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MySuper: A Stage in an Evolutionary Process

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Synopsis

We interview Australian fund executives about how their organisations responded to MySuper, a regulatory framework for default retirement savings funds that providers were required to have in place by the beginning of 2014. In addition to providing an account of the influences on product design and how MySuper was perceived by the industry, we discuss how the superannuation industry is shifting its focus towards meeting the retirement needs of members who are assumed to be largely disengaged. We argue that MySuper has promoted change and innovation through separating out default members, thus providing a mechanism through which the needs of this particular group are explicitly addressed. Asset accumulation and relative returns appear to be relegated to secondary considerations, at least for fund executives.
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1. Executive Summary

Many members of Australian superannuation (pension) funds delegate decisions about the investment of their savings to fund providers who act as trustees of those funds. In any setting where investment decisions are delegated, questions arise as to how well incentives and aims are aligned between investors and their agents. We generate insight into these issues through conducting in-depth interviews with 28 executives from 20 Australian superannuation fund providers. The premise of the interviews was to investigate their response to the MySuper regulatory framework governing default retirement savings funds, which fund providers were required to implement by the beginning of 2014. We asked participating executives (‘participants’) first about their perceptions of the needs of their members; second about how they approached designing their MySuper offering, including its underlying investment strategy; and third about their views on the related regulations and their implementation. On one level, this allows us to provide an account of the design and management of default products; as well as the response of the industry to a major regulatory change. On another level, we uncover some important changes currently occurring within the Australian superannuation industry, particularly with regard to how it addresses default members. We discuss purpose and motivation; how fund executives perceive default fund members and their needs; the key influences on the design of MySuper products; and views on the impact of MySuper as a regulatory change.

Our Main Messages

A key finding relates to the sense of purpose and motivation conveyed by the industry, which appears to be evolving towards a better alignment with perceived member interests. Specifically, our participants express their primary concern as the needs of their members. Business considerations, such as performance and fees, are described either as secondary or as constraints. Importantly, these statements are corroborated in many cases by observable behavior. In sum, we detect signs that the member is being placed at the centre, at least with respect to the design of default funds. We interpret this as a something of a shift in focus, which in turn has been facilitated by MySuper through requiring funds to explicitly consider the nature and needs of their default members in reviewing their default offering. Fund providers appear to have approached this task in a somewhat paternalistic manner, considering what would be the ‘best’ product for this specific group. Further, our participants describe the main need of members as related to retirement outcomes.

The proposition that fund providers are primarily focused on the needs of their members cuts against some common perceptions. The Australian superannuation industry is often criticised as being too focused on short-term peer-relative performance and growth in funds under management. Further, the for-profit retail sector is at times accused of being profit-driven. These perceptions underpin claims that member needs are treated as secondary. Our findings contest these concepts. Evidence exists in support of the notion that the avowed focus on members may indeed be genuine, including for retail providers. First, indications that the industry is placing member needs at the center were sustained throughout our interviews. Second, heightened focus on member needs also aligns with an increasing business incentive to do so. Intermediaries like employers and financial advisers can play a role in this regard, to the extent that providers need to convince these ‘gatekeepers’ that their default offering meets member needs in order to make the sale. The incentive to act in the best interests of members is further enhanced by the maturing of the superannuation system and increasing member age and balances. This raises the possibility that members may become more engaged over time, and may even contemplate setting up a self-managed fund. The incentive to focus on the member and build trust is thus increased, with an eye to member retention. In sum, our interviews suggest that the industry is

1 Banning of commissions under the Future of Financial Advice legislation is relevant in this regard, as it removes a source of misalignment and should raise the relative importance placed on member needs.
taking its fiduciary duty towards default members increasingly seriously; and we see business imperatives for this to be a genuine intention.

A related claim is that insufficient attention has been given to helping members provide for a more comfortable retirement. Again we uncover evidence to the contrary. The discussion by our participants around member needs universally focuses on retirement outcomes. Further, in giving an account of the design of their MySuper product, the vast majority used language that aligns with life cycle theory, including mentions of sequencing risk. We also encounter references to shifting the basis of member communication towards reporting of projected retirement outcomes, while de-emphasising account balances and returns. We heard numerous remarks about the need to address the retirement phase (see Butt et al. (2014)), as well as many expressions of intention to do so. Although the industry may well have primarily focused on the pace of asset accumulation and relative performance in the past, this has changed. We note that refocusing towards the retirement phase also aligns with the maturing of the superannuation system coupled with increasing member age and balances. Whatever the reason, our analysis suggests that the industry has clearly turned its sights towards the destination, which is now being seen as more important than the journey.

On MySuper, our participants expressed mixed feelings. Some viewed MySuper as a catalyst for constructive change; others saw it as a waste of time; and most considered it costly and disruptive. Nevertheless, a broader perspective on our findings suggests a more positive interpretation. Arguably the major benefits of MySuper stem from separating out default members into a single product group. This had the effect of requiring providers to consider explicitly the needs of these members, and design a product accordingly. Most participants are approaching this task from the perspective that the typical default member is disengaged and probably poorly informed; and that it is their job to look after them. In other words, MySuper heightened the sense of fiduciary duty and paternalism towards this segment. Further, allowing providers to choose designs that they consider appropriate for default members is facilitating innovation. The emergence of a range of lifecycle funds serves as an initial example. The potential for ongoing innovation is enhanced by perceived latitude to make changes to the MySuper product offering, without the need to secure explicit permission or convince members to make a choice. If this perceived latitude to innovate is combined with a genuine focus on member needs, then members should benefit.

**Summary of Findings**

In addition to the above main messages, other findings to emerge from our research are as follows:

- **Member needs are the primary consideration, but are subject to business-related constraints.** While our participants convey their central purpose and primary motivation as meeting member needs, they also recognise that MySuper products need to be competitive. This is particularly the case where the ‘sale’ is made via an intermediary such as a sponsoring employer. In this instance, aspects such as performance, fees, product features and servicing have heightened relevance. The primary focus on the member can survive nevertheless, providing that these intermediaries are also concerned with member needs.

- **While participants view retirement outcomes as central, they also recognise that default members have a range of needs.** Our participants characterise default members as disengaged, and perceive their major needs to be related to retirement outcomes. Short-term returns are viewed as largely irrelevant to the members themselves, with the exception of an acknowledged dislike of negative return ‘shocks’, especially near retirement. Beyond these simplifying characterisations, participants are broadly aware of heterogeneity in members and their needs. While providers design their MySuper products around a ‘typical’ member, the nature of this typical member varies
considerably across funds. Further, participants know that members of a specific fund are all different, and that ‘one-size-fits-all’ is second-best. This realisation is prompting many participants to look for ways of addressing differing needs by introducing more tailoring, or sparking greater engagement. Increasing the availability of advice is one response.

**Balanced and lifecycle providers tended to approach MySuper from different perspectives.** While all participants allude to reviewing their default offering in response to the introduction of MySuper, the approaches differ. Many of those adopting a balanced MySuper fund talk about having conducted an open review of the options. Some gave serious consideration to introducing a lifecycle strategy; and indicate that they may move in that direction at a later time. Others used the review to confirm the suitability of their balanced fund. In contrast, many of those adopting a lifecycle strategy appear to have worked from a prior belief that it is an inherently better approach.

**Industry thinking is aligning with life cycle\(^2\) theory.** The vast majority (85%) of our participants made comments that point towards MySuper being designed to serve members over their life cycle, looking towards retirement. Most speak in terms that align with life cycle theory, such as references to: retirement income streams or income replacement ratios; the relevance of the public pension; human capital or other assets outside superannuation; or even spending in retirement as a liability to be met. Others refer to sequencing risk, which indicates a concern with how investment strategy should be varied over the life cycle. ‘Returns’ are typically mentioned in ancillary ways, such as the need for adequate real returns over the long run to underwrite retirement outcomes; and the ‘reality’ that funds operate within a competitive market that often focuses on performance.

**There are various influences on MySuper design.** The most-mentioned influences in shaping the design of MySuper products include: the nature of the member base; regulation; cost and fee budgets; competitive positioning; and administration or member information constraints. The typical approach to MySuper design is best described as building a product to generate retirement outcomes for a specific member base, subject to various business constraints. Evidence exists that ‘fee budgets’ were particularly influential for some providers, most notably in the retail sector.

**Investment strategies differ significantly.** We find a considerable variation in the investment strategies underpinning MySuper products. This is not surprising, given the diversity in member bases and organisational circumstances. Meaningful differences exist in: governance structures; the objectives and risk definitions used in practice; asset allocation processes; and the range of asset classes considered. One ubiquitous feature is that all participants intend to pursue some form of dynamic asset allocation (lifecycle providers around the specified glide path). Active management within asset classes remains dominant; although passive management is used in some sectors in whole or part by a number of funds.

**Implementation of MySuper was costly, difficult and disruptive.** A large majority of our participants referred to the difficulties of implementing MySuper. Key concerns included: lack of initial clarity around the requirements; too many updates and changes; the timetable was too short; significant cost; and diversion of attention from managing for the benefit of members.

**MySuper had a range of impacts.** We detect no consensus from the industry on whether MySuper was a positive or negative development on balance. Our participants point towards various impacts from MySuper, including that it:

\(^2\) ‘Life cycle’ in this context refers to the theory of optimising consumption and investment over an individual’s lifetime; not lifecycle investment products. To help distinguish, when addressing general life cycle concepts we use two distinct words, and use the single word ‘lifecycle’ when referring to products.
Acted as a catalyst for re-evaluation and change; although the latter was limited to parts of the industry such as the retail sector and a few other funds;

- Altered the competitive landscape; including an increase in the diversity of offerings and a reduction of the fees charged by retail providers;

- Provided a circuit-breaker on peer comparisons, particularly for lifecycle providers;

- Enhanced the focus on fees and costs, with many providers holding the view that this would be to the detriment of members;

- Increased underlying system costs at the margin due to higher compliance burdens; and,

- Raised system integrity, when viewed as a component in a suite of regulatory changes.

Relation to the Financial System Inquiry Recommendations

This paper was completed around the same time that Australia’s Financial System Inquiry (FSI), led by David Murray, delivered its Final Report (see FSI (2014)). Many of the FSI’s recommendations on superannuation and retirement align with what our participants are either requesting, or are intending to implement. This includes: the suggestion to establish clear objectives for the system based around provision of ‘income in retirement’; establishing a mechanism for trustees to ‘pre-select’ retirement income products for members, into which they are defaulted in the absence of choosing otherwise; and communication of retirement income projections to members. Recommendations aimed at improving the quality and alignment of financial advice also accord with the view of many participants that advice is an important component in meeting member needs.

The major feature of the FSI report that runs contrary to our findings is its theme of primarily relying on market forces and competition to deliver outcomes. This theme is most clearly reflected in the recommendation that a ‘formal competitive process’ (i.e. tender or auctions) be established to allocate new default members to funds, if a review conducted from 2017 fails to find significant improvements in competition and efficiency (i.e. lower fees). Our findings question the need for such a solution in two ways. First, we find that alignment with members is improving, with providers aiming to deliver better outcomes for default members under the combined influence of a sense of fiduciary duty and business incentives. Second, we encounter member heterogeneity both within and across funds, of which our participants are well aware and aiming to cater for. The FSI’s recommendations contrast with these insights by raising the prospect of a competitive bidding process, rather than aiming to enhance and rely on fiduciary duty; and by proposing a solution that would generically apply across all new default members, when many industry participants perceive the need for increased tailoring.

This Paper in Context

In this paper, we report and interpret what a representative group of fund executives reveal about their decision processes, perceptions and viewpoints during the course of interviews. That is, we largely rely on what participants say. Potential exists for important aspects to be either omitted due to oversight, or conveyed in a manner that does not accurately reflect actual practice. Behavioural or social influences could affect how participants rationalise their position and actions; for instance, telling the interviewer what they may want to hear. We try to limit the scope for biased interpretation by considering whether propositions are consistent with the interview discussions in their entirety, any observable actions, and incentives faced by fund executives and their organisations. In any event, reporting how fund executive articulate a range of issues is of value in its own right. Readers are also invited to make up their own minds.
This paper follows up on two CIFR papers examining MySuper. In a companion to the current paper, Butt et al. (2014) draw on the interviews to report on the views of fund executives on the superannuation system and its regulation in general. Chant, Mohankumar and Warren (2014) provide an overview of MySuper products as of early-2014, including: the regulations; the broad approach by industry sector; the underlying investment strategies; fees; and the product changes occurring with the introduction of MySuper. Chant, Mohankumar and Warren (2014) examine “what” the MySuper landscape looks like; leaving it to the current paper to investigate the “how” and “why” of MySuper product design.

2. Background

In this section, we provide background from various perspectives. In Section 2.1, we discuss the importance of default pension funds, and key attributes of the Australian superannuation system. In Section 2.2, we detail the MySuper regulatory framework. In Section 2.3, we overview related literature on default fund design, describing the state of knowledge and drawing out issues that are the focus of debate. In Section 2.4, we highlight some of the literature on governance and regulatory frameworks related to default funds.

2.1. Significance of this Research

Pension funds matter due to their sheer scale. According to TheCityUK, global pension fund assets in 2012 were estimated at US$31.5 trillion, exceeding the estimated US$23.8 trillion invested in mutual funds. Australia has a well-developed pension industry which is the fourth largest in the world with US$1.6 trillion invested during 2013, the majority of which (84%) is invested in defined contribution (DC) funds. Indeed, Australia has the second largest pool of DC money in the world, behind the US.

Default funds are important within retirement saving systems. A large majority of members invest in the default option (Beshears et al. (2009)). For Australia, Cooper (2010) suggests about 80% of members are invested in the default fund nominated under their employment contract; a percentage that is not dissimilar to that reported for other countries. For example, Byrne et al. (2007) report that just over 80% of members are invested in a default fund in the UK. There is some debate around the reasons for this outcome, and the extent to which members have actively selected the default. This does not change the fact that design of default products can have important welfare implications.

Australia is an interesting place to examine the design of default funds due to some unique aspects of its system, including the competitive dynamics. Employer contributions to retirement savings accounts have been mandatory for most workers in Australia since the introduction of the Superannuation Guarantee in 1992. The providers of superannuation products break down into the four sectors of retail, industry, public sector and corporate funds. Retail funds are for-profit providers, while the

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5 Beshears et al. (2009) suggest three potential reasons for preferring the default, including: (1) the complexity of making a non-default selection; (2) behavioural effects, specifically present-biased preferences and procrastination; and (3) adopting the default as an implicit endorsement.
6 Cooper (2010) mentions that about 20% of members may have actively chosen the default based on industry feedback; although Bateman et al. (2014) question whether this may underestimate the actual level of active choice.
others are considered not-for-profit. At June 2013, the not-for-profit sectors managed 40% of the assets and 50% of the accounts (see APRA, 2013). Meaningful competition for members exists, in particular between the retail and industry fund sectors: a notion that is confirmed by the attention given to competitive positioning during our interviews. Further, Australian superannuation members may set up their own ‘self-managed superannuation fund’ (SMSF). This facility adds another element to the competitive dynamics within the system. Indeed, we argue that this possibility contributes to the pressure on fund providers to act in the best interests of members. The SMSF sector contained 31% of assets although only 3% of accounts at June 2013 (APRA, 2013).

There are important differences in origins, motivations and governance structures between the sectors (see Langford et al. (2006); Sy (2008)). Retail funds typically operate under the umbrella of a financial services corporation, many of which are large and vertically integrated, e.g. banks, insurers, or investment management companies. Important channels by which they gather assets include the outsourcing by employers of the management of a superannuation fund of their employees, and via the recommendation of financial advisers (planners). In some cases, advisers may be ‘tied’ to the organisation. Not-for-profit funds traditionally have enrolled members as a consequence of employment contracts, with industry funds originally linked to a particular industry under industrial awards. The latter distinction of industry funds has been eroded through mergers and opening of funds to the public, resulting in some of the larger industry funds serving members from a wide range of industries or employers.

Thus the Australian system is relatively large and well-developed, with a considerable default component nested within a competitive, choice-based DC system. Australia also offers a wide range of fund providers with differing organisational objectives and varying connections to their members. Analysis of this system could provide insight into how institutional settings and the primary source of assets under management may influence the way in which member needs are perceived and addressed.

2.2. MySuper Regulatory Framework

MySuper is a regulatory framework for default funds in Australia. MySuper is one element of the Stronger Super reforms announced by the government in December 2010 in response to the Review of the Governance, Efficiency, Structure and Operation of Australia’s Superannuation System (the so-called ‘Cooper Review’). The broad philosophy of the Cooper Review was that the superannuation system comprises three types of members with varying degrees of engagement with their superannuation: self-managed superannuation fund members who are typically the most highly engaged; ‘choice’ members who select from the gamut of products offered by superannuation fund providers; and disengaged members who largely accept the default fund that is offered through their employer. MySuper is intended for the latter group, which comprise the majority of fund members. The Cooper Review (Part 1, page1) summarised its vision for MySuper as follows:

“MySuper is a simple, well-designed product suitable for the majority of members. The MySuper concept is aimed at lowering overall costs while maintaining a competitive market-based, private sector infrastructure for super. The concept draws on and enhances an existing and well-known product (the default investment option). MySuper takes this product, simplifies it, adds scale, transparency and comparability, all aimed at achieving better member outcomes.”

Corporate funds are not-for-profit as they are provided as a service for employees, rather than as a source of profit for the sponsoring company. However, a majority of corporate funds outsource the management, often to a for-profit provider.
Major specifications for a MySuper product include:

- Each registered superannuation entity (RSE) can generally offer one MySuper product;
- Investment strategies must be either a single well-diversified investment strategy (which we will denote a ‘balanced fund’), or a lifecycle strategy where asset allocation is varied with age;
- Standard fees must be charged to all members, with the notable exception that discounts on administration fees may be offered to corporate plans negotiated on behalf of their employees;
- Fees are generally restricted to: administration fees; investment fees; and certain transaction fees on a cost recovery basis, such as buy and sell spreads, exit fees and switching fees;
- Standardised reporting requirements, including information on investment strategy, return target (CPI-plus), standard risk measure (expected number of negative return years out of 20), fees and insurance offering; with certain items to appear in a ‘product dashboard’;
- Default life and total and permanent disability insurance must be offered on an opt-out basis; with many funds providing an option to vary coverage or add income protection insurance; and,
- Access to financial advice is required to be made available, with most providers offering advice on a paid basis, and some providing free advice which is usually limited in scope.

