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Submission to Conexus consultation on growth/defensive asset classification

ABOUT US

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre**,** is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system.

During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established 60 years ago, it is an independent voice, ensuring consumers get a fair go.

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Introduction

Super Consumers Australia supports the development of a single industry standard for growth/defensive asset categorisation. Too often consumers are left unassisted to grapple with complex financial concepts that even the industry has not reached consensus on. This has led to significant consumer harm, with people ending up in superannuation products they don't understand and which will leave them worse off in retirement. More consistent classification of assets by funds has the potential to improve outcomes for members through contributing to enhanced market transparency, integrity and efficiency.

In saying this, the benefit for consumers will be indirect. Providing people with access to a comparable growth/defensive score is unlikely to help most of them to make a better decision about their choice of super fund and/or investment strategy. Disclosure of information, on its own, has been shown to be a limited consumer protection.[1] Moreover, research on consumer decisions that involve weighing risk (such as choosing an investment strategy) shows that people tend to resort to a heuristic approach when making decisions.[2] In ASIC's experience, "disclosure has proved particularly ineffective in enhancing consumer understanding of the level of risk involved in a product or service."[3]

The major benefit of developing a single industry standard for growth/defensive asset categorisation lies in assisting industry, regulators and providers of financial advice and fund rating/comparison services to better interrogate and compare fund performance. Improved confidence in the rigour and integrity of performance assessment should help increase competition, contributing to a healthier marketplace for consumers.

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[1] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019

[2] Hazel Bateman, Christine Eckert, John Geweke, Jordan Louviere, Stephen Satchell, and Susan Thorp, 'Risk Presentation and Portfolio Choice', *Review of Finance*, 2016, pp201–229

[3] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p11

Inconsistency and lack of transparency

Traditional definitions of growth and defensive assets have become less useful as investments by superannuation funds have become more complicated. Research by PwC in 2015[4] found that funds are not consistently classifying growth and defensive assets, and a more recent survey by Chant West in 2018 confirmed that there is an inconsistent approach to asset categorisation both across and between fund sectors.[5]

Inconsistency makes comparing investment risk between different funds/products a fraught exercise. For example, PwC found that funds that classify property, infrastructure and alternatives as partly growth and partly defensive may be understating their level of risk relative to funds that take the strict approach of classifying everything other than cash and investment grade fixed interest as a growth asset.[6] This is clearly problematic from the perspective of the effective management of investment risk, but also because ratings agencies, financial advisors and APRA have regard to funds' subjective classifications to categorise their investment options and rate their performance.[7]

Inconsistency due to subjective categorisation of assets by funds isn't the only problem. A lack of transparency in relation to the methods used by individual funds to classify their assets also undermines confidence in the robustness of performance assessment, fueling concerns about subjectivity and gaming.

APRA's Heatmap is a cornerstone consumer protection adding transparency and comparability to the outcomes experienced by consumers in the superannuation sector. For this consumer protection to be effective the regulator needs to be confident that it can make like-for-like comparisons of products. Without a common understanding of risk rating the regulator's work is inhibited and consumers ultimately suffer. APRA acknowledged the challenges it faces in "creating a single document that robustly assesses the outcomes provided by products with

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[4] PwC Investment Consulting, 'Comparing super funds: Apples for apples or fruit salad?', June 2015. https://www.pwc.com.au/consulting/assets/publications/comparing-super-funds-15.pdf
[5] Chant West, 'What's Going On With Not-For-Profit Funds And Growth/Defensive Assets?', September 2018.https://www.chantwest.com.au/resources/what%E2%80%99s-going-on-with-not-for-profit-funds-and-grow
[6] PWC Investment Consulting, 'Comparing super funds: Apples for apples or fruit salad?', June 2015.
[7] Barbara Drury, 'What is a growth asset? Time to set some standards', 3 August 2020. https://www.superguide.com.au/comparing-super-funds/define-growth-asset-standards

widely different risk profiles and asset allocations", pointing out that it needs to make certain assumptions of the data that funds supply.[8]

Widespread adoption of an industry standard for categorising growth/defensive assets would help to overcome the problems of inconsistency and opaqueness that presently limit the capacity to make confident and comparable assessments of fund performance.

