Submission to the Financial System Inquiry

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Executive Summary

This submission concerns the responsiveness of superannuation trustees in meeting the evolving needs of members within the context of highly complex and dynamic financial markets. To the extent that the retirement planning needs of members are not being met effectively, so too the achievement of the government's retirement income policies will be compromised. Further examination needs to be given to factors that are inhibiting the superannuation industry from better servicing the life cycle needs of members in planning for their retirement.

The typical investment approach adopted for superannuation funds involves investing to a certain asset allocation rather than pursuing a target return.[1] While this approach pervades the industry, it has serious limitations in an environment where the majority of superannuation members are not actively involved in managing their superannuation. The pathway of investment returns has a significant affect on members' retirement income levels even where average returns are consistent with the fund's objectives. Downside volatility towards the end of a member's working life can have severe consequences on terminal wealth in view of the greater size of the member's account balance and the limited working life remaining to recoup any losses. Simple approaches that reduce members' risk exposures as they near retirement are also defective given the episodic nature of asset class returns. This highlights the need for a greater degree of customization, if not individual tailoring, in the development of investment strategies for members.

Many superannuation trustee boards are responding to this issue in varying degrees. Responses range from providing education and tools to allow members to develop their own retirement plan; through to providing a highly customized set of investment

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[1] Members choose among a menu of investment options each corresponding to a certain mix of assets. A default option, now called MySuper, is offered by each fund where member do not make an explicit investment choice.

strategies for different member cohorts.[2] Such developments provide encouraging signs. Nonetheless, the speed of evolution of investment options since the superannuation system was established in 1992 gives cause for concern about the pace of innovation in this core area. This lack of responsiveness can be attributed to a host of factors including insufficient competitive pressure and regulatory change fatigue. An important contributing factor, as discussed in this Submission, is the reliance placed within the industry on investment returns as the predominant performance evaluation measure. This submission argues that a focus on investment returns has only served to buttress a system of investment options that were not serving the interests of member well and has impeded innovation in finding better approaches. This submission argues for the adoption of a broader system of performance evaluation for superannuation funds that takes into account forward indicators of performance measurement. It also calls for improved disclosure by superannuation funds on their performance against such a broader range of measures. Such action would enable the monitoring of progress on a cross fund comparative basis that would serve to motivate trustee boards to be more responsive in customizing products and services for their members. In due course, as the market develops, it could be expected that the duty of the trustee would be interpreted to cover the identification of an investment strategy suitable for individual members.

1. Introduction

Since the introduction of a compulsory pension system in 1992, the Australian pension industry has grown rapidly and now represents the world's fourth largest pension pool. Australia's superannuation assets at $1.6 trillion in 2012 represent 101% of GDP, with projections to reach 120% of GDP by 2025[3]. The superannuation industry is highly complex and its activities have repercussions throughout the economy. Employees and self-funded retirees have a vested interest in the performance of their superannuation as it provides a critical means of financial support during retirement. The government provides substantial tax expenditures for superannuation savings to meet the public policy goal of providing adequate savings for retirement. The reliance on the private

[2] QSuper as reported on 31 March 2014.
[3] Commonwealth Treasury.

sector to deliver an important public policy goal raises the question of whether the superannuation system is able to effectively accomplish these goals.

Many superannuation fund members do not play an active part in the management of their own retirement savings.[4] Their ability to do so is thwarted by a number of factors including, the wide investment options on offer, inadequate financial disclosure, complex taxation and transfer systems; behavioural factors and informational asymmetry (Sy 2011) (Coleman, Esho et al. 2006) (Mitchell, Mottola et al. 2006). All these features negate the possibility that competition among superannuation funds for members, and the ability of members to transfer their superannuation from poorly performing funds to better performing funds, will serve as effective disciplines on fund performance. The absence of effective market disciplines increases the onus on effective internal governance through board of trustee oversight. The superannuation governance framework places central responsibility for the prudent management of funds on the trustee. For this reason it is appropriate that the effectiveness with which trustees undertake their responsibilities, particularly the efficiency with which they allocate capital, should be subjected to scrutiny.