The timetable for introduction of MySuper was relatively short. The relevant legislation and regulations were passed over 2011 and 2012; and funds were able to apply for MySuper licenses from 1 January, 2013. Products could be launched from 1 July, 2013. After 1 January 2014, all new default fund contributions were required to be invested in a MySuper product. By 1 July 2017, all remaining default fund balances\(^8\) must be transferred into a MySuper product. In effect, all providers needed to have their MySuper offering up and running by the start of 2014 in order to continue operating a default fund. They had about one year to design and implement their MySuper products, notwithstanding the final regulations being available only around the half-way point. Although many providers merely ‘rebranded’ an existing fund as their MySuper offering (see Chant, Mohankumar and Warren (2014)), our interviews suggest that the majority of providers performed an in-depth review of their default offerings. A significant number developed entirely new products for MySuper. The tightness of the timetable should be borne in mind when considering what our participants have to say about the MySuper regulations and its implementation.

Another notable aspect is that the introduction of MySuper occurred while the memory of the Global Financial Crisis (GFC) of 2008-2009 was still manifest. This may have been influential in encouraging the development of lifecycle funds, by making sequencing risk especially salient.

2.3. Pension Fund Design

We now review the literature on pension fund design that is most relevant for our analysis. Three research papers are particularly notable for conducting work that is close to our own. Bryne et al. (2007) conduct a survey and interviews of investment professionals in the UK on the motivations and influences on the design of defined contribution pension funds. These authors point to a reluctance of UK trustees and employers to take an active role in pension fund design due to concerns over legal liability; an observation that stands in stark contrast to the attitudes expressed by our participants. The

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\(^8\) MySuper applied to defined contribution funds only. There is no requirement to transfer defined benefit balances into a MySuper fund. It is understood that many funds have transferred balances already.
two other closely-related papers are Chant, Mohankumar and Warren (2014) and Gomersall and Freeborn (2014), both of which overview the landscape of Australian MySuper products. In addition, Gomersall and Freeborn (2014) conduct interviews of 11 fund executives, and provide a list of the factors they find are considered in designing MySuper products. The latter two papers provide background information, as well as various points of confirmation and contrast to our findings.

A range of other materials provides a backdrop by setting out the underlying concepts and raising areas of debate. In the discussion that follows, we note the large gap that exists between academic theory and practice; the absence of a clear statement of purpose and objectives for the Australian savings retirement system; and the relevance of agency and alignment.

**Related Academic Literature**

Much of the academic literature on pension fund design focuses on three aspects: governance and regulatory frameworks; drivers of performance; and optimal investment strategy under ‘life cycle’ models. We address governance and regulation in Section 2.3, and comment on the other aspects here.

In terms of the relation between fund design and performance, the international research tends to focus on the selection of specific investments in equity portfolios (e.g. Lakonishok et al. (1992); Del Guercio and Tkac (2002); Heisler et al. (2007); Goyal and Wahal (2008); Stewart et al. (2009); Busse et al. (2010); Jones and Martinez (2013)). Other studies consider the role of scale economies (refer Bikker (2013)); while MacIntosh and Scheibehut (2012) discuss internal management. The Australian literature has adopted a broader perspective by relating superannuation fund performance at the plan level to a range of aspects such as asset allocation, fund type, governance, scale, fees or expenses, and the number of external managers (see Faff et al. (2005); Coleman et al. (2006); Langford et al. (2006); Bateman and Thorp (2007); Ellis et al. (2008); Cummings (2012); Basu and Andrews (2014); Liu (2014)). These studies confirm the importance of asset allocation and fees. They also highlight differences in performance and portfolio structure between not-for-profit and for-profit funds, most of which relate to the greater use of unlisted assets by not-for-profit funds. Few clear messages or any strong consensus emerges on the fund designs that are likely to maximise member outcomes; although there is a broad recognition that scale efficiencies exist with respect to administration costs.

A sizable body of literature examines investment strategy under life cycle theory, where the objective is typically to maximise utility of consumption over an individual’s lifetime. For a comprehensive overview of the issues surrounding the life cycle theory of savings and investment, see CFA (2008). Researchers often build a life cycle model to generate the distribution of retirement outcomes, which is usually evaluated through simulations. Notable references include: Bodie et al. (1992); Farhi and Panageas (2007); Blake et al. (2008); Gomes et al. (2008); Berstein et al. (2014); and Kingston and Fisher (2014). Simulation methods are applied to Australian data by Basu and Drew (2010) and Burnett et al. (2014). Byrne at al. (2007) compares default fund designs in the UK, estimating impacts on the distribution of the income replacement ratio. This body of research identifies considerations in the optimal design of retirement savings products. The long list of relevant factors includes: asset allocation strategy over the life cycle; return assumptions and uncertainty over returns; human capital and contribution levels; flexibility around the work/leisure/retirement choice, as well as around contributions and withdrawals; the availability and conditions governing social security benefits; existence of other assets; life risks such as health and longevity; bequests; and risk aversion.

**Application of Theory**

While the main influences on retirement outcomes are becoming increasingly well understood, the application of life cycle theory when designing retirement savings products has remained limited and
sporadic. Cooper (2014) reviews the existing defined contribution plans and finds them wanting, observing that a range of potential models exist. Perhaps the main area where theory has been embraced is through the development of lifecycle or target date funds, under which asset allocation follows a 'glide path' towards a lower return / lower risk asset mix as retirement approaches. Lifecycle funds are a key feature of the retirement saving product landscape in the US, in a large part because these products accord with the requirements of the Pension Protection Act of 2006. They are also prevalent in the UK, reinforced by a regulatory requirement to offer some form of lifecycle asset allocation strategy (Byrne et al. (2007)).

Lifecycle strategies have become a larger component of the Australian product landscape after they were explicitly permitted under the MySuper regulations. Chant, Mohankumar and Warren (2014) detail the use and design of lifecycle strategies within MySuper. This study adds insight into how Australian funds responded to the option to use a lifecycle strategy within their MySuper default fund. Nevertheless, available lifecycle products still fall far short of addressing life cycle theory in its totality – notwithstanding the name. Most products are based on the single factor of member age; and typically incorporate few of the wide range of relevant factors identified in the literature. Many lifecycle products are designed through to the point of retirement, and thus fail to encompass the entire life cycle including the retirement phase. Our interviews provide insight into the awareness of fund executives of these shortcomings, and their approach to dealing with them.

**Purpose and Objectives of the Superannuation System**

An important issue for pension fund design is the need for a common understanding of the purpose and objectives of retirement saving systems. In Australia (as well as many countries), this common understanding has often been lacking. This is reflected in calls for the system objectives to be better defined in submissions to the FSI, e.g. see AIST (2014); ASFA (2014). The call for common agreement was subsequently taken up by the FSI, which recommended in its Final Report that the Government seek broad agreement based around the primary objective: “To provide income in retirement to substitute or supplement the aged pension” (FSI (2014), page 95).

Historically, attention has been directed towards returns, asset accumulation to the point of retirement, and building balances within the system. Focusing on short-term returns and accumulation of balances leaves a large gap with the life cycle theory as discussed above. More recently, there has been a shift toward focusing on the need to provide an adequate income in retirement. Examples of the state of debate can be found in AIST (2014), ASFA (2014), Butt et al. (2014), Chee and Callil (2014), Cooper (2014), and Mather and McKenzie (2012); as well as Merton (2014) and Stewart (2014) internationally. Also, Blake et al. (2008) provide an excellent discussion of how pension fund design may be linked to retirement objectives. The FSI recommendations should provide impetus to this shift.

Further, regulations around the retirement phase have been placed under consideration by the FSI. A key recommendation is to establish a mechanism for trustees to ‘pre-select’ retirement income products for members, into which they are defaulted in the absence of choosing otherwise. This recommendation would set up a bridge between MySuper and default retirement products, hence giving latitude to design products that look ‘through retirement’. By constrast, the MySuper regulations only cover ‘to retirement’.

Accompanying the shift in focus towards adequacy of income in retirement has been an increasing recognition of the desirability of tailoring towards the specific circumstances and needs of individual members, e.g. see Aspinall (2013); Chee and Callil (2014); Deloitte (2014). Our interviews provide evidence that Australian superannuation fund providers are indeed changing their interpretation of their own purpose and objectives in accordance with these concepts and related life cycle theory.
Agency and Alignment

The issue of agency and alignment is highly relevant for our research. Given that pension funds entail delegation of investment management by members to pension fund managers, the nature of the principal-agent relation becomes of central interest. In addition to the known problems related to potentially differing objectives between principals and agents, Binsbergen et al. (2008) identify the specific alignment issues that arise under delegated investment management. They include: inefficient diversification as a consequence of the manager being responsible for only a subset of the investor’s assets; potential for differences in risk attitude between managers and investors; misalignment of time horizons; and failure to take investor liabilities into account. Agency problems are discussed in the context of Australian superannuation funds by Drew and Stanford (2003) and Bird and Gray (2013); while Langford et al. (2006) and Sy (2008) focus on how alignment may vary between for-profit and not-for-profit providers in an Australian context.

In the case of default funds, the implications of misalignment can be exacerbated. Default members are more likely to be disengaged and/or poorly informed, and consequently may be poor monitors. In part this reflects limited financial literacy, which is evident across most populations (Lusardi and Mitchell (2014)) including Australia (Bateman et al. (2012)). Low engagement and poor financial literacy is likely to be more acute among members who have not made an active choice: although absence of an active choice does not provide prima facie evidence of low engagement, as members may have intentionally selected the default (see Bateman et al. (2014)). Further, default fund members are placed into a common investment pool, thus heightening the potential for misalignment when their circumstances vary from the average member in the pool. While exercising choice may be optimal in some situations, it is doubtful whether many default fund members have the capacity to manage their affairs without assistance, e.g. see Ashcroft and Stewart (2010); Cooper (2014). Further, Ashcroft and Stewart as well as Stewart and Yermo (2008) cast doubt on whether competition can work effectively given the limited capacity of many members and the potential for conflicts of interest, especially within for-profits sectors. Given this background, our research casts light on the awareness and response of fund executives to agency issues with respect to default members. We also raise and discuss the role played by intermediaries such as employers and financial planners in the agency arrangement between members and fund providers.

2.4. Governance and Regulatory Frameworks

The imposition of a regulatory system is often motivated by limits on competition or some forms of market failure such as externalities; and may itself be affected by behavioural influences (see Hirshleifer (2008)). A basic impetus to the current superannuation system is a concern that many individuals would not, by themselves, save enough to establish a meaningful retirement income. Low or inadequate retirement savings can be a consequence of a number of factors, including: myopia; lack of knowledge; literacy or ability; tangibility of services; or inattention (see for example, Lusardi and Mitchell (2011)). Developing a system that provides meaningful governance for potentially ill-equipped members who have been compelled to participate provides a unique challenge.

It is worth noting that most superannuation funds are set up as trusts. Donald (2011) notes that trust structures play a key, multi-layered role in the Australian superannuation system. The interaction between trust law and expanding regulatory oversight has been ongoing, and predates the introduction of the Superannuation Guarantee in 1992. Donald (2011) notes that this interaction has trust law providing infrastructure, interpretive, default, and exhortative roles in superannuation governance. This interplay between trust law and statutes provides a relatively flexible and coherent environment where regulators and trustees alike shoulder considerable responsibility for member welfare.
However, this system is not without its challenges. The introduction of choice of fund legislation in 2005 meant that most members were able to select their superannuation fund, which could allow for better matching of members and funds. However, expanding choice tends to undermine the role of the trustee (see Donald (2008)), thereby diluting protections for less able members. Furthermore, Fear and Pace (2009) note that relatively few members exercised fund choice after it was introduced. This could be because members are satisfied with the features of default funds. Alternatively, members may be disengaged; in which case the selection of the default option becomes crucial. To the extent that default members are disengaged, the trustee structure of superannuation funds and regulatory oversight becomes especially relevant.9

Another consideration is behavioural finance and economics. There is a growing appreciation that traditional economic models may not fully capture decision processes. For example, people may make decisions without incorporating all information, may make errors in assessing uncertain events, and may have attitudes towards risk that are not consistent with traditional models (see Barberis and Thaler (2003); Hirshleifer (2014)). Research into choice and participation in retirement savings, as well as into member disengagement, generates findings that are consistent with such notions. Drawing on behavioural economics, Sunstein (2013) and Thaler and Sunstein (2003a, 2003b) make a case for “libertarian paternalism” in some regulatory environments. They argue that framing choices can have a powerful, positive impact on outcomes, while preserving the basic freedom to choose. As a simple example, Sunstein and Thaler (2003a) note that the order in which food is presented in a cafeteria may influence which items are chosen by customers. Hence, the cafeteria manager may preserve the ability of customers to choose, while making it more likely that they select a healthier diet. This is libertarian because people choose without coercion; and it is paternalistic because choices are framed to draw customers to “better” selections. Following on from Fear and Pace (2009) and Cooper (2010), this insight applies to the existence and design of default funds.

Such analysis speaks directly to the relation between member choice and default funds in the superannuation system. The nomination of the default fund and its investment strategy is very important, especially for disengaged members who are unlikely to ‘choose to choose’. However, it is worth pointing out that under the superannuation guarantee, the system is more one of “paternal libertarianism”. That is, participation is compulsory; but members are able to make selections thereafter.10 Trust law also comes to the fore under circumstances where members are relying on fiduciaries to choose the default in the initial instance. In this context, the MySuper reforms can be seen as balancing trustee oversight, regulatory intervention and member choice. By adopting a specific focus on default funds that are likely to contain any disengaged members, the MySuper reforms have created an environment where more paternalistic trustee and regulatory oversight might be provided more effectively.

3. Method and Sample

We now detail our research design. We discuss the rationale for using a qualitative, interview-based approach in Section 3.1; detail our sample selection in Section 3.2; describe data collection in Section 3.3; and set out the method of analysis in Section 3.4.

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9 We know from Bateman et al. (2014) that not every default member is “disengaged”.
10 Under the cafeteria example, it is as if customers are compelled to use the cafeteria, but may select anything they want.
3.1. Research Approach

Qualitative methods offer the potential to identify factors and influences that may be difficult to extract or identify through quantitative techniques. Nevertheless, qualitative research has been used in only a modest number of finance studies.\footnote{Kaczynski et al. (2014) provide an overview of qualitative research and its potential application to finance research.} Much of this work comprises surveys, notably in corporate finance (e.g. Lintner (1956); Graham and Harvey (2002)). More recently, there are signs that the use of qualitative techniques in finance may be broadening out. For example, Tuckett (2012) reports on interviews with fund managers about their stock selection processes; Schwartz-Ziv and Weisbach (2013) analyse board meeting minutes; Foster and Warren (2014) interview superannuation fund executives about their approach to constructing multi-manager equity portfolios; while Beshears et al. (2014) conduct a field experiment to measure the effect on savings decisions of 401(k) plan members of disseminating information about peer behaviour. This body of work highlights the potential for qualitative methods to generate deep insights into how decisions are made in practice, especially where a high degree of subjectivity and judgment is involved.

An interview-based approach offers two main advantages in the current context. First, using interviews to examine decision processes is particularly useful where there exists high uncertainty and information ambiguity (see Tuckett, 2012). This is the case with pension fund design, which involves trading-off a wide range of considerations such as organisational objectives and constraints, regulatory requirements, and member needs. Second, interviews reveal the perceptions and rationalisations that are associated with observed behaviours, including accommodating further enquiry through follow-on questions and discussion. As a consequence, interviews are well-suited to identifying aspects that may not be so readily captured by responses to rigid survey questions, let alone analysis of quantitative data. In addition to Tuckett (2012) and Foster and Warren (2014), other examples of studies that use interviews to extract deep insights into the basis of decisions include Langley (1989), Willman et al. (2002) and Rivera (2012).

3.2. Sample Selection and Characteristics

Our research is based on in-person interviews with 28 fund executives from 20 Australian superannuation funds. Table 1 provides details of the sample. By fund provider, our sample of 20 is responsible for managing superannuation assets of A$450 billion in total and over A$210 billion in default fund money at June 2013.\footnote{Asset data is drawn from fund-level profiles reported by the Australian Prudential Regulation Authority (APRA). Australian superannuation funds had assets under management of A$1,619 billion at June 2013, of which A$1,066 billion was invested in larger funds, i.e. excluding SMSFs.} The sample covers 17% of the 120 MySuper fund providers in existence at the time (116 at June 2014). However, it probably captures over 20% of the MySuper funds that are directly managed, given that the majority of the 35 corporate funds out-source their management to mainly retail sector providers. By assets, our sample is responsible for 42% of the total assets and 45% of the default money managed by large ‘institutional’ funds. Our 28 fund executives have responsibility for oversight, design or management of MySuper products. The sample comprises six Chief Executive Officers (CEOs), nine Chief Investment Officers (CIOs), four portfolio managers, four product managers, four asset consultants, and a head of legal and compliance. The asset consultants were all involved in implementing the investment strategy of a MySuper product under an outsourcing arrangement.

Sample selection was aimed towards achieving adequate representation across the three dimensions of fund sector, investment strategy (balanced versus lifecycle) and fund size. We looked to build a sample that spanned the aspects deemed to be most relevant for our inquiry, rather than reflect the...
observed industry distribution. The sample drew on existing contacts of the researchers, referrals\textsuperscript{13} and cold calls; and was subject to the availability and willingness of those contacted to participate.\textsuperscript{14} Willingness to be involved proved to be a constraint, although not to the extent that it undermined the representativeness of our sample (discussed below).

Table 1 also reports the spread of the sample across fund sectors. The sample comprises eight industry, six retail, four public sector and two corporate providers. Of the four public sector funds, one considers themselves as an industry fund, and another views themselves as an industry-public sector hybrid. The low number of corporate funds reflects the limited availability of corporate superannuation funds that are internally managed, given that the day-to-day management of most corporate funds is out-sourced.

