MySuper: A New Landscape for Default Superannuation Funds

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Synopsis

This report examines the Australian superannuation default fund landscape following the introduction of MySuper. The two main products are outlined – single strategy 'balanced' and lifecycle – including their underlying asset allocation and glide path strategies. While lifecycle approaches address sequencing risk, they also reduce expected return through reducing exposure to growth assets on an asset-weighted basis over the lifecycle. Many retail providers responded to MySuper by significantly revising their default offerings, including switching to lifecycle approaches, reducing fees, and increasing use of passive management while limiting use of alternative assets. MySuper fee structures are also documented. Whether members are better off as a consequence of MySuper remains an open question, which hinges on whether prospects for adequate balances at retirement have improved for retail fund members. Much depends on the view held on debatable issues such as the trade-off between sequencing risk and expected return, active versus passive management, and the benefits of alternative assets. Hopes that MySuper might lead to a range of simple, low cost, easy-to-compare default products have not been realized, particularly in light of the introduction of lifecycle products.

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1. Executive Summary

This report examines the Australian superannuation default fund landscape following the introduction of MySuper: the product under which all default balances will be eventually managed. It documents the investment approaches and fee structures of MySuper products; drawing on industry knowledge in interpreting the data and providing insight. The key messages are summarized below.

- **Two main offerings: balanced and lifecycle** – There were 120 MySuper products registered at March 2014, of which 81% involve a single diversified strategy which are referred to here as ‘balanced’ products. The remaining 19% use a lifecycle strategy, which entails reducing member exposure to growth assets as they transition towards retirement. Lifecycle products are offered by providers responsible for about 35% of MySuper assets (including balances not yet transferred).

- **The main changes were among retail funds** – It was largely the retail sector that embraced MySuper as an opportunity to revise their default fund offerings. A majority of retail providers responded by introducing lifecycle products and reducing fees by increasing their use of passive management and further limiting their exposure to alternative assets. Meanwhile, most industry funds rebranded an existing default fund in accordance with the MySuper requirements.

- **Diversity in investment strategies** – The typical MySuper balanced product has between 70% and 80% invested in growth assets. However, they hold a broader range of asset classes, have a lower home bias and demonstrate greater willingness to pursue dynamic (i.e. active) asset allocation strategies than seems generally appreciated. Across lifecycle products, there are a number of design variations. Differences are observed in the ‘glide paths’ by which growth asset exposure is reduced as a member transitions towards retirement. Some providers implement this transition by assigning members to cohorts; while others switch members between existing funds as they age. Some products are designed ‘to retirement’; whereas others are configured to manage a member’s investment ‘through retirement’.

- **Lifecycle reduces risk, but also expected returns and potentially fees** – Lifecycle products address ‘sequencing risk’ by reducing exposure to growth assets as a member nears retirement, thus limiting the chance of incurring large losses when balances are highest. This feature also means that a member’s investment is tilted towards lower growth exposure over the lifecycle on an asset-weighted basis. Our estimates suggest that lifecycle products offer lower expected returns of about 1% per annum (after investment fees and taxes); while providing room for investment fee reductions of around 10 basis points (bps), compared to remaining invested in a balanced fund with 70% growth assets over a person’s working life. In short, lifecycle funds increase the surety of retirement balances but decrease their expected value.

- **Fees sit around 1% p.a., but need to be interpreted carefully** – The average fee paid by a MySuper member with a $50,000 account balance stands at 106 bps per annum. The average fee for all sectors except actively managed retail products sits within a relatively tight band of 94 bps (public sector) up to 105 bps (industry funds), with passively managed retail products charging 95 bps. Actively managed retail product charge an average headline fee of 131 bps. We caution against taking fees at face value. Not all members in retail funds pay the rack rate, as retail providers can offer discounts to corporate-sponsored plans of up to 70 bps. What members get for their fees varies considerably, with industry funds tending to have larger exposures to alternative assets and retail funds containing a larger passive element.

- **Whether MySuper leaves members better off is an open issue** – The main changes associated with the introduction of MySuper included: (a) emergence of lifecycle products; (b) retail providers
reduced fees by about 14 bps per annum in their actively managed products through a combination of
increase use of passive management, decreased use of alternative assets and lower margins; (c) retail
providers also introduced passively-managed products with much lower fees; and, (d) underlying costs
in the industry rose at the margin, reflected for instance in a 4 bp increase in the average industry fund
fee. The net impact of these changes largely depends whether retail default fund members will benefit
from the mix of fee reductions and product design changes. The greater use of lifecycle strategies is a
probably a net positive by helping to address sequencing risk; but there is an associated cost of lower
expected balances at retirement. Whether other product design changes are seen as positive depends
on one’s viewpoint on hotly contested issues such as active versus passive management and the
benefits of using alternative assets in the mix.

- **Things are not simpler** – One of the motivations behind MySuper was to foster a range of simple,
low-cost, easy-to-compare default products. This goal has not been realized. If anything, the
introduction of lifecycle products coupled with other differences in product design gives rise to a
more diverse range of offerings. Further, the industry still falls short on fee comparability.
Nevertheless, the need for simplicity and comparability may not be paramount, providing those
choosing the default fund on behalf of members are informed and act in members’ best interests.

2. **About this Report**

In 2013, the Centre for International Finance and Regulation (CIFR) made a call for research on default
superannuation funds. One of the topics of interest was framed as follows:

> “What investment approaches are being used by default superannuation funds during the
accumulation phase?”

As none of the submitted research proposals addressed this question directly, CIFR decided to cover the
topic using internal resources. The research is being performed in conjunction with Chant West, an
independent superannuation research and consultancy firm that conducts research on most leading
superannuation funds, asset consultants and implemented consultants in Australia. Chant West is
contributing both its data and considerable industry knowledge to this project. Its position as a leading
superannuation industry researcher brings both an appreciation for the finer details and a level of insight
that could not be easily replicated through other sources. In addition, Geoff Warren has recently been
involved in interviewing superannuation fund management about the design of their MySuper products,
undertaken as part of CIFR Project SUP002. This further informs this report.

The shape of default superannuation funds in Australia recently changed with the introduction of
MySuper. The system is transitioning towards all default money being managed within a MySuper product
by 1 July 2017. The development of MySuper has been occurring in conjunction with a raft of other
regulatory changes impacting on the superannuation industry. These include the SuperStream measures
designed to improve the 'back office', enhanced governance requirements including the introduction of
new prudential standards, and the Future of Financial Advice ('FOFA') Act which alters the regulations
on financial advice and is currently under review. These changes have imposed a strain on the industry,
with many reports of complaints about the cost, diversion of management attention and overall regulatory
fatigue. Whether the reforms have improved outcomes for members remains a point of contention. This
report helps shed light on this issue.