Concerns have been raised about the approaches taken by superannuation trustees in managing the funds within their care and the degree to which these approaches are effective in achieving the objectives underlying the superannuation system. In particular this submission discusses limitations associated with the design and delivery of superannuation investment choices as the primary mechanism for providing savings for retirement. It further makes suggestions in relation to the ideal retirement planning system and makes recommendations on how to stimulate innovation in retirement savings design and delivery that is closer to this ideal.

This submission is outlined as follows: Section 2 contextualizes the submission by outlining the factors that inhibit the effectiveness of competition in acting as a market discipline and that provide the rationale for policy scrutiny of the industry. Section 3 discusses the effectiveness of the design and delivery of superannuation investments to members raising issues of particular concern. Section 4 identifies a straying from the

[4] Self managed superannuation fund trustees are highly involved in the management of their superannuation. They are not included in this discussion of members or this research.

fundamental purpose of superannuation and discusses the need to refocus on the underlying objectives of superannuation. Section 5 argues for a more holistic performance measurement approach coupled with an enhanced disclosure regime. Section 8 provides concluding remarks and recommendations.

2. Competition and governance in the superannuation system

The Australian Superannuation system was founded on the assumption that market competition would deliver economic efficiency in a largely private defined contribution system. The system has been based on a market-orientated approach that relied primarily on competition to efficiently deliver products with a range of risk- return characteristics from which investors could choose to suit their own circumstances. For comparable products, people would switch from high-cost to low-cost products, thus exerting a downward pressure on the overall cost of the superannuation system.

This ideal however hasn't necessarily played out as effectively as envisaged. The majority of superannuation members do not play an active part in managing their superannuation. Legislation was enacted by the government in 2005 in part to facilitate investor choice of superannuation funds and to enhance market competition. Since *Choice* was enacted, there was a decline in switching rates between funds from about 6% in 2005 to 2% by the end of 2009 (Sy 2011).[5] Superannuation fund members seemed to be less active in making choices, rather than more active as was expected. The vast majority of members did not change their investment strategy either before or during the extreme market volatility of 2007-8. Only 5-7% of members in the sample made a choice and they all reduced their exposure to risk assets. [6] In consolidated terms, the majority of members who made a change, reduced their risk exposure and did so just as the market reached its trough (65%) with only 35% making a change during the pre global financial crisis period (Gerrans), 2010). Recurrent episodes of market crises have thus reinforced concerns

[5] The estimated overall fees for the superannuation system as a percentage of total assets averaged 1.37% in 2002, 1.30% in 2004, 1.26% in 2006, and 1.21% in 2008 (Rice Warner, 2005, 2007, and 2008).[8] For some retail master trusts, the fee actually increased from 1.67% in 2006 to 1.69% in 2008 (Chant West, 2008).

[6] Of this group:

- 25% made a change during the pre GFC period
- 60% in the GFC period
- 15% both periods

about the ability of the average defined contribution plan participant to deal with volatile investment environments.

A number of factors have been identified to explain the apparent difficulties that superannuation members face in managing their superannuation. These factors include:

- Product complexity - Pension products are not easily understood without a high level of financial literacy and errors in choices are often not recognized for many years. Superannuation therefore provides limited scope for timely consumer learning while the probability and impact of wrong choices are significant (Sy 2011).
- Excessive choice – there are over 200 public-offer funds, 20,000 investment options and many intermediaries involved in superannuation. Behavioral economics suggests that market competition is ineffective when investors are rationally bounded by complex choices (Sy 2011).
- Information asymmetry – In numerous surveys, consumers have lamented the lack of accessible and comprehensive information (Sy 2011). Information is either distorted or lost through multiple transmissions between the many service providers.

Thus, a number of institutional and behavioural factors inhibit a large proportion of members from playing an active role in the management of their own retirement savings. This subdues the disciplining role of competition on superannuation fund performance. The absence of effective competition increases the onus on internal governance through board of trustee oversight. As discussed below however, trustee governance has its own limitations as a mechanism for protecting the interests of pension and superannuation fund members.

