Australian Government

The Treasury

POST IMPLEMENTATION REVIEW:

Tailored MySuper

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1. Tailored MySuper — background

Superannuation funds are able to offer tailored MySuper products to members who are part of an employer group consisting of more than 500 members. This is an exception to the rule that each fund is only allowed to offer one MySuper product. There are currently five funds that offer tailored MySuper products and there are a total of 13 tailored MySuper products on offer.

Before outlining and evaluating the tailored MySuper provisions, it is important to understand the superannuation system, the historical context of default products prior to MySuper, as well as the policy intent of MySuper. These are discussed below.

The superannuation system

With over 2 trillion in assets, superannuation is the second-largest sector in the financial system. Since the introduction of compulsory superannuation in 1992, the sector has grown rapidly and it is now six times larger than it was in 2004.

The superannuation sector is regulated under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), mainly by the Australian Prudential Regulation Authority (APRA), with the Australian Taxation Office regulating self-managed superannuation funds. The Australian Securities and Investments Commission (ASIC) regulates superannuation fund disclosure under the *Corporations Act 2001.* Employer obligations to pay superannuation contributions are regulated under the *Superannuation Guarantee (Administration) Act 1992* (SGA Act).

The SGA Act requires employers to pay 9.5 per cent of an employee's salary into superannuation, with some exceptions. Most employees can choose a fund into which these contributions are made. Employees who do not choose a fund are 'defaulted' into a fund with a standardised product called a MySuper product. Employers must choose a fund with a MySuper product to be a 'default fund' for their employees.

The default market has a high incidence of member disengagement (members who do not pay attention to superannuation). Many employees do not choose to participate in the market — were it not compulsory, they may not choose to hold a superannuation account, or would contribute less to superannuation. These employees generally value money today (income for consumption or investment) more than money in the future (income saved for retirement) and (particularly when young) do not pay a great deal of attention to their retirement savings.

Employees who do not make a choice of fund are known, loosely, as default fund members — although some employees do choose to be members of a default fund. As quoted in the Productivity Commission's Inquiry Report on default superannuation funds in modern awards (2012), around 70 per cent of individuals are members of the default fund selected by their employer.

Default products prior to MySuper

Prior to the introduction of MySuper, superannuation arrangements were largely designed on the assumption that members were making active choices about their superannuation. The key characteristics of these arrangements were the availability of choices and the focus on disclosure so that members could make informed decisions.

However, in practice many members did not make an active choice. The Super System Review (or Cooper Review) found that of almost 12 million Australians who held a superannuation account, approximately 80 per cent had their compulsory superannuation contributions paid into a 'default' superannuation fund. This means that employers make compulsory superannuation contributions on behalf of employees who do not make an express choice of fund.

In default products, members are usually not engaged to ensure that the product meets their needs. In many cases, they rely instead on their employer to select a default product that meets their needs. However, some employers may not have the resources to ensure that an appropriate default product is selected for their employees. This is particularly the case where the employer is small and efforts to negotiate a suitable default product only benefit a small number of employees.

Policy intent of MySuper

The Super System Review recommended the introduction of a standardised, default superannuation product called a 'MySuper' product. The Government implemented MySuper in December 2012. MySuper products could be offered from 1 July 2013. It became mandatory for default superannuation contributions to be made exclusively into MySuper products from 1 October 2013.

The MySuper changes were aimed at providing a simple, cost-effective product with a diversified portfolio of investments for the vast majority of Australian workers who are invested in the default option of their current fund. Because most of these workers would not have exercised choice to be invested in a default option (though some may have actively chosen the default option), the changes involved implementing a governance model that better accommodated the needs of these disengaged members.

The arrangements help build scale in MySuper offerings because employees that do not make an active choice now have their contributions placed into the MySuper offering. Scale is central to a trustee optimising operating costs in the best interest of fund members. A report prepared for the Super System Review by Deloitte Actuaries & Consultants Limited describes the power of economies of scale in reducing per member investment, advice and operating costs, and so the scope to reduce total member fees.

