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Superannuation policy processes: the case of MySuper and SuperStream

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Abstract
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Keywords
mysuper, case, superstream, processes, superannuation, policy

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Superannuation Policy Processes: The Case of MySuper and SuperStream

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The Australian superannuation system has been praised as one of the best in the world. Yet a major review by the Cooper Committee in 2010 found numerous problems that have been undermining the performance of the system, proposing a number of recommendations for improvement. The subsequent adoption and implementation of two such recommendations saw the introduction of ‘MySuper’ and ‘SuperStream’ by the government resulting in the most significant reform in the superannuation industry since the introduction of the Superannuation Guarantee (SG) in 1992. This paper critically analyses: the relevant Deloitte and Financial Services Council and Ernst and Young’s report used in support of this major reform. It is concluded that the scope of these studies is limited and they are predominantly constrained to industry funds and are presented by interested players, limiting their ability for full representation. A call for independent academic research is made.

JEL Code: M38 and D14

KEY WORDS: Cooper Committee, financial services, superannuation, SuperStream, MySuper, retirement.

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“My kind of loyalty was loyalty to one's country, not to its institutions or its office-holders. The country is the real thing, the substantial thing, the eternal thing; it is the thing to watch over, and care for, and be loyal to; institutions are extraneous, they are its mere clothing, and clothing can wear out...”
Mark Twain, A Connecticut Yankee in King Arthur’s Court

1. Introduction

Australia’s superannuation system is listed as the fourth largest superannuation system in the world (Mason, Walker et al. 2013) with assets in excess of $1.6 trillion as of June 2013 (Australian Prudential Regulation Authority 2013), and has been praised as one of the best systems in existence. Despite this praise, a major review of the system was commissioned in May of 2009 following concerns over the losses experienced post the global financial crisis (GFC), and the high levels of fees charged by superannuation fund providers (Lateline 2009). It was perceived that Australia’s superannuation system, having such a high asset base, may need to consider the potential impact of the GFC.

The review committee, chaired by Jeremy Cooper, was charged with the responsibility of examining the governance, efficiency, structure and operation of the superannuation system, with the best interests of the members as its focal point (Super System Review 2010). The committee, in its final report, put forward 177 recommendations, 139 of which were subsequently either fully supported, or supported in principle by the then government (Stronger Super 2011). This resulted in significant reforms. This paper is specifically interested in the core recommendations for the establishment of MySuper and SuperStream, and how these reforms came about.

At the core of the recommendations was the proposal to establish a low cost, privately managed fund which would be available to all members. Titled MySuper, the proposed fund would consist of a “…single, diversified portfolio of investments for the vast majority of Australian workers…who are in the default option in their current fund” (Super System Review 2010, p.11). The projected savings through reduced fees and charges was assessed to be $400 million per year (Super System Review 2010), based on the balance of funds invested in default investment options. This balance of funds was $340 billion of the total $560 billion invested in default funds (Super System Review 2010). The savings estimates were based on a report prepared by Deloitte, detailing the result of their investigation into the costing projections of the proposed MySuper fund. These saving estimates have been the main justification for the implementation of MySuper. In its final report, the Cooper Committee¹ translated such savings into reduced fees, and therefore improved returns for fund members who would be moved from the previous default funds into the new simple, low-cost MySuper funds. Therefore the Deloitte report is an important document to consider as its findings had policy implications for super funds and the impacts of these would be borne by members.
The other significant recommendation of the review focused on funds’ efficiency and the quality of their reporting. It was recommended superannuation funds make greater use of technology in their back office administration to improve these aspects (Super System Review 2010). Their use of manual processing was believed to be a significant cost to members both in the timeliness of their reporting, and financially. Such costs could be avoided using computerised processes that have the ability to identify members through the use of their tax file number (Super System Review 2010). Research conducted jointly by Financial Services Council (FSC) and Ernst & Young (2010) estimated the outcome of implementing SuperStream to be a savings in operating costs of $1 billion per year reaching $20 billion over a ten year period. A contentious assumption made in this projection was that the funds under management would continue to grow at the same rate as they had done in the past.