The superannuation governance framework places central responsibility for the prudent management of funds on the trustee. The SIS Act emphasizes the fiduciary responsibilities of trustees for the prudent management of funds. In particular, the legislation provided specific prescriptions aimed at reducing the riskiness of superannuation investments, as well as dealing with retirement incomes policy and other governance matters (Thompson 2008). Apart from proscriptions aimed at preventing the gross misuse of funds (Thompson, 2008, p7), *"the legislation contained only a general requirement that trustees formulate and give effect to an investment strategy that took [sic] into account risk and return, diversification, liquidity the ability of the entity to discharge its existing and prospective liabilities"* (Thompson 2008, p7).

More particularly, **s.52(2)(6a) of** the amended Superannuation Insurance (Supervision) Act 1993 (SIS) requires Trustees:[7]

(a) to formulate, review regularly and give effect to an investment strategy for the whole of the entity, and for each investment option offered by the trustee in the entity, having regard to:

(i) the risk involved in making, holding and realising, and the likely return from, the investments covered by the strategy, having regard to the trustee's objectives in relation to the strategy and to the expected cash flow requirements in relation to the entity; and

(ii) the composition of the investments covered by the strategy, including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification; and

(iii) the liquidity of the investments covered by the strategy, having regard to the expected cash flow requirements in relation to the entity; and

(iv) whether reliable valuation information is available in relation to the investments covered by the strategy; and

(v) the ability of the entity to discharge its existing and prospective liabilities; and

(vi) the expected tax consequences for the entity in relation to the investments covered by the strategy; and

(vii) the costs that might be incurred by the entity in relation to the investments covered by the strategy; and

(viii) any other relevant matters;

(b) to exercise due diligence in developing, offering and reviewing regularly each investment option;"

Trustees are also required to implement a sound investment governance framework and manage investments in accordance with APRA Prudential Standard SPG 530. This standard recognizes that the investment governance framework needs to be specifically tailored for the size, nature and complexity of the Registrable Superannuation Entity (RSE). It further reinforces the need to approve an investment strategy in the best interests of members both for the whole RSE and for each investment option offered

[7] Effective 1 July 2013.

within the RSE. The key requirements of the prudential standard are that the RSE licensee must:

- *"formulate specific and measurable investment objectives for each investment option, including return and risk objectives;*
- *develop and implement an effective due diligence process for the selection of investments;*
- *determine appropriate measures to monitor the performance of investments on an ongoing basis; and*
- *review the investment objectives and investment strategies on a periodic basis; and*
- *formulate a liquidity management plan."*

Superannuation trustees are required to maintain superannuation funds for the sole purpose of providing member benefits; and to do so until such time as the member withdraws their funds (ie meets a 'condition of release', including retirement, reaching preservation age, or being permanently incapacitated).

Unlike corporate boards, the expectation is that trustees will be more deeply involved in strategy[8] and the responsibilities of trustee boards are not normally limited by managers' operational responsibilities (Clark 2007); (Ambachtsheer 2007). The increased complexity of fund investment management and financial markets over the last 100 years severely limits the effectiveness of the "19th century ideal" of trustee management (Clark (2004), p 250) where the trustee is actively involved in the investment strategy of the fund. It is appropriate that the role of trustee boards should be examined for its ability to efficiently manage superannuation assets in an environment of growing complexity and dominance of specialized experts within global financial markets.

In summary, significant behavioural and institutional factors inhibit the scope for competition to act as a market discipline in the superannuation sector. While there is scope to reduce these institutional rigidities the fact remains that trustees must play a critical role in protecting the interests of the majority of superannuation members. It is

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[8] The governing board of a pension fund is more directly involved in the running of the organisation than is a corporate board of directors. The pension fund board has control over a wide range of critical decisions relating to the fund, including setting actuarial assumptions, investment of fund assets and monitoring of the management of the fund. Whereas a corporate board's role is to assist in the setting of strategy, to monitor management's execution of the strategy to protect shareholders' interests while providing management with advice. (Hess and Impavido (2004) p79)

therefore appropriate that the effectiveness of trustee boards in serving the interests of members should be subjected to further scrutiny.