MySuper members receive the protection afforded by the duties imposed on a traditional trustee who is a fiduciary acting single mindedly in the best interests of members. The simple product features of MySuper offerings (set out in Table 1) also aim to ensure that members do not pay for any unnecessary 'bells and whistles' they do not need or use. There is a limited role for external advice because intra-fund advice would be 'embedded' in the product and there would be limited choices to be made by the member. Standardised disclosure aims to enable members, employers and market analysts to compare funds more easily based on a few key differences. Members also bear less of the costs of compendious disclosure documents, which the member would not benefit from as a result of not exercising choice. Some degree of homogeneity on the product should also result in price competition to produce more positive outcomes for members and to help trustees contain costs.

<table>
<tr><th colspan="2">Table 1 — the product features of MySuper</th></tr>
<tr><td>Trustee duties</td><td>New duties for trustees, including a specific duty to deliver value for money as measured by long-term net returns, and to actively consider whether the fund has sufficient scale.

A single diversified investment strategy (which could involve a lifecycle strategy) suitable for the vast majority of members who are in the default option.

Comparable data on long-term net returns published by APRA.

Restrictions on unnecessary or excessive fees, including:
• banning commissions in relation to retail investment products and group insurance;
• new standards for the payment of performance fees to fund managers;
• a ban on entry fees charged to new members; and
• switching fees not payable to the trustee in their personal capacity.

The fees a member can be charged are limited to the following.
• Investment fee (including a performance based fee, subject to limitations)
• Buy and sell spreads (limited to cost recovery)
• Exit fee (limited to cost recovery)
• Switching fee (limited to cost recovery)
• Administration fee. On administration fees, employers will be able to negotiate with funds to obtain a discounted administration fee for their employees. This recognises that there may be administrative efficiencies in dealing with some employers that warrant a lower administration fee.

A fair and reasonable allocation of costs between MySuper and other products.

Standardised reporting requirements written in plain English.

A requirement to accept all types of contributions.

Life, and total and permanent disability insurance (where available, depending on occupational and demographic factors) offered on an opt-out basis. In addition to the flexibility around administration fees, there is additional flexibility around insurance. Although MySuper products will be required to offer a standard, default level of life and total and permanent disability insurance, members of MySuper products will be able to increase or decrease their insurance cover without having to leave the MySuper product.</td></tr>
</table>

Governance benefits of one MySuper product per fund

A key feature of MySuper is that a fund is generally only able to offer one MySuper product to all of its default members, regardless of which employer the member belonged to. This feature was in response to the findings of the Super System Review on the operation of default funds prior to the introduction of MySuper. Scale helps produce positive benefits for members by containing trustee costs. It maximises employer scrutiny of any particular MySuper product because the employees of all employers in that fund use the single MySuper product. The scrutiny of any particular employer that is brought to bear on the MySuper product will benefit all members (including those of other employers in that fund). This focuses the trustee's efforts and thereby minimises per member operating costs with respect to MySuper members. The following figures show how these benefits could arise.

Multi-employer fund before MySuper

Employer One subplan	Employer One choice product members	Employer One default product members
Employer Two subplan	Employer Two choice product members	Employer Two default product members
Public Officer subplan	Public Officer choice product members	Public Officer default product members

Each fund subplan operates semi autonomously. As a result the efforts that, say, Employer One makes to ensure default products suit their default members do not benefit Employer's Two default members, and vice versa. Neither employer's efforts benefit public offer default members. The issue is not as acute for choice members, as they are likely to be more engaged in their superannuation.

Multi-employer fund after MySuper

Employer One subplan	Employer One choice product members	All MySuper members
Employer Two subplan	Employer Two choice product members	
Public Officer subplan	Public Officer choice product members	

For default members, there is a single MySuper product. The efforts of all employers in the fund to ensure that the default products suit default members benefit all MySuper members (who are mainly disengaged).