The combined savings to be brought about by the proposed introduction of MySuper and SuperStream to the entire system were estimated to be $1.55 billion per year in the short term and $2.7 billion per year in the long term (Super System Review 2010). An ‘average’ superannuation fund member is estimated to pay 40% less fees in the long term, adding a total of $40,000 to their superannuation fund after 37 working years (Super System Review 2010), an approximate average of $1,080 per year.

The projected benefits to members promised by the savings are compelling, and given the impact on policy they are significant. However, such savings are projections and estimates based on a series of assumptions which need closer scrutiny. This paper examines the basis of such projections through an analysis of two research reports; one produced by Deloitte on the impact of MySuper; and the other prepared jointly by FSC and Ernst and Young on the impact of SuperStream.

This paper is structured as follows: section two positions this paper in the extant literature; section three outlines the methodological approach taken and sources of data; section four offers an analysis and discussion of the data, while section five draws a summary and presents concluding arguments.

2. Literature Review

There is a dearth of academic literature on the superannuation industry and its regulation. The Australian Government’s policy on superannuation is fundamental to the discharge of its social welfare policy and a key strategic initiative for a nation with an increase in the average age of its population. Despite the impact that superannuation policy decisions could have on the retirement savings of every Australian worker as well as the Australian economy as a whole, little interest to date has been shown by academics in critical analysis of these major reforms and policy processes. The very few identified studies that are relevant to this paper will be briefly discussed. The literature is classified into three themes: first, arguments pertaining to the diversification of funds’ investment portfolios; second, the simplicity of the investment strategy of the superannuation fund as a function of the members'
competencies; and third, the costs of implementing new regulations and related infrastructure costs of *MySuper*.

### 2.1 Diversification of investments

An early study by Sy (2009) used statistical modeling to calculate returns for passive versus active management of funds. This study concluded that a simple universal default option would be optimal for most investors due to the reduced costs of passive investment management. This study is sympathetic to the policy approach of *MySuper*.

In a study with contrary findings to Sy (2009), Basu and Drew (2010) examined the appropriateness of a default investment option in defined contribution plans. Statistical models were applied to compare the simulated performance of a default investment option (having the least percentage of funds invested in stocks), to other funds (having higher percentage of funds invested in stocks). The study found that investment portfolios with more stock investments tended to be safer compared to those with more fixed interest securities indicative of the default investment options. Basu and Drew (2010) argue that Australians whose superannuation funds are invested in a diversified default investment option would be better off having all their funds in stocks. This finding is supported in part by industry (see Barrymore 2010; Stewart 2011). It must be noted, however, that the wealth projections simulated in this study were based on past performance of the stock market and bond market which may not be experienced in the future. Basu and Drew’s (2010) findings are inconsistent with the proposed *MySuper* model which is to be a diversified, simple and low cost product. Therefore the diversification of investments is an important criterion against which to consider *MySuper*.

### 2.2 Simplicity of investment strategy

The simplicity of *MySuper* is more a view of the members’ investment competence (or literacy) than an argument for a simple model. The *MySuper* proposal was made based on the view that most fund members are not sophisticated investors and do not get involved in managing their superannuation investments (Ingles and Fear 2009; Gruen and Wong 2010). Supporting this view is the evidence provided in research conducted by the Australia Institute following the implementation of the choice of fund legislation in July 2005 (Fear 2008; Fear and Pace 2008). Consumers were found to avoid making financial decisions when faced with numerous options. Information overload was found to result in a failure in the intention of the choice of fund legislation, which aimed to do just the opposite (Fear 2008; Fear and Pace 2008).