3. Effectiveness of the superannuation system

The following section evaluates the superannuation system specifically in relation to its effectiveness in providing retirement incomes for members.

Within a defined benefit plan members receive a predefined benefit entitlement. Within the defined contribution scheme of the Australian superannuation system, the focus of this submission, rather than receiving a predefined benefit entitlement, members are offered a choice of investment options, with each option corresponding to a certain mix of growth and conservative assets. Members may select among this range of investment options. Where members do not make an active choice, their contributions are allocated to a particular investment option, referred to as a default option, normally a balanced portfolio with in the order of 60-80 per cent allocated to growth assets (primarily listed equities) and the remainder in secure assets (bonds, interest earning deposits and cash).[9] (From July 2013 onwards, the default option was superseded by the *MySuper* product with particular regulatory requirements.)[10]

Modelling by Cooper, Doyle et al. (2012) provides a test of the effectiveness of a traditional strategic asset allocation to achieve a return objective of 5%. Specifically it analysed a 'stylised' balanced portfolio with exposure to growth assets of 60% and defensive assets of 40%. This modeling showed that:

- the portfolio underperformed a 5% real return objective 49% of the time on a rolling 5 year basis and 47% of the time on a rolling 10 year basis;
- the worst rolling five year period provided a -10.8% p.a. real return and the worst rolling 10 year period a -3.7% p.a. real return; and
- historically, if the target was CPI plus 4%, this would have required a time horizon of

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[9] APRA (2013).
[10] MySuper seeks to replace the existing default products with a more cost effective alternative. MySuper products have a simple set of product features, irrespective of who provides them. The intention is to enable members, employers and market analysts to compare funds more easily based on a few key differences. Source: http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm

53 years to achieve this with 90% probability. A CPI plus 5% target with 90% probability required an 85-year time horizon.

This analysis suggests that medium term volatility can have a significant affect on the achievement of retirement objectives. The design of the investment options, based largely on fixed asset allocations, has significant limitations as a means of saving for retirement. This can be further explained with reference to three interrelated features of the retirement saving system: namely the portfolio size effect, sequencing risk and the 'retirement risk zone'.

First, the 'portfolio size effect' refers to the fact that an investor's portfolio generally grows more rapidly in the latter part of the accumulation phase of retirement (as compared with the earlier part). This differential growth rate is caused by the combination of salary growth, contributions and compounding returns (Basu and Drew 2009). Second, 'sequencing risk' refers to the fact that the timing of a bull or bear market is more important than the actual size of the associated returns (Doran, Drew et al. 2012) (Macqueen and Milevski, 2009). Put another way, a market correction will have a differential impact among younger and older investors reflecting both the relative size of their respective superannuation asset balances (portfolio size effect) and the length of time the individual has until retirement to recover the loss (Doran, Drew et al. 2012). Flowing from the above, the retirement risk zone represents the period towards the end of a member's working life and early in their retirement when they are exposed the greatest amount of risk by virtue of the fact that their retirement savings balances are high while they have limited working years left (if at all) to recover any losses. Based on empirical analysis, the retirement risk zone has been defined as the final 10-15 years of working life and the first 10 years of retirement (Doran, Drew et al 2012).

Given the existence of portfolio size effect and sequencing risk, members need to regularly review and monitor their investment portfolios against their retirement income objectives and make adjustments to their asset allocation to manage their risk exposure particularly as they approach the latter years of the accumulation phase. However, evidence suggests that many superannuation investors are not actively engaged in managing and reviewing their super. A menu of investment options based on largely fixed asset allocations is not an effective way of designing a retirement savings system in an environment where a majority of individuals lack the wherewithal to actively manage their retirement savings in a dynamic financial market environment.

In the context of limited member engagement, so called lifecycle or target date investment options represent an attempt to solve the problem of the growth in risk levels as members age. Such funds typically involve the progressive reallocation of the portfolio from growth assets to non-growth assets as the member nears her planned retirement date. However a mechanical rebalancing of the portfolio without taking into account the conditions of the market represents, at best, a partial solution to the above issues.