Consumer decision making

Despite being the second largest financial investment most people will make during their lifetime, levels of disengagement with super are high. Research by CHOICE in 2016 showed that just thinking about super makes many people anxious and uncomfortable.[9]

The Productivity Commission found that around two thirds of people open an account with their employer's chosen default super fund when they join the workforce or change jobs.[10] Despite some clear benefits of moving to a better performing fund, switching rates in superannuation are low, with between 2% and 10% of people switching funds in a given year.[11] Approximately half of these switches are the result of a new job or an employer changing the nominated default super fund.[12] This low level of activity extends beyond switching to include decision making about things like benefit structure and investment strategy.[13]

Information asymmetry makes product comparison and assessment difficult, fuelling disengagement. It might seem reasonable to conclude that providing people with more information about how their fund categorises assets, together with a comparable growth/defensive score, would empower them to make better decisions about their choice of super product and/or investment strategy. After all, financial services disclosure has traditionally been assumed to inform and help consumers to make 'good' financial decisions.

However, the research strongly suggests that this is a flawed assumption. In their 2019 report *Disclosure: Why it shouldn't be the default*, ASIC and Dutch Authority for the Financial Markets identify why disclosure, on its own, is an inadequate consumer protection and may even cause

[8] APRA, 'APRA published MySuper Heatmap', Media release, 10 December 2019.
[9] CHOICE, Project Superpower, 2016, p.14
[10] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p. 262
[11] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.21
[12] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.251
[13] Geoffrey Kingston and Susan Thorp, Superannuation in Australia: A Survey of the Literature, Economic Record,Vol.95, No.308, March 2019, pp141–160.

harm by placing an unrealistic and onerous burden on consumers – for example, expecting them to overcome complexity that is inherent in products and processes.[14] Not only does disclosure not solve complexity, it does not deal with the contextual and emotional dimensions of financial decision making.

Behavioural economics research indicates that when it comes to making decisions about complex products, people's ability to distinguish between 'good' and 'bad' options becomes markedly impaired once they have to take into account more than two or three different product attributes - regardless of levels of numeracy and education.[15] Research also shows that in consumer decision-making that involves weighing risks, most people judge risk intuitively and inaccurately, either over or under estimating it due to difficulty understanding probabilistic processes.[16]

While technically an exposure metric, growth/defensive has become widely used as a proxy for risk.[17] Research to assess the actual impact of risk disclosures on consumer decisions about the investment of retirement savings found that even simplified risk information was irrelevant to the decisions of approximately 75% of participants.[18] Only 5% of participants used all or almost all of the prescribed information and, at times, these participants used the information in unexpected ways.[19] As ASIC has observed, this heuristic approach to allocation "can result in outcomes that are not informed by appropriate risk-return trade-offs."[20]

CHOICE's Project Superpower research in 2016 clearly demonstrated that people don't want more information about their super - they want a trusted source to provide them with a shortcut to make decisions.[21] It isn't that people aren't engaged with their super because they simply

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[14] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p4
[15] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p8
[16] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p10
[17] Chant West, 'What's Going On With Not-For-Profit Funds And Growth/Defensive Assets?', September 2018
[18] H Bateman, LI Dobrescu, BR Newell, A Ortmann & S Thorp, 'As easy as pie: How retirement savers use prescribed investment disclosures' (PDF 1.28 MB), *Journal of Economic Behavior & Organization*, vol. 121, 2015, pp. 60–76
[19] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p31
[20] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p31.
[21] CHOICE, Project Superpower, 2016

aren't interested, it's because they don't feel sufficiently skilled to deal with the complexity that making good choices about investments or funds requires.

As Geoffrey Kingston and Susan Thorp explain:

> *"Retirement savings and investment decisions require people to solve inherently complicated and heterogeneous problems with outcomes that are realised well into the future. In cases such as these, most people will find it hard to know what choice is in their own best interest..."*[22]

In this context, the development of an industry standard for categorising growth/defensive assets has significant potential to improve the quality of data that is available not only to industry and regulators, but also to providers of financial advice and fund rating/comparison services. Super Consumers is currently undertaking research to test the best ways to assist people to make decisions via a comparator tool. The goal is to develop an assisted decision making prototype based on consumer testing and expert rating methodology to help people to select a product that will provide the best value for their needs and circumstances. A industry standard for classifying growth/defensive assets would add significant value to the integrity of this work.

Conclusion

While limited as a consumer protection, disclosure can and does contribute to better financial markets when media, competitors and intermediaries use it to gauge and enhance competition, and when regulators use it to drive market integrity and efficiency.[23] Requiring funds to classify their assets against an industry-wide standard would strengthen the usefulness and reliability of the information they disclose about their management of investment risk. This would help enhance the transparency, integrity and efficiency of the superannuation 'marketplace' - a necessary precondition to improving the quality of member outcomes. For this reason, while the benefit to consumers is indirect, we support the work to develop an agreed industry standard of asset classification.

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[22] Geoffrey Kingston and Susan Thorp, 'Superannuation in Australia: A Survey of the Literature', *Economic Record*, Vol. 95, No. 308, March 019, pp141-160, p 53.
[23] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p4.