### 2.3 Regulatory structure
The regulatory structure of the Australian Superannuation Fund is viewed to have been “...developed in an *ad hoc* manner and largely in response to various public demands for regulation” (Cortese, Aylward et al. 2006, p.32). Despite arguments to simplify legislation, the Australian regulation including the licensing and implementation of *MySuper* adds to the previously complex system, according to Taylor (2011). It is argued that multitudes of regulatory changes, particularly licensing reforms, over time have cost fund members between 1.26 to 1.35 percent of the superannuation assets (Taylor 2011). Any inadequacy or flaw of the licensing regime will have major consequences for *MySuper*’s projected cost savings (Taylor 2011). Since 80% of superannuation assets will be invested in *MySuper* products (Washington in Taylor 2011) the infrastructure costs may well cancel any expected relief in fees. For example, the lack of differential pricing under the proposed *MySuper* model is claimed to increase fees for approximately 6% of Australian workers (750,000 workers) rather than reducing them as it has been promised (Chant West 2011). This occurs as a result of the subsidization of the costs of running smaller funds by those of the larger funds within the *MySuper* structure (Chant West 2011).

It is argued that regulation of superannuation is directed more at the industry’s agents and their behaviours than at the prudential adequacy of superannuation funds. Pender (2010) argues that the focus of the regulation has been on conduct rather than structure, with requirements being unnecessarily extensive (Pender 2010). According to Pender (2010), more structural and capital requirement regulation is needed to address the current problems with the system since structural regulation affects conduct and therefore performance. Pender (2010) argues that even though the terms of reference of the Cooper Review were appropriately worded to include a review of both the ‘structure’ and the ‘efficiency’ of the superannuation system in the best interests of its members, the committee has failed in the implementation of these terms of reference. Rather than considering the impact of the current regulatory system on the formation of the industry structure and ultimately the member returns, the review has focused on reducing the ‘intermediary’ costs as a way of improving member returns (Pender 2010).

Pender (2010, p.46) believes that “Poor investments, done cheaply, do not result in a good outcome”, arguing that reforms should focus on changing the features of the financial system which have resulted in the shift of investment capital away from businesses. Examples of such features include negative gearing, no tax on the family home, tax preferred capital gains and agricultural concessions (Pender 2010). Business investments (such as bank deposits and shares) are thought to ultimately result in higher returns (by facilitating growth for businesses) and therefore provide growth in super funds (Pender 2010). Therefore, while Pender (2010) supports the review’s proposal to upgrade the technological aspect of the back office services (*SuperStream*), he views that *MySuper* default funds only add more complexity to the system with very few benefits to the members.
From the above discussion we can conclude that with respect to the diversification of superannuation investments, studies to date provide no definitive results with respect to the benefits of a universal default fund such as MySuper. In reference to the appropriate level of complexity of a default fund, the literature suggests that rather than being solely a technical problem, policy pertaining to MySuper should make reference to social aspects as its outcomes are a function of members’ investment competency. The literature also signals that the costs of implementing regulation and associated infrastructure costs necessary to the operation of MySuper may outweigh the anticipated financial benefits for its members.

3. Methodology and Empirics

This study uses a qualitative approach of a case study (Neuman 2011) of the Australian Federal Government’s initiatives of MySuper and SuperStream. This study addresses the research question what are the assumptions underlying the projected savings from the adoption of MySuper and SuperStream? This question comes from the literature, and is put forward as a criterion against which the two reports will be analysed. This analysis is discursive in nature.

The method of this study is an analysis involving a close reading of two primary source documents as the empirics for this analysis: the Deloitte Report (2010) “Super System Review: Default Fund costs under the MySuper proposals” (hereafter termed Deloitte Report), and the Financial Services Council and Ernst and Young Report (2010) “The $20 billion prize: An industry blueprint to implement SuperStream” (hereafter termed FSC & EY Report). These documents are worthy of analysis because their recommendations are the basis on which government policy for the Australian superannuation industry has been formulated. Assumptions made deferential to the financial services industry have implications for the wider public interest and the long term stability of the Australian economy.