2 Some of the data used in this report is proprietary to Chant West, and hence appears in summary form. Any reader
interested in subscribing this data and related services should contact Chant West directly.
3. MySuper Regulatory Environment

MySuper emerged out of the Super System Review of 2010 (the ‘Cooper Review’), and the Superannuation Legislation Amendment (Stronger Super) Act (2012) that subsequently followed. The broad philosophy espoused in the Cooper Review was that the superannuation system comprises three types of members with varying degrees of engagement with their superannuation. The three types include self-managed superannuation fund members who are typically the most highly engaged; ‘choice’ members who select from the gambit of products offered by superannuation fund providers; and disengaged members who largely accept the default fund that is offered by their employer. MySuper is intended for the latter group, which comprise the majority of members in superannuation funds. The Cooper Review (Part 1, page1) summarized 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.”

The major specifications for a MySuper product are listed below.

- **One MySuper product** – Each registered superannuation entity (RSE) can offer one MySuper product licensed by APRA, although exceptions are permitted in certain situations.

- **Investment strategies: balanced or lifecycle** – MySuper products must be either a single well-diversified investment strategy or a lifecycle strategy. No restrictions are placed on the number of age divisions or cohorts permitted under a lifecycle strategy.

- **Standardized fees** – MySuper products must have a standard set of fees available to all prospective members. Single diversified strategies can only charge one standard set of fees. Lifecycle strategies are able to vary fees across four different age groups, i.e. four ‘price points’. A notable exception to the common fee rule is that funds may offer discounts on administration fees to corporate plans that are negotiated on behalf of their employees.

- **Limits on type of fees** – Fees are generally restricted to administration fees; investment fees (with allowance for performance-based fees, subject to some limitations); and certain transaction fees on a cost recovery basis such as buy and sell spreads, exit fees and switching fees.

- **Standardized reporting requirements** – These include information on investment strategy, return target (CPI-plus), standard risk measure (number of negative return years out of 20), fees and insurance offering. Certain items are to appear in a ‘product dashboard’ aimed at making funds comparable.

- **Insurance** – Default life and total and permanent disability insurance must be offered on an opt-out basis. Costs may be deducted from a member’s account. Many funds offer the option to vary insurance coverage, often including scope to add income-protection insurance.

Key milestones in the development of MySuper appear in the box over. There are two main dates to note. The first is 1 January 2014, after which all new default fund contributions must be invested in a MySuper product. The second is 1 July 2017, by which all remaining default fund balances must be transferred into a MySuper product. This means that all default balances will be transitioning across to MySuper over the next 3 years or so. Our understanding is that the vast majority of not-for-profit funds have transferred
balances already, assisted by the fact that they made minimal changes to their default offerings as a consequence of MySuper. This contrasts with the situation for retail funds, where transfers are likely to take considerably longer and the timing remains unclear.

<table>
<thead>
<tr>
<th>Date</th>
<th>Milestone</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June, 2010</td>
<td>Cooper Review delivers its Final Report.</td>
</tr>
<tr>
<td>1 January, 2013</td>
<td>First date for lodgment of MySuper applications.</td>
</tr>
<tr>
<td>28 June, 2013</td>
<td>Final MySuper regulations released.</td>
</tr>
<tr>
<td>1 July, 2013</td>
<td>MySuper products could be launched.</td>
</tr>
<tr>
<td>1 January, 2014</td>
<td>Only authorized MySuper products permitted to receive default super contributions from an employer. (Note: Existing default balances may be retained within their existing fund structure.)</td>
</tr>
<tr>
<td>1 July, 2017</td>
<td>Final date by which all remaining default balances must be transferred to a MySuper Product. (Note: There is no requirement to transfer defined benefit fund balances.)</td>
</tr>
</tbody>
</table>

4. **Broad Approach: Use an Existing Balanced Product, or Move to Lifecycle?**

As of March 2014, 120 registered superannuation entities (RSEs) had registered a MySuper product. In designing their MySuper products, the typical choice faced by RSEs was to either reconfigure (i.e. rebrand) an existing default fund offering to accord with the MySuper requirements, or adopt a lifecycle strategy whereby asset allocation is varied based typically on a member’s age. Table 1 presents a breakdown of the registered MySuper products by industry sector and strategy.
Table 1: Number of MySuper Products by Sector and Design

<table>
<thead>
<tr>
<th>Sector</th>
<th>Industry</th>
<th>Public</th>
<th>Corporate</th>
<th>Retail</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Breakdown by Number</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single Strategies (Balanced)</td>
<td>44</td>
<td>7</td>
<td>34</td>
<td>12</td>
<td>97</td>
</tr>
<tr>
<td>Lifecycle Strategy</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>17</td>
<td>23</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>46</td>
<td>10</td>
<td>35</td>
<td>29</td>
<td>120</td>
</tr>
<tr>
<td>Percentage of Total</td>
<td>38%</td>
<td>8%</td>
<td>29%</td>
<td>24%</td>
<td>100%</td>
</tr>
<tr>
<td>Percentage of Lifecycle Products</td>
<td>4%</td>
<td>30%</td>
<td>3%</td>
<td>59%</td>
<td>19%</td>
</tr>
</tbody>
</table>

**By Fund Size, December 2013 #**

| Assets under Management ($b) | 301.3  | 119.1  | 41.4    | 113.2  | 575   |
| Percentage of Total          | 52%    | 21%    | 7%      | 20%    | 100%  |
| Percentage with Lifecycle Product | 10%    | 76%    | 32%     | 60%    | 35%   |

**Notes:**
# Based on all superannuation funds under management for sample of 95 funds. Products excluded are non-public offer funds with assets below $500 million and tailored MySuper products (i.e. corporate plans managed by another fund).

Data Source: Chant West Super Fund Fee Survey, December 2013

Notable comments on Table 1 include the following:

- While 120 MySuper products have been registered, this overstates the number of providers and distinct, independent products that are available in the market. We believe the majority of the 35 corporate products have outsourced their investment management to retail providers. In many cases, these funds are an extension on the retail provider’s offering. Also, a few of the larger retail operators have been permitted to have multiple MySuper products within their structure.

- There are 23 lifecycle MySuper products, constituting 19% of the registered MySuper products by number. These lifecycle products are offered by providers that manage 35% by value of our sample of 95 larger superannuation funds. Most of these lifecycle products were not in existence prior to MySuper.

- Lifecycle strategies have been largely embraced by retail funds and to a lesser extent public sector funds. Seventeen out of the 23 lifecycle products are offered by retail providers. Lifecycle products represent around 60% of the retail sector by both number and value. Three out of 10 public sector funds offer lifecycle products, although this equates to 76% by value as the two largest public sector funds (QSuper and First State Super) adopt a lifecycle approach.

- Meanwhile, most of industry and corporate funds simply rebranded an existing single strategy (i.e. balanced) default fund as their MySuper offering.

