trustee tailored super

Mr Alan Raine
Acting Committee Secretary
Senate Economics Legislation Committee
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Dear Alan,

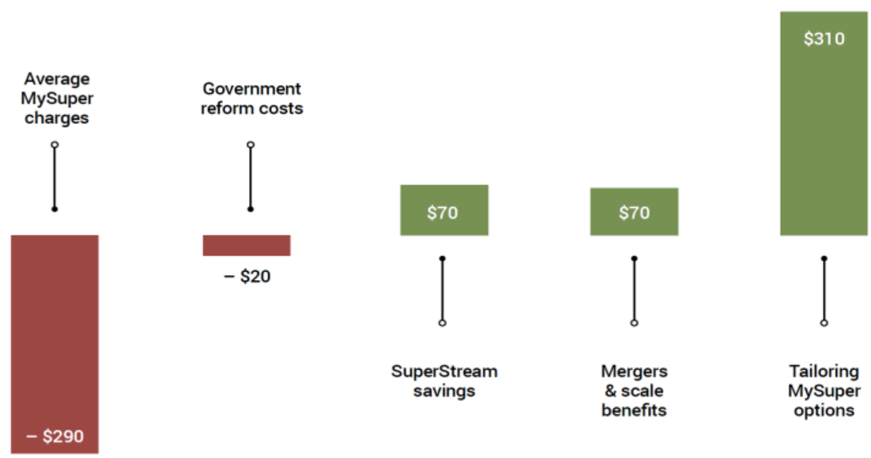
Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017

Thank you for the invitation to make this submission. We strongly support the annual MySuper outcomes assessment and other associated measures. Congratulations on the Bill.

Superannuation has never been about current account balance or yearly net return, interest paid or fees – it is quite different to bank accounts. Superannuation balances cannot be withdrawn as needed, but are 'locked away for retirement' until prescribed conditions are met. Yet performance is currently measured in a very similar way to bank accounts.

The current short term (yearly) return and fee focus based on account balance needs to evolve into a more sophisticated longer term mechanism based on retirement outcomes and the purpose of the superannuation system. We believe this Bill will ultimately achieve this member retirement outcomes focus.

The retirement objective provides a unique long term investment horizon which is not currently being optimised for MySuper members. We have quantified that unrealised benefit from focusing on retirement outcomes at $310 p.a. for each of the 14.9 million MySuper accounts.



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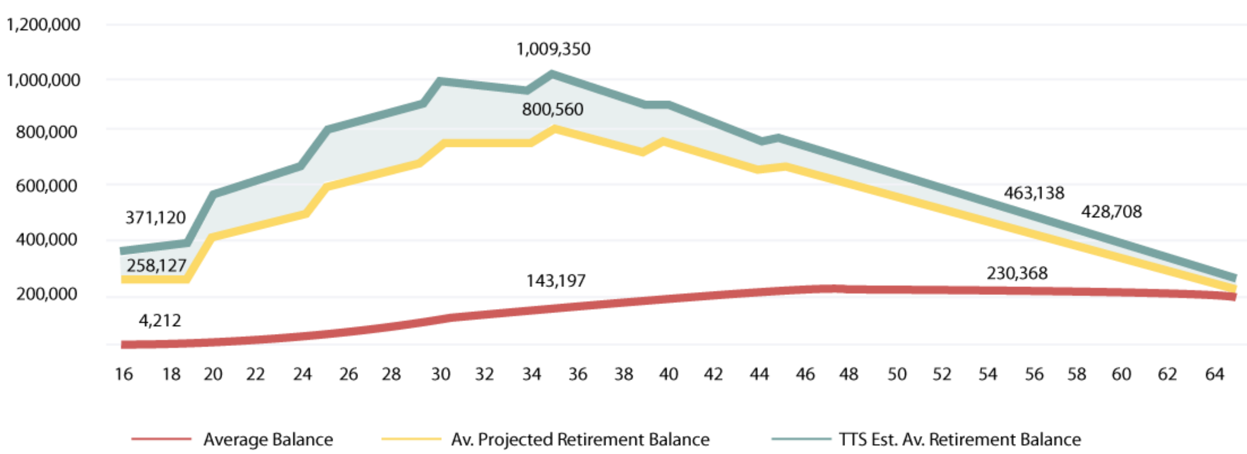
The benefits achievable from tailoring MySuper investment options at $310 are more than fees paid $290 or potential merger benefits $70 or Superstream $70 on average for these accounts.

