Strategic and transfer planning: enhancing member outcomes

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](#).

About Geoff Warren

Dr Geoff Warren is an Associate Professor at the Australian National University and Research Director with the Consensus Institute, as well as a member of various investment and research advisory boards. Warren's research focuses on investment-related areas specially including superannuation and retirement, and is widely published in leading journals. He has a prior career in the investment industry spanning over 20 years. Full bio [here](#).

***** The authors are willing and able to participate in further consultation. *****

1. Summary and recommendations

We fully support APRA's efforts to enhance member outcomes assessment. In this submission, we comment on a small number of the areas detailed in the Discussion Paper, which also focuses on some nuanced sub-topics where we have little to add. On the areas where we do offer comments, we are generally supportive of the proposed changes.

We view member outcomes assessment as one of the most important policy tools at APRA's disposal. It is also an extremely difficult area. We believe that aspirations for what member outcomes assessment can achieve should be set higher, which motivates a number of our recommendations as summarised below:

1. *Self-assessment of key capabilities* should be a fundamental component of the member outcomes assessment framework.
2. Superannuation funds need to be encouraged to develop capabilities for *ex ante assessment* and quantitative *projection of member outcomes*.
3. *Separate assessment of member outcomes of accumulation and retirement phases* should be permitted, if not required. Whole-of-life outcomes are difficult to assess, and do not gel with a policy framework and industry practice that largely treats the two phases separately.
4. Acknowledgement of *member inequities* should be a component of the member outcomes assessment framework.
5. More explicit requirements could be created around *projection of flows* and *member retention expenditures.*

1.1. Structure of this submission

This submission is structured along two lines in two sections:

Section 2: Addresses specific issues raised by the APRA in the discussion paper.

Section 3: Revisits some issues raised by Conexus Institute in its submission (here, 18 November 2022) in response to APRA's consultation: "Strategic planning and member outcomes: Proposed enhancements".

2. Specific areas raised by APRA

2.1. Strategic objectives and member outcomes

We note that *"APRA proposes to embed review findings into the SPS 515 framework to ensure an appropriate focus is placed on the needs of retired members and members approaching retirement. The updates include amendments to SPS 515 to require an RSE licensee to consider the retirement income strategy when developing strategic objectives."*

While we support these updates by APRA, we hold the view that it is important to incorporate explicit requirements when integrating retirement into the member outcomes assessment framework. Our concern is that a self-assessment process with no explicit requirements will not represent an effective baseline to underpin the assessment of retirement income strategies. We acknowledge that it is a difficult task to develop explicit requirements, and these would likely need to be evolved (in subsequent reviews of the SPS 515 framework) as leading examples of retirement assessment practices are developed by industry. We discuss the concept of baseline standards for outcomes assessment in (2.2) while some specific issues related to retirement are explored in Section (3).

2.2. Annual outcomes assessment

With regard to the annual outcomes assessment, industry feedback has requested greater alignment and integration between the annual outcomes assessment, the annual performance test, and other metrics by which to assess performance. We note that *"APRA acknowledges this feedback and proposes to revise the annual outcomes performance test requirements and guidance to clarify the interaction between, and consideration of, metrics to assess performance."*

We have reviewed outcome assessments published on some superannuation fund websites, while acknowledging that these may be simplified versions of more comprehensive assessments to protect proprietary information. Our impression is that these are generally modest in terms of the depth and breadth of self-assessment.

We believe APRA needs to take strong steps to raise industry practice. Some form of minimum standards of what should be included in fund assessments would be beneficial in this regard. Showcasing 'best practice' assessment methods to industry should also improve outcomes assessment over time by establishing benchmarks of excellence and invoking competitive instincts. The multiple ways that benefits accrue from a strong and effective member outcomes assessment is outlined in Figure 1.