4. Analysis and discussion

4.1 The Deloitte Report

Deloitte Actuaries and Consultants was commissioned by the Cooper Committee to do a projection of what would be ‘reasonable costs’ that a large default superannuation fund within the proposed MySuper model could charge members with account balances of $25,000 (Super System Review). Costs were projected for various fund sizes and various investment strategies (Deloitte 2010). These projections are shown in Figure 1, as extracted from the Cooper Review report.
Figure 1: Estimated total annual percentage costs for MySuper products of varying sizes (investment costs, plus operating costs and intra-fund advice)

<table>
<thead>
<tr>
<th>MySuper fund size/investment strategy</th>
<th>$2b</th>
<th>$5b</th>
<th>$10b</th>
<th>$20b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passive balanced</td>
<td>0.60%</td>
<td>0.46%</td>
<td>0.38%</td>
<td>0.32%</td>
</tr>
<tr>
<td>Passive conservative</td>
<td>0.58%</td>
<td>0.45%</td>
<td>0.37%</td>
<td>0.32%</td>
</tr>
<tr>
<td>Active balanced</td>
<td>0.94%</td>
<td>0.83%</td>
<td>0.70%</td>
<td>0.60%</td>
</tr>
<tr>
<td>Active conservative</td>
<td>0.80%</td>
<td>0.70%</td>
<td>0.59%</td>
<td>0.49%</td>
</tr>
<tr>
<td>Active balanced (with alternatives)</td>
<td>1.04%</td>
<td>0.89%</td>
<td>0.77%</td>
<td>0.66%</td>
</tr>
<tr>
<td>Active conservative (with alternatives)</td>
<td>0.89%</td>
<td>0.76%</td>
<td>0.64%</td>
<td>0.54%</td>
</tr>
</tbody>
</table>


4.1.1 Assumed features for MySuper

Key features of MySuper as well as the licensing conditions placed on MySuper providers are used to guide the costing estimates.

Below is the list of the assumed key features as shown in the report (Deloitte 2010, p.4)

- Separate accounting and reporting’ Streamlined member reporting and disclosures;
- An obligation to accept all types of contributions;
- A single investment option is to be offered;
- Limits to cross-subsidies;
- Exclusion of bundled advice, but access to general and intra-fund advice in accordance with ASIC RG 200;
- No trailing commissions or ongoing advice payments;
- Basic insurance can be offered but with no commission or like payments;
- Certain requirements surrounding fees:
  - No entry fees
  - Buy/sell spreads demonstrably linked to costs
  - No non-explicit discounts and no rebates
  - Any performance-based fees must comply with Performance Fee Standards to be developed by the Panel in consultation with the industry.
Although most of the key features point to a reduced fee structure, it can be argued that at least two of the licensing conditions would increase the cost of a MySuper product, contradictory to its objectives, through additional administration costs that will be incurred for meeting these conditions.

First is the requirement to have separate accounting and reporting for MySuper products. There were as at October 2010, 9.6 million Australians whose superannuation investments were in a default fund to be transferred into a MySuper fund (Stronger Super 2010). This transfer involves calculation of account balances as of the date of transfer, which together with the requirement to separately account for and report on the MySuper products will create extensive administration costs. Such costs, according to the proposed model, will be borne directly by members through a deduction of a set weekly fee (Charaneka and Ebsworth 2013). Magnifying these costs is the requirement to have a separate license to offer a MySuper product (Newman 2010) and the fact that the details of the requirements are not clear and have caused confusion and delays in their implementation (Taylor 2012).

Second is the obligation to accept all types of contributions. This feature adds to the operational complexity of MySuper funds since different contributions are subjected to different taxation and administration rules within the current regulatory framework. The overall operational complexity resulting from these requirements together with the focus on cost reduction at the expense of innovative investment strategies could result in increased fees for MySuper (Rice Warner Actuaries 2012).

It is suggested that focused academic research is required so a more accurate insight into the ultimate impact of such reforms on fees and performance of MySuper funds is gained.