Table 1: MySuper Interview Sample

<table>
<thead>
<tr>
<th>PANEL A: Provider Sample</th>
<th>Industry</th>
<th>Public</th>
<th>Corporate (a)</th>
<th>Not-For-Profit</th>
<th>Retail</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>By Number</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interview Sample</td>
<td>8</td>
<td>4</td>
<td>2</td>
<td>14</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>MySuper Product Providers (b)</td>
<td>46</td>
<td>10</td>
<td>35</td>
<td>91</td>
<td>29</td>
<td>120</td>
</tr>
<tr>
<td>- Sample / MySuper Providers</td>
<td>17%</td>
<td>40%</td>
<td>6%</td>
<td>15%</td>
<td>21%</td>
<td>17%</td>
</tr>
<tr>
<td>Superannuation Industry (c)</td>
<td>52</td>
<td>38</td>
<td>108</td>
<td>198</td>
<td>127</td>
<td>523</td>
</tr>
</tbody>
</table>

| By Assets, ASbn at June 2013 |          |        |              |                |        |       |
| Default Assets              |          |        |              |                |        |       |
| Interview Sample (d)        | 94       | 80     | 8            | 182            | 28     | 210   |
| Funds with more than 4 Members (c) | 218      | 138    | 29           | 384            | 82     | 466   |
| - Sample / Large Fund Total | 43%      | 58%    | 27%          | 47%            | 34%    | 45%   |

| Total Assets                |          |        |              |                |        |       |
| Interview Sample (d)        | 161      | 121    | 22           | 303            | 147    | 450   |
| Funds with more than 4 Members (c) | 325      | 257    | 61           | 643            | 423    | 1066  |
| - Sample / Large Fund Total | 49%      | 47%    | 35%          | 47%            | 35%    | 42%   |

<table>
<thead>
<tr>
<th>PANEL B: Interviewee Sample</th>
<th>Chief Executive Officer</th>
<th>Chief Investment Officer</th>
<th>Portfolio Manager</th>
<th>Product Manager</th>
<th>Legal</th>
<th>Asset Consultant (Implemented)</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>6</td>
<td>9</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>4</td>
<td>28</td>
</tr>
<tr>
<td>- % of sample</td>
<td>22%</td>
<td>32%</td>
<td>14%</td>
<td>14%</td>
<td>4%</td>
<td>14%</td>
<td>100%</td>
</tr>
<tr>
<td>Females</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>6</td>
</tr>
</tbody>
</table>

Notes:
\( (a) \) We only consider internally-managed corporate funds. The management the majority of corporate funds is out-sourced.
\( (b) \) Source: Chant, Mahonkumar and Warren (2014)
\( (c) \) Source: APRA Annual Superannuation Bulletin, June 2013 (revised 5 February 2014)

\textsuperscript{13} We would like to thank Warren Chant from Chant West, Joanna Davison from FEAL and David Haynes from Australian Institute of Superannuation Trustees for their assistance in building our sample.

\textsuperscript{14} We contacted 10 additional funds who either declined to be involved, or the enquiries otherwise led to no interview for a variety of reasons.
In terms of investment strategy, our sample is evenly split between providers using a lifecycle strategy and those that retained a balanced approach. A substantial cohort of lifecycle funds emerged with the introduction of MySuper,\textsuperscript{15} with some providers using the opportunity afforded under the MySuper regulations to deliver a lifecycle strategy to their default members. Given that emergence of lifecycle products represented one of the major changes in response to MySuper, we were keen to ensure that lifecycle products were well-represented.

With respect to fund size, Figure 1 plots the distribution of our sample by DC default assets under management at December 2013. As the APRA data on assets in default funds reflects a combination of DB as well as DC assets, we generate Figure 1 using data sourced from Chant West.\textsuperscript{16} The Chant West data identifies the value of assets being managed in 94 default funds that were available for transfer across to a MySuper fund in due course. Our sample has a reasonable spread across most fund sizes, reflecting our aim to form a balanced panel across the dimension of size. There is some under-representation among the smallest funds (sample of three below A$3 billion), which is the area where it proved most difficult to find willing participants.\textsuperscript{17} Compared to the industry as a whole, our sample is over-represented in larger funds.

\textbf{Figure 1:} Distribution by Assets in Default Product (A$, December 2013)

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{chart.png}
\caption{Distribution by Assets in Default Product (A$, December 2013)}
\end{figure}

Two notions lead us to conclude that our sample is adequately representative. First, a key aim is to attain a point of saturation, in the sense that conducting additional interviews would be unlikely to yield further insights (Guest et al., 2006; Bowen, 2008). We judged the main issues and the range of related views to have started becoming evident after about a dozen interviews. This notion was confirmed during analysis of interview transcripts, when categories (‘coding’) were substantially defined after a handful of transcripts; and a clear sense for the debate around the issues emerged well before all transcripts were processed. Second, we monitored the sample as we proceeded. At the point of about 15 or 16 interviews, we treated the remaining interviews as an opportunity to fill any gaps in

\textsuperscript{15} Chant, Mohankumar and Warren (2014) report that lifecycle strategies are used in 19% of MySuper products by number, and 35% by value of default assets under management.
\textsuperscript{16} We thank Chant West for making this data available.
\textsuperscript{17} A number of the smaller funds contacted declined to be involved, perhaps because more limited internal resources made it more difficult to offer up their time. Larger organisations were found to be amenable to involvement as a general rule.
coverage and confirm our sense that saturation had been reached. After having performed 20 interviews, we formed the view that coverage across the dimensions of interest was adequate, and that additional interviews were unlikely to yield further insight.

Table 2: Attributes of the Sample by Provider

<table>
<thead>
<tr>
<th>A) Provider Details</th>
<th>Interview Sample</th>
<th>Overall Industry (where available)</th>
<th>Source</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median % Assets in Default</td>
<td>67%</td>
<td>57%</td>
<td>APRA, June 2013</td>
<td></td>
</tr>
<tr>
<td>Number also Managing Defined Benefit</td>
<td>13 / 20 (65%)</td>
<td></td>
<td>Interviewees</td>
<td></td>
</tr>
<tr>
<td>Number Open to Public</td>
<td>16 / 20 (80%)</td>
<td>62%</td>
<td>APRA, June 2013</td>
<td></td>
</tr>
<tr>
<td>Median Number of Investment Options</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-mixed</td>
<td>6</td>
<td></td>
<td>Product disclosure statements</td>
<td>Range: 4 to 28</td>
</tr>
<tr>
<td>Single Sector</td>
<td>7</td>
<td></td>
<td>Product disclosure statements</td>
<td>Range: 0 to 101</td>
</tr>
<tr>
<td>Total</td>
<td>13</td>
<td>9</td>
<td>Product Disclosure Statements; APRA, June 2013</td>
<td>Range: 1 to 2899 (platform)</td>
</tr>
</tbody>
</table>

B) MySuper Products

<table>
<thead>
<tr>
<th>Objectives (Balanced Strategies Only)</th>
<th>Interview Sample</th>
<th>Overall Industry (where available)</th>
<th>Source</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median Return Target</td>
<td>CPI +4.0%</td>
<td></td>
<td>Product disclosure statements</td>
<td>Range: CPI +3% to +4.8%</td>
</tr>
<tr>
<td>Median Standard Risk Measure</td>
<td>Negative 4 years / 20</td>
<td></td>
<td>Product disclosure statements</td>
<td>Range: 2.4-5.0 years / 20</td>
</tr>
<tr>
<td>Explicit Peer Comparison Objective</td>
<td>3 / 10 (30%)</td>
<td></td>
<td>Product disclosure statements</td>
<td></td>
</tr>
</tbody>
</table>

Investment Strategy

<table>
<thead>
<tr>
<th>Target Asset Allocation (Balanced Strategies)</th>
<th>Interview Sample</th>
<th>Overall Industry (where available)</th>
<th>Source</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>52%</td>
<td></td>
<td>Product disclosure statements, Chant et al. (2014)</td>
<td>Range: 45% to 60%</td>
</tr>
<tr>
<td>Property</td>
<td>10%</td>
<td></td>
<td>Product disclosure statements, Chant et al. (2014)</td>
<td>Range: 0% to 15%</td>
</tr>
<tr>
<td>Fixed Income &amp; Cash</td>
<td>20%</td>
<td></td>
<td>Product disclosure statements, Chant et al. (2014)</td>
<td>Range: 7% to 38%</td>
</tr>
<tr>
<td>Other</td>
<td>18%</td>
<td></td>
<td>Product disclosure statements, Chant et al. (2014)</td>
<td>Range 5% to 35%:</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Median Growth Assets</td>
<td>73%</td>
<td>73%</td>
<td>Chant West Fee Report, December 2013</td>
<td>Lifecycle: weight at age 50</td>
</tr>
<tr>
<td>Passive (vs Active) Management</td>
<td>4.5 / 20 (23%)</td>
<td></td>
<td>Interview feedback</td>
<td>0.5 = &quot;substantial passive&quot;</td>
</tr>
</tbody>
</table>

Average Fees

| Investment Fee                              | 0.57%            | 0.61%                               | Chant West Fee Report, Dec’13; Chant et al. (2014) |       |
| Other Percentage Fees (Administration, etc)  | 0.30%            | 0.30%                               | Chant West Fee Report, Dec’13; Chant et al. (2014) |       |
| Total Percentage                            | 0.86%            | 0.90%                               | Chant West Fee Report, Dec’13; Chant et al. (2014) |       |
| Fixed Dollar Fees (Member Fees)             | $78.30           | $77.31                              | Chant West Fee Report, Dec’13; Chant et al. (2014) |       |
| Fee at $25,000                              | 1.17%            | 1.21%                               | Author calculations |       |
| Fee at $50,000                              | 1.02%            | 1.06%                               | Author calculations |       |

Insurance

| Death and Total and Permanent Disability    | Option to increase cover: 18 / 20 (90%) | Product disclosure statements; interviewees |       |
| Income Protection                           | Default 6 / 20 (30%); available 16 / 20 (80%) | Product disclosure statements; interviewees |       |

Advice

| Limited free advice                        | 14 / 20 (70%)    |                                     | Product disclosure statements; interviewees |       |
| Access to in-depth paid advice             | 19 / 20 (95%)    |                                     | Product disclosure statements; interviewees |       |

Table 2 reports a range of attributes for our provider sample and their MySuper funds, including comparisons to the overall industry where data is available. Our sample contains providers with a moderately higher portion of default assets that the industry on average (67% versus 57%). It also contains more funds that are open to the public (80% versus 62%). Sixty-five percent of our sample manages some DB in addition to DC funds; although the DB amounts are relatively modest in the...
majority of instances. The stated objectives of the 10 balanced funds in our sample suggest that they are targeting higher returns for higher risk, with a median return target of CPI+4% and an expectation of negative returns in four years out of 20.\(^\text{18}\) Only 30% of the balanced MySuper products in our sample have an explicitly stated objective to outperform their peer group. Given that none of the lifecycle products have peer objectives, this means that three out of 20 (i.e. 15%) of our sample have a publically-declared peer-relative objective. Both the average exposure to growth assets (73% \(^\text{19}\)) and the average fee charged by our sample for their MySuper products are broadly in line with the industry. The large majority (90%) of our sample offers their members the option to vary life and total and permanent disability insurance;\(^\text{20}\) while 80% offer access to income protection insurance (with 30% providing it as a default). With respect to advice offering, 70% of the sample provides free advice (typically limited in scope); and 95% provide access to more in-depth advice on a paid basis.\(^\text{21}\)

### 3.3. Data Collection

Our data is collected from in-person interviews, written documents and media reports. Interviews were of a planned duration of one hour, although some ran over-time. Two researchers attended each interview, one of whom attended all of the sessions. One researcher conducted the interview, with the other taking notes and asking supplementary questions as appropriate. Interviews were recorded, and verbatim transcripts prepared for analysis. Interviews were conducted in a largely open-ended format, with a view to permitting participants to tell their own story. The ‘Interview Guide’ appears in the Appendix.\(^\text{22}\) The guide is structured around a sequence of lead questions to open up an area of inquiry, with follow-up questions to seek further detail on items of specific interest. Written documents included product disclosure statements (PDS’s) and other marketing material downloaded from fund websites. A number of participants made additional internal documents available. Finally, media reports were collected of statements made by representatives of providers in the sample, as well as other industry participants. These written documents and media reports provide additional evidence on product design and viewpoints about the industry or its regulation.

### 3.4. Analysis

Analysis involved allocating statements in the interview transcripts and other data into categories (grouping of coding into ‘nodes’\(^\text{23}\)) that align with common themes, concepts, viewpoints or facts appearing in the data; but without specifying the categories in advance. The process was iterative, in the sense that the number of categories and allocation of statements was reviewed and updated on an ongoing basis. Coding was undertaken by one researcher, and checked independently by another researcher. Once categories were formed, a structure was formulated by which the findings were written-up. Further checking and iteration occurred in the process of translating the coding into written text. The findings include a combination of insights into decision making processes, thoughts expressed by participants, and a range of details on various aspects of MySuper product design. Views received on the superannuation industry and its regulation in general are written up separately in Butt et al. (2014), leaving the current paper to focus specifically on MySuper.

\(^{18}\) Expectations for a negative return in four years out of 20 sits at the border of “medium-to-high” and “high” risk under the standard risk measure.

\(^{19}\) This estimate takes the growth exposure for lifecycle strategies at age 50 as indicative.

\(^{20}\) The regulations require death and total and permanent disability insurance to be offered on an opt-out basis.

\(^{21}\) One provider offers free advice only, with no paid advice.

\(^{22}\) We thank Warren Chant and Joanna Davison for helping to review the interview questions.

\(^{23}\) NVivo 10 software was used in the analysis.
Various techniques exist to ensure that qualitative research is trustworthy and consistent. Our paper ensures integrity by referring to the literature described in Section 2 for conceptual framing, drawing on multiple data sources, and analysing data from various perspectives. More specifically, the following three methods are used in this study:

- **Data triangulation** – Where possible, interview data was cross-checked against observed behaviour (e.g. MySuper designs) or written documents. Checking against documents was of mixed benefit, as the depth of insight revealed by documents such as product disclosure statements is limited. Data triangulation was highly beneficial in some cases, and marginal in others.

- **Researcher checking** – Initial data analysis was completed by one researcher. The node structure was then checked by another researcher, operating with reference to the original transcripts. During the write-up of results, the structure by which the findings were collated, presented and interpreted was further rationalised and checked by other researchers until convergence.

- **Participant checking** – Draft reports and findings were shared with the participants, and they were asked to comment on their accuracy and plausibility. No substantial issues were raised; although some participants did offer some suggestions that were mostly adopted. This included a few minor adjustments to quotes, aimed at making their meaning clearer.

### 4. Findings: Purpose and Motivation

We commence reporting our findings by reflecting on what our participants indicate about their purpose and motivations as designers of MySuper products. Section 4.1 recounts comments about the central role played by member needs; and puts forward some affirmations for these remarks. Section 4.2 discusses how the focus on members needs is tempered by business considerations, specifically the requirement to generate an offering that is attractive in the market. In Section 4.3, we address the question of who is the customer. This is a complex issue, as the ‘sale’ sometimes involves an intermediary such as a sponsoring employer or a financial adviser. Nevertheless, a primary focus on the end-member seems to prevail. Section 4.4 offers some summary thoughts.

#### 4.1. Member at the Centre

Every participant we spoke to made statements to the effect that they viewed their central purpose and primary motivation as building products to meet the needs of their members. Such statements are to be expected: the issue is the extent to which they reflect genuine intentions. We see evidence to support the notion that the expressed motivations may indeed be genuine. Comments consistent with member needs being considered as primary were sustained throughout the interviews, including during the discussion of MySuper design (see Section 6), reflections on MySuper (Section 8), and in commenting on the industry and its regulation (see Butt et al. (2014)). Evidence of participants saying one thing yet doing something else were limited: the reporting of decisions taken and the underlying reasons are largely consistent with our participants treating meeting member needs as central. We also argue further below that there are business reasons for focusing on member needs.

There is a perception that not-for-profit providers are more likely to have a keen focus on member needs, given their ownership and governance structures and the absence of a profit motive. What we heard from our not-for-profit participants accords with this notion. Hence we concentrate on what we were told by the retail providers in the sample. The actions of retail providers are of particular interest not only because of the profit motive, but also because the ‘sale’ is often made via an intermediary
such as a sponsoring corporation or a financial adviser. Below we extract quotes from all six retail providers where they declare their focus to be on member needs:

“we actually sat back and said what's the right option for a default member? ... what generic features or factors can we take into account in the design, which is what led us down the lifecycle path. ... we're not just building products that we think have some great investment characteristics, whatever we build meets a client need.”

“The board and investment committee don’t spend any time looking at peer comparisons, so it’s very much focused on the member outcomes. ... There would be awareness of commercial considerations, but any decision that’s made by the board has to be demonstrably in the interest of the members.”

“For disengaged members ... there’s opportunity there to be a little bit paternalistic, to guide them through life and to take more risk when they’re young and less risk when they’re old and try not to blow them up just before they hit retirement; look at sequencing risk. ... So for us, lifecycle ... had the benefit of saying well let’s sort of step away from this dysfunctional peer analysis ... we think, better for the member over the long term.”

“To a large extent, the people we deal with are the corporates, they are the trustees; but they are responsible for the members and that has that paternalistic aspect to it. We work with them with the members’ needs in mind all the time through; and similarly they try and act in the best interest of their members. So we tend to find that there’s not a strong conflict of interest there at all: all working towards the same goal.”

“Personally I see the clients as being the end investors.”

“the focus really became on the member ... and it’s actually a part of our strategy: our corporate strategy for [company name] is the customer at the forefront ... going back to the members and our customers, actually developing product and services from their needs rather than going through an intermediary”

The suggestion that retail providers may be primarily focused on members over and above the needs of the business sits at odds with the scepticism over lack of alignment in the for-profit sector expressed by authors such as Langford et al. (2006), Sy (2008), Stewart and Yermo (2008) and Ashcroft and Stewart (2010). How might a primary focus on members be reconciled with the profit motive? The above quotes provide a hint. First, many retail providers view the need to demonstrate that a product is in the best interests of members as a key component of the value proposition; the ‘selling point’. Indeed two of our retail providers (the first and sixth quoted) alluded to their organisations having recently shifted to a customer-centric business model.

Second, the notion that retail providers often access the member through employers and advisers can be influential. These intermediaries play the role as ‘gatekeepers’. To the extent that these gatekeepers are looking out for the member’s best interests, they can encourage the design of products that meet member needs; and providers in turn will need to convince them that the product is fit for purpose. This check has long existed in the case of employers, who are particularly important when disengaged
default members are involved, given they choose the fund supplier in many situations. The fourth quote above makes this point directly.24

Under the advice channel, member alignment has historically been less apparent. Advisers were in the past paid commissions by retail providers (Langford et al. (2006)). Further, the adviser may be tied to the provider in some cases. Nevertheless, change is occurring in the advice industry to enhance alignment between advisers and members. The advice industry has moved from a commission-based to a fee-for-advice model, reinforced by the Future of Financial Advice (FoFA) legislation which has banned commissions on specific advice and emphasised the primacy of customer best-interest. A couple of high-profile advice scandals (involving Commonwealth Bank and Macquarie Bank advisers) also appear to be spurring moves to rebuild trust through enhancing skills, integrity, and member alignment within the major adviser networks. It is early days; but the chances have increased that advisers will become more effective as custodians of member interests going forward.

Another consideration is the maturing of the superannuation system, and increases in member age and balances. A number of our participants refer to members becoming more engaged as they approach retirement and balances increase. As members become more focused on their superannuation fund and retirement, there is a heightened incentive for providers to ensure they satisfy member needs, and that they build trust through demonstrating alignment with member interests. The threat of losing larger balances to the SMSF sector only reinforces this incentive.

The bottom line is that the business imperatives to act in the best interest of members are on the rise, including in the retail sector. This provides a reason to believe expressions that member needs are central may reflect genuine intentions.