If the current SAA approach is not effective, this raises the following questions:

- Why is it the predominant approach if it doesn't work very well?
- Is there is superior approach?
- What stands in the way of developing and implementing a better approach?

The following section seeks to shed light on these issues by exploring the role that the choice of performance measurement plays in motivating behavior within the superannuation industry. It proposes that the current emphasis on investment returns in evaluating the performance of superannuation funds (and fund managers) has served to buttress a system that is not working well and has impeded the development of improved product choices. A movement away from the current focus on investment performance would contribute towards the evolution and innovation in improved investment options to better serve the needs of members.

4. Refocusing on the objectives of the superannuation system

Evaluation of the superannuation and funds management industry is heavily focused on the comparison of investment return performance across peer funds. Returns are reported as frequently as quarterly and leagues tables are compiled by various parties including APRA and third party research houses.[11] The release of this data on a regular basis places considerable scrutiny on relative fund performance. Coupled with the focus

[11] eg Morningstar, Chant West.

on returns performance is an emphasis on volatility of returns as the primary measure of portfolio risk.

The way investment objectives are articulated affects investment policies/strategies and in turn performance (Blake, Lehmann et al. 2002). Fund managers remuneration is more sensitive to the assets under management than to return performance. At the same time, their survival is dependent on relative performance rather than absolute performance. Investment managers seek to avoid the under performance relative to their peer group that would trigger a net outflow of assets. This creates the disincentive for managers to deviate too widely from their peer group's asset allocation so as to reduce the risk of under performance (Blake, Lehmann et al 2002). It is acknowledged within the industry that in the absence of peer group risk, managers would invest their portfolio's differently. [12] Some trustees have eliminated explicit peer group performance targets, which is a step in the right direction. However, in the absence of alternative ways of measuring performance, investment returns of the fund will be the primary focus.

Rather than risk adjusted returns and standard deviations as the primary measures of performance, a greater focus should be placed on how well the fund meets the needs of the investor. Similarly, rather than simply seeking to maximize returns, investment policy needs to take into account the dynamic effects of accumulation, particularly the combination of sequencing risk, portfolio size effect and longevity risk particularly during the retirement risk zone as discussed above. A focus on wealth creation as the objective would motivate a different approach to investment strategy compared with a focus on returns (Bianchi, Drew et al. 2013). A wealth creation objective would take into account trustees' progress in facilitating the development of a retirement plan for members taking account of a broader set of considerations specific to the investors' circumstances including contribution rates, size of current balance, time to retirement and income growth (Bianchi, Drew et al. 2013).

Merton (2003) takes this reasoning one step further, arguing that standard of living is the objective that matters for retirement planning rather than wealth creation. Merton (2003) illustrates this point simply in the context of reinvestment risk by posing two

[12] See for example Damien Lillcrop, QSuper in CIE.

choices: Option A is $5 million with a 10 percent real rate while Option B is $10 million and a 1 percent real rate. A wealth focus would see this as a choice between $5 million and $10 million with Option B as the clear preference. The overall choice however depends on how many years the investor has to live with the cross over point for the preference between the choices being ten years. An income focus would view this as a choice between a $500,000 income stream versus a $100,000, with Option A as the clear preference, reversing the previous selection. This serves to illustrate the point that end of period wealth is an inadequate measure on which to base investor welfare. What really matters is how much that wealth, or income, can generate in terms of consumption or income stream.

A focus on post retirement income of the individual should look beyond financial assets and take into consideration other significant household assets and expenses. In particular Merton 2003 emphasizes the following factors:

- Human capital – in addition to taking into account projected compensation as a lump sum of wealth, account should be taken of the volatility of this income stream and its correlation with other assets in the member's portfolio.
- Housing – taking into consideration the need to hedge for asset price growth differentials between real estate prices in the location the investor lives prior to retirement and their target location post retirement;
- Targeted major expenditures (such as private school fees or tuition costs and retirement home costs).
- Taking account of the above assets and major expenses in a retirement income plan would necessitate moving from a heavy reliance on diversification towards incorporating additional risk management approaches including hedging and insurance.