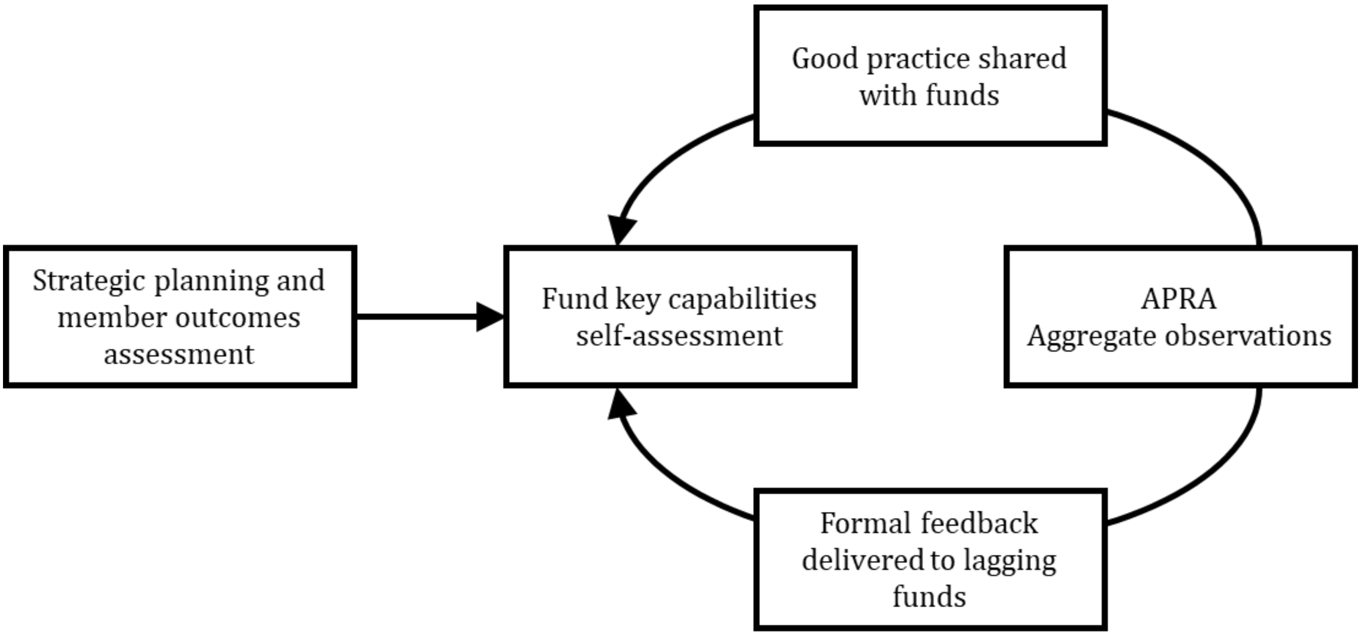

Figure 1: Multiple ways that the strategic planning and member outcomes assessment can be used to improve fund and industry-level outcomes.

Finally, as in (2.1) we acknowledge the challenge of incorporating retirement into the annual outcomes assessment, albeit critical given this is the key regulatory tool for assessment. We address some of the associated issues in (3).

3. Specific issues not addressed by APRA

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

Our view remains that an *assessment of capabilities* is paramount to any assessment of a fund's strategic planning and member outcomes. All areas relevant to the delivery of member outcomes should be considered. The priority should be on areas that have the most sizable direct impact on member outcomes.

To acknowledge this we suggest that Figure 2, lifted from APRA's August 2022 Discussion Paper "Strategic planning and member outcomes: Proposed enhancements" be re-framed along the lines of Figure 3.