4.2. Competitive Positioning Matters

While member needs may be central, other business considerations such as competitive positioning remain highly influential. For a start, for-profit providers still need to make a profit. We encountered numerous comments referring to an underlying desire to retain if not attract members, from not-for-profit and for-profit providers alike. As a consequence, most providers want to ensure that their offerings are attractive in terms of either the performance they deliver or their product features, and ideally are competitively priced. The quotes immediately below are again from our six retail sector participants, arranged in the same order as the quotes appearing in Section 4.1:

“It was very important for us to have not only a relevant and the right offer for members, but also a competitive offer. So we do still want, as I said, to sell to employers. ... it’s reasonably competitively priced”

“the real tension point ... was the precise construction of the MySuper option. So lifecycle, fine, everybody agreed to that, we didn’t flounder there. ... And then there’s

24 Although employers may in many cases choose suitable products and achieve substantial fees discounts on behalf of their employees (potentially of up to 70 basis points for large funds; see Chant, Mohankumar and Warren (2014)), this is not guaranteed. For instance, the Productivity Commission (2012) notes that some employers may lack the capability or incentive to select funds in the best interest of their employees, perhaps due to a desire to minimise search costs, or focus on administrative efficiencies and other benefits for their own organisations. Nevertheless, as long as a meaningful portion of employers remain concerned with the interests of their employees, then fund providers will have an incentive to ensure that their (single) MySuper offering is designed to meet the needs of members. However, the attentiveness of any particular employer to the interests of their employees, as well as their willingness to tender, may impact on the fee paid by the member
the commercial reality that the press and APRA and the whole world, the whole Australian world, is going to be focusing on price ... there was a very strong view on the business side that we don’t have to be the lowest fee but we can’t be the highest and we don’t want to be in the upper quartile of fees. ... then understandably enough, the business also wanted to be able to make a profit”

“it was an horrifically complex piece of work to work out what made commercial sense for us, what made commercial sense for advisors ... what made sense to the membership and how that fitted with peers who had yet to disclose a product”

“Fees do come into it though because you ... pitch your product against others ... you need to be able to argue and articulate for the solution”

“So the risk as the business presents it to me is one of we want to ensure that our product set is outperforming relative to a competitor set, or is above median in terms of its outcome. ... we deliver investment solutions ... objective of making sure individual MySuper clients ... don’t come back five years later and say, “Well look, I just wish I’d chosen another firm, XYZ”

“the focus within the superannuation industry and by legislators was all around costs, right, not necessarily by performance. Cost was definitely the driving factor.”

Comparable comments also emerge from the not-for-profit sector, albeit to varying degrees. Within the not-for-profit sector, industry funds appear more attuned to their competitive positioning than public sector and corporate funds. This is probably due to public sector and corporate funds facing less member competition due to being closely tied to the employment relationship, under which the product is explicitly designed for employees within the organisation. The two quotes below are from industry funds. They indicate the importance of competitive positioning for players in that sector:

“we recognise that in order ... to provide a valuable service in the super industry, we have to offer it on a competitive basis”

“ultimately we’re very, very aware that this is a competitive industry ... the main focus was more actually around the demographic profile of our members. ..... But clearly, you don’t have a default option without thinking about where you’re situated relative to peers and other competitive forces”

The manner in which business considerations are discussed by most participants indicates that they are considered not as a prime driver, but either as secondary or a constraint. This notion is encapsulated in the term ‘fee budget’, which is widely used in the superannuation industry. As the above quotes reveal, fees are often determined based on considerations of competitive positioning. Once fees charged to the member are set, they establish the budget available to pay for the combination of investment management costs, other expenses, and any profit margin. Similarly, the requirement to generate ‘adequate’ shorter-term peer-relative performance is partly viewed as another business constraint, in the sense that there is a concern that underperformance might lead to a re-evaluation of the provider. Alongside this, we heard many comments that focusing on short-term performance only serves to distract attention from meeting the long-term retirement needs of members (see quotes reported elsewhere in this paper, as well as Butt et al. (2014)). These perspectives can be reconciled by interpreting the delivery of adequate shorter-term performance as a business consideration our participants feel they need to address to remain competitive, rather than as a central objective.

25 Some participants observe the importance for members of delivering solid performance over the long term.
4.3. Who Is The Customer?

Section 4.1 mentions the involvement of intermediaries such as employers and advisers who act as gatekeepers. While such intermediaries are prevalent in the retail sector, they also play some role in the industry fund sector, most notably where the provider is nominated by the employer. In other parts of the industry fund sector, and in most of the public fund sector, the default provider is nominated under an industrial award and hence there is no intermediary involved. Most providers will also be servicing a cohort of choice members, which may have invested ‘direct’ on their own behalf, or might be directed by a financial adviser. These facets amount to a complex web of relationships between members, their providers and various intermediaries. In an attempt to disentangle this web, we made follow-up queries during the interviews around who our participants considered to be the customer. Below we give a sense for the responses, which were mixed. As one retail sector participant put it:

“We have three lots of clients. So we have an advisor, we have the end customer, and we also have the employer. We provide different services to each of those.”

The following quote best sums up the situation when an employer acts as an intermediary:

“You essentially sell this product to the employer, and then service it to the employee.”

The fact that the sale might be made to the employer is not sufficient for our participants to consider the employer to be the primary customer. When asked about who is the customer, most of our participants responded by focusing initially on the member. A common stance was that the ultimate objective was to meet member needs; and that the aim was to convince the employer that they will do well for their employees. Nevertheless, they also recognise the requirement to cater for the employer. Usually this involves providing an efficient service that addresses the employer’s obligations under the superannuation guarantee levy. The three quotes below draw out these tensions. The first quote is from the retail sector, and the other two are from not-for-profit funds.

“The client is always the end-member. It’s always the end-client. We have absolutely defined this for the end-client. We have a sale that we have to do with an employer, so there is a buyer of the service that is the employer. But it’s absolutely a product designed for the member. And we believe that if you build a product in the best interests of the member, it should sell itself to employers because you are developing something that’s in their employee’s best interests. … one of the best ways to sell any product, is to show that it is in the best interests of their employees.”

“… in the DC space, the member owns the asset so the member is the client. We are very careful to talk to our employers though, because at the end of the day ... the members are their employees, and we want to make sure there are limited stresses from superannuation on those employers.”

“we regard both the employer and the employee as a client, someone that we have to look after. There’s a greater level of involvement with those corporate clients, and they see the superannuation as being a core part of what they’re offering their members, and they want to have a say in how it’s offered.”

While financial advisers are more important for choice members, they can play an intermediary role with respect to default members in two ways. First, they could direct a member to invest in an appropriate default fund. The latter tended to be discouraged under a commission system. This should now change under FoFA, which has banned commissions in favour of fixed fees for service. Second,
advisers may assist employers to select the providers and products they make available to employees. The following two quotes provide a sense for the role played by advisers. Based on what we were told, advisers tend to focus on performance; prefer a wide range of product choices to recommend; and have a need for information with which to service their clients:

“The people who look at performance more are the engaged employers and their advisors. … Mostly you’re talking to advisors and employers to say why this is a good thing for disengaged members.”

“… all the corporate superannuation business has an advisor attached and the advisor will always provide you with that feedback about how the default funds are working … if there’s underperformance in the short term … the financial planners will squeal”

For public sector and internally-managed corporate superannuation funds where no intermediary is involved, the member is clearly the ‘customer’ and the central focus. Corporate funds are interesting as they are embedded in an organisation, which affords a level of intimacy with the member:

“because we are a corporate fund, we sit in the organisation, we interact with members in the normal course of going to the kitchen, walking around in the building, we have many rich opportunities to get their feedback. … you could describe it as family-like … [we] have member directors from different sectors of the workforce … they’re very engaged”

Overall, the perception of who is the customer depends on the situation, and can be blurred when an intermediary is involved. Perhaps the most important point is that existence of multiple ‘customers’ does not seem to be distracting fund providers from treating member needs as central. In the case where an employer is the intermediary, the need for the provider to demonstrate that their product suits the needs of employee-members helps to ensure that the focus remains on the member. Advisers are less important in the default fund arena. Nevertheless, the banning of commissions might be expected to encourage a greater focus on the member going forward.

4.4. Summary

Our interviews indicate that the superannuation industry presents its central purpose and primary motivation as meeting member needs. We have provided reasons to believe that there could be substance behind these claims. Not only was the primary focus on member needs maintained throughout the discourse; but we can see business imperatives for pursuing such an approach. This notably includes for-profit providers, who appear to be increasingly adopting a member-centric stance as a business model. A number of factors increase the onus on providers to demonstrate that they are acting in the best interests of members. One factor is the prospect that the relationship with the member may encompass an intermediary such as an employer or adviser who might be concerned with member needs (the relevance of which should be enhanced by changes in the financial advice industry towards a fee for service model). Another is increasing member age and balances which may lead to members becoming more attentive, reinforced by the threat of leakage of funds to the SMSF sector. We might add that the desire of the industry to (re)build trust should be encouraging a greater focus on member needs. Nevertheless, most of the industry is also concerned with their offering being competitive in the market place; in part because this is monitored by intermediaries such as employers and advisers. As a consequence, various aspects like relative performance, fees and product features also matter to our participants in their attempts attract and retain members.
5. Perceptions of Member Needs

We now examine what our participants said about the needs of their members. There are many nuances; but again what we heard is consistent with a keen focus on members. We commence in Section 5.1 by listing the multiple input channels used to gauge member needs. Channels receiving the most mentions include research on the member base, member surveys, feedback from financial planners and member interactions. In Section 5.2, we discuss how our participants perceive default fund members and their needs. While most find it convenient to characterise this group as largely disengaged and often poorly informed, we also detect an appreciation that members can be diverse. We uncover a widely-held view that the major need relates to retirement outcomes. Short-term performance is considered of limited relevance to default members themselves; although some participants expressed the view that members dislike shocks. Others suggest that some members just want somebody to look after their superannuation for them. In Section 5.3, we highlight how the member base can vary substantially across funds. Major sources of variation include: demographics; wealth levels (e.g. average balances and incomes); the degree of heterogeneity across members; behaviours; culture; engagement and financial knowledge; and the involvement of intermediaries. In Section 5.4, we touch on member communications, observing how some providers are looking to shape member perceptions of their own needs. Section 5.5 summarises.

5.1. How Member Needs are Gauged

We asked participants how they went about forming perceptions of the needs of their members. Figure 2 lists the main input channels, along with the number of times each was mentioned (by provider). These counts should not be taken as a comprehensive measure, as there is risk of omission under open-ended, semi-structured interviews. Further, some participants were being asked to comment on activities outside their own area: two participants declined to comment for this reason. Nevertheless, the number of mentions provides a useful guide.

Figure 2: Input Channel for Gauging Member Needs
Of the 18 participants who commented, 3.8 input channels were mentioned on average, with a range from one up to six. The most prevalent is research on the member base, including its demographic structure and observed member behaviour. A few participants commented that researching the member base is particularly important in the case of default members, given that they are often disengaged. Also prevalent are member surveys, and feedback from financial planners. Considerable attention is paid to interactions with members during seminars and the like; monitoring of queries and complaints (two participants said they personally listened to call centre recordings); and feedback from representatives of the members such as company or union officers.

5.2. Perceptions of Default Fund Members and their Needs

An understanding of customers is fundamental to any product design. We report on participant perceptions of default fund members and their needs. A few features stand out amidst a broad range of mixed responses. The major aspect is a strong sense that it is the fund provider’s job to cater for default members, and to help them prepare for retirement. The tone was one of paternalism towards a group that was widely considered to be mostly disengaged and probably poorly informed.

The ‘Typical’ Default Member Is Characterised As Disengaged

The Cooper Review (2010) had a vision for MySuper as being intended for disengaged members. We found that most participants did indeed describe the ‘typical’ default fund member as largely disengaged, and designed their MySuper offering accordingly. But we also encountered a general awareness that this characterisation is an over-simplification.

The following quote sums up what was a fairly widespread ‘knee-jerk’ sentiment about the ‘typical’ default fund member:

“If we’re talking about MySuper, many members possibly don’t even know they’re a member of the fund.”

A large majority of our participants (17 out of 20, or 85%) either made explicit statements similar to the above quote, or indicated that they were adopting a paternalistic approach to MySuper on the basis that the average default member was either disengaged or poorly informed. Of the remaining three, one participant was reluctant to comment on member needs as it was not their responsibility. The other two may have just failed to make mention of the level of member engagement as a consideration; although both had distinctive member bases with less than a quarter of assets invested in the default.

There is broad awareness that the characterisation of default members as inherently disengaged is an over-simplification. A majority of our participants commented that members tend to become more engaged as they age (typically sometime after 50 years), or as their superannuation balance increases. Our participants mostly welcome member engagement. If anything, they are trying to think of ways to foster greater engagement. There is widespread recognition of the shortcomings and danger of a one-size-fits-all approach. Some participants also went out of their way to make the point that members are all different. This reveals an acknowledgement that members have various needs, and that characterising the average default member as disengaged is nothing more than a convenient construct to facilitate the design of MySuper products. The quotes below reflect these sentiments:

“we looked at the demographic of who was in default; we looked at our 30 year olds, over 85% of those members were in default. As we aged it and looked at our 55 year
olds, it was less than 30% were in default. ... we also found that as salaries increased, people begin to choose; and as balances increase, people begin to choose.”

“we’ve got multiple types of members ... young members who are somewhat disengaged and therefore they’re happy to be stuck in a default fund ... those who are in their 30s to 50s who are going through the classic lifestyle changes and they’re becoming more engaged ... there are those on the other side who fit in two camps: those who don’t have enough to retire and are worried about what the future is; and those who have been fortunate enough to have a bit to retire on and are thinking of what type of strategies they need to protect their retirement income and what type of drawdowns they want in their post-retirement phase. ... you’ve got to try and look at the more collective group as part of the process and look at the average member, for want of a better term, when you never have an average member”

“every single person is different – what’s the right retirement portfolio for an individual? It could be anything from 100% cash to 100% shares”

“we’re probably conscious of avoiding stereotype ... because it is so diverse”

Focus on Retirement – Income Streams versus Balance at Retirement

Virtually all of our interviews either explicitly or implicitly refer to the primary need of superannuation members as being related to retirement outcomes. Further, the vast majority (75%) made statements to the effect that the main focus should be income in retirement. This suggests that the dominant view within the industry is that the function of superannuation is help build retirement income streams. Hence the recommendation of the FSI (2014) of establishing a primary system objective ‘to provide income in retirement’ appears to reflect a perspective that is already widely held within the superannuation industry. Nevertheless, sitting alongside this is a perception by some participants that balance at retirement is relevant in its own right. Some considered balance at retirement to matter because members have an option (often exercised) to take their money and go elsewhere. A related reason is the observation that many members use part of the balance they receive upon retirement for purposes such as spending (e.g. overseas holiday) or repaying debt. Consequently, the commentary varied over whether the task should be framed as aiming to maximise balances at retirement, versus working towards retirement income streams.

At one end of the spectrum were those who strongly believe that income in retirement should be the exclusive focus. Those with this belief are often searching for ways to shift the focus of members and the basis of conservation away from account balance towards retirement income streams:

“... ultimate goal of providing an adequate and sustainable income in retirement for members. For us, that’s the primary objective for any fund, and it shouldn’t be moved into any other direction.”

“we’re focusing very heavily at the moment on changing the conversation away from lump sum at retirement to income through retirement. We think we’ve got to change the way we again, manage money, the way we talk to members about through, not to, retirement is pretty critical.”

Others acknowledge that members may use some of the balance at retirement needs to be considered. Some even saw it as their role to accommodate this behaviour:
“Our members are not prioritising wealth creation for its own sake. Rather they are prioritising certainty of the level of income they will be able to draw from their capital through their [uncertain] term of retirement. ... [however] ... we’ve noticed that our members take money out of their retirement. On average they take 15% to 20% of their assets ... I’m not sure what it is they do. So we’ve sort of opted, for the moment at least, to secure that number for them.”

A few even took the view that most members are primarily interested in a healthy balance at retirement. They hence see their role as working towards this objective:

“... most members at this point do take their final sum as a lump sum, and the other option is to obviously take it as annuity, but a lot of members are taking it as a lump sum. And we know that capital protection is quite important for those members as they reach retirement. So philosophically we believe that you should have something that de-risks you as you move towards retirement if you’re unengaged.”

A more even-handed view is that one should not presume, as it depends on the member:

“The truth is that there are a lot of people who have come into the system ... they’ll never have enough. The annuity stream is a government pension and then the more serious debate is what should they do with that small pot of money? Should they invest it? Should they just spend it? What do they need to do? And it might be as simple as, you know what? I’m going to take it and pay off the mortgage. So it’s horses for courses.”

While there is obviously debate around whether delivering an income stream should be the dominating and perhaps exclusive objective, one thing is constant. Our participants by and large express the view that the main objective is to deliver a retirement outcome – especially for disengaged members – rather than year-to-year performance and asset accumulation for its own sake.

**Short-Term Returns and Peer-Relative Performance of Limited Relevance**

One of the more surprising findings from the interviews was the extent to which our participants viewed short-term performance as largely irrelevant for the members themselves, especially those who are disengaged. Indeed, our discussions with participants seemed at odds with the general perception that the industry is too focused on short-term returns. In most instances, we had to actually ask about the importance of short-term returns and peer-relative performance. Further, the responses tended to be off-hand. The impression we received is that much of the industry considers short-term performance a distraction when managing default funds; and an aspect to be managed that is largely of interest to intermediaries such as engaged employers and advisers (refer to Section 4). Short-term performance is considered of little consequence for disengaged members, who mostly ignored it anyway. The notable caveat is that some participants held the view that members want returns to be positive and adequate, and that they tend to care when returns are negative particularly near retirement (discussed below). The series of quotes below provide a good sense for the type of responses we received when asking about the relevance of short-term performance:

“an unengaged default member probably couldn’t give two hoots about the performance of their fund, or wouldn’t know or wouldn’t understand. ...They want to see it growing, I think, but they don’t care if it’s 8% or 15%. ... they probably don’t get the peer relativity of it”
“Our annual member survey indicates that returns are not a primary objective … but … it needs to be within a right range for their expectations … how much do we talk about being a CPI fund as opposed to a peer driven fund? The marketers tell us that promoting that message too hard and is actually too complex for our members.”

“… it has almost no relevance to them… We have consciously stepped away from metrics like peer relative returns … We look at risk-adjusted retirement incomes.”

“we don’t get a lot of members asking about year-to-year performance … peer risk relative … it didn’t figure large … From a member point of view it’s not important.”

Members Don’t Like Shocks

While performance doesn’t emerge as a prime focus per se, there is a view that members dislike negative returns especially near retirement. This thinking provides the genesis of lifecycle investing. In accordance with these observations, 10 (i.e. 50%) of our participants made statements indicating a belief that members want to be insulated from return shocks. A selection of representative quotes appears below.

