opportunity to sense-check the assumptions of funds and ensure sustainability analysis is realistic.

2.8. Retention vs expenditure

We remain sceptical of the system-level benefits of brand and advertising activities on member outcomes. This is linked to a broader concern we have around retirement where we suspect that the dominant form of competition will be based on brand and not merit.

Given the potential for future industry spend on brand and advertising to be higher it could be a valuable insight for APRA if funds were required to formalise the link between brand and advertising activities with member outcomes.

As per the discussion on organic growth expectations (2.7) we suspect there would be benefit to APRA if key assumptions were captured via a template. This would enable APRA to aggregate individual assumptions, compare this against a sensible aggregate industry assumption, and challenge the assumptions of individual funds.

Appendix 1 - Comparing features in strategy assessments

Feature	Accumulation	Retirement
Objective	• Maximise balance at retirement, subject to managing investment risk	• Maximise expected income • Manage income risks (investment, longevity, inflation, other) • Provide flexible access to funds
Focus of assessment	• Accumulated account balance	• Income stream over retirement
Primary driver of outcomes	• Investment returns	• Investment returns • Drawdown decisions • Longevity protection • Mortality outcomes
Primary risks to manage	• Poor real returns	• Poor real returns • Sequencing risk • Drawdown and mortality synchronisation, i.e. outliving savings *vs.* dying with unused assets • Inflation (cost of living) risk
Accounting for member differences in assessments	• Evaluating returns# reveals bulk of the story	• Large differences across retired members and thus objectives require tailored assessments
Relevance of providing assistance to members	• Default arrangements plus choice framework means this assessment piece is not essential	• Guidance and advice mechanisms required are expected under the RIC, and impact on member outcomes
Outcome assessment	• Ex post assessment feasible (providing representative return history is available)	• Ex ante assessments unavoidable, given ex post assessment infeasible as income delivered over decades