4.1.2 Assumed management style

The report makes it explicitly known that although MySuper is to be a “…low-cost, no-frills, base superannuation option…” (Deloitte 2010, p.4), trustees can and in fact should make decisions which may result in higher costs but are necessary to achieve higher returns for the members (Deloitte 2010). For example, the trustees may appoint highly paid investment managers or establish high cost diversified funds if they ‘strongly’ believe that such decisions will result in higher net returns for the members (Deloitte 2010).

Our paper argues this assumption highlights the fallacy of the projected lower costs argument, due to the unpredictability of the results that such decisions could bring. The trustee’s ‘strong belief’ is not a guarantee for higher net results for the members and therefore such decisions may result in net losses rather than net returns, as experienced throughout the GFC - the very reason why a review was made into the superannuation system (see Lateline 2009).
4.1.3 Quality and the sources of data used

The Deloitte Report (2010) acknowledged from the outset that:

“It is widely recognised that there is a lack of quality and consistent data throughout the superannuation industry in Australia. It is not easy for individual Australians, let alone experienced industry practitioners, to compare and contrast performance and costs of funds” (Deloitte 2010, p.6).

Furthermore, it is stated that:

“The lack of standard (and mandatory) reporting templates means that it is very difficult to compare cost structures between funds, between industry sectors and over time. This is true of fees, costs and profit margins earned by those who are providing services to the industry
Costs are particularly difficult to assess because the annual reports of superannuation funds typically:
• Only record a small component of total investment related expenses; and
• Aggregate other expenses into a single amount which may or may not be described in the notes.
Proprietary data does exist within a number of research houses but is rarely comprehensive or readily comparable across the entire industry.”
(Deloitte 2010, p.6)

Due to a clear lack of quality data across the industry, the results of a Deloitte research report conducted in 2008⁴, adjusted for inflation, were used as the basis of operating and investment costs associated with the MySuper default fund. Two concerns are raised in this regard. First is that the use of 2008 Deloitte report would have limited the analysis in terms of the scope and depth of data used. According to Deloitte (2010), their 2008 report was based on data from industry funds only, due to lack of sufficient and consistent data from other types of funds in the industry.

Industry funds are the super funds offered by employer groups or unions for the benefit of their members (Taylor and Juchau 2013). A specific feature of industry funds is that profits made within the fund are used for the benefit of the members and are not distributed to owner/managers (Industry Funds Forum Inc.). This feature of the funds could have cost implications since it may directly impact trustee conduct and decision making.

A survey of annual reports of various superannuation funds over a seven year period to 2002, suggested that while retail and industry funds incurred higher expenses, they underperformed compared to public sector and corporate funds (Coleman, Esho et al. 2003). A similar and more recent longitudinal study of the superannuation fees by Rice Warner Actuaries (2012) also reported similar results for average fees charged by industry funds, despite a 13 basis point decline in fees charged by such funds in prior years.
Given that the structure of *MySuper* is very similar to that of an industry fund (Whiteley 2010), the projected costs should have been closer to the average fees charged by industry funds which stood at 1.13% (year to 30 June 2011) (Rice Warner Actuaries 2012).

The second concern relates to the possible impact that the GFC could have had on operational and investment costs of industry funds since 2008. As the previous Deloitte report was prepared based on data collected immediately prior to the GFC (Deloitte 2010), the relevance of it to future periods may be questionable even after adjustments for inflation are made.

Deloitte (2010) has also relied on the ‘experience’ of ‘superannuation practitioners’ as another source of data used in their analysis. While the experience of practitioners is respectable, it can be biased and very subjective particularly if it is not appropriately documented and transparent for future scrutiny. This is more so in an industry known for using its lobbying powers only when their self-interest is threatened (see Vamos 2012).