Deciding on the tailored MySuper policy option

The experience prior to MySuper was one of multiple default products within a single superannuation fund, even for small employers whose members had no special need for default products with 'bells and whistles'. Therefore, there was concern that employers may try to avoid using the generic MySuper product even if their employees had no particular need for tailored features. Accordingly, policy options were considered about the restricted circumstances in which a tailored MySuper product could be offered, as an exception to the one MySuper product per fund rule.

Allowing tailored MySuper products to be offered to only certain large employers is consistent with the intention of MySuper because large employers:

- are likely to have sufficient resources and the incentive to make an informed decision about whether a tailored product, rather than a generic MySuper product, would be in the best interests of its employees; and
- only large employers have the economies of scale to spin off into a stand-alone corporate fund, meaning that these costs can be avoided if a tailored MySuper product is available to them.

The impacts of tailored MySuper are discussed in section 2 of this paper, including bespoke benefits, the reduction in governance benefits and spin off costs. The problem that the tailored MySuper policy endeavours to resolve is the need to appropriately balance these impacts while also taking into account the decisions made by some employers before the MySuper changes. It was decided that classifying employers by the number of employees (regardless of the proportion of them that take up MySuper product or choice products) was the most appropriate way to gauge the size of employers. The different policy options considered were:

- 50 employees, which largely identified employers that possibly have sufficient resources to make an informed decision about whether a bespoke MySuper product was in their employees' best interests. This threshold is more relevant if the most common situation is one where the bespoke MySuper benefit exceeds the value of the governance benefit that is lost through the exception to the one MySuper product per fund. Employers that have the resources to make an informed decision on behalf of their employees should be empowered to do so, even if they do not have scale to spin off in the hypothetical absence of a tailored MySuper product.
- 1,000 employees, which largely identified employers that, in addition, have the economies of scale to spin off. This threshold is more relevant if the bespoke MySuper benefit only exceeds the combined value of the governance benefits lost and the spin off costs. Employers should be allowed to be offered a tailored MySuper product only if they would otherwise spin out.

Ultimately, the policy option taken was to allow funds to offer a tailored MySuper product to members who are part of an employer group consisting of more than 500 members. The *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* received royal assent on 28 November 2012, which inserted subsection 29TB into the *Superannuation Industry (Supervision) Act 1993*, which is the tailored large employer MySuper provisions, containing the 500 employee threshold.

Some survey responses indicated that the threshold should be raised, but no change is proposed to be made because the 500 threshold seems appropriate given the uncertainty around the relativities between the value of bespoke MySuper benefits, the governance benefits lost from the tailored MySuper provisions, and the spin off costs (if any). In any case, industry data indicates that the 500 employee threshold is indeed significantly lower than the minimum number of members of a stand-alone corporate superannuation fund. APRA confirmed that the smallest large employer MySuper product had 1,084 employees at the time of application.

Further, the 500 employee threshold has the benefit of flexibility, in that it caters for any future technological change which lowers the cost of employers setting up stand-alone corporate superannuation funds. Also, the 500 employee threshold provides greater confidence that a significant bespoke MySuper benefit exists due to the larger potential number of affected default members (that is, potentially 500 members for a given tailored MySuper product, as opposed to a smaller number of potential beneficiaries like 50 members).

2. Impacts and net benefit of tailored MySuper

There are 13 tailored MySuper products currently authorised, with a total number of member accounts (not necessarily members) of 111,293 with total investments of 3.3 billion.

The tailored MySuper exception can result in a reduction of governance benefits but the provision is still worthwhile if this is outweighed by a combination of:

- bespoke MySuper benefits to employees; and
- the elimination of extra spin off costs that might have been borne by employers in the absence of the exemption.

Reduction in governance benefits

The one product per fund rule is a centrepiece of the MySuper provisions, representing a significant change which can help to reduce fees in default superannuation products. Section 1 of this paper establishes how the one MySuper product per fund rule helps to create governance benefits by maximising employer scrutiny on any particular MySuper product.