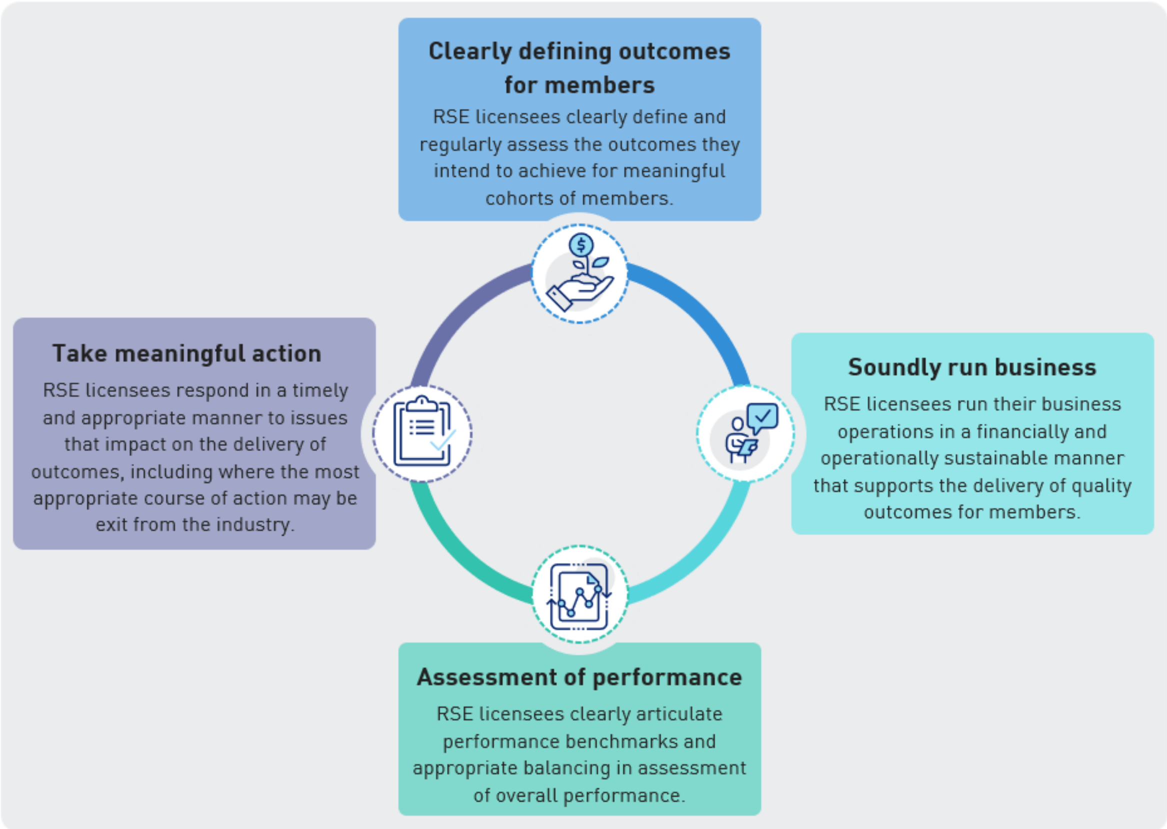

Figure 2: The APRA's focus on four key actions that drive RSE licensee decision-making and delivery of outcomes for members.

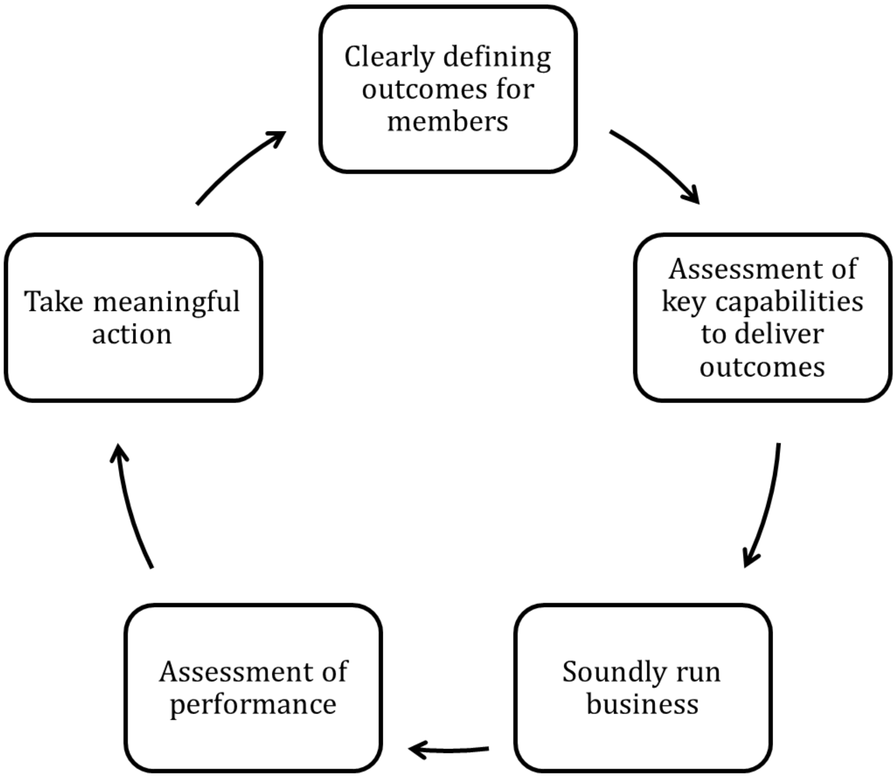

Figure 3: Alternative framing: five key actions that drive RSE licensee decision-making and delivery of outcomes for members.

We make the following reflections in comparing the frameworks proposed in Figures 2 and 3:

1. Outcomes assessment should extend beyond being a soundly run business. 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, as framed in Figure 1.

2. The assessment of key capabilities in Figure 3 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 aligned to member outcomes.

3. Assessment of key capabilities requires an ex ante (forward-looking) assessment lens. This is expanded upon in (3.2).

3.2. Ex-ante assessment needs to be more prominent

We advocate that ex-ante (or forward-looking) assessment needs to be more prominent in the outcomes assessment framework. Ex ante assessment better aligns with the challenge and key goal of delivering good outcomes for members in the future.