“it’s about smoothing the ride … the predominant theme when we start talking about MySuper … is really understand sequencing risk and understand that smoothing the ride is so important for the members. … stability in year-to-year return and to try and reduce the probability of a negative”

“they want reasonably high security so they want their funds to be well managed and probably on a more conservative rather than more aggressive nature”

“we’d had a relatively successful peer-relative GFC and I sort of made this presentation that we’d done better than many other funds. A [retiring member] walked down to me after it and he said, ‘Do you know what? Keep this number in your head.’ He said, ‘Five years. … That’s how long I’m going back to work to replace the contributions you guys have lost, and the fact that you think you’ve done a good job is inspiring me to get out of this fund.’ He said, ‘I’m not invested in [fund XYZ], mate. I don’t care what [XYZ] did, and the fact that you did a little better than them is irrelevant.’ … on the way back, I said, ‘My God, we cannot do this to these people’”

Some Just Want a Guardian Angel

Six of our participants conveyed a view that what their members really want is to be looked after. Members are putting their trust in the provider in general or the trustees specifically to provide a product that they could rely on and is fit for purpose. The following quotes are representative:

“they’re putting their trust in us to look after their retirement savings”

“I don’t find it’s conversations about returns, it is actually to say ‘is it safe?’ and ‘you guys are looking after it and doing a decent job’”

Other Needs Mentioned

Some other needs are raised by a minority of participants. Three made explicit mention of ethical or sustainability beliefs as being very important to their members. Three alluded to a requirement for reasonable fees, although typically this was a supplementary rather than central point. One considered the provision of financial advice for all members as important.

5.3. Nature of the Member Base

The discussion has focused so far on the perceptions of our participants about the needs of a ‘typical’ default fund member. Another critical dimension is the nature of the members invested in the fund: most providers designed their MySuper offering in accordance with the specific attributes of their member base. There exists considerable heterogeneity across the member bases that our participants are attempting to address. An appreciation for this heterogeneity is important in understanding the choices on MySuper design to be described in Section 6. We have selected a few quotes to give a sense for the wide range of descriptions of the member base that we encountered, and how these differences might translate into fund design:

“... average age 29 years old who are totally disengaged and do not normally exercise choice as evidenced by the 90% that are in the default option. What that does is affords you a longer investment horizon, allows you to be in greater amounts of illiquid assets”

“broad cross-section of low to middle income Australia ... other key hallmark ... is that the average age is relatively young ... The account balances are generally speaking quite low, and almost all of the contributions are superannuation guarantee. ... people that are reaching retirement are likely in almost all instances to be reliant on the part pension and in many cases the full aged pension, which is very critical when we come to talk about asset allocation strategy. and it makes us quite different from a number of funds”

“very high balances .... also an older demographic”

“They’ve got high contribution rates, they’re mandatorily part of the fund and there is a very significant accountability that is felt moderately by the fund to provide something for them, you know, like essentially everything for them. ... they have a social set around them. ... they mirror the lifestyle of their contemporaries and even though they could afford more, they don’t aspire to more”

“We serve the [...] tribe ... uniquely servicing that [...] segment of the market ... we’re a value-driven organisation”

“Our membership is not particularly distinct ... it’s fairly much a cross section of the Australian community”

The above quotes provide just a taste for the ways in which member bases varied. Below we list the key dimensions of variation that were mentioned during the interviews, to which we add our own discussion of the implications. How these dimensions impact on the design of MySuper products will be drawn out in Section 6.
• **Demographics** – Age tends to be conveyed as a primary demographic variable, given that it impacts on attributes that are important for product design such as average balance, engagement, cash flows and proximity to retirement. A younger member base tends to encourage a focus on maximising long-term returns; while an older member base suggests a more conservative approach aimed at protecting the retirement nest egg.

• **Wealth: average balances, incomes and contributions** – The level of wealth is seen as relevant in its own right due to the link with social security, particularly the age pension. Low wealth and smaller balances at retirement increase the importance of the social security component of post-retirement income, and decrease the call for de-risking as retirement approaches. This concept is reinforced by the means-testing of the aged pension, under which it acts as a hedge for investment returns. Low balances thus reduce the logic to switch into fixed income assets as retirement nears.

• **Heterogeneity** – Greater heterogeneity in the member base provides encouragement to look towards more tailored solutions. Lifecycle was the major option available under MySuper for tailoring; although heterogeneity is also relevant for aspects like the potential value of advice.

• **Behaviours** – Some participants refer to biases towards certain behaviours within their member base, such as a particular level of risk aversion, or the tendency to take lump sums at retirement. These biases may be revealed by observing member behaviour, such as the response to shocks like the GFC, switching activity, and actions at the point of retirement.

• **Culture** – Some providers noted that they are servicing a member base with a peculiar culture. Three of our participants consider sustainability and ethical considerations to be very important for their members. Another example is the stark contrast between the two corporate funds we interviewed. One has members who want to be looked after by their fund; while the other has more engaged and active members, with a low percentage invested in the default.

• **Engagement and financial knowledge** – Whether members are engaged and informed – or may become so – can influence the extent to which the provider adopts a paternalistic approach in designing the default offering. Some participants indicated that they are alert to the potential for members to become more engaged at a future point, and were aiming to accommodate.

• **Involvement of intermediaries** – The role of intermediaries such as employers and advisers was discussed above. Pursuant to the discussion, the involvement of intermediaries in the member relationship might increase the emphasis on peer risk, demand a higher standard of professionalism, and lessen the emphasis on paternalism on behalf of the provider.

### 5.4. Member Communications and Encouraging Engagement

We received a number of comments on the link between communications, member needs and engagement. These comments provide evidence that some providers are not just interpreting member needs, but are aiming to shape member perceptions of their own needs. Most prevalent (mentioned by seven participants) were allusions to shifting the focus away from returns and the value of the account balance, towards how members are tracking towards their retirement goals. In most cases, this goal was taken as related to retirement incomes, although there were some mentions of adequate balances at retirement. In any event, it is apparent that the recommendations of the FSI (2014) around facilitating the communication of retirement income projections to members aligns with the intentions already held by many in the industry. We also heard mention of how communicating with members in this way may spark a conversation which leads to greater engagement:
“if you can communicate with them that you’re on track to meet a certain target at retirement … performance will become less of an issue … we do think this is a mechanism to better engage those members because you can make it more relevant … just track how we’re going relative to what we said we would on a longer-term basis. … If we think it’s a breach that we can’t get back, at this stage our solution to that would be to use communication as our tool”

“Now we’re not there yet, but I want to get a point where we are actually giving income projections in annual statements as opposed to lump sums … If we can have a conversation about the dollar impact on income, I think we’ve got a better, more stable conversation”

“… all of the metrics that we use, all of the engagement that we have with the trustee for our default members is around the provision of a retirement income. We have consciously stepped away from metrics like peer relative returns”

A number of participants express a desire to see default members become more engaged. This is partly in recognition that MySuper products are designed as a ‘one-size-fits-all’ solution that may not be appropriate in all circumstances. Financial advice is seen by some as very important in this respect. Nine of our participants made unprompted mention that they have a significant advice offering; and seven said they are either introducing or expanding their advice services.

“we’re introducing limited advice in 2014, so that people who are in the MySuper option, we’ll try to encourage them to make use of the telephone and online tools so that there is that sort of information and hopefully sufficiently engage in tools that they can do some online modeling … the plan is to have those conversations along the way.”

“We do run financial planning internally, and we actively promote planning to our members to ideally have our members becoming more engaged as they age”

“I don’t think for a second that this is a substitute for good financial advice. For any investor who is willing to get engaged and see a financial planner, you can potentially get just something more customised to your scenario. So I don’t for a second think that default funds give you necessarily the best outcome”

“Member engagement will be the biggest thing in this industry in the next 10 years.”

5.5. Summary

Perceptions of member needs are a fundamental consideration when designing products. Most of our participants use a variety of input channels to form opinions about the needs of the ‘typical’ default fund member. Most characterise these members as disengaged and often poorly informed. Nevertheless, many made statements indicating awareness that any characterisation of a ‘typical’ member is a necessary over-simplification. Commonly-held perceptions about the needs of default members include: the concept that the primary need is related to retirement outcomes; that short-term relative performance is largely irrelevant; but that members do not like return shocks. We also encounter perceptions of considerable heterogeneity in the nature of the member base across funds. We now move on to describe how these perceptions of member needs and the nature of the member base are taken into account in designing MySuper products.
6. Considerations in MySuper Design

We now discuss the comments by our participants on aspects that were taken into consideration in designing their MySuper products. Section 6.1 commences by describing the discussion around the scope of what was considered. MySuper acted as a catalyst for nearly all providers to review their default offering. However, a different tack appears to have been taken by those retaining a balanced approach, and those adopting a lifecycle strategy. A majority of those retaining a balanced approach talked about giving (often serious) consideration to a lifecycle strategy as part of their deliberations. In contrast, our impression was that most lifecycle providers entered the process with a predisposition towards a lifecycle strategy. We also encounter comments that point toward an underlying desire for greater tailoring. Section 6.2 summarises the many and varied influences on MySuper design that received mention. The more prominent include: the perceived needs of members over their lifecycle; the specific nature of the member base; the regulatory framework; cost or fee budget considerations; and competitive positioning. In Section 6.3, we discuss the trade-off between product design and price (i.e. costs or fees). Section 6.4 summarises.

6.1. Scope of What Was Considered

Nearly all of our participants told us that MySuper acted as a catalyst to review their default offering, with many undertaking an in-depth review. (Section 8.2 provides quotes and related discussion on MySuper as a catalyst for review.) The MySuper regulations permit adoption of either a single diversified (balanced) strategy or a lifecycle strategy based on age. We convey a sense for the scope of the designs that were considered within these broad specifications; as well as glimpses of future plans. The latter includes a desire for greater tailoring towards individual members.

*Those Who Chose a Balanced Strategy*

At least seven out of the ten participants adopting a balanced approach for MySuper told us that they gave serious consideration to a lifecycle strategy. Three intimate that they may revisit the choice sometime in the future. Listed below is the range of reasons we heard for not choosing lifecycle, roughly arranged in order of their prevalence in the conservations:

- **Suitability for members** – Some providers considered lifecycle as unsuitable for their member demographic, most notably those with young members and/or members with low balances. The idea was that members with modest means are likely to end up on the pension, which provides an income hedge and mitigates the need to de-risk. Such members were often thought to be better off remaining invested in growth assets.

- **Need for de-risking** – Lifecycle reduces return in order to reduce (sequencing) risk. Some queried whether this is appropriate, given the need to provide income in retirement that might last decades.

- **Better tailoring is required** – Some viewed basing the glide path on age alone as too simple. Those making this observation thought that lifecycle strategies require greater tailoring than is possible under current member data and systems.

- **Low interest rates** – Another view is that de-risking members into defensive assets would be imprudent at the current low level of interest rates.

- **Administrative constraints** – A few participants note that their administration platform could not handle lifecycle at this stage.
• **Limits of the regulations** – The view was expressed that the MySuper regulations are inadequate because they only cover to retirement, when a whole-of-life solution is required.

• **Other ways to deal with market risk** – Mention was made of the notion that market risk might be addressed within a balanced fund through dynamic asset allocation.

Some of these insights are reflected in the quotes below. The last quote is particularly notable for its conceptual agreement with lifecycle strategies, but advancing a view that the appropriate time to de-risk for their members was beyond retirement.

> “The first thing we did was look at, do we want to be lifecycle or do we want to be a straight default balanced fund. ... I started with the predisposition that we should be cohort managed, it made sense to me. As we looked at the data and as I looked at the implementation and as I looked at the law, we decided that lifecycle was actually not the right way, and that the jury is still out as to whether or not it gives better results and whether you give up too much on the upside to create the certainty on the downside.”

> “We agonised over the strategy. The alternative was to do a lifecycle, and we spent a bit of time trying to figure out why we should do it. ... we felt that superannuation is a long term investment ... one of the areas that mitigated against it was ... interest rate cycle around the world and Australia was very low.”

> “We looked strategically at the lifecycle option ... chose not to in the interim, on the basis that based on the member demographic again, looking at the best fit for the majority, not everyone; we felt that the growth [balanced] option was still a suitable default option. ..... we didn’t have the system capability to implement a lifecycle option, we felt, in the timeframe. So it’s a strategic question we’re going to address into the future.”

> “… we’re of the view that a lifecycle 2.0 has some merit, where there’s a true sort of individual member tailoring around it. But in the context of the MySuper regulatory environment, in the context of the data available at a member level and the ability to translate that into custom investment solutions, we think it’s probably too early for a lifecycle 2.0 solution in this market, which is why we’ve chosen [balanced]”

> “... about two years earlier we had formed the view that a lifecycle product would benefit our members ... but the area that we couldn’t actually overcome ... our administrator ... their systems required significant changes ... we will relook at lifecycle default towards the end of the year.”

> “we went through a process to decide what to do for the MySuper option ... might be potentially open for criticism to say, well you just rebadged your existing default ... we’ve been criticised for not having a lifecycle approach. The reality is that’s actually incorrect, and we’re actually one of the first funds in the country to actually implement one. We just fundamentally disagree with how early some of the de-risking occurs, but that is actually having regard to our member demographic.”

**Those Who Chose a Lifecycle Strategy**

The impression we received from those who chose a lifecycle strategy is that the decision was often based on a prior belief that lifecycle is an inherently better product than a balanced approach, at least
for their own default members. We formed this impression because the majority of this group (with one exception) tended to advocate for lifecycle, without referring to undertaking an in-depth analysis comparing lifecycle and balanced approaches. It may be that they had done the analysis, but failed to mention it; or that the groundwork had been done at a much earlier stage. Nevertheless, we were left with the impression that many had approached the choice with a predisposition.

The following is our interpretation of the underpinnings of this preference for a lifecycle strategy. A key element is addressing sequencing risk on behalf of disengaged default members, i.e. mitigating the possibility that members could suffer a large loss when it matters most near retirement. The experience during the GFC seems to have been important in bringing attention to sequencing risk. Lifecycle strategies make the assumption that members are able to accept greater risk within their superannuation fund at younger ages, but then become more averse to investment risk as retirement approaches. This assumption relies on two notions. First, wealth at a young age is concentrated in human capital (i.e. earning power). The balance then progressively shifts towards other assets as a member ages, and human capital is depleted. Second, superannuation itself becomes an increasingly large component of the portfolio, reaching near its maximum level around retirement. As a consequence, members become more heavily reliant on their superannuation savings as they approach retirement, and their propensity for bearing investment risk in their superannuation fund is lowered. Another consideration is that members near retirement ‘have less time to recover’ if their superannuation balance declines; although some may have an option to defer retirement and work a few more years. The notion that MySuper products only cover ‘to retirement’ also seems to have been influential. This perspective seems to heighten focus on the risk of delivering a balance at retirement, rather than encouraging looking ‘through retirement’ to the whole life cycle.

Most proponents of lifecycle investing would acknowledge that the above line of argument has its shortcomings. For instance, some who talked in the language of life cycle theory or asset-liability management view designing a lifecycle fund ‘to retirement’ as an unnatural construct. Perceptions about whether member needs align with a lump sum at retirement or income in retirement are relevant here: those who emphasise the lump sum are more inclined to perceive their role as protecting its value. It is broadly acknowledged that applying solely age-based lifecycle strategies misses some key components, including: the role played by aspects such as account balance; social security as an asset or downside protection mechanism; and the existence of substantial other assets outside of superannuation. Another consideration is whether the optimum time to de-risk might be later in life, especially in light of increases in longevity. While most lifecycle proponents conceded that their products have limitations, they nevertheless considered them superior to a balanced approach.

For those adopting lifecycle strategies, the discussion revolved around issues of product design, such as whether to incorporate information other than age, e.g. member balances or market pricing.27 While only one provider designed their lifecycle strategy to allow for account balance as well as age, five (50%) of the lifecycle participants expressed a desire to extend the range of factors used in future, subject to the availability of member information. The two quotes below reflect this desire:

“we considered the full range of possibilities ... we turned our attention towards constructing a lifecycle option ... our ideal was to have multiple dimensions, and for a long time we thought we would start with at least two ... balance as well as age. ... administratively it would have introduced a lot of complexity and would not have been a useful feature. ... mass customisation for the individual: that would be the ideal.”

27 Another design issue is whether to adopt a cohort-based approach, where members are assigned to cohorts according to age; versus a member-switching approach, which involves switching members between existing funds as they age. For further information, refer Chant, Mohankumar and Warren (2014).


“I think you can over engineer these things … If you start adding these other factors, you’re almost compounding the unknowns … you’re making other assumptions about what they may or may not want, depending on either age or income levels or some other criteria. … we may even go there in the future if we feel that either technology or our information about the client is such that it kind of lends itself to that, but at this stage we’ve decided not to.”

Looking Forward: Further Tailoring, Further Innovation

The desire for more tailoring is a theme that appeared regularly. Lifecycle products may be considered a basic form of tailoring. The quotes above from both balanced and lifecycle fund providers are peppered with references to intentions to move towards more tailored solutions. The desire for greater tailoring seems implicit whenever the role of financial advice is discussed (see discussion in Section 5.4). The common thread is that our participants appear to view their role as catering for disengaged members, of which tailoring is seen as a component. The sentiments as reflected in the following quote appear to be held by many of our participants:

“The best solution for any individual member is a solution catered for their own situation … super funds have some information, whether that’s salary and age and marital status, etcetera, but you don’t always know how many assets outside of super they have, etcetera, etcetera. … ultimately we feel that that’s where we will end up, is with tailored lifecycle type solutions for the individual based on their own circumstances. … the more features you can incorporate the better … [and] … In the future, we anticipate that we will be able to significantly alter the allocations based on member experience relative to the outcome targets.”