### 4.2 FSC & EY Report

The projected benefits of the proposed *SuperStream* were quantified in a research report prepared jointly by the Financial Services Council and Ernst & Young (2010). In summary, the research identifies the need for an investment of $1 billion initially to establish the streamlined systems but predicts that this investment will provide operating cost savings of $1 billion dollars per year, accumulating to $20 billion over a ten year period (Financial Services Council and Ernst and Young 2010).

These projections were based on a survey of 30 representatives from various sectors of the superannuation industry including self-managed super funds representing approximately 70% of the superannuation funds under management (Financial Services Council and Ernst and Young 2010). Other stakeholders participating in the survey included the Reserve Bank of Australia and a few superannuation industry associations (Financial Services Council and Ernst and Young 2010).

The “informed estimates” of the participants in the survey (Financial Services Council and Ernst and Young 2010, p.7) were used as data rather than data from proper analysis of processes involved in the implementation and appropriate costing estimates. If such analysis was indeed done, it is not evident in the report and therefore an evaluation is not possible. Participants were asked to rate certain aspects of the proposed *SuperStream* based on their ‘opinion’. Examples of the questions asked include ‘the business relevance of *SuperStream*’, ‘support for *SuperStream* tenets’, and ‘diversity of costs and benefits’ of *SuperStream* implementation. It appears that the responses of the participants to the latter group
of questions were used as the basis for estimating the costs and benefits of implementing SuperStream.

It is quoted that “Our research indicates that the industry believes the benefits from SuperStream will be substantial. In a high level assessment of the benefits our research suggests the industry could save up to 25% of current administration costs. For a more than $1 trillion dollar industry this equates to $1 billion in annual savings, equating to over $20 billion in 2020 should assets under management continue to grow at their current rate” (Financial Services Council and Ernst and Young 2010, p.10).

In the absence of any other explanation of how such figures have been arrived at, it can be concluded that the cost and saving estimates are purely opinion based, further highlighting the need for appropriate research of academic nature.

5. Summary and Conclusions

The Cooper Committee, chaired by Jeremy Cooper, was commissioned to review the governance, efficiency, structure and operation of the superannuation system with the best interests of the members being the focus. The committee proposed 177 recommendations in its final report, 139 of which were either accepted or accepted in principle by the government of the time. Two such recommendations have resulted in the most significant reforms in the superannuation industry since the introduction of the Superannuation Guarantee in 1992. Titled ‘MySuper’ and ‘SuperStream’, these reforms call for a compulsory transfer of superannuation funds in employer default funds into a new simple, low-cost fund and an upgrade of the back office services of superannuation administrators to a more computerised and streamlined system respectively.

To support the benefits of these major reforms two research reports have been commissioned and the results used by officials publicly. One report prepared by Deloitte Actuaries and Consultants estimated the approximate costs and savings resulting from the implementation of MySuper. The other report prepared by Financial Services Council (FSC) and Ernst & Young (2010), estimated the required initial cost and the resulting savings in operating costs of implementing SuperStream.

Given the impact these reports have had on policy, this paper examines the basis of their projections using a qualitative assumption approach. It is concluded that the scope of these reports is limited and they are predominantly constrained to industry funds and are presented by interested players, limiting their ability for full representation. A call for independent academic research is made.

End Notes
1. Cooper committee was the panel of experts commissioned in 2009 to examine and analyse the governance, efficiency, structure and operation of Australia's superannuation system. The Chair of the Review was Jeremy Cooper, the former Deputy Chairman of ASIC. Jeremy was supported by a Panel of seven part-time members. Further details can be found at: http://www.supersystemreview.gov.au/content/the_review.aspx

2. These findings were used by the government in its response to the Cooper committee recommendations to support their adoption of the proposed SuperStream.

3. Choice of Fund legislation came into effect from 1 July 2005 allowing employees more flexibility and choice in their super fund options. From 1 July 2005, employees have had the option of choosing the superannuation fund they wish to have their employer contributions invested in.

4. The name of this report was not disclosed in the Deloitte 2010 report and therefore it is not clear which Deloitte 2008 report is used for this purpose.

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