It could possibly be argued that the tailored MySuper exception to this rule could result in some level of reduction of these governance benefits, which can impact negatively on employees in generic MySuper funds. This is because efforts of large employers to ensure that a tailored default product suits the needs of members do not necessarily flow through to members of other MySuper products in the same fund. Further, economies of scale are important in enabling bigger funds to charge some of the lowest fees, so the flexibility to allow funds to also establish tailored MySuper products can theoretically detract from this.

However, in reality, given that there are only 13 MySuper products on offer, the impact that the tailored MySuper provisions have had on the reduction in governance and scale benefits is likely to have been negligible. No available evidence suggests that governance benefits have actually been reduced by the tailored MySuper provisions, so it is difficult to quantify the reduction, indeed if there has been any reduction at all.

Bespoke MySuper benefits

When an employer's default fund is a tailored MySuper product, the bespoke benefits for its employees are the particular bespoke features of the product net of the costs of providing that product, including the costs of setting up a tailored MySuper product. If the benefits do not outweigh the cost of setting up a tailored MySuper product, then there are no bespoke MySuper benefits, so the employer should take members' best interests into account by simply using the generic MySuper product offered by the multi-employer fund.

Responses to a survey suggest that the main reasons why superannuation funds offer tailored MySuper products is to allow for some or all of the following features.

- differential investment fees;
- specific investment strategies to meet the needs of the employees of (such as a conservative investment structure for employers who hire older employees, or ethical investments);
- a corporate plan within a larger master trust to have its own retained member section for members who cease employment and who would otherwise be transferred to the fund's standard MySuper product, meaning that former employees can continue to have discounted fee arrangements. This is because the administration fee exemption is only available to current employees and only applies to current employees; and
- brand recognition for large employers including badging of material to members so that it looks as if the product is offered by the employer.

APRA also indicated that it is not aware of any applicant that applied for a tailored product on the grounds that they wished to offer differential member services.

The positive impact for employees is that their superannuation is more closely tailored to the particular needs and desires of that cohort, such as a conservative investment structure for older employees. These benefits are likely to be ongoing. Employers can likewise benefit by offering tailored MySuper products partly due to the desire for brand recognition.

As at 30 June 2014 (published in APRA MySuper Statistics Selected Feature on 2 October 2014: www.apra.gov.au/Super/Publications/Documents/20141002_MySuper_selected_feature_overview.pdf), the median statement of fees and other costs for a representative member for generic MySuper products was $532 and was $395 for tailored MySuper products. Therefore, it does not appear that there have been any detrimental effects in terms of fees and other costs for members in tailored MySuper products. This is not surprising because if employers are sufficiently large and engaged with their member's super that they consider tailored MySuper products, then it is likely that there would be sufficient scrutiny on the products to ensure that fees are reasonable.

However, the extent of opportunities for bespoke MySuper benefits seems to be limited due to the flexibility regarding administration fees and insurance which was ultimately allowed under the generic MySuper provisions. The Australian Institute of Superannuation Trustees suggested that a barrier to establishing a tailored MySuper product is the limited capacity to provide additional benefits to members. APRA noted that because funds can offer differentiated insurance offerings within the one generic MySuper product, there is no need for them to seek authorisation of large employer exemption products on the grounds of bespoke insurance arrangements. The generic MySuper provisions allow members to choose different insurance levels — during consultation, one firm suggested that had there been a single level of insurance in a MySuper product, then that firm alone would have applied for 120 different tailored MySuper products. The MySuper provisions also allow for different administration fees to be imposed on different employer groups in a multi-employer fund through different discounts for administration fees.

It is difficult to value these bespoke MySuper benefits, because they are not the type of considerations that can be easily quantified. However, it is likely that the value of the bespoke benefits varies according to the group of employees and the circumstances of each particular case.

Reduction in spin off costs

If the bespoke MySuper benefits to members are sufficiently high, then employers may have the incentive to 'self-help' around the one MySuper product per fund rule by 'spinning off' into a stand-alone corporate superannuation fund. The costs of spinning off (or remaining spun off) negatively impacts employers and employees, and includes setting up and operating a stand-alone corporate fund.