The main constraint appears to be information about members, as reflected in the quotes above as well as the one below:

“… we don’t know enough information about members to be able to create such a product. For example we know what their contributions are, we know what their age is, we know whether they’re a man or a woman, but we don’t know what their spouse has, we don’t know what money they have outside of superannuation, we don’t know what their risk tolerance is necessarily, unless they come in and utilise some form of advice”

We heard three other notable responses upon asking about the future development intentions with respect to MySuper. First, there were multiple comments on the need to address the retirement phase: the re-focusing on retirement is covered by Butt et al. (2014), and was a key focus of the FSI (2014). Second, five participants allude to the intention to make various improvements to their investment strategy process. Third, two participants responded by pointing out it is all about ongoing improvement. This includes the following sweeping vision of what needs to be addressed in the future:

“[it’s] in its infancy. … I don’t want to misrepresent this as some sort of completely orchestrated final solution. It’s probably the first step of the next 100 years … The next 100 years is going to be about understanding and reacting to a fund where the member bears all risk … the aspiration – if you apply this logic – you would want to do a study for every member and every member has certain idiosyncrasies about them. So continuous improvement for us is realising that we’ve just made some big decisions that in 10 years’ time our successors will be laughing about. But I think what we’ve done is framed the problem. In post-retirement, we haven’t even really framed the problem yet so that’s the next big step for us.”
6.2. Key Influences

Our participants refer to an assortment of influences on the design of their MySuper products. Table 3 lists the influences receiving a mention, noting the number of balanced and lifecycle providers that raised each influence. This list provides an insight into the considerations that were top-of-mind. It is possible that some participants may have failed to mention certain influences due to oversight, or because they didn’t enter in the flow of discussion. Nevertheless, Table 3 provides an indication of what might matter most.28 For a large majority of the participants, the design task was framed as how to best address the needs of members over their life cycles. Specific influences mentioned by at least half the participants include: the nature of the member base; the regulatory framework; cost or fee budget considerations; and competitive positioning. Discussion of these areas follows Table 3.

Table 3: Influences on MySuper Mentioned During Interviews

<table>
<thead>
<tr>
<th>Sample Size</th>
<th>Influences Mentioned During Interviews:</th>
<th>Total Sample</th>
<th>Balanced</th>
<th>Lifecycle</th>
<th>Non-For-Profit</th>
<th>For-Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Conceptual basis</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Language of life cycle theory, or asset-liability modeling</td>
<td>12</td>
<td>7</td>
<td>5</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Primarily focused on sequencing risk (overlap of 2 with above)</td>
<td>7</td>
<td>2</td>
<td>5</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Intersection: Lifecycle, ALM or sequencing risk mentioned</td>
<td>17</td>
<td>8</td>
<td>9</td>
<td>11</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td><strong>Member-Related</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Demographics of member base</td>
<td>14</td>
<td>9</td>
<td>5</td>
<td>13</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Observed behaviour or feedback from members</td>
<td>11</td>
<td>6</td>
<td>5</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td><strong>Regulatory</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Regulations were influential: aimed to adhere to requirements</td>
<td>14</td>
<td>7</td>
<td>7</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Directly lobbied or advocated for lifecycle</td>
<td>3</td>
<td>na</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Constraints</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost or fee budgets (impact on choice of assets or strategies)</td>
<td>13</td>
<td>7</td>
<td>6</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>… <em>Nevertheless, our focus is on net return</em></td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Administration constraints - cost or complexity</td>
<td>9</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Limited member information prevented more tailored solution</td>
<td>7</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Time Constraints</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td><strong>Business Considerations</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Product positioning, particularly relative to peers</td>
<td>10</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Lifecycle takes focus off short-term, peer-relative performance</td>
<td>4</td>
<td>na</td>
<td>4</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td><strong>Legacy-Related</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Existing default was fit for purpose</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Wanted to leverage off existing structures</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Openly stated desire to retain performance history</td>
<td>0</td>
<td>0</td>
<td>na</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

28 There is considerable overlap in the influences on MySuper design mentioned by our participants and the factors listed by Gomersall and Freeborn (2014). However, there are some differences. Gomersall and Freeborn (2014) refer to retention of existing investment performance and time pressure as considerations; whereas we received no direct mention of these factors. Their account of perceptions of member needs also varies at the margin. The most notable is a reference to members tending to make investment choices based on past performance; when our participants tended to suggest the majority of default members are not focused on performance (see Section 5.2). Our list of influences appears broader overall, containing additional items like conceptual basis and regulatory considerations.
Discussion: Conceptual Basis or Framing

Most interesting is what our discussions reveal about the conceptual basis that underpins the design of MySuper products, i.e. how the participants frame the task at hand. Most participants view MySuper as a product that contributes towards serving members over their life cycle, with an eye on retirement outcomes. Indeed, 12 participants (60%) made explicit comments suggesting that they are thinking in terms that align with life cycle theory. This is revealed by reference to aspects such as: the need to provide for income streams in retirement; income replacement ratios; the role of the pension or assets outside superannuation; human capital as a declining asset; or spending requirements as a liability to be serviced by available assets. Seven participants refer to sequencing risk, which indicates a concern with how investment strategy should be varied over the life cycle. The concept of sequencing risk might be considered as arising from life cycle theory, although it portrays the issue in a limited dimension. In total, 17 participants (85%) make reference to either life cycle concepts and/or sequencing risk. That is, the problem is being largely framed in life cycle terms.

Also interesting is the absence of talk about maximising returns or asset accumulation as a primary consideration in its own right. Nevertheless, returns do come up in two ways. First, there is a broad acknowledgement that adequate real returns are needed over the long run to underpin retirement outcomes. Second, the view was widely expressed that funds operate within a market that is often focused on performance.

Member-Related Influences

Most participants refer to what they know about their members as a starting point. Our providers are clearly building MySuper products that are deemed suitable for their particular member base. For many, member demographics are the main point of departure. Aspects such as average age, account balance or incomes, were mentioned by 14 participants as being influential. There were also mentions of catering for a ‘unique’ member base. Intriguingly, all 14 who referred to demographics were not-for-profit providers: none of our six for-profit retail providers explicitly mentioned member demographics in giving their account of MySuper design. We deduce two reasons for this. First, retail funds are often servicing a broad demographic with few distinguishing features. At least two retail participants directly refer to covering a broad cross-section of the community; and this probably applies to most retail funds. This may also help explain why retail providers favoured lifecycle strategies, which cater for a broad membership through tailoring according to age. Second, retail funds may not be trying to cater for a particular demographic, given that they aim to sell product through a range of employers across industries. By contrast, many not-for-profit providers cater to specific industries or types of members. In the latter circumstance, it seems more appropriate to build a single balanced fund that is tailored to the needs of a specific member base.

Other member-related influences relate to either observed member behaviour, and/or member feedback (11 mentions). This incorporates: the propensity to take lump sums at retirement; reactions to market declines as evidence of risk aversion; member switching activity; insights from the financial planning process; and expressed desire for ethical or sustainable investing. Thus some providers are attempting to design products to meet the revealed preferences of their members.

Regulatory

Many providers make comments suggesting they had one eye on the regulatory requirements when designing their MySuper product. Fourteen (70%) refer to the regulations. Usually this was to indicate a desire to offer a product that adheres to the letter, if not the intent, of the MySuper regulations. Some lifecycle providers designed their product on the basis that the MySuper regulations only covered to
the point of retirement. In most cases, our participants indicated a passive acceptance of the regulations. The notable exception was two lifecycle providers who admitted to actively lobbying for a lifecycle approach. A third lifecycle provider saw themselves as an early advocate for lifecycle investing within the industry, but did not indicate that they lobbied either APRA or the Government.

**Constraints**

Some participants refer to constraints that inhibit the adoption of alternative designs. Costs or fee budgets are the constraint receiving most (13) mentions. The majority of participants view costs and fees as a constraint that they need to work within, which in turn influences the mix of assets and strategies that are used in the portfolio. Some acknowledge this constraint; but then argue that they focus on maximising net returns rather than aim to limit fees. There are also a few participants that appeared not to be overly focused on fees. Fee budget constraints may be more influential than apparent from our interviews, particularly in retail funds. Chant, Mohankumar and Warren (2014) highlight how retail providers reduced their fees in response to MySuper, while changing their product designs towards greater passive management and less use of alternatives. This evidence is consistent with fee budget constraints having an important impact on MySuper product design, at least in the retail sector. Given the attention that fees are currently receiving, the trade-off between fees and product design is discussed further in Section 6.3.

Administration constraints are mentioned by nine participants; and information constraints by seven participants. While these mentions cover a range of aspects, most notable is the impact of these constraints on lifecycle investing. In Section 6.1, we observed how administrative and member information constraints acted to inhibit the development of more tailored lifecycle solutions; and even prevented one provider from implementing a lifecycle approach. Despite the short timetable for introducing MySuper, time constraints were only mentioned by one participant.

**Business Considerations**

Design of product is not all about member needs, but occurs in the context of organisations that are concerned with their competitive position. Accordingly, it was of no surprise that we received mentions of ‘business considerations’. We received 10 references to how the MySuper product would be ‘positioned’ in the market as being influential. These references relate to how the product compares to peers in terms of its returns, price, value-for-money and product features. While many participants are quite mindful of the need to have a competitive offering, most convey this as a secondary driver. Only a minority (three participants) left us with a strong impression that market positioning was a key driving influence. Another business consideration (with four mentions) was that a lifecycle approach has the desirable effect of diverting attention from short-term performance or peer-relative returns. We further consider this aspect in Section 8. One of our corporate providers mentioned the relevance of meeting the requirements of the sponsoring corporation.

**Legacy**

Few participants made overt reference to the legacy position as a major influence, i.e. there was little in the way of a declared preference for retaining an existing product because it is cheaper or convenient to do so. However, six participants who rebranded their existing default fund argue that it not only met the MySuper requirements, but was also the most appropriate product for their members. This includes four industry funds, plus two public sector providers who already had lifecycle strategies in place prior to MySuper. Three participants mention that they designed MySuper in part to leverage off existing structures, including systems and investment approaches that are well-recognised by members. No participants mention using an existing fund in order to retain a performance record.
Summing Up

Most of our participants point towards a range of influences on their MySuper product design, in terms of either its broad strategy (balanced or lifecycle), or its design features such as the specifics of the investment process, assets used, fee levels, and other features. Nevertheless, not all influences are equal: there seems to be an implicit hierarchy. Meeting perceived member needs is identified as the primary consideration for the majority. In turn, our participants refer to retirement outcomes as the major need to be addressed. The theory of life cycle investing appears to underpin much of what we heard (even if the participants were not aware they were talking in these terms). Most other influences are referred to in a manner that suggests they are treated either as secondary considerations, or as constraints. Many participants appear to be alert to regulatory requirements, as well as business considerations placed upon them by the marketplace such as fee constraints. Administrative and informational constraints also need to be worked within. For most participants, these myriad other influences seem to be approached as matters to be managed – although market positioning is clearly a key issue. There is some evidence that fees budgets are a relatively important influence in the retail sector. In sum, the comments from our participants are consistent with the retirement needs of members acting as the primary concern, with regulatory and business considerations being important but subsidiary considerations that require addressing along the way.

6.3. Product Features and Fees

In this sub-section, we begin by briefly summarising some of the broad features of the MySuper products of our participants (other than investment strategy, which is addressed in Section 7). We then reflect on how providers ’pitched’ their MySuper product in the market, drawing out the trade-off between value-add and price, i.e. fees.

Product Features

Our sample comprises 10 providers of balanced products, and 10 providers of lifecycle products. Among the 10 balanced products, seven reported substantially rebranding an existing balanced fund without significant change. In four of these cases, participants explicitly indicated that they viewed the existing balanced fund as fit for purpose. In the other three cases, it was implicit that this is the case, even though it was not mentioned. For the remaining three cases, substantial changes were made to an existing fund, or an entirely new balanced product was created. Among the 10 lifecycle funds, 5 were based around cohorts and 5 around member switching. Four of the 10 lifecycle funds charge members differing fees as they move through their life cycle.

Another feature is whether the MySuper product is designed to link with the retirement phase. In general, this area seems underdeveloped. Four participants refer to a link between MySuper and a retirement product that they either currently offer or plan to introduce. Four mention that they accommodate the desire of most members to spend a portion of their benefit at retirement, via either their product design or in their modeling. These four funds were all lifecycle providers.

Where the Product is Pitched: Value-Add versus Price

Some participants indicated where they are pitching their MySuper product in broad terms. Here the range of positions was wide. Three participants (all of which were retail funds) talked about aiming for simplicity. Two funds allude to designing their product as a low-cost offering. Four participants made statements consistent with pitching their product as a premium offering, with greater value-add but at a
higher price. The remainder either attempt to balance cost and benefit, or didn’t make their stance apparent. The quotes below provide a sense for the web of influences that are in operation:

“we’re very mindful of fees. So that’s one of the reasons why we do have a lot of passive in the fund and one of the reasons why we negotiate and use our scale to bring fees down as much as possible.”

“... the key priority was to put the best option out that we thought possible for the members. And some of the related considerations ... around the cost of the option, and that’s been I guess a particular area of focus. And our view is that in very, very simple terms, we only spend members’ money to add significant value ... have to come back to the members in better long-term returns. ... So we have a judicious use of active management and we’ve set a fee budget, a sort of tolerance level that we think is appropriate to get a reasonable amount of outperformance.”

“So pricing was this huge piece of work ... 1% was seen as being the acceptable threshold”

“... we can do things very cheaply by sacrificing returns. But we’re not prepared to do that, which is why we are now focused on net benefit to members which is really another way of saying, risk adjusted returns are taken into account. But the proof is in the pudding.”

“We didn’t want to position this as our low cost default offering. ... We made a decision this was going to be our bells and whistles product offering. ... So we have used things like active management, illiquid assets ... active asset allocation around the glide path ... risk management on some of the older cohorts ... So it’s a premium offering from our perspective.”

“Cost is an outcome.”

Where a product is pitched raises the nexus between price (i.e. fees) and product design, particularly the mix of assets that can be accessed affordably. As a general rule, lower fees associate with restrictions on the use of higher cost investments such as active management and alternative assets (see Chant, Mohankumar and Warren (2014)). Providers were faced with deciding the fee to charge for their MySuper product, not being sure where the market might settle, while determining what product design would be feasible within a given fee budget. Some report doing a lot of work around pricing, most notably retail providers. Our conversations indicate a perception that there is a limit on the fees that are viewed as acceptable by members, or that the market will bear. One of our participants provided subsequent feedback that a perception emerged during the development of MySuper that “1% was considered an acceptable fee”. The same 1% number was mentioned by another participant during the interviews; and closely accords with the average fees 1.06% across MySuper products for a $50,000 balance as reported by Chant, Mohankumar and Warren (2014). This suggests some kind of market-driven cap on fees that places an upper limit on fee budgets, which accords with one of the constraints on product design that was identified in Section 6.2. Providers appear to be choosing where to pitch their product on the value-add versus price spectrum, while keeping within the perceived fee ‘cap’ imposed by the market.
6.4. Summary

The account given by our participants about how they approached MySuper design is consistent with the central theme that the primary consideration is the needs of members, which in turn is interpreted as related to retirement outcomes. However, this is by no means the full story. At the same time, most of our participants are very aware of the regulatory, organisational and market environment within which they operate. Participants seem to view the task as building a product that meets the needs of members while satisfying related constraints. The more notable constraints appear to include regulation; the need to decide and work within a fee budget; administration capabilities; and the requirement to ensure that the product is competitive within the market. A diverse set of products emerges as a consequence of member and organisational differences. We suspect that this diversity is accentuated by variation in the qualitative views of key decision-makers across organisations. Hence MySuper products are far from commoditized, notwithstanding the expressed vision of Cooper (2010) for a ‘simple’ product.

7. Investment Strategy

Chant, Mohankumar and Warren (2014) and Gomersall and Freeborn (2014) examine the investment strategies for MySuper products, including asset allocation within balanced funds and glide paths for lifecycle funds. Our aim is to augment this work by providing an account of the ‘why’ and ‘how’ of investment strategy within MySuper funds. Our areas of focus relate to the setting of asset allocation, including: governance structures (Section 7.1); objectives and definition of risk (Section 7.2); asset universe (Section 7.3); the asset allocation process (Section 7.4); and the choice between active and passive management (Section 7.5). A summary appears in Section 7.6.

7.1. Governance – Who Determines Asset Allocation

We asked our participants who decides asset allocation. The responses point towards a range of governance structures, typically involving input from multiple people. In some instances, the structure as described seemed opaque, and exactly who makes the decision was not clear. Half of our participants describe a governance structure whereby internal management and/or the asset consultant perform analysis and make asset allocation recommendations. These recommendations are then signed off by either the Investment Committee or the Board, which hold both the responsibility and accountability. Under these cases, it can be hard to tell who is driving decision making without being able to observe the process directly. Regarding the setting of strategic asset allocation (SAA) and dynamic or tactical asset allocation (which we will call DAA²⁹), the descriptions were blurred and left no sense of any consistent delineation between these functions. Figure 3 plots our evaluation of who “makes the call” on substantial asset allocation shifts, based on what we were told. Figure 3 comes with the caveat that we have low confidence in categorising in some cases, especially where multiple parties are involved.

We also received feedback on the use of asset consultants. Consultants appear to drive the asset allocation decision for two providers. For one, this occurs under an outsourcing arrangement. For the other, the consultant puts forward recommendations to be signed off by the Investment Committee. Another 14 mention consultants as providing input into decisions to varying degrees, ranging from being integral to the process through to supplying supplementary services such as modeling.

²⁹ Dynamic asset allocation (DAA) is a broader term that encapsulates a wide range of strategies for time-varying asset allocation. The term ‘tactical asset allocation’ is often associated with shorter-term market timing.
7.2. Objectives and Risk

During our interviews, we asked participants to nominate the objectives that are most keenly pursued and monitored by management and the Board, as well as how risk is defined from an operational perspective. We uncovered multiple objectives and definitions of risk. These often do not closely accord with the reporting requirements under MySuper, which are based around a real return objective (CPI-plus) and the ‘standard risk measure’ (expected number of negative return years out of 20). While CPI-plus objectives are widely prevalent, they are typically an over-simplified depiction of the objectives actually being pursued. The standard risk measure seems a particularly poor representation of how our participants perceive risk. The frequency of negative returns appears to have limited relevance to our providers, who are shifting their attention towards the risk around achievement of retirement outcomes (as discussed earlier). We also received some insightful comments around how performance evaluation should be separated from the process of making forward-looking decisions.

Broad Objectives

Those who operate balanced funds discussed a variety of objectives that are afforded differing degrees of emphasis. The next set of quotes are drawn from providers of both MySuper balanced products and those with ‘member switching’ lifecycle strategies. In the latter case, which involves switching members between existing balanced funds of various risk grades as they age, balanced funds survive as building blocks. These quotes include references to real returns (CPI-plus), retirement outcomes, peer-relative returns, and performance versus a benchmark asset allocation. While retirement outcomes are viewed as the objective that matters most to default members, in practice many funds appear to be managed towards multiple and often differing sets of objectives. In particular, comments made by fund executives that operate balanced fund products indicate that they are very aware of peer comparisons when managing the funds; even though they recognise it holds limited relevance for the end-member themselves.

"we have both an absolute and a peer relative objective … absolute return targets … they’re back figured off saying if we deliver to this return, this is the kind of retirement
outcome people will get in terms of a level of income. ... the peer relative objective for us is really about saying for areas like active management in particular, that we do have to have some shorter-term disciplines around adding value against some form of a benchmark. But we recognise that, and our investment process takes account of the fact that the longer-term objective is the more important ... our view about peer relative performance is that we need to have better peer relative performance over the long term (10 years), not over any given year.”