The benefit arises from MySuper trustees utilising the two well-known investment concepts of investment horizon and objective based investing through targeting retirement outcomes - not just net yearly performance. The solution involves a fund using its own choice investment options in an automated manner, rather just dumping all MySuper members in the single 'balanced Option'. As a result some members are exposed to higher growth options, hence higher returns for longer when younger, but lower risk (and return) options as retirement approaches. The process is outlined more fully in the attached joint Financial Services Council (FSC) - TSS report:

Innovation in Superannuation – Smart MySuper Defaults issued on 26 September 2017.

Many regard this Smart Default innovation as the next more efficient step in age only based life-cycling. Noting that a third of the industry since 2013 has already moved to introduce Age Based life-cycling by following established oversea models.

We are also able to quantify, using a fund's own choice options return and loss ratios and member data (age, balance and projected retirement balance), the impact on individual retirement balance outcomes - as being a third improvement with lower or equal risk of loss as retirement approaches (sequencing risk).



This third improvement is best understood as the green shaded area in the graph above, with the relative improvement in projected retirement balance from tailoring greater the younger members are when tailoring is commenced (numbers are at ages 18, 35 and 55 years old).

In this digital age, its' no longer appropriate for MySuper trustees to just dump two 40 year olds, one projected to retire on the Age Pension - the other with $1.6M in the same balanced investment option for the next 25 years. Trustees tell their choice members to consider their investment horizon and projected retirement balance when selecting an investment option – but don't follow their own advice when it comes to selecting an investment option on behalf of MySuper members.

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Industry Structural Barriers

Despite huge advances in other sectors, including the finance industry (with block chain and robo advice for example) new technologies have so far had minimal impact on the operation of superannuation funds. Default MySuper product providers in particular have undertaken no discernible technological change over the past decade.

Efficiency in the accumulation phase and innovation in the Super sector was recognised as an issue by the Financial System Inquiry (FSI). With recommendation 10 being:

Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

That twin (competition and efficiency) review by the Productivity Commission is underway. We have been involved in the efficiency part of that exercise (Stage 1 Submissions April 2016, August 2016 and Stage 3 August 17) and also made a submission to the FSI in March 2014. But not the default discussion.

Clearly there is the intent, in that recommendation, that efficiency improvements continue over the period up to 2020. However that has not proved to be the case. Our 25 year old superannuation system must be made fit for purpose and target the retirement objective that is so important to millions of Australians. New technology has made it possible to deliver superannuation products that are better tailored to members' individual circumstances, but the current default system means trustees have not had much incentive to innovate, until now. The **Annual MySuper Outcomes Assessment**, which will force funds to either prove how they are achieving better retirement outcomes for their members or to merge, plus **APRA new enforcement powers** will change this barrier.

We, like many have been dismayed by the lack of progress being made. After 25 years average current retirement balances are estimated at only $293,000 for men and $138,000 for women. Further some 80% still require the Age Pension and that is not expected to materially change by 2050. Instead of hearing about these outcomes, members are bombarded with short term net return and fee comparisons when that timing suits a given fund. The status quo is not providing solutions to the industry's issues or contributing optimally to the retirement savings funding gap.

It would appear that funds and there director trustees are not focused on retirement outcomes when acting in the member's best interests. They seem to be too busy, too used to mandated inflows, too concerned members may engage then switch and too concerned with other ancillary matters – even when a one third improvement in retirement outcomes, lower sequencing risk and higher member engagement is on offer.