- Industry funds managed 52% of total default assets at December 2013, based on our sample of 95 larger funds. This compares with the 29% that industry funds constituted of total superannuation assets excluding small funds (i.e. SMSFs) at June 2013, according to APRA data. The relative prevalence of industry funds in the default fund segment arises partly as a consequence of being nominated providers under industrial awards.
5. Investment Strategy: Balanced Funds

We commence with an overview of the investment strategies underpinning the balanced default funds being used as a MySuper offering. Lifecycle products are reviewed in Section 6. Due to the absence of comprehensive data, we rely on a representative sub-sample of funds. Chant West collects detailed information on strategic asset allocation (SAA) for a wide range of funds, of which 21 are balanced funds that have been rebranded as MySuper products. This provides a sample that captures a substantial portion of the MySuper products offered by the not-for-profit sector, including all the major industry funds by size. Chant West also collects actual asset allocation data, which is available for a subset of 16 funds out of the 21 funds. The data is augmented with commentary on asset allocation practices by drawing on Chant West’s industry knowledge. Points of focus include the “typical” asset weightings, the distribution of those weightings, the spread of assets used, and the manner in which asset allocation is actively varied around SAA.

Asset allocation for our sample is summarized over in Table 2. The first column of data reports the average SAA. The second and third column examines the deviation of actual asset allocation from SAA for the 16 fund subset. Here the average difference provides a (rough) guide to the typical active position taken relative to the target position as at December 2013. The standard deviation of the difference gives some sense of the degree to which the deviations from SAA vary across funds. The last group of columns reports the distribution of SAA weights for each individual asset and within each broad asset category. As the data in this last group of columns are percentiles, the numbers do not sum and each line should be considered separately.

The following observations can be made based on Table 2 and our understanding of the industry:

- **Growth/defensive mix** – The MySuper balanced products in our sample are mostly a bit more aggressive than the typical ‘70/30’ fund, i.e. they have more than 70% invested in growth and less than 30% in defensive assets. The average growth weighting is 72%. Funds with 70% growth assets are positioned at the first quartile. Figure 1 plots the full distribution. It shows that the majority of our sample has a SAA weighting in growth assets of between 70% and 80%. Only two funds have a growth weighting of below 70%, including one at 68% and an outlier at 50%.

- **Equity exposure** – The average equity weighting is around 52%, comprising about 27% in Australian equities and 25% in international equities. While overall equity weightings in most balanced funds have trended down over time, equities still comprise the dominant asset class in terms of weighting and (given their volatility) the influence over performance.

![Figure 1: Distribution of Growth Weightings](image)

Data Source: Chant West Strategic Asset Allocation Survey

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4 One of these funds supplies actual asset allocations, which we have used as a proxy for their SAA.

5 This excludes the one fund where actual allocation is used as a proxy for SAA.

6 Deviations may arise as a consequence of either active positions, lags in rebalancing, or the possibility that a fund might not have had sufficient time to transition towards an SAA that has been recently been updated.
Table 2: Asset Allocation of MySuper Balanced Funds

<table>
<thead>
<tr>
<th>December 2013 (Percentage Weighting)</th>
<th>Average SAA (21 funds)</th>
<th>Actual vs SAA (16 funds)</th>
<th>Distribution of SAA Within Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Difference</td>
<td>Std Dev</td>
<td>Min</td>
</tr>
<tr>
<td>GROWTH ASSETS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australian Equities</td>
<td>26.7</td>
<td>-0.6</td>
<td>3.6</td>
</tr>
<tr>
<td>International Equities</td>
<td>25.4</td>
<td>2.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Total Equities</td>
<td>52.2</td>
<td>1.4</td>
<td>4.8</td>
</tr>
<tr>
<td>Total Growth Property</td>
<td>6.4</td>
<td>-0.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Private Equity</td>
<td>3.4</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Unlisted Infrastructure</td>
<td>4.8</td>
<td>-0.1</td>
<td>0.8</td>
</tr>
<tr>
<td>Listed Infrastructure</td>
<td>0.4</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>1.2</td>
<td>0.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Commodities/Gold/Resource</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Other</td>
<td>3.8</td>
<td>-0.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Total Growth Alternatives</td>
<td>13.6</td>
<td>0.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Total Growth Assets</td>
<td>72.2</td>
<td>0.9</td>
<td>3.2</td>
</tr>
<tr>
<td>DEFENSIVE ASSETS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>4.8</td>
<td>2.7</td>
<td>3.4</td>
</tr>
<tr>
<td>Australian Fixed Interest</td>
<td>4.2</td>
<td>-0.6</td>
<td>1.2</td>
</tr>
<tr>
<td>International Fixed Interest</td>
<td>3.4</td>
<td>-0.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Australian Inflation-Linked</td>
<td>0.5</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>International Inflation-Linked</td>
<td>0.3</td>
<td>-0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Broad Fixed Interest</td>
<td>4.8</td>
<td>-0.4</td>
<td>1.8</td>
</tr>
<tr>
<td>Total Fixed Interest</td>
<td>18.0</td>
<td>0.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Australian Unlisted Property</td>
<td>3.6</td>
<td>-0.8</td>
<td>1.2</td>
</tr>
<tr>
<td>Global Unlisted Property</td>
<td>0.0</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Total Defensive Property</td>
<td>3.7</td>
<td>-0.8</td>
<td>1.2</td>
</tr>
<tr>
<td>Debt</td>
<td>0.8</td>
<td>-0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>2.3</td>
<td>-0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>1.8</td>
<td>-0.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Other</td>
<td>1.1</td>
<td>0.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Total Defensive Alternatives</td>
<td>6.1</td>
<td>-0.9</td>
<td>1.7</td>
</tr>
<tr>
<td>Total Defensive Assets</td>
<td>27.8</td>
<td>-0.9</td>
<td>3.2</td>
</tr>
<tr>
<td>Total Assets</td>
<td>100.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Hedge Ratio (Int'l Equities)</td>
<td>34%</td>
<td>-6%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Data Source: Chant West Surveys on Strategic Asset Allocation and Actual Asset Allocation, December 2013

- **Home bias** – Estimating effective country exposure is a vexed issue.\(^7\) Nevertheless, our sample appears to have somewhere between 50% and 60% in Australian-based assets. The equity component comprises 51% Australian and 49% international equities on average. The local weighting sums to 55% for the identifiable Australian/international categories across equities, property and fixed

\(^7\) Effective international exposure is typically opaque and difficult to measure. For instance, the international component is not visible for many alternative assets and within broad fixed interest mandates with no specified geography. Further, locally-listed assets may effectively contain exposures to international operations or assets.
interest. We get an Australian weighting of 58% across the entire portfolio if we notionally allocate 50% of broad fixed interest and all of infrastructure to Australia, but treat other alternatives as international assets. The level of home bias in our MySuper balanced fund sample is much lower than for the entire superannuation industry, where the Australian Bureau of Statistics reports a weighting in local assets of 83%. It is also probably less marked than commonly perceived. Further, the portion of Australian assets has been trending lower over time. Hence while home bias is still evident, it may be less of an issue than perceived at least within MySuper products.