“The return target for the accumulation fund is determined primarily with consideration to ‘retirement sufficiency’. We estimate a notional liability for our average accumulation plan member ... real return target estimated as sufficient to provide a balance in retirement of at least 6.6x final income ... maximise real returns over a rolling 3-year horizon ... risk and liquidity constraints”

“We didn’t have a CPI plus objective until this came around. ... the balanced fund’s objective was to do better than the conservative balanced objective, whose objective was to do better than cash .... cash is the riskiest asset we have .... if your objective is maximising your amount at retirement, then one sure fire way of not reaching that objective is to invest in conservative cash along the way.”

“objectives are that we deliver on our real rate of return promise ... we’re cognisant of peer risk probably in our two flagship funds ... for the conservative fund ... [we] downweight any comparison ... because I believe basically conservative guys want more of an absolute return and focus”

“ultimately we’re very, very aware that this is a competitive industry and we need to perform relative to peers ... remuneration is linked to performance on the Super Ratings scales ... but ultimately what drives our thinking is the retirement benefit; it’s not only driven by relative performance ... long term SAA is driven off net replacement ratios”

We heard quite different comments about objectives and risk from the providers of lifecycle products based around age cohorts. In these instances, the objectives and risk measures are essentially directed towards retirement outcomes, either balance at retirement or income in retirement. The absence of a balanced fund that is being peer-ranked seems to afford them the luxury of ignoring peer risk altogether, and focus on the ultimate objective.

“we did this product design we did it as a whole of product design ... glide path for the whole of their working life, we want to ensure that at the end of that time they have the ability to live a comfortable retirement ... we measure absolute risk that we’re taking ... I’m talking about volatility. And understanding where your risk is coming from. ... measure it relative [to] the glide path as your neutral position and we have a neutral asset allocation at each level ... less meaning that it would for a peer related fund ... We do scenario testing as well.”

“... framework of dollar balances ... focus on adequacy, we’ve related it to an objective measure and in this case the one that we commonly use is the ASFA Retirement Standard Measures ... our long term stochastic models are calibrated with 20-year asset class return and risk assumptions ... at the individual cohort level ... we do have secondary objectives there in terms of return expectations and risk expectations for cohorts along the glide path.”
“We have consciously stepped away from metrics like peer relative returns ... We’ve looked at risk-adjusted retirement incomes. So essentially we’ve got now eight default funds and each of them has its own asset liability study ... starting with a risk-free asset, which is of course different for each cohort ... we ask the question: ‘Is it prudent to take further investment risk?’ ... risk is the variance and uncertainty around the future income. ... What we’re trying to do is have a very high probability of getting at least something like ASFA comfortable.”

Risk

Our participants allude to a many varied definitions, measures and perceptions of risk. Below we list the full range of descriptions of ‘risk’ that we heard during the discussions. While the risk to retirement outcomes is a common thread, the length and diversity of this list suggests that the industry is a long way from having a consensus view on what is risk and how it should be evaluated.

Descriptions of ‘Risk’ Heard During the Interviews

- Shortfall versus target retirement outcomes
- Failure to adequately fund the retirement ‘liability’
- Failure to achieve real return targets (inadequate real returns)
- Volatility in either returns or account balance
- Probability or magnitude of near-term losses (includes the standard risk measure)
- Underperformance versus peers
- Underperformance versus a neutral benchmark
- Sequencing risk
- Failure to meet the objectives on which a product has been sold
- Illiquidity
- Exposure to adverse scenarios (scenario testing)
- Permanent capital loss
- Exposure to markets when they are expensive and vulnerable
- Factor risk exposure (economic / market factors)
- Assets defined into risk buckets
- Asset-specific risks (e.g. construction, volume, refinancing, events, etc)

Performance Evaluation versus Decision-Making

A few participants offer some insightful comments on the difference between evaluating performance versus objectives, and making decisions to deliver the best chance of meeting objectives going forward. These participants talk about gauging how they are travelling by comparing past performance with their CPI-plus objective, a neutral benchmark, or a peer group. However, they point out what matters more are measures that inform decision-making: past performance is historic, and the key issue is what to do next. In this sense, performance versus a long-term CPI-plus objective is seen as not being very helpful. Performance versus benchmarks or peers may reveal what has worked, and what may need to be changed. More important, however, are forward-looking projections. These often seem to be conducted conditionally, taking into account the current outlook for asset class returns and perhaps the (path-dependent) position of the fund or members given what has happened historically. There are mentions of the use simulation analysis to evaluate expected outcomes and their

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30 This refers to the ASFA Retirement Standard for the annual budget needed by Australians to fund a comfortable standard of living in the post-work years. At September 2014, it stood at $42,597 for singles and $58,326 for couples.
distributions, with a view to estimating either balance at retirement or retirement incomes associated with various strategies. The following quote contrasts backward versus forward looking perspectives:

“The report that goes up to the investment committee or the board every month monitors the performance of the funds against the CPI objective. It also shows the performance of the fund against the strategic benchmark ... and it shows the performance of the fund against peers. ... reviewing performance is different from the decisions that you make on that day ... the reason why we measure performance against the strategic benchmark, for example, is to assess the efficacy or the skill involved in active asset allocation decisions and manager selection decisions; and the knowledge of that skill or how effectively we’re able to do that informs then the strategy going forward for how we want to deliver long-term member outcomes. ... when we’re building the asset allocation on a forward-looking basis ... we are using a risk budgeting tool. That’s when we are entirely cognisant of the long-term performance objectives of the funds which were designed by the consultant to be able to grow wealth to such a point as to be able to generate the most meaningful income stream possible, which is the long-term member outcome.”

7.3. Asset Allocation Investment Process

As our interviews did not delve into detail on investment processes, our observations are at a more general level. Figure 3 indicates the broad approaches to setting asset allocation that we could identify from the interviews. Eleven of our sample mention using what we term a “traditional” approach, where SAA is subject to a cycle of review (often at yearly or triennial intervals), along with scope for DAA in the interim. This approach relates to balanced fund providers, including the balanced fund components within member switching lifecycle products. Three participants use a variation where there is only one target asset allocation, which is monitored on an ongoing basis and altered as required. All five cohort lifecycle providers refer to their glide paths between growth and defensive assets as a benchmark or neutral position, around which they intend to vary where justified. The final participant stated that they were primarily concerned with allocation of available cash flow, rather than managing toward some pre-determined asset allocation. They describe their SAA as “a light on the hill”. Perhaps with this last exception, every one of our participants alludes to actively managing their asset allocation on an ongoing basis.

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31 In this case, as the allocation of cash flow could be influenced by market conditions, this provider can in no way be described as devoid of an appreciation for market dynamics.
We picked up a number of insights into the basis for asset allocation decisions. Again a broad range of considerations are mentioned, with some general themes and interesting techniques becoming evident. The list below conveys the more noteworthy aspects, along with the number of mentions.

- Twelve participants made mention of quantitative modeling, typically expected return projections. Most use quantitative analysis as a starting point, before bringing in judgment in making the decision.

- Ten participants refer to having a strong valuation or contrarian element to their asset allocation approach. This implies a high prevalence of investing for mean reversion.

- Eleven participants refer to giving consideration to a range of sometimes eclectic inputs, including views on market conditions and economic fundamentals. Some of the participants who adopt a valuation or contrarian focus also take a broader range of inputs into account.

- Six participants say that risk control is important, including avoidance of market declines.

- As mentioned, all five cohort lifecycle providers told us they are willing to deviate from the neutral glide path. In addition to a willingness to vary the growth/defensive mix based on projected market returns, some also refer to the possibility of deviating from the specified glide path based on cohort experience, e.g. de-risking more quickly if returns have been good.

- Six participants allude to tailoring asset class portfolios as a supplement to the asset allocation process. This includes the five lifecycle providers, most of which intend to build less risky portfolios within selected asset classes as members near retirement.

- Three participants (all lifecycle providers) refer to using downside hedging strategies. One intimated that hedging for older cohorts is an ongoing feature.
7.4. Asset Classes

The responses to queries about the asset classes used in building MySuper products reveal a large element of personal perceptions and beliefs in nominating the assets that are deemed suitable. For example, some participants said they do not like hedge funds due to high fees and a lack of transparency; some are disillusioned with the private equity model; and a few express an aversion to commodities. Other influences on asset class use include: fee constraints (as discussed above); desire to diversify equity-related risk; tolerance for illiquidity; and a preference for simplicity.

Retail providers have tended to make less use of alternative assets than not-for-profit funds (see Chant, Mohankumar and Warren (2014)). The quotes below relay the justification given by three retail providers. Two of these quotes make reference to cost, which is in line with the fee budgets acting as a constraint on MySuper product design as discussed in Section 6.

“what we are constrained by are costs ... that precludes some of the more expensive alternatives.”

“100% liquid ... that's our philosophy ... rebalancing a portfolio is complex if you’ve got an illiquid piece you can’t sell down. And from a corporate memory point of view we’ve got products that have been very difficult to get rid of those unlisted illiquid investments without taking sort of years and years and years. In fact, we’ve got a product I reckon we’ve been talking about for the last five years; it’s one of these legacy things. ... every time you put a new member into an illiquid asset, you’re diluting the existing members so there’s equity issues as well. So there’s sort of a whole range of reasons why we don’t use illiquid assets.”

“... we had to look at asset classes that were easy to understand ... all of it is listed, it’s very liquid assets ... definitely around being simple and easy for our customers, our direct customers, to understand and because obviously the super fund could only have one MySuper product ... If we can get [alternatives] at a reasonable cost and perhaps cost isn’t such a heavy focus as well, we would try to perhaps move that into the underlying asset classes. ... alternative assets which provide different correlation than traditional asset classes, there is the benefit of doing that, but at the moment with the scale and the underlying fee budget that we have, we know that’s not really in our sphere of our asset set.”

Chant, Mohankumar and Warren (2014) observe that a wide range of assets is used by Australian superannuation funds. Indeed, the asset class and investment strategy toolbox continues to grow. This is described in the quote below, which arises from a retail provider that makes use of a wide spectrum of assets and strategies:

“... it’s very holistic and it’s more granular year in, year out. So it’s anything illiquid through anything fully liquid. It’s growth, defensive, alternatives. It’s active versus passive. It’s single manager versus multi manager. It’s cap-weighted benchmark versus smart beta benchmarks. ... when I think about taking on this role [x] years ago ... things were more static, they were narrower. They just continue to get more expansive year in, year out. And also there becomes more and more internal capabilities. ... we’ve switched on derivative overlays ... I guess the toolkit just gets richer and deeper. ... within existing asset classes, and also broadening out in terms of new asset classes.”
7.5. Active versus Passive

We asked about the use of passive versus active management, and how the choice is made. Table 2 reports that ‘4.5’ out of 20 participants use a passive approach, with the ‘0.5’ reflecting a provider that uses both but declares themselves as “substantially passive”. Our enquiries establish that two out of the 15 who use an ‘active’ approach said that they adopt an active philosophy, but still hold notable exposures to passive investments within their funds. In sum, an active approach is prevalent within our sample, but is far from ubiquitous.

In the interests of space, we provide a brief summary of the key considerations in choosing between active, passive, or some combination. In addition to fee budget constraints, our participants make mention of: expectations of whether an active approach can add value; whether the market context is conducive to outperformance by active managers; and the certainty of fees versus the uncertainty of alpha. One participant referred to a vigorous internal debate. Another observes that active and passive are not absolute concepts, but that a spectrum exists. The comments of our participants accord with the findings of Foster and Warren (2014), who give a detailed account of the choice between active and passive management within the equity portfolios of Australian superannuation funds.

7.6. Summary

A wide variety of investment strategies and related decision structures are mentioned by our sample of providers. This is hardly surprising given the heterogeneity in MySuper designs, as well as the related organisational and member related influences that are highlighted in Section 6. Key areas of variation include: governance (i.e. who makes the call); the emphasis placed on objectives outside of maximising retirement outcomes; how risk is perceived and defined; the range of asset classes and strategies used; and the approach to asset allocation. Nevertheless, certain aspects are prevalent across a majority of our sample. This includes the focus on maximising retirement outcomes as a central objective; the majority use of traditional SAA / DAA decision structures; the tendency towards value-based or contrarian asset allocation processes; and the use of active investment approaches.

8. Reflections on a Major Regulatory Change

This concluding section examines the impact of MySuper as a regulatory change. We highlight some of the broad outcomes, as well as the responses and views of our participants. MySuper was a relatively influential regulatory change for the Australian superannuation industry. In requiring a single product to be specified for default fund members, providers were prompted to address what type of product was appropriate for this particular cohort. Providers were required to complete the process within a relatively short period of time of about one year. Section 8.1 documents how most our participants found the implementation of MySuper as difficult, costly, and perhaps dysfunctional. In Section 8.2, we recount a range of consequences arising from MySuper as identified by participants; while Section 8.3 conveys the (mixed) reflections they had on its overall impact. In Section 8.4 we sum up with our own interpretations of MySuper, arguing that it is constructive on balance.
8.1. Implementation Was Difficult

A large majority of our participants commented on the difficulties and costs involved in implementing MySuper. The following concerns were expressed widely:

- The rules and requirements were not clear to begin with;
- There were too many frequent updates and changes, and hence wasted effort;
- The change happened on too short a timetable;
- It involved significant costs; and,
- MySuper diverted attention from managing funds for the benefit of members.

Notwithstanding the above complaints, a few participants are more forgiving. Some make the point that learning along the way was unavoidable; and that the process of consultation and re-adjustment during the implementation phase resulted in a better outcome than the alternative of setting in stone some flawed rules and pushing ahead regardless. It is also acknowledged that the process was hard on APRA, the supervisory regulator. Overall though, there emerged a pervading sense that implementation might have been more effective. The following quotes provide a sense for the depth and range of viewpoints on the implementation process, roughly arranged from the highly sceptical to the more constructive:

“... there’s absolutely no doubt that both policy-making and implementation of this entire thing ... was incredibly poor. Things were changing, the cost estimates were flawed, there was no clarity at any stage of the process.”

“Various parts of MySuper, whether it be fees or costs or auto consolidation type things, they went on and on for four months or more without being settled and we were incurring costs trying to comply with a moving target ... So that was all very badly handled. The timeframe to get all this in place was far too short, and so the whole industry I think will tell you that they have been diverted and deflected from serving the interests of their members to try and get to compliance with all this; not just MySuper, but the whole range of regulatory reform over the last 18 months. Everyone really has just had a gutful of regulatory change, because all it does is put costs on the funds and ultimately the members.”

“Behind the scenes we have spent hours and hours discussing papers. We lodged our application, which was over 600 pages in documentation that we had to write to lodge to get a MySuper license, and at the end of it, what has actually really changed?”

“... horrifically complex piece of work to work out what made commercial sense for us, what made commercial sense for advisors, what made .... sense to the membership and how that fitted with peers who had yet to disclose a product ... It’s been very disruptive and extremely expensive. ... someone said it was a billion dollars across the industry. I think that might be understating it.”

“... large organisational distraction ... sucked a lot of oxygen out because it forced the organisation to be very compliance/legislative driven for nine to 12 months.”

“the biggest challenge with all of the MySuper, and I talk Stronger Super more generally, has been that it was really regulation on the run ... I also think the regulator and the funds were learning at the same time.”
“It was a difficult process and you can’t blame APRA. APRA were given a specific task to achieve and a specific deadline that wasn’t going to change, and they were not given additional resources. I reckon whilst the funds had a tough time, APRA had an equally tough time as well.”

“I think the process was taxing in terms of there was inefficiency and wasted effort, but given where everyone was coming from, I don’t think it was too bad or too onerous to make that effort once every five or 10 years or something.”

“I think the process was okay.”

“I think it was good that there were quite a few rounds of consultation … we ended up with something that was much better than the original version, which was just a focus on low cost and one size fits all.”

8.2. Consequences of MySuper

Our participants note a wide range of impacts associated with MySuper. Perhaps most interesting is the extent to which the perceptions vary. In part, this variation seems to depend on sector. Many retail funds viewed MySuper as a catalyst to make a change for the better. Not-for-profit funds tend to have a much less positive view. The more constructive comments from not-for-profit providers focus on MySuper as a chance to review their offering, with some making modest changes as a consequence. Others note that, while MySuper made little difference to their own funds, they see beneficial developments arising as part of the package of reforms, such as the tightening of industry standards. Those taking a more pessimistic stance consider MySuper as a distractive and costly exercise, with little or no net benefit for members. We also relay a range of comments on other impacts, including those related to the competitive environment, peer comparisons, fees, costs, and system integrity.

**Impact on Product Offerings: MySuper as a Motivation to Reconsider Default Fund Design**

In this section we present a series of wide ranging comments about the impact of MySuper on default offerings. The discourse is arranged in clusters, going from participants who consider the effect on product to have been positive; through to those who view the impact as minimal or even negative.

Our first cluster contains nine participants who intimate that MySuper acted as a catalyst to introduce a new product, or otherwise make changes that are considered constructive for members. Of the nine, five are retail, two are corporate funds, and two are from the industry fund sector. One participant saw MySuper as a prompt to consider a lifecycle approach; but also points out that they would have pursued a lifecycle approach regardless once having given it consideration. A few participants refer to the importance of being able to innovate around the default offering. As discussed earlier, we consider this an important insight: funds were given an opportunity to impose changes on members without requiring members to exercise choice. In the absence of this opportunity, lifecycle investing might not have become a meaningful facet of the Australian landscape. One retail provider observes that capacity to innovate around the default offering helped to overcome organisational resistance to change, specifically with respect to financial advisers (see last quote). Below is a representative series of quotes from this first cluster:

“I think we have taken the opportunity to say okay, we’ll have to ask ourselves, are we doing the best we can by the default members? We decided, you know, maybe not. So I have to say that it was a catalyst for change and it’s good in that respect”
“... we came out of it with something far better than what we had”

“What the MySuper legislation has done is forced us to look at what we were doing, and I think that’s the most valuable thing. ... it’s actually forced us to review and forces us to change what we do.”

“... actually look at asset allocation as they age and looking at the benefits of asset allocation through different periods of your life. ... it’s given trustees the ability to ask the question for a cohort of disengaged members, what is the right thing to do to provide the best possible retirement outcomes for them”

“MySuper acted as a catalyst. We were doing a lot of work on that front in any case. But when MySuper came along and explicitly also made reference to lifecycle funds ... the permission sort of came through.”

“A lot of the old default options were also choice options, so I think the benefit of the legislation was actually distinguishing the default option as distinct from the choice option. ... I think one of the reasons lifecycle hasn’t taken off in this country before now ... in an advice-dominant retail market, advisors see their role ... as being the person who does that ... this was an opportunity for us to innovate in that way for the default members.”