This element in part goes to the level of competition and for some funds access to the pool of default members, however bigger issue is the lack of innovation. Tailoring benefits at $310 per average MySuper account outweighs all current average costs at $290. As a result we support move to greater competition and independence, not because we believe that will materially lower costs but because it will drive innovation and efficiency including towards Smart Defaults.

National Impact

At a national level, the estimated $5+ billion per year benefit from Smart Defaults is significant when compared to the 2015/16 Age Pension cost of $44 billion and could significantly fill the impending retirement funding gap over time. That gap is currently $1.5 trillion and is estimated to deepen to $8.7 trillion by 2050[1]. Hence focusing on retirement outcomes is very important.

We have requested that Federal Treasury run a version of tailoring via their new MARIA Model, which we understand is being/has been favourably considered, with the results to be provided to the Productivity Commission (our public submission to their current enquiry provides further detail). The result of that modelling would provide an estimate not only of the benefit across the whole $595 billion in the 14.9m MySuper accounts, but also the impact in future decades on Australia's National Accounts.

Retirement Outcomes Focus

The paramount importance of retirement outcomes for superannuation has always been clear, but perhaps more so now that this retirement objective is specifically being legislated via the Superannuation (Objective) Bill 2016.

The retirement focus is already included within the Sole Purpose Test in section 62 of the SIS Act, which in general terms requires trustees to maintain a fund solely for a core retirement purpose. This has been interpreted by courts as ensuring that the paramount consideration in making superannuation investments is financial retirement outcomes.

The core purpose envisages the provision of retirement benefits for each member, by the trustee, rather than a collective whole. The legislative covenants and duty of care requirements mean trustees must act in members' best financial retirement interests. That is not a passive requirement (i.e. trustees need to be seen by regulators such as APRA to be actively applying strategies to enhance the retirement interests of members).

For 'choice' members, that requirement may be largely outsourced as there is an overarching caveat that they are to be invested as selected.

However, for MySuper members, that is not the case. Instead (section 29N (a)) specifically requires the promotion of the net financial performance interests of MySuper members. Further, MySuper trustee's standard of care has been set higher in statute, as being that of the Prudent Superannuation Trustee.

The prudent superannuation trustee role requires the assumption of investment risk, which includes formulating an investment strategy for the whole of the entity, and for each investment option, having regard to the trustee's objectives (must include a retirement outcome focus) and the ability to discharge its existing and prospective liabilities (requires consideration of when members will retire).

[1] World Economic Forum White Paper, We will live to 100, can we afford it? May 2017

Against this background, it needs to be recognised that MySuper members effectively delegate responsibility for their investment decisions to their fund trustees. Those trustee's investment strategy committees should be taking into account members projected retirement outcomes and time to retirement in selecting investment options but that currently does not happen.

Treating every member in the same way - by placing all members in a 'one-size-fits-all' investment pool - is unlikely to be seen as actively applying strategies to optimise long term investment outcomes and hence retirement balances, when there are now known implementation ready Smart Default solutions.

Recommendations

1) An improvement to the Bill would be to add the words 'for their retirement' to the end of S29VN (2)(a) and (2)(b), as follows. This is consistent with the purpose of the Bill and aligns with the objective of superannuation. It also overcomes arguments around which timeframes outcomes should measured against. It may speed up the process of trustees adopting a retirement focus.

Section 29VN

(2) In determining whether the financial interests of the beneficiaries of the fund who hold the MySuper product are being promoted by the trustee, the trustee must assess each of the following:
  (a) whether the options, benefits and facilities offered under the MySuper product are appropriate to those beneficiaries **for their retirement**;
  (b) whether the investment strategy for the MySuper product, including the level of investment risk and the return target, is appropriate to those beneficiaries **for their retirement**;

2) We also respectfully suggest, given the quantum involved and potential national impact, that the Committee recommend that Federal Treasury run a version of a tailored Smart Default via the MARIA model and provide those results to the Productivity Commission.

We are available to attend to present to the Committee in order to answer or clarify any issues raised.

Yours sincerely

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29 September 2017

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