- **Range of assets used** – Funds in our sample use a wide range of assets, although many of these exposures are relatively small. Holdings are observed in a variety of asset classes that might be considered ‘non-traditional’. This not only includes well-recognised alternative assets like infrastructure, private equity, hedge funds and commodities. Holdings are observed in global property (both listed and unlisted), international inflation-linked bonds, and alternative debt securities. In addition, there is an average weighting of nearly 5% in the ‘other’ alternatives category. The average total weighting in alternatives is just under 20%. Chant West as well as other providers have kept asset allocation data over time which reveals two further points. First, there has been a gradual trend towards diversifying away from traditional assets, particularly equities. Second, funds have become more adventurous through branching out into new asset classes. The culmination of these trends are reflected in the upper tail of the distribution in our sample, where weightings in assets once considered somewhat exotic can be as much as 5%-6% at the 3rd quartile and around 10% maximum. While there is much that might still be done to better diversify portfolios, a fair amount has been already achieved.

- **Currency hedging** – The observed average SAA hedge ratio within international equities stands at 34%, with a range from 0% to 60%. Currency hedging across the total portfolio is more difficult to judge. Our understanding is as follows. It is standard industry practice to fully hedge international fixed interest and global listed property, as well as hedge funds in a majority of cases. Further, many funds treat currency as a separate asset class, estimating a target level of foreign currency exposure for the overall portfolio which is typically in the range of 15%-20%. In these cases, international equities are used as the vehicle by which hedging across the overall portfolio is managed towards the desired target, including bringing to effect any tactical positions.

- **Deviations from SAA** – Dynamic asset allocation around SAA has become widely embraced by the industry over recent years, particularly since the global financial crisis. Of interest is what the data reveals about the tenor of the positions taken. While we only have a snapshot at December 2013 for a subset of 16 funds, the deviations observed from SAA provide some indication. On average, our sample is modestly overweight growth assets by 0.9%. Notable overweight positions versus SAA include +2.7% in cash and +2.0% in international equities. Underweight positions include -1.9% across the fixed interest categories and -1.7% in property. The average hedge ratio in international equities of 28% is -6% below SAA. The numbers suggest that our fund sample on average favors world equities, dislikes bonds, and expects an A$ decline. These positions seem to accord with general industry commentary at the time. The underweighting in property is more difficult to interpret, and could partly reflect the difficulty of managing towards benchmark in illiquid asset classes.

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8 We assume that cash is held in A$ in doing this calculation.
9 This number is based on ABS 5655.0 “Managed Funds, Australia”, December 2013. APRA reports weightings of 25% in international equities and 6% in international fixed interest across all default funds as at June 2013, which is similar to our numbers for these two asset classes. APRA does not identify the international component in other asset classes.
10 The influence of the hedging decision on fund risk and return (and positioning on league tables) tends to be under-appreciated. For Australian-based funds, hedging has historically offered higher long-run returns. This reflects not just the strength of the A$ (which could prove unsustainable); but also the fact that hedging captures the forward premium and the associated forward rate bias which relate to Australia’s relatively high interest rate structure. On the other hand, unhedged positions have tended to lower overall risk due to the correlation structure between equities and the Australian dollar.
The standard deviation of the differences from SAA reveals a meaningful spread of positions around the sample average. Standard deviation stands at 3.2% for growth versus defensive assets, 4.8% for overall equity exposure, and 3.4% for cash. These numbers are substantial enough to suggest a reasonable degree of disparity in positions across the sample. They imply that some funds are willing to take moderately large positions versus their own SAAs and their peers. This hints at less industry herding than often seems presumed . . . at least around the margin of the SAAs on which funds are ‘sold’.

The data broadly accords with Chant West’s understanding of asset allocation practices among Australian superannuation funds, which is as follows. While some form of dynamic asset allocation is now common practice in the industry, there is considerable variation in the approach used. Some funds, for example, tend to make infrequent but relatively aggressive changes in position based on valuation analysis or market views, particularly those that use Frontier or JANA as their asset consultants. Indeed the target SAA itself may be varied on a regular (e.g. yearly) basis, which blurs the lines between strategic and dynamic asset allocation. In these cases, observed deviations from SAA are more difficult to interpret as they could merely reflect lags in attaining a revised SAA target. Other funds follow a more traditional approach involving establishing long-term SAAs around which there is occasional variation, usually when markets are judged to be at some unsustainable extreme.

6. Investment Strategy: Lifecycle Funds

This section initial sets out the rationale espoused by providers who have opted for a lifecycle approach. The construction of lifecycle products is then examined. This is followed by an analysis of the impact of a lifecycle approach on the member experience over the lifecycle. The analysis reveals that lifecycle products not only reduce risk, but also reduce expected return while providing potential for lower effective fees when viewed on an asset-weighted basis.

A key motivation of a lifecycle approach is to reduce sequencing risk, i.e. address the possibility that members could suffer a large loss in fund value when it matters most near retirement. An underpinning assumption is that members become more risk averse with respect to their investment in superannuation as retirement approaches. This is based on two notions. First, the balance of wealth shifts away from nearly-exhausted human capital towards other assets in their portfolio as a member ages. Second, the superannuation balance is likely to be a large component of the portfolio, given that it will be near its maximum level around retirement. Hence with older members being more heavily reliant on their superannuation fund, their propensity for bearing risk in that fund is lessened. 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.

Proponents of lifecycle investing acknowledge that the above line of argument could potentially overstate the importance of de-risking the superannuation fund, to the extent that due consideration is not given to (a) the age pension as an asset or downside protection mechanism, (b) the existence of substantial other assets outside of superannuation, and (c) the possibility that markets can tend to mean-revert after large falls -- in which event the option to remain invested in growth assets may be a valuable alternative to crystallizing the losses.\(^\text{11}\) Also, lifecycle approaches implicitly make presumptions that may be incorrect about member preferences and their attitudes towards risk in their superannuation fund.\(^\text{12}\) Nevertheless, the general concept of de-risking as retirement approaches is probably appropriate for many default members.

\(^\text{11}\) Some lifecycle fund providers have intentions to build a ‘richer’ model that takes these other considerations into account, subject to availability of member data.

\(^\text{12}\) Some proponents add that the preferred position is for members to become engaged and exercise choice in line with their own preferences and needs.
We now turn to how the lifecycle approach is being implemented within MySuper. Permitting providers to adopt a lifecycle approach opened up a path towards broader use of lifecycle products through allowing them to be mandated within default funds. Some providers have taken up this opportunity, most notably within the retail fund sector. The lifecycle strategies that have resulted largely involve reducing exposure to growth assets as a member progresses towards retirement based on the single indicator of age. This transition is commonly called the ‘glide path’.