Further, a post retirement income objective rather than a wealth-maximizing objective, provides a basis for managing the trade-off between pre-retirement and post retirement consumption. This recognizes that saving too much also represents a risk in terms of foregone opportunities for certain middle income cohorts that needs to be traded off against longevity risk.

Given the difficulties of developing individually tailored investment strategies for each member, super funds have opted to offer members a range of investment options and allowed them to select the option best meeting their individual circumstances. However, the above discussion indicates the importance of tailoring strategies to the individual members' circumstances.

If the above represents the future of retirement planning, what are the implications for superannuation funds in the delivery of their objectives? How far does the trustee's fiduciary duty extend?

Insight into the question of how far does the trustee duty extend is provided by Donald (2008) that discusses the implications of the introduction of member investment choice for trustees' fiduciary duty. As previously stated, **s.52(2)(6a) of** the amended Superannuation Insurance (Supervision) Act 1993 (SIS) requires Trustees to:[13]

"(a) formulate, review regularly and give effect to an investment strategy for the whole of the entity, and for each investment option offered by the trustee in the entity,"

This section envisages that a superannuation fund provides a range of investment options, and follows not one but several investment strategies. It is the member who is able to chose which investment strategy they want their funds allocated to. According to Donald (2008), the trustee's responsibility extends to ensuring that the choices offered to members are prudent ones on a standalone basis. They also need to ensure that the menu of choices as a whole is appropriate for the membership. However,

> *"The courts do not require that the trustee find an investment strategy that is in each beneficiary's best interests, since in many cases that would be impossible.38 Rather, the courts require that trustees be impartial between different classes of beneficiary, recognising that in many cases beneficiaries have competing or conflicting interests."*

Donald (2008)'s conclusion that the fiduciary duty does not require an investment strategy "*that is in each beneficiary's best interests*" rests on the conclusion that "*in many cases that [a tailored investment strategy] would be impossible*". While the trustees' duty may not require it, trustees seeking to adopt a best proactive approach may well seek to encourage

[13] Effective 1 July 2013.

members in the development of a tailored retirement planning approach. Moreover, if it were practically possible to develop a mechanism for developing a highly tailored plan to the individual beneficiaries needs, would that then change the interpretation of the trustees duties? Does a standard menus of options continue to be appropriate in an environment where technological advancement makes possible the customization of retirement solutions to members? According to Merton (2003):

*Advisory services should use the full toolkit of financial instruments and institutions to address client problems. ….Lots of important data can be incorporated into the models now because of the computational power available. Eventually, we will move to relatively seamless lifecycle financial solutions for risk management for individuals and households. We have the financial knowledge base to move forward significantly (*Merton, 2003 p 21-22).

In summary, the current emphasis on investment returns is highly limited in evaluating the performance of superannuation funds (and fund managers). Such measures provide lagged indicators of performance and encourage a focus on short-term performance. Moreover, a focus on investment returns has only served to buttress a system of investment options that is not working very well and has impeded the innovation of new approaches to better servicing the needs of members. Superannuation funds need to evolve to a model that focuses on an overarching goal: Are members' post retirement income goals (to achieve an appropriate balance between pre-retirement and post-retirement consumption) being achieved?

The following section discusses the need for a holistic performance evaluation system for superannuation funds.

6. Towards an Holistic Performance Measurement Approach

Kaplan and Norton (1992) developed the balanced scorecard to overcome a number of deficiencies of accounting models that placed exclusive reliance on financial measures. In particular financial measures represent lagged indicators of outcomes from previous activity (Kaplan and Norton 2001a). Porter (1992) identified the problem that excessive reliance on financial measures could encourage actions that promote short-term performance at the expense of long-term performance (Kaplan and Norton 2001a, Speckbacher 2003).