Alternatively, an employer with bespoke product needs might 'remain spun off' — that is, refrain from joining a multi-employer fund — if its superannuation needs are currently being met by a stand-alone corporate superannuation fund. The Australian Institute of Superannuation Trustees notes that there are pre-existing corporate funds that have not sought MySuper authorisation. In addition, Australian Super indicated that single employer sponsors have continued to operate their fund without it seeking MySuper authorisation for bespoke products, on the basis that their employees have to choose the fund as a condition of employment.

APRA and other survey responses expect these spin off costs to be considerably higher than a tailored MySuper product. By offering a tailored MySuper product instead of spinning off, employers and employees can therefore save the difference between the cost of spinning off as compared to the cost of establishing and operating a tailored MySuper product.

One submission estimates that it costs around $100,000 to set up a tailored MySuper product. Submissions suggest that the costs of a tailored MySuper product include administrative costs, disclosure and reporting obligations, the costs of operating segregated products such as websites and the additional costs of having separate insurance products with different insurers.

One measure of success of the 500 employee threshold is to determine whether any employer group has exited a multi-employer fund in order to set up a stand-alone fund. In this respect, it appears that the tailored MySuper provisions have been successful, as there do not appear to be any such spin offs. Responses to a survey indicated that no employer group sponsors have set up a stand-along separate superannuation fund solely or predominantly for the purpose of offering a bespoke MySuper product to their employees.

Similar to the other impacts of tailored MySuper, the reduction in spin off costs cannot be quantified. If spin off costs outweigh bespoke benefits, an employer acting in the best interests of its employees would not spin off. Therefore, it may not always be correct to say that a tailored MySuper product saves spin off costs, because the fund may not have spun off anyway. In such circumstances, only the bespoke benefits and the reduction in governance benefits should be weighed up to assess the net benefit.

Regulatory burden

The regulatory burden for superannuation funds involved the time and effort spent in reviewing and understanding the final tailored MySuper provisions, as compared to the generic MySuper provisions, so that the tailored MySuper offers could be developed. One superannuation fund that offers tailored MySuper products suggested that this one-off cost was between $125,000 and $150,000. To calculate the regulatory burden, we have assumed the midpoint of this range, which is $137,500.

Once the regulatory provisions and requirements were well understood, whilst there are ongoing operational costs of providing the tailored MySuper offers, there is essentially no regulatory burden in terms of needing to reanalyse the tailored MySuper provisions as compared to generic MySuper.

Therefore, the only regulatory costs were the one-off costs. The 13 tailored MySuper products currently operating are offered by just five funds, so to calculate the regulatory burden, the $137,500 figure is multiplied by five. One average over a ten year period, this means the regulatory cost equals $68,750 per year, as set out in the following table.

Average annual regulatory costs (from business as usual)				
Change in costs ($million)	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	$68,750	-	-	$68,750

Assessment of net benefit

It is difficult to assess the net benefit of the tailored MySuper provisions. As discussed, the value of the bespoke MySuper benefits to the particular employees and the reduction in governance benefits to the remaining members of the fund cannot be quantified, so their relative value to each other is unclear. It is difficult to determine how often spin off costs would arise and to estimate the extent to which the tailored MySuper provisions can reduce spin off costs. This is because, in the hypothetical absence of the tailored MySuper provisions, the expected value of the bespoke benefits would affect whether or not the employer would spin off.

Furthermore, net impact analysis depends on the counterfactual of making tailored MySuper products available. In one situation, the counterfactual is that funds accept the generic MySuper products and do not spin off. In this case, the drawback of the tailored MySuper product is the loss of governance benefits for members of generic MySuper products, and the advantage is the bespoke MySuper benefits to employees in that product. By contrast, in situation two, the counterfactual is funds spinning off into a new stand-alone corporate fund, in which case the advantage of tailored MySuper is both the bespoