End of year super reforms surge in preparation for 2017

APRA deputy chairman Helen Rowell has the power to force mergers of super funds. *Ryan Stuart*

In the last month, the first public skirmishes of a reform war, that has been brewing since the 2013 MySuper changes, has seen trustees taking sides, running for cover and sizing up the opposition. The big guns are coming out, being sighted in preparation for rounds being fired in the new year.

On one side, as the AFR, Chanticleer reported on 8 December in their Selfish and reckless trustees resist industry mergers, article:

"One of the most pressing and least talked about issues in the superannuation industry is the need for scores of smaller funds to merge with each other to protect the interests of members. Unfortunately this much-needed process is being held back by the personal interests and concerns of super fund trustees who do not want to lose their jobs. This selfish and reckless approach to the governance of compulsory savings vehicles is definitely on the radar of the Australian Prudential Regulation Authority.

In November, Rowell told the annual conference of the Association of Superannuation Funds of Australia that APRA was progressively implementing the revised prudential framework for super. She made it clear that APRA expects much more than just compliance with the prudential standards. Rowell said all trustees should be continuing to lift the bar across all areas of their operations and that doing "just enough" was not good enough in terms of meeting community expectations."

Already, as reported by the Investment Magazine, Transport Super has merged with MyLife MySuper (formerly Catholic Super Fund) as part of a master trust, effective from December 1, 2016. It states

"Research by consulting firm Third Horizon showed that in 2015 Transport Super had a decline in market share of assets, a decline in market share of members, and net contribution outflows.

Twenty-two other funds showed similar characteristics in that year, including Mercer, MLC, Meat Industry Super, Equipsuper and Qantas Super…. though a number of them have deployed new strategies to counter these trends."

Then, this week it was announced that Mercer would take over Virgin Super. The takeover follows Mercer's recent acquisition of Pillar Administration.

These early moves principally focus on scale of operations and represent one element in this efficiency war.

In November, as reported by the Investment Magazine, international pensions expert Keith Ambachtsheer put a few noses out of joint when he told a gathering of Australian superannuation executives that:

"about $50 billion" in funds under management was the level at which funds are large enough realise "real economies of scale".

Scale can however only go so far – otherwise there can ultimately only be one! At that $50B level there would only be 7 funds – a politically unacceptable outcome. It would quickly be compared unfavorably to the banking industry.

Rowell has been much more circumspect than Ambachtsheer about the ability of small and mid-size funds, with appropriate outsourcing arrangements, to deliver value for members. Speaking at a conference in 2015 she indicated:

"APRA was concerned about the ability of many funds with "less than $1 billion or even $2 billion" to continue delivering sufficient economies of scale without a viable growth strategy".

So funds are muscling up their defenses and alliances on other fronts largely revolving around implementing growth plans. They will use resources available to them, other than raw size, in much the same way as smaller banks, credit unions and niche insurers have done, in APRA's other industries, to survive. They will use their own membership demographics to carve out viable member attraction and retention plans via tools, like Smart Defaults (i.e. Trustee Tailored Super), to prove to they are acting in members best interests for their member's retirement.

Given that the auditable 35% improvement in retirement balances available by using a Smart Default exceeds the currently assumed scale benefits of around 30 basis points (which is hard to define and subject to considerable debate), the case for introduction would appear clear. Not only do Smart Defaults use a funds own demographics to provided improved retirement balances (which is aligned to the new industry retirement objective), but they also drive member engagement over time. Once a trustee tailors to a MySuper members own retirement prospects, the member is more likely to stick around (as a Choice member) after they engage in their super (typically as their balance grows and retirement approaches).

The Investor Daily, on 29 November reported that Forcing smaller superannuation funds to merge is unlikely to be in the best interests of members.

"The emphasis on increased scale and mergers as the mechanism to deliver efficiency has been a significant distraction to the determination of what actually drives efficiency and inefficiency in both large and small funds," said Ms Mastrippolito NESS Super CEO.

"If the goal of a superannuation fund is to be efficient, rather than subject only small funds to scrutiny, it is our recommendation (to the recently closed Productivity Commission review) that all funds be required to publish an efficiency ratio and, where this ratio exceeds an industry benchmark, be required to justify their use of members' funds."

Further *"If it is not scale which drives efficiency, the real issue to be addressed is looking beyond scale to what factors actually drive efficiency and what are the practices that detract from providing value to members that should be stamped out," said Ms Mastrippolito.*

The Productivity Commission in its recently released report would appear to agree. Noting Smart Defaults and the role they are set to play in the industry achieving efficient retirement outcomes.

In the 26 October academic CIFR submission to the Commissions 2nd inquiry on default fund selection it was noted:

"Member heterogeneity makes it important to accommodate the ability to tailor and foster the development of smarter defaults.