Figure 2 plots the average glide path across the 23 MySuper lifecycle funds, along with 4 selected examples to illustrate the some differing paths. While broadly similar glide path is followed by many of the products, there is some notable variation. Most products carry a high growth exposure of 85% or more until the member achieves an age around their 40’s, then progressively transition towards weightings centered around 30%-40% sometime prior the retirement age of 67. Figure 2 presents contrasting examples of the aggressiveness by which growth asset exposure may be varied. The most aggressive is AON MySuper, which commences with 100% growth assets then transitions to 0% at retirement. At the other end of the scale is First State Super, which makes a moderate single transition from 70% to 50% growth at age 59. The other examples appearing in Figure 2 represent more typical glide paths, including one on the higher side (CFS FirstChoice) and one on the lower side (Suncorp). Table 3 presents data on the distribution of glide paths across all 23 products.

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**Figure 2: Illustrative Glide Paths**

Data Source: Chant West Multi-Manager Quarterly Survey, September 2013; product disclosure statements

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13 Lifecycle funds had previously been offered as a choice product, but the take-up was very limited.
Table 3: Glide Paths – Spread across 23 Products

<table>
<thead>
<tr>
<th>Age / Cohort</th>
<th>Distribution of % Growth Assets</th>
<th>Growth Weighting Landmarks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Max</td>
</tr>
<tr>
<td>15-19</td>
<td>90</td>
<td>100</td>
</tr>
<tr>
<td>20-24</td>
<td>90</td>
<td>100</td>
</tr>
<tr>
<td>25-29</td>
<td>89</td>
<td>100</td>
</tr>
<tr>
<td>30-34</td>
<td>88</td>
<td>100</td>
</tr>
<tr>
<td>35-39</td>
<td>83</td>
<td>100</td>
</tr>
<tr>
<td>40-44</td>
<td>74</td>
<td>100</td>
</tr>
<tr>
<td>45-49</td>
<td>64</td>
<td>84</td>
</tr>
<tr>
<td>50-54</td>
<td>53</td>
<td>74</td>
</tr>
<tr>
<td>55-59</td>
<td>40</td>
<td>74</td>
</tr>
<tr>
<td>60-64</td>
<td>34</td>
<td>50</td>
</tr>
<tr>
<td>65-70</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Data Source: Chant West Multi-Manager Quarterly Survey, September 2013; product disclosure statements

Obviously there is more to lifecycle product design than just the glide path for growth versus defensive assets. Other distinguishing features are discussed below:

- **Implementation methods** – The two main approaches used to implement the transition along the glide path are ‘cohorts’ and ‘member switching’. By our count, 16 out of the 23 lifecycle funds have adopted a cohort approach. This involves placing members into a group based on their date of birth, to which a specific investment strategy will be applied as they move through their lifecycle. The number of cohorts varies somewhat, with 10-year decade and to a lesser extent 5-year cohorts being notable choices.\(^{14}\) Member switching involves transitioning members between existing pre-mixed options as they age, such as progressively shifting them from high growth to growth to balanced and finally to the conservative option by the time they reach retirement age.

- **Dynamic management** – A lifecycle strategy may vary specific asset weightings and the growth versus defensive mix relative to the benchmark glide path based on evaluation of the outlook, similar to that which occurs in balanced funds. In addition, some providers point towards further possibilities for dynamic management, specifically under a cohort rather than member-switching approach. One possibility is shifting towards lower risk asset classes or securities within the growth and defensive categories over the lifecycle as an adjunct form of de-risking. Another possibility is dynamically responding to the actual return experience of a particular cohort.\(^{15}\) For instance, poor returns may leave a cohort on track for lower-than-desirable balances on retirement. The provider might then decide to deviate from the planned glide path, either to raise the chances of recovery or increase the surety of retaining what wealth has been accumulated.

- **‘To retirement’ versus ‘through retirement’** – ‘To retirement’ lifecycle products manage towards a balance at retirement, while ‘through retirement’ products envisage a continuation of the member’s

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\(^{14}\) Mercer (2014) reports a minimum of three cohorts and a maximum of 19 cohorts, amongst products using a cohort-based approach.

\(^{15}\) The number of differing cohorts will proliferate over time as members age and incur different return paths.
investment with the fund beyond retirement.\textsuperscript{16} Two influences encouraged some funds to design ‘to retirement’ products, thus ignoring what happens beyond that point. One is the fact that the MySuper regulations cover only the accumulation stage. The other was a sense that members tend to focus on the size of their balance at retirement, motivated by the observation that many redeem all or part of their investment with their fund upon retirement.

- **Building blocks** – Lifecycle products contain a greater prevalence of passive management. Nine out of the 23 or 39\% of lifecycle products substantially use passive management. However, if retail providers with multiple offerings are treated as a single fund, the portion of passive management amongst lifecycle products comes to just under 50\%. In any event, the use of passive management in lifecycle products is much higher than for the industry overall, where active management is more the norm.

- **Fees** – Fifteen out of the 23 lifecycle funds (65\%) opted for a single fee, notwithstanding being permitted up to four price points. Of the eight that did vary their fees, four used all four price points, two used three, and two used only two. All but two of the eight varied their fees by less than the average difference between high growth and conservative fund fees, which stands at 26 bps according to Chant West data. The average reduction in fees across the lifecycle was 17 bps for the eight fund sub-group using multiple price points, and 6 bps across all 23 funds.

- **Beyond pure age-based products** – A feature of Australian lifecycle products is that members are assigned largely based on age. The one exception is QSuper, which utilizes both age and account balance data. Many lifecycle providers recognize that there may be benefit in incorporating other member attributes to provide more tailored solutions. However, greater tailoring is inhibited by lack of member information.

**Expected Member Experience under Lifecycle Investing**

It is worthwhile considering how member experience may vary under a lifecycle strategy relative to investing in a standard balanced ‘growth’ fund throughout the accumulation phase. A key message is that simple time-weighted averages can be misleading in the case of lifecycle strategies. When viewed on an asset-weighted basis, lifecycle funds are in fact skewed towards lower growth exposure. This arises as a consequence of shifting towards a more conservative asset allocation later in the lifecycle when account balances are highest. While lifecycle funds may appear similar to a balanced growth fund on a simple time-weighted basis, they are in fact likely to reduce expected return as well as risk on an asset-weighted basis. It is asset-weighted and not time-weighted returns that a member actually receives over the course of their lifecycle.