The second cluster contains four participants, all not-for-profit providers. These participants saw benefit in the chance to review and potentially upgrade their offering; even though they used an existing fund without making any major changes. One of the four responded by conducting a serious review of their default fund; although in retrospect seemed to question whether it was worth the effort. The following quote reflects the feeling conveyed by the group:

“the MySuper and Stronger Super Reforms, for us, in some senses were an affirmation or a reaffirmation of what the fund is trying to do. In many instances it resulted in a codification of a lot of the things that we were already doing ... gave us the opportunity to ensure that we were heading in the right direction, and that everything is properly codified and the processes were as robust as they need be.”

The final cluster of seven participants viewed MySuper as having a limited or possibly even negative impact. These participants considered themselves as either already doing what was appropriate for their members, or what was required by the regulations. One in this group is a retail provider, and six are not-for-profit. Some in this cluster made explicit mention of the governance changes occurring in parallel with MySuper as having a positive impact.

“... in terms of the investment bit of the product, no, not a lot of that has changed ... [but] ... you will see a whole lot of broad governance stuff that’s on our website that are outcomes of MySuper.”

“the spirit of the legislation was for a low cost simple solution that benefited the bulk of members. ... It wasn’t just because it was the legacy product ... It ticked all the boxes of MySuper.”

“... we have always considered that our balanced option hit the mark in terms of providing what we considered our members were after”
“I don’t think the MySuper legislation itself has done a lot ... but it hasn’t done much harm ... We would have done this [moved to a lifecycle approach] anyhow.”

MySuper Altered the Competitive Landscape

MySuper appears to have disrupted the competitive landscape. Chant, Mohankumar and Warren (2014) detail the changes that occurred in default funds with the introduction of MySuper (also see Gomersall and Freeborn (2014)). They highlight how the diversity of default product offerings increased following the introduction of MySuper. This largely reflects changes among retail funds, many of which moved to lifecycle, increased their use of passive management, and further restricted their use of alternative assets. Retail funds also reduced their fees, with some establishing products based on passive management with lower fees on average than the industry funds. The upshot is that the degree of differentiation in product design has increased, while differentiation on fees has decreased. These developments are mentioned by a number of our participants, with the quote below providing an encompassing perspective:

“I think part of the complexity is still that MySuper products are diverse, they’re not all the same. So you’ve got industry super funds which may just have one diversified investment option that gets all lifecycles, stages in life; versus retail super funds who have the lifecycle investment strategies, but then you’ve got 10 year cohorts, you’ve got active management, you’ve got passive management, you have dynamic asset allocation, you’ve just got static SAAs. ... If as a result MySuper trustees have thought about that and come up with different approaches, I think that’s a positive thing for the industry, rather than starting from a starting point of what everybody else does and trying to do the same thing.”

Nevertheless, the overall opinion of our participants about the change in the competitive landscape is hard to glean. While the participant responsible for the above quote saw a richer competitive environment as constructive development, others seem to just acknowledge that the situation had changed without offering any judgment. Presumably the not-for-profit funds may not have welcomed a dwindling in their fee advantage.

MySuper as a Circuit Breaker on Peer-Driven Behaviour

The fact that many of our participants consider the heavy focus on peer comparisons to be detrimental to member needs is documented in Butt et al. (2014). Related to this observation, some of our participants welcomed MySuper as an opportunity to shift attention away from peer comparisons. This view is primarily expressed by those adopting a lifecycle approach. Essentially, one perceived side-benefit of a lifecycle approach is that it provides an escape from the ranking game – at least for the time being – due the absence of history and a standard way to compare performance. While sceptics might consider this as a ploy to avoid being accountable, our participants did not convey any sense of this as their motivation. Rather, they allude to ranking funds based on past performance as being dysfunctional because it distracts from pursuing member needs. The following quotes are indicative:

“... as an industry this whole peer relative thing has really gone too far, and I think we as investors are not necessarily working in the best interests at all times of our investors because the peer issue is so significant. I think this is a great break; this is a way for us to redefine how we move forward ... moving away from peer group tables to client objectives, a clearer definition of client objectives.”
“[MySuper] had the benefit of saying well let’s sort of step away from this dysfunctional peer analysis, peer risk measurement, and try and construct portfolios in a different way, which also has the benefit of being, we think, better for the member over the long term.”

“One thing which could be good is if we can finally get away from peer group comparisons, which everyone says is not really the right way to do things.”

Focus on Fees

It is broadly perceived that one of the aims of MySuper was to help lower fees, as reflected in the following quote from one of our participants:

“... focus within the superannuation industry and by legislators was all around costs, right, not necessarily by performance. Cost was definitely the driving factor.”

Butt et al. (2014) report on the view from our participants that focusing on reducing fees and costs in isolation can have adverse impacts for members, reflecting the idea that cheaper is not necessarily better. Lower fees are seen as leading to less in terms of active management, alternative assets, services and innovation. We reproduce three representative quotes below:

“... some of these default members may end up being worse off through now being invested in funds that are largely passive in nature or funds that strip out some of the bells and whistles to save cost.”

“... if you go too far on fees, you’ve done yourself a disservice if it results in you getting rid of asset classes that you could have otherwise been in.”

“... you don’t get a lower cost for free, you might get a lower return and you might get less innovation or you might get less entrepreneurial risk-taking ... potentially the focus on cost could be a barrier to improvements or innovations.”

A few participants raise the possibility that if the focus on fees leads to widespread use of passive management, there may be unintended consequences for market efficiency. The idea is that buying assets purely due to their index inclusion may damage price discovery, disrupt the efficiency of prices, and even reduce returns over the long run (see Wurgler (2010) for a related discussion). The following quotes reflect this concern:

“if everyone goes to passive, the inefficiencies of the system will not be discovered through the active process.”

“... focusing on overall fees leads to more passive management and loss of price discovery in the market. And I think we have already seen some of the impacts. If RIO can at times trade in Australia at a 30% premium to RIO in the UK and BHP at 25%, for entitlement to EXACTLY the same cash flows from the company (OK, franking credits on the small dividends might be relevant but not to the extent that 30% is justified), this indicates a severe distortion. Are other stocks in Australia, without this clear comparison, even more distorted? Banks, perhaps?”
**System Costs Have Increased**

The earlier discussion on how MySuper was costly to implement essentially refers to the one-off cost of transition. Some participants also perceive there to be an element of permanent increase in costs, albeit marginal:

“I actually think our fee base has probably risen because of compliance issues ... what it has actually done is produced a layer of compliance for all super funds, raising the cost.”

“... whole bunch of stuff that we have to do now which I don’t think is going to add a lot of value, like product dashboards and other bits and pieces”

“... it has done nothing but raise costs and hasn’t changed the outcomes for members at the end of the day.”

**Greater System Integrity**

A number of our participants mention that MySuper and other associated regulatory changes should have a positive impact on the integrity of the superannuation system. Many of these comments are directed at the new prudential standards (discussed in Butt et al. (2014)); although regulatory change was often viewed as a package by those who commented. The following quotes reflect sentiments that seem to be held by many in our sample:

“Lifting the bar and improving the safety net in and of itself is a pretty good consumer protection”

“there’s a whole lot of stuff around MySuper that’s part of it about governance, about disclosure and a range of things that are not actually part of the product and they’re all good healthy things ... now more formalised”

“will drag some people who were – you know, poor governance into the tent or force them to go and reconsider their options.”

**8.3. General Reflections on MySuper**

So far in this paper, we have unbundled, presented and interpreted what our participants said around specific issues. What this can miss is their general impressions of MySuper, i.e. it can obscure the view of the overall picture. In this section, we give a sense for how our participants perceive the introduction of MySuper in its totality. We have selected seven quotes that reflect the range of views, and provide an indication of the trade-offs. The first two quotes are the most sceptical; and the last two the most supportive The three in the middle are selected for the manner in which they sum up a range of considerations. Some of the quotes are lengthy, reflecting that our participants were often weighing up various impacts. These longer quotes incorporate some shorter quotes appearing earlier, which appear here in a fuller context.

“... what an utter debacle the entire process has been, in terms of it has done nothing but raised costs and hasn’t changed the outcomes for members at the end of the day. ... there’s absolutely no doubt that both policy-making and implementation of this entire thing under the previous government was incredibly poor. ... The outcomes, by and
large, for the majority of Australians will be unchanged; and yet nothing is being added but complexity (when simplicity was demanded) and cost to the system, which ultimately flows back to individuals; when the objective was the opposite as well.”

“we started off by saying well, what other possible default can we use ... So we looked at life stages and all these different types of funds before we actually ... got to say okay, one single investment option ... the balanced fund ... so at the end of the day what has really changed for our members from a MySuper perspective ... we’ve changed the wording in the PDS ... had to restructure the fees ... fees have actually gone up through this process, but nothing else has changed from a member’s perspective ... Behind the scenes we have spent hours and hours discussing papers. We lodged our application, which was over 600 pages in documentation that we had to write to lodge to get a MySuper license and at the end of it, what has actually really changed? It’s perhaps gone slightly backwards. There’s other changes that have happened as part of the prudential standards with super that have definitely improved. So there are a lot of positives that have come out of some of the reforms; but in terms of MySuper, not from our perspective. It’s just a lot of work, a lot of money.”

“I think it provides benefits. ... the ability for members, I guess from a fee perspective, to compare superannuation funds. ... it gives us an opportunity to actually engage with the members, and talk about the benefits of asset allocation and changing asset allocation as they age. ... it’s given trustees the ability to ask the question for a cohort of disengaged members, what is the right thing to do to provide the best possible retirement outcomes ... If as a result MySuper trustees have thought about that and come up with different approaches, I think that’s a positive thing for the industry, rather than starting from a starting point of what everybody else does and trying to do the same thing. ... Well hopefully it drives the right outcomes. I think it may be too early to tell. But I think the actual process itself – for a long time it wasn’t clear ... and a lot of money has been spent within the industry ... and that cost obviously passes back to members.”

“the MySuper and Stronger Super Reforms ... were an affirmation or a reaffirmation of what the fund is trying to do. In many instances it resulted in a codification of a lot of the things that we were already doing ... an opportunity to ensure that we were heading in the right direction, and that everything is properly codified and the processes were as robust as they need be ... for us, there wasn’t a substantial revolution ... but ... the competitive landscape in terms of the response from a lot of other people has been quite drastic in some cases; and it has forced us to consider what the value proposition is as a result of what we do; retesting whether we think we’re doing the right thing by members. ... That’s probably been the major thing. But it was, without question, an expensive exercise ... arguably that money could have been better spent elsewhere for the members. ... the reality is not everyone is a member of a fund like ours, and lifting the bar and improving the safety net in and of itself is a pretty good consumer protection.”

“I think the benefit of the legislation is it did give – retail funds particularly – the opportunity to innovate in that default book. ... time will tell how helpful it has been for the industry, I think is the short answer, because it certainly has add a lot of cost into the industry across the board, and a lot of time and a lot of focus away from other things ... I think there’s a lot of development to be done. I’m surprised the government didn’t start with the pension phase rather than the superannuation phase. ... It’s been much harder because there’s uncertainty about what will be legislated post-retirement. So that was
one of the things we kept coming up against, whether people are taking it as a lump sum or an annuity stream ... some of these default members may end up being worse off through now being invested in funds that are largely passive in nature or funds that strip out some of the bells and whistles to save cost. The time, effort and cost involved in getting these structures up and running has also been onerous ... many funds were not looking at new investments/strategies through last year due to the focus on My Super. So ultimately that resource effort and cost will likely have come at the expense of members.”

“so the good thing is it has forced us to reconsider the model. I think lifecycle generally is an improvement for members. I don’t think MySuper has made a lot of difference for most funds because they’re essentially doing the same piece. ... It’s been very disruptive and extremely expensive ... there’s a whole bunch of stuff that we have to do now which I don’t think is going to add a lot of value, like product dashboards and other bits and pieces ... we’ll look back and [we will have] lifecycle funds ... a track record ... a deeper understanding ... industry funds running balanced funds ... better governance ... hopefully some of the sillier things get washed out ... in 5 or 10 years time you’ll come out of the back of that and you’ve got a more robust offer. But it’s exceptionally disruptive now and expensive now.”

“MySuper acted as a catalyst. ... reference to lifecycle funds ... the permission sort of came through in that way. ... It’s focused the attention back on the member and what constitutes a good default option more broadly. So I think by increasing the debate on the topic, it’s really opened up a whole gamut of possible solutions. Lifecycle is obviously one of the beneficiaries of that extended debate; but it’s also meant that trustees have actively gone back and looked at their own demographic. ... There’s many different approaches now of default funds.”

8.4. Summary – Our Take

Was MySuper a positive development for the Australian superannuation industry? On balance, we think so. A major achievement of MySuper was that it sharpened focus on the needs of default members, by requiring providers to consider their default fund offering. Most responded by asking what was appropriate for members who are largely disengaged. It appears that this examination helped facilitate a change in emphasis towards considering the retirement needs of members; and away from wealth accumulation, shorter-term performance and peer-relative returns. This change in emphasis might have occurred regardless of MySuper. Nevertheless, MySuper definitely abetted and accelerated the process. Undoubtedly it caused some providers to start thinking about issues and considering options that they may not otherwise contemplated until a later time.

The significance of creating a product dedicated to default members is worth emphasising. Separating out default option members resulted in this group being treated as a distinct cohort. Further, the cohort is being approached under the assumption that the ‘typical’ default member is largely disengaged, and uninterested in short-term performance. This engenders a sense of license to design products thought to be suitable for such members, under the presumption that they are likely to accept what is offered. The perceived need to focus on short-term performance and product features as selling points is dulled accordingly. For instance, some of the retail funds who shifted to a lifecycle approach welcomed MySuper as a chance to divert attention away from short-term performance, towards building a product that would carry members through to retirement. In effect, funds were practicing a form of
libertarian paternalism, as espoused by Thaler and Sunstein (2003a, 2003b) and mentioned by Cooper (2010).

MySuper has facilitated increasing product innovation and diversity. Again, the key element is the separating out of default members into a single, core product. There is less of a perceived need to ‘sell’ default products to the members. At best, they need to be sold to ‘gatekeepers’ like corporate sponsors or advisers. This creates an environment where providers may feel that they have the latitude to pursue innovations that are deemed beneficial for members. One notable example of how MySuper has facilitated innovation in this way is the emergence of lifecycle funds. Providers were given the scope to deliver lifecycle strategies to their default members, and a number decided to do so. It is unclear whether lifecycle funds would have emerged in any meaningful way under a choice system: they existed prior to MySuper, but the take-up was minimal. Many of our participants allude to plans for future innovation, notably including greater tailoring to members. Hence MySuper could potentially accommodate ongoing innovation and even greater product diversity. (The recommendation of the FSI (2014) that MySuper be reviewed from 2017, with the possibility of being replaced with a tender or auction system, may create a disincentive to pursue any major innovations in the interim.) One implication of greater perceived latitude to innovate within the default option is that the importance of fiduciary duty and the need for vigilant regulators becomes heightened.

MySuper has also affected costs and fees. Here it is much harder to discern whether the changes have been positive for members. Retail funds reduced their fees with the introduction of MySuper. However, the associated reduction in fee budgets also led to changes in product design involving greater use of passive management and decreased use of alternatives. Meanwhile, underlying industry costs appear to have risen marginally as consequence of the associated regulatory requirements. Whether members are better off under this mix of changes is a moot point. Refer Chant, Mohankumar and Warren (2014) for analysis and discussion of these issues.

While the implementation of MySuper appears to have been costly and disruptive, it has potentially set the stage for ongoing innovation and evolution. Our interviews provide strong evidence that the superannuation industry in Australia is turning its attention away from accumulating assets and from worrying most about short-term performance; towards considering how to provide for the retirement needs of members. MySuper is playing an important part in this evolution through having encouraged a focus on the suitability of default products in the accumulation phase, which in turn is being approached through the lens of building towards retirement outcomes. MySuper has hence established a platform from which retirement products might be constructed, even though it only covers the accumulation phase in itself. Going forward, the evolution should continue through a further honing of MySuper products, and ultimately integration with the retirement phase.
Appendix

Interview Guide – Design of MySuper Products

1. Opening

About this interview:

• Our broad aim is to better understand how the investment options of super funds came to be structured as they are, including asset allocation and overall product design. We also want to gather views on how effectively member needs are being met. To achieve this, we would like to focus on the development of your MySuper product as a case study.

• This interview will be structured into four main parts:
  1. Gather some background information;
  2. Obtain an account of how your MySuper product was designed;
  3. Find out how the underlying asset allocation is determined;
  4. Ask for your views on the effectiveness of current industry structures.

Checks to perform:
  i. Consent form?
  ii. Permission to record interview and take notes?
  iii. Observe right to opt out of involvement or cease recording at any time
  iv. Any questions?

2. Background Information

a) First, we have done some preliminary research into your fund and MySuper product based on publically available information. Can you tell us if the summary provided is accurate, and help us fill in any gaps?

b) Can we also ask about:
   • Your industry sector – how do you view yourself?
   • Your member base – any distinguishing features for your fund?

c) What is your understanding of the needs of your members?

3. Account of MySuper Product Design

Can you give an account of how your MySuper product came to be structured as it is?
4. Asset Allocation

We now want to ask you to describe investment strategy for the MySuper product.

a) Who is involved in determining asset allocation?
   - Follow-up question: What is the role of any asset consultant?

b) What asset classes are considered?

c) What is the investment philosophy and objectives which underlie asset allocation? Specifically how are risk and return defined, and then traded off?

d) Can you describe the process of how asset allocation is determined?

5. Effectiveness of Current Industry Structures

We now want to get your thoughts on the effectiveness of current industry structures. First, we will ask about MySuper specifically. Then we will get your thoughts on the superannuation system in general (if time permits). Our aim is to document industry perspectives on the effectiveness of the system in meeting member needs.

a) Do you have any comments on the extent to which MySuper is likely to enhance the ability to meet the needs of members?
   Follow-up questions:
   i. Do you have any comments on the MySuper development process?
   ii. Do you have any comments on the relevance of fund scale?

b) Are there any design aspects of your MySuper product that you either have plans to improve, or would like to do so if possible?
   Follow-up question:
   - Do any notable barriers exist to making these improvements?

c) Do you have any comments on the superannuation system in general, and how well it is configured to meet the needs of you members?
   Follow-up question:
   - Any notable strengths or weaknesses of the regulatory framework, including either the regulations and/or the regulators?

6. Other Issues and Wrap-up

a) Any other important items that we have overlooked?

b) Would you mind being contacted if we any follow-up questions?

c) Can we send a copy of the transcript, and then our write-up, for your comments?
   - This would help to ensure that our account and interpretations are correct.

d) Thank-you again!
References