The potential for sub-optimal outcomes increases under 'one-size-fits-all' defaults in the presence of heterogeneity. The implication for the review of default arrangements is that care should be taken to engender the scope and incentive for tailoring, including fostering the development of smarter defaults.

In addition, recognising that members are different, many funds are looking for ways to enhance their capability to tailor to members.

A key conclusion of the CIFR MySuper research is that there is a need for smarter defaults to address member heterogeneity, especially given that many members accept the default they are offered as a matter of trust."

To further emphasis, Reuters on 8 December reported that Australian fund legalsuper resists 'pathway to mediocrity' merger pressure. Andrew Proebstl, chief executive of the $3 billion fund is quoted as stating.

"The problem is that there is a fixation on growth for the sake of growth, which can be a quick pathway to mediocrity. Whether a fund is small, medium or large, it needs to have clarity of purpose and can deliver better value for its members relative to larger super funds," he said. He said legalsuper's purpose was exclusively to service the legal sector and its specific needs. The profile of the profession, for instance, has allowed legalsuper to negotiate preferential terms with life insurers so that premiums have not risen for six years".

Those are fighting words indeed he could as easily said "prove it". With Smart defaults you can, member by member using a funds own investment option return and loss ratios.

Change in 2017, is coming to this industry and Smart Defaults, like TTS will have large role in fund survival regardless of if a fund is deemed to be large or small. More about the company (TSS) behind TTS can be found here.

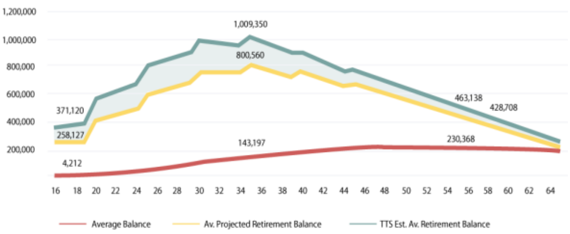
About Tailored Superannuation Solutions Ltd

Tailored Superannuation Solutions Ltd (TSS) is marketing a new product Trustee Tailored Super (TTS) – the next generation “Smart Default” for Australia’s 116 MySuper funds.

The market size is $452 billion and currently growing at 17+%, including 9.5% in mandated contributions.

TTS is a specialised FinTech application which optimises projected retirement balances to members of MySuper funds by significantly boosting efficiency through tailoring to lifestyle prospects.

The product, as graphically demonstrated below increases returns by around one-third (over 1% p.a. increase on average MySuper fund real returns of 3.65%) and increases cumulative returns on average by more than 35% during the accumulation phase of members.



The graph summarises what TTS can achieve, is from the TTS Prototype, is consistent with the results from actual beta superannuation fund tests, past research and forms part of the Customised Report provided to trustees.

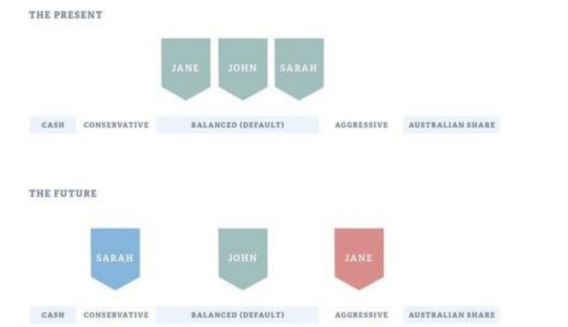
To illustrate at age 18, the current average balance of MySuper members is $4,212 and projected retirement balances average is $258,127. The application of TTS lifts the projected retirement balance average to $371,120 – an increase of 44%.

At age 55, current balances average $230,368 and projected retirement balances average $428,708. The application of TTS lifts the projected retirement balance average to $463,138 – an increase of 8%.

TTS will supersede current generic ‘one-size-fits-all’ practices by better tailoring investment strategies to the needs of members. It will evolve lifecycle products beyond simple aged-based strategies to include factors such as current incomes, current balances, and lifestyle factors.

TTS focusses on the Objective of Superannuation, currently being legislated and taps into an emerging market direction for MySuper funds which has been recognised by independent industry experts and commentators (Financial System Inquiry, Centre for International Finance and Regulation, Productivity Commission)

The processes involved are outlined below:



MEMBER	AGE	BALANCE	WAGE	FEES	RETIREMENT BALANCE	HURDLE	NEW INVESMENT OPTION
Jane	29	10,000	35,000	300	225,000	2	Agresssive
John	49	20,000	60,000	400	120,000	2	Balanced
Sarah	61	60,000	100,000	700	85,000	1	Conservative

TTS is the only known fully implementation ready Smart Default product in Australia

TTS also generates significant public policy benefits by reducing pressure on Australia’s struggling Aged Pension System.

Douglas Bucknell
Managing Director
Tailored Superannuation Solutions Ltd
14th December 2016

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