Table 4 presents estimates to gauge the implications of moving through the glide path. We project the expected experience of a member who joins a lifecycle fund at age 19 that implements using member switching. This member earns a lifetime salary and hence has a contribution profile over time reflecting the ‘average’ Australian. The lifecycle product transitions them from a high growth option to a growth option at age 41, then to a balanced option at age 51, and finally to a conservative option at age 61. Each option earns their target return, and charges an investment fee equal to the industry average for the category. Our interest is comparing the lifecycle strategy with the growth option, and contrasting the estimates on a time-weighted and asset-weighted basis.

\textsuperscript{16} Mercer (2014) reports that 14 out of 22 lifecycle products they identify as being to retirement.
Table 4: Expected Experience under a Proxy Lifecycle Strategy

<table>
<thead>
<tr>
<th>Age</th>
<th>Option</th>
<th>Growth Asset Weighting</th>
<th>Investment Return</th>
<th>Investment Fee</th>
<th>Time-Weighted %</th>
<th>Asset-Weighted %</th>
</tr>
</thead>
<tbody>
<tr>
<td>19-40 years</td>
<td>High Growth</td>
<td>90%</td>
<td>7.0% (CPI+4.5%)</td>
<td>0.76%</td>
<td>44.9%</td>
<td>8.4%</td>
</tr>
<tr>
<td>41-50 years</td>
<td>Growth</td>
<td>70%</td>
<td>6.0% (CPI+3.5%)</td>
<td>0.69%</td>
<td>20.4%</td>
<td>17.4%</td>
</tr>
<tr>
<td>51-60 years</td>
<td>Balanced</td>
<td>50%</td>
<td>5.0% (CPI+2.5%)</td>
<td>0.57%</td>
<td>20.4%</td>
<td>35.1%</td>
</tr>
<tr>
<td>61-67 years</td>
<td>Conservative</td>
<td>30%</td>
<td>4.0% (CPI+1.5%)</td>
<td>0.50%</td>
<td>14.3%</td>
<td>39.2%</td>
</tr>
</tbody>
</table>

Average

Time-Weighted: 69% 6.0% 0.67%
Asset-Weighted: 49% 4.9% 0.58%

Note: Profile of salary and hence contributions was modeled with reference to median wage per age from ABS 6310.0 "Employee Earnings, Benefits and Trade Union Membership", plus assumed underlying wage growth of CPI+1.0%

Source: Chant West Super Fund Fee Survey, December 2013; author estimates

Figure 3: Balance Invested on an Asset-Weighted vs. Time-Weighted Basis

The last two columns in Table 4 compare the portion of assets invested in each option on a time-weighted and asset-weighted basis. The weights are plotted in Figure 3. They are roughly mirror images. On a time-weighted basis, our representative lifecycle member spends 44.9% of the time invested in the high growth fund and only 14.3% in the conservative fund. However on an asset-weighted basis, only 8.4% of the invested balance is exposed to the high growth fund, while 39.2% is exposed to the conservative fund. The differences in weighting are reflected in contrasting estimates for effective growth asset exposure, expected return and investment fees over the accumulation phase. On a time-weighted basis, the lifecycle
experience appears similar to the ‘growth’ fund, i.e. 69% invested in growth assets with an expected return of 6% (CPI+3.5%) and paying a fee of 67bps. However, on an asset-weighted basis the member has only 49% invested in growth assets with a commensurately ~1% lower expected return of 4.9% (CPI+2.4%). They incur a weighted average fee of 58 bps, which is around 10 bps lower than that for the benchmark growth fund. The latter provides a measure of the potential for lifecycle products to reduce fees.

The analysis of Table 4 underlines to the importance of evaluating lifecycle products on an asset-weighted basis. Viewed in this way, a lifecycle approach effectively moves members down the risk-return spectrum over the full lifecycle. Dealing with sequencing risk may make balances at retirement more assured, but comes at the cost of reducing their expected value.

The question arises of the extent to which lifecycle funds reduce risk. While a detailed examination of this complex issue is best kept for another time, it is possible to give a sense for the extent to which being invested in a conservative option near retirement reduces the risk of loss. Since 1980 there have been five episodes where growth funds have generated negative returns: 1990, 1994, 2002, 2008 and 2011. The median growth fund return during 2008 was about -22½% after fees and tax, compared to -7½% for conservative funds. Hence being invested in a conservative strategy during 2008 would have resulted in a 19% higher balance at the end of the year (i.e. $0.925 versus $0.775 per $1 invested). However, returns in the other four negative return years were no worse than less than -5%. The case for giving up return in order to avoid such relatively modest losses does not seem as compelling. Another consideration is extent to which any losses are sustained: the danger is much lessened if markets rebound after a sell-off as often occurs. Thus the case for de-risking near retirement partly depends on aspects such as risk preference and the likelihood of suffering significant and sustained losses, say as a consequence of GFC-like conditions.

7. Fees

An aim under MySuper was to makes fees more visible and comparable, with an underlying objective of helping to ensure that default members were not over-charged. The upshot has been that retail providers have indeed reduced fees, although fees for not-for-profit funds have risen marginally. Whether retail fund members are better off as a consequence of these fee reductions remains a moot point, which is discussed in Section 8. With respect to the goal of better fee comparability, while there has been some improvement, the industry still falls short.

We analyze fees using Chant West data for 94 MySuper products, based on the same sample that underpins Table 1. In constructing the data, lifecycle product fees are incorporated as those applicable to a 50 year old member. Chant West attempts to adjust their fee data for the numerous inconsistencies in the way that funds report their fees. Two main problem areas include the treatment of income tax and the disclosure of performance-based fees. While funds are required to disclose fees gross of tax obligations, some still quote fees net of tax which Chant West grosses up. The issue of performance-based fees is more complex. Some funds do not disclose them, or disclose them to differing degrees and using different methodologies. Chant West makes adjustments to approximately one-third of their sample in order to make the data as comparable as possible. The fact that so many adjustments are required suggests that the objective of ensuring ready comparability of fees has not been achieved.