The balanced scorecard indicators are usually grouped into four perspectives: financial, customer, internal, and learning and growth. The incomplete-contract view of organizations confirms the primacy of shareholders in firms as the residual claimants (Speckbacher 2003). Kaplan and Norton (1992, 1996) adopt this view and place the shareholders' financial perspective on top of the balanced scorecard. Originally the balanced scorecard was conceived as a performance measurement system. However recognizing that measurement has consequences, companies began to integrate their performance measures into a strategic management system to take further advantage of the system.

The balanced scorecard has since been adapted for use in not-for-profit organizations by removing the shareholder at the top of the scorecard and replacing it with the relevant group or groups of stakeholders (Speckbacher 2003). Applying the balanced scorecard in the not-for-profit sector involves starting one step earlier by defining the overarching objective of the organization that may involve trading off competing interests of various stakeholders. However reflecting the different nature of not for profit organizations compared with for-profit companies, application of the Balanced Scorecard in the not-for-profit sector has involved the adoption of key performance indicator (KPI) scorecards rather than integrated strategy maps.

Similarly, in the case of superannuation, deficiencies with investment measures of performance, as discussed in the previous section, suggest the importance of developing non-investment performance metrics. In the case of defined contribution funds, members are placed at the top of the balanced scorecard because they are the primary residual claimants. The extent to which trustees enhance the post retirement incomes of members is important for the overall effectiveness of the system. The contribution that trustees make towards placing investors in a better position to develop a retirement plan and meet their own post retirement income objectives in an important component of trustee effectiveness. Accordingly, the development of a broader set of key performance indicators or an adaptation of the balanced scorecard is needed to provide a broader measure of trustee effectiveness and encourage behavior conducive to the achievement of these broader goals.

A movement away from the current focus on investment performance towards a more holistic performance evaluation system would contribute towards innovation in better serving the particular needs of members.

7. Conclusions and recommendations

The typical investment approach adopted for superannuation funds involves investing to a certain asset allocation rather than pursuing a target return.[14] While this approach pervades the industry, it has serious limitations in an environment where the majority of superannuation members are not actively involved in managing their superannuation. The pathway of investment returns has a significant affect on members' retirement income levels even where average returns are consistent with the fund's objectives. The existence of portfolio size effect and sequencing risk, investors need to regularly review and monitor their investment portfolios against their retirement income objectives and make adjustments to their asset allocation to manage their risk exposure particularly as they approach the latter years of the accumulation phase. However, evidence suggests that many superannuation investors are not actively engaged in managing and reviewing their super.

The current emphasis on investment returns is highly limited in evaluating the performance of superannuation funds (and fund managers). Such measures provide lagged indicators of performance and encourage a focus on short-term performance. Moreover, a focus on investment returns has only served to buttress a system of investment options that is not working very well and has impeded the innovation of new approaches to better servicing the needs of members. Superannuation funds need to evolve to a model that focuses on the overarching goals: Are members' post retirement income goals (to achieve an appropriate balance between pre-retirement and post-retirement consumption) being achieved?

[14] Members choose among a menu of investment options each corresponding to a certain mix of assets. A default option, now called MySuper, is offered by each fund where member do not make an explicit investment choice.

Many superannuation trustee boards are responding to this issue in varying degrees. Responses range from providing education and tools to allow members to develop their own retirement plans; through to providing a highly customized set of investment strategies for different member cohorts.[15] Such developments provide encouraging signs. Nonetheless, the speed of evolution of investment options since the superannuation system was established in 1992 gives cause for concern about the pace of innovation in this core area. This submission argues that a focus on investment returns has only served to buttress a system of investment options that were not serving the interests of member well and has impeded innovation in finding better solutions.

This submission argues for the adoption of a broader system of performance evaluation for superannuation funds that takes into account forward indicators of performance measurement. A movement away from the current focus on investment performance towards a more holistic performance evaluation system would contribute towards innovation in better serving the particular needs of members.

It also calls for improved disclosure by superannuation funds on their performance against such a broader range of measures. Such action would enable the monitoring of progress on a cross fund comparative basis that would serve to motivate trustee boards to be more responsive in customizing products and services for their members. In due course, as the market develops, it could be expected that the duty of the trustee would be interpreted to cover the identification of an investment strategy suitable for individual members.

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