The need for greater ex-ante assessment is most relevant in retirement. Our research on the topic of assessing retirement income strategies[1] makes the point that there is limited scope to undertake meaningful ex-post analysis in retirement, in a large part because outcomes are delivered in the form of income streams over long horizons. In other areas such as investment during accumulation, an over-reliance on ex-post analysis can result in unhelpful behaviours such as confirmation bias, managing to benchmarks, and short-termism.

There is a risk that the framework provided in Figure 2 provides insufficient encouragement for funds to assess on an ex-ante basis, and instead weighs too heavily on ex-post analysis. The additional consideration incorporated into Figure 3 – assessment of key capabilities – covers an area where ex-ante analysis has strong resonance.

3.3. 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 not sufficiently advanced in establishing in quantitative terms how their products and services may impact on member outcomes. Figure 4 summarises three different stages of assessment, with Stage 3 being the most advanced.

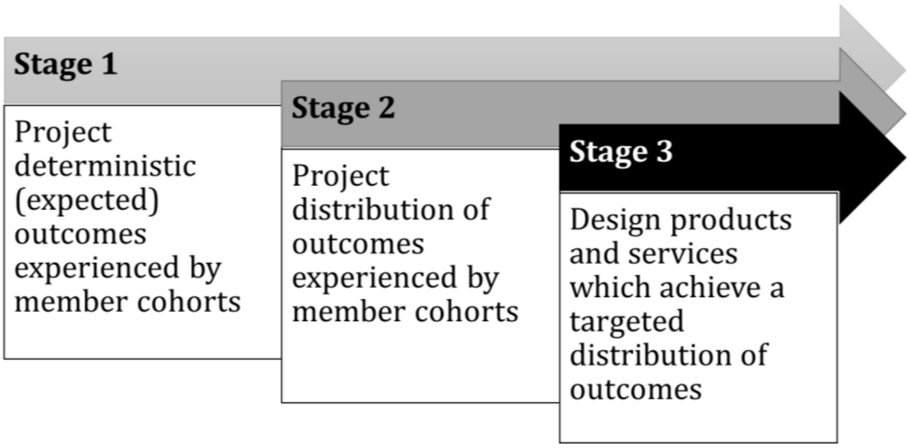

Figure 4: Advancement stages in member outcomes assessment.

In Figure 4, Stage 1 entails basing assessments on projecting deterministic (expected) outcomes experienced by member cohorts. To us, this represents a threshold minimum standard. We have seen some funds undertaking this type of assessment, which is similar to that undertaken by the Productivity Commission in its analysis.[2]

Stage 2 entails more advanced metrics that capture the distribution of outcomes experienced by member cohorts. We advocate that the industry needs to reach this level in order to account for dispersion in member outcomes and hence risk. However, we have seen only limited use of this style of analysis in the industry.

Stage 3 involves trustees designing products, services, and solutions towards delivering a targeted distribution of outcomes, while making informed trade-offs between expected outcomes

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[1] "*Assessing retirement income strategies… when outcomes are but a promise*", December 2022.
[2] "*Superannuation: Assessing Efficiency and Competitiveness - Inquiry report*", Productivity Commission.

and the range of outcomes. There has been limited development in this space. While this level of analytical capability would help determine appropriate designs in accumulation (e.g. improve analysis of lifecycle versus constant risk approaches), it is crucial for development of retirement income strategies. Here the ability to work towards a targeted distribution of outcomes becomes more important due to the need to manage income risk and to cater for significant member differences. Funds that fail to reach Stage 3 will struggle to deliver retirement income strategies to an appropriate quality.

We encourage APRA to consider being more prescriptive around expectations around quantitative assessment methods. Direction might be given in the form of a 'good practice' guide.

3.4. Separate assessment of retirement and accumulation preferable over focus on whole-of-life outcomes

Our broad understanding is that APRA would like funds to present whole-of-life outcomes in their member outcomes assessment. We see a strong case for requiring separate retirement outcomes assessments for accumulation and retirement, with the latter accompanying the Retirement Income Covenant (RIC). We consider it important that funds have well-formed and fit-for-purpose assessment methods that can cover retirement as well as accumulation, before potentially progressing to whole-of-life outcomes assessment at a later time.