17 The return for 1990 is based on simulated rather than actual data, and was about -5%.
18 One outlier has been excluded.
19 Comparability can also be distorted by manner in which fees are incurred and reported across different investment vehicles. A simple example is investing via an indexed fund versus via an equivalent ETF (exchange traded fund). A similar management fee may be effectively incurred in both cases. However, it is only accounted for as part of the fee chain for the indexed fund. For the ETF, the fee is not reported but is embedded in the security price. Similar inconsistencies can occur when investing in property directly versus via listed property (REITs).
20 The observations made in this paragraph suggest that the APRA fee reporting standards need to be tightened.
Table 5: MySuper Fee Structures

<table>
<thead>
<tr>
<th>Sector</th>
<th>Industry</th>
<th>Public</th>
<th>Corporate</th>
<th>Retail - Active</th>
<th>Retail - Passive</th>
<th>Total Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Funds</td>
<td>44</td>
<td>10</td>
<td>14</td>
<td>17</td>
<td>9</td>
<td>94</td>
</tr>
<tr>
<td>Total Assets ($bn)</td>
<td>301</td>
<td>119</td>
<td>41</td>
<td>92</td>
<td>22</td>
<td>575</td>
</tr>
<tr>
<td>Average Size ($bn)</td>
<td>6.8</td>
<td>11.9</td>
<td>3.0</td>
<td>5.4</td>
<td>2.4</td>
<td>6.1</td>
</tr>
</tbody>
</table>

Percentage Fees:
- Investment Fee: 0.68% 0.64% 0.60% 0.5441% 0.35% 0.61%
- Administration Fee: 0.19% 0.19% 0.17% 0.5676% 0.41% 0.28%
- Other Fees: 0.01% 0.03% 0.00% 0.0424% 0.02% 0.02%
- Total: 0.88% 0.86% 0.78% 1.1541% 0.78% 0.90%

Dollar Fees:
- Member Fee (pa): $78.80 $52.10 $83.07 $79.82 $84.33 $77.31

Total Fee (%):
- $10,000: 1.67% 1.38% 1.61% 1.95% 1.63% 1.68%
- $25,000: 1.20% 1.07% 1.11% 1.47% 1.12% 1.21%
- $50,000: 1.04% 0.96% 0.94% 1.31% 0.95% 1.06%
- $100,000: 0.96% 0.91% 0.86% 1.23% 0.87% 0.98%
- $250,000: 0.91% 0.88% 0.81% 1.19% 0.82% 0.93%
- $500,000: 0.90% 0.87% 0.80% 1.17% 0.80% 0.92%

(Data Source: Chant West Super Fund Fee Survey, December 2013)

Figure 4: Average MySuper Fees by Industry Segment (For $50,000 Balance)

(Source: Chant West Super Fund Fee Survey, December 2013)
Table 5 summarizes fees across industry sectors. Figure 3 plots average fees for a member with a $50,000 balance. The retail sector is divided into active and passive products. This acknowledges the marked difference in product offering and hence the associated fee levels. A notable feature is that fees comprise both percentage-based and dollar-based components. The percentage-based components largely entail investment management fees and any percentage-based administration fees.21 We call the dollar-based fees ‘member fees’, although these are often denoted as administration fees in product disclosure statements. The dollar-based fee creates a fixed cost element that means the effective total percentage fee paid varies with account balance. Allowance is made for this fixed cost effect by reporting total percentage fee across a range of account balances at the bottom of Table 5. The implications of the fixed dollar fee component are explored further below.

The data reveals that not-for-profit funds (i.e. industry, public sector and stand-alone corporate funds) have higher investment fees than the actively managed retail funds. For instance, the average investment fee is 68 bps for industry funds versus 54 bps for actively managed retail funds. This difference is mainly because not-for-profit funds invest more in unlisted alternative assets, which tend to be more expensive to manage than traditional assets. In addition, retail funds have reduced the cost of their offering through an increased use of passive management. This is most apparent in the passively managed retail funds, where the average investment fee is 35 bps. Also several actively managed retail funds have included a greater element of passive management to help hold down costs.

On the other hand, retail funds charge higher administration fees. Figure 3 shows that for balances of $50,000, the administration fee averages 77 bps for active retail and 60 bps for passive retail products. Averages for the not-for-profit categories are in region of 32-36 bps. There are three reasons for the difference. First, retail funds implicitly include a profit margin within their administration fees. Second, they provide services to financial advisers to assist them in managing their clients’ (member) portfolios. Third, retail funds tend to keep investment fees low and ‘load up’ on administration fees so that they can offer discounts to corporate plans, which are a significant customer of retail providers. To some extent this is driven by the MySuper regulations, which permit variations on administration fees but require all members to be charged the same investment fee. The administration fee thus becomes the vehicle for differential pricing.

The final set of columns in Figure 3 plots average total fees at a balance of $50,000. The average across the entire sample is 106 bps. All sectors except for actively managed retail are clustered within a relatively tight band of 94 bps (public sector) up to 105 bps (industry funds). Passive retail products charge an average of 95 bps, suggesting that some retail providers have positioned their passive offering to match if not better the ‘price point’ benchmark set by industry funds. Active retail funds charge an average of 131 bps. Here the average headline fee does not tell the entire story. Chant West estimates that companies can negotiate fee discounts of as much as 70 bps for a $1 billion-plus plan, meaning that their employees may pay as little as 60-70 bps. While the active retail fees may appear high at face value, this may not represent the experience of all members in these funds.

Finally, we consider the implications for members of how fees are structured. Figure 4 illustrates the variation in total fee according to structure and account balance. Three lines are shown: the industry average; a product with a high (90th percentile) percentage fee but a low (10th percentile) dollar-based fee; and a product with low percentage fee and higher dollar-based fee. Figure 4 reveals that members with very small balances pay comparatively large fees, which in turn reflects the influence of a fixed dollar-based fee.22 As balances increase, the relative importance of the dollar-based fee decreases while that of

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21 There is a small amount of ‘other’ fees, averaging 2 bps. This largely comprises the Operation Risk Levy and/or the Stronger Super Levy that will only be paid for the next 1-3 years.

22 While this is probably justified on a cost-recovery basis, it does illustrate the fee burden borne by low-balance members such young part-time workers. It also underscores the importance of consolidating any small accounts.
the percentage fee increases. The lines cross at a balance of around $8,300. The total fee paid eventually asymptotes toward the percentage fee at high balances.

Two implications arise from Figure 5. First, members with all but the smallest balances should care most about the percentage-based fee they pay. The importance of the percentage-based fee is underlined by the considerable variation across MySuper products, with a difference between the 90th and 10th percentile on percentage-based fee sitting at 46 bps (119 bps – 63 bps). Second, the variation in percentage and dollar-based fees across the industry also works against fee comparability. It adds to complexity, and makes the effective fee paid by the member dependent on their account balance. The standardized reporting of fees based on an account balance of $50,000 appearing in product disclosure statements is only partly effective at getting around this issue. Indeed, standardizing the presentation of fees in this manner could be misleading for members with small balances of (say) below $10,000.

8. **What Changed With MySuper?**

This section examines what changed with MySuper. We first observe that the majority of the industry made no substantial changes to default offerings, with retail funds being the notable exception. Changes in fees are then documented. Finally, we discuss the nexus between changes to fees and product design amongst retail funds. We conclude that it remains an open issue whether members are better off as a consequence of MySuper.
Who Changed Their Default Offering

MySuper provided an opportunity for all funds to re-examine and re-consider their default product offering. Most industry and public sector funds rebranded an existing balanced fund, with a few exceptions such as QSuper. These two segments comprise about two-thirds by value of our sample of 95 large superannuation providers, and 45% of the 120 MySuper funds by number. The most substantial changes occurred amongst retail providers, a segment that is directly responsible for 24% of large superannuation funds by value and 19% of MySuper products by number. However, some of the changes in the retail sector also flow through into the corporate funds, to the extent they outsource to retail providers. In addition, certain funds that manage default money did not obtain a MySuper license. This largely involved public sector funds that are not APRA-regulated including those in South Australia, Tasmania and Western Australia. Overall, we surmise that at least two-thirds of default funds by value and more than half by number underwent no meaningful change following the introduction of MySuper.