The RIC and associated creation of retirement income strategies has sparked a deeper focus on the post-accumulation phase. This focus was further heightened by the APRA / ASIC (2023) joint thematic review "Implementation of the retirement income covenant". Design and assessment of retirement income strategies and the associated retirement solutions offered to members have numerous key points of distinction versus the delivery of investment options in accumulation. Retirement income strategies are far more complex. Key differentiating factors relate to outcomes being largely defined by delivery of income rather than by return generation, and the presence of a broader range of underlying drivers of outcomes and risks to consider, e.g. longevity risk. These complexities contribute to large lags in the development of assessment methods for retirement outcomes, which are likely to evolve very slowly.

Some of the more notable challenges in conducting member outcomes assessment in retirement, and creating the need for dedicated assessment, include the following:

1. Quantifying outcomes from retirement income strategies is quite difficult, in a large part because income is delivered over long horizons as noted in (3.2). We have recommended both qualitative and quantitative frameworks[3], and expanded on how the quantitative assessment might be implemented in a second paper.[4] We believe these two papers provide direction on how member outcomes assessment for retirement could be framed.

2. A greater weighting needs to be placed on the benefit of services (such as advice and guidance) and solution design relative to products in retirement, relative to accumulation where investment options are central. While outcomes generated by accumulation

[3] "*Assessing retirement income strategies… when outcomes are but a promise*", December 2022.
[4] "*How to Approach Quantitative Assessment of Retirement Income Strategies*", June 2023.

products can be measured in terms of accumulated wealth or returns, retirement assessment needs to focus on the outcomes arising from the overall solutions.

3. Catering for member differences is an important feature of the retirement phase, while the primary concern for all members in accumulation is return generation. This complicates retirement assessment, which should evaluate how well trustees are meeting differing member needs and wants.
4. Industry feedback suggests that accumulation and retirement cohorts do not match up well. We have also obtained anecdotal comments that cohorting is proving difficult in the retirement phase; while there is evidence that funds are using different approaches. Challenges in defining consistent cohorts makes assessment of whole-of-life outcomes more difficult than separately assessing retirement and accumulation. Indeed, this point alone suggests that whole-of-life assessment may be too difficult in the near term, and would risk slowing down the development of assessment of retirement income strategies.

Another issue that supports separate assessment is the differing policy frameworks that apply to accumulation and retirement. For example, MySuper defaults are dominant in accumulation, whereas retirement operates under member choice. Trustee obligations in the retirement phase are governed by the RIC, with no comparable legislation in accumulation. The Age Pension and other forms of social security are important features in retirement, and tax status differs between the two phases. Retirement and accumulation accounts are also legally separate entities, meaning that there is a lack of natural continuity between the two phases.

For these reasons, funds should be permitted – if not required – to account for accumulation and retirement outcomes separately within the strategic planning and member outcomes assessment framework. While funds might be encouraged to attempt connecting the two phases into whole-of-life outcomes, a whole-of-life lens should not be established as the underlying basis of member outcomes assessment at the present time. Separate assessment would provide room for funds to understand and establish their retirement outcomes assessment, and recognises that it will take a lengthy period before the industry could produce a quality whole-of-life member outcomes assessment. Whole-of-life assessment might be reconsidered for establishment as the standard approach at a later date, e.g. perhaps in three-five years.

3.5. Acknowledgement of member inequities

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

Trustees undertake many activities that create member inequities. Examples include cross-subsidisation in areas like insurance and member fees, and investment strategy or product design features such as member liquidity mechanisms for funds that invest in illiquid assets.

Trustee accountability could be improved in this area. We understand that many funds do not have any formal framework for assessing member inequities. A prompt from APRA may be required to ensure that trustees have established frameworks for acknowledging and managing the member inequities within their business activities. Addressing this area would require a combination of subjective and objective techniques.

3.6. Organic growth projections

We consider the net inflow position of a fund to be an important feature of their competitive position. Analysis of flows can inform both investment activities such as scale opportunities and illiquid asset budgets, and corporate strategy such as capital required for new initiatives. As such, funds should compile and provide detailed net inflow projections.

APRA could be more explicit in what is required in these areas, potentially via a template presented in a practice guide. Requiring funds to provide their flow projections, along with the underlying assumptions, would also provide APRA an aggregated dataset that could be compared against a forecast of system growth. This analysis would provide a good opportunity for APRA to sense-check and challenge the assumptions of funds and ensure sustainability analysis is realistic.

3.7. Retention expenditures

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 rather than merit of products, solutions and services being offered.

Given the potential for higher future industry spend on brand and advertising, requiring funds to formalise the link between brand and advertising activities with member outcomes could be a valuable insight for APRA. As per the discussion on organic growth expectations (3.6), we suspect there would be benefit in capturing projections and key assumptions 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.