Changes in Fees

We initially document the changes to fees, before considering them in a broader context. Change in fees are measured by comparing fees as at end-December 2013 with fee data collected by Chant West in July 2012 (i.e. before there were any MySuper products). The data analysis considers only industry funds and actively managed retail funds with assets of $1 billion or more. The findings are summarized in Figure 5.

Figure 6: Changes in Fees with MySuper (For $50,000 Balance)

<table>
<thead>
<tr>
<th></th>
<th>Investment</th>
<th>Admin</th>
<th>Total</th>
<th>Investment</th>
<th>Admin</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2012</td>
<td>66</td>
<td>31</td>
<td>97</td>
<td>67</td>
<td>51</td>
<td>81</td>
</tr>
<tr>
<td>December 2013</td>
<td>68</td>
<td>33</td>
<td>101</td>
<td>79</td>
<td>81</td>
<td>146</td>
</tr>
</tbody>
</table>

Data Source: Chant West Super Fund Fee Survey, December 2013

Total fees for not-for-profit funds increased slightly, with the average industry fund fee going from 97 bps to 101 bps. The marginal increase in fees for not-for-profit funds can be interpreted as reflecting the additional costs imposed on the industry by regulatory change. To recoup the transitional costs of

Industry commentary suggests that this was a costly and somewhat distracting exercise.
implementing Stronger Super and the requirement for an Operational Risk Reserve, several funds have introduced levies that will typically apply until 2017. The associated additional fees will be borne by current and future members, at least for the next few years.

MySuper acted as a catalyst for meaningful reductions in the fees charged by retail providers. Figure 5 reports that fees for actively managed retail funds fell by about 14 basis points, from 146 bps to 132 bps. When coupled with the parallel development of passive retail products at an average fee 95 bps (Figure 4), it is clear that the overall fee reduction for the retail sector was substantial. Figure 5 further reveals that the reduction for active retail is largely attributable to reductions in their investment fees. Administration fees increased by 2 bps, the same as for industry funds. We suspect that establishing a competitive price point relative to industry funds may have been a guiding consideration for retail funds in setting their fees. In this regard, the scrutiny placed on fees by MySuper has had an effect on fees as intended. The broader implications of these fee reductions are discussed next.

**Placing the Changes in a Broader Context**

The fee reductions by retail providers need to be evaluated alongside the associated changes to product design. Fees paid by members are shared between the fees remitted to investment managers, fund operating costs and any profit margin. Chant West believes that retail providers probably conceded some profit margin as a consequence of fee reductions, at least in their actively-managed products. But the magnitude is difficult to gauge. This issue is further complicated by the possibility that some of the impact of fee reductions may be passed on to suppliers such as fund managers. In any event, the lowering of ‘fee budgets’ impacts on product design through creating an incentive to use lower cost strategies, assets and managers. Retail members may be paying less, but they are getting a different product as a result.

The notable changes in retail product design include the shift to lifecycle, increased use of passive management and more limited use of alternative assets. All of these changes involve the use of lower cost investments. Whether this product mix enhances prospects for adequate balances at retirement is a moot point. It depends in part on the view taken on some debatable issues. Section 6 discussed how lifecycle strategies decrease the risk around the balance at retirement, but also decreases its expected value. They hence move the member down the risk/return spectrum. In doing so, lifecycle strategies make implicit assumptions about member preferences and needs that may be arguable.

Judging the efficacy of passive management runs into the active versus passive debate. Some will argue that members are better off in passive based on (largely US-based) evidence that the average active manager doesn’t generate alpha after fees. Others will contend that it is possible for a well-selected portfolio of active managers to outperform at wholesale fee levels, and that US-based evidence need not translate to other markets like Australia. Similarly, lowering exposure to alternative assets involves trade-offs. It limits portfolio diversification. On the other hand, alternatives carry exposure to illiquidity; and it can be debated whether any add-value in alternatives merely accrues to managers in the form of fees.

For the record, it is Chant West’s opinion that members in retail funds are worse off as a consequence of these changes. Chant West bases this view on two notions. First, that active management adds value when evaluated at wholesale investment management fees, noting that active managers have been comparatively successful in the Australian equity market. Second, Chant West believes that alternative assets are beneficial to members by virtue of the diversification that they bring.

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24 Recall the analysis presented in Section 6 (Table 4) highlighted that a lifecycle approach is potentially ‘cheaper’ on an asset-weighted average basis by about 10 bps relative to a comparable balanced growth fund.

25 For instance, Mercer reports that the median Australian equity manager outperformed the S&P/ASX200 to March 2014 by 2.3% over 12-months, 1.5% over 3-years and 0.9% over 5-years prior to fees (see Australian Financial Review, 16 April 2014). These gross returns comfortably exceed the wholesale fees typically paid to investment managers.
9. Concluding Comment – Not So Simple After All

The default fund landscape following the introduction of MySuper presents a picture that is somewhat complex and nuanced. A motivation behind MySuper was to encourage a range of simple, low cost, easy-to-compare default products that were suitable for a disengaged member. If anything, the industry has moved further away from this goal in creating a richer range of product offerings than had existed previously. There were already some meaningful differences in approach prior to MySuper, such as the tendency of industry funds to hold greater exposure to alternative assets than retail funds. If anything these differences are now wider as retail funds have increased their use of passive management and limited further their use of alternative assets. The introduction of new lifecycle products has added an important new dimension to the range of offerings in the market. These products are harder to understand, in part because they should ideally be evaluated on an asset-weighted basis over the lifecycle. They are also much harder to compare. Lifecycle products offer no performance history, differ in their growth asset exposures through the glide path, and over time there will emerge a proliferation of cohorts with differing experiences.

In addition, the industry still falls short on achieving the goal of ready fee comparability. Fees are still reported and structured in different ways. Tax effects and performance fees are not being reported across products in a consistent manner. Differences in dollar-based and percentage-based fees mean that effective fees can vary across members in a non-straightforward manner, including depending on their account balance. The ability to discount administration fees means that the headline fee may not be relevant for all members, especially those investing via a corporate fund.

Nevertheless, these issues should be considered in context. MySuper is intended for disengaged members who accept the default chosen by another party, such as their employer. Providing those making the choice are informed and act in the best interest of members, an absence of simplicity and easy comparability may not be too much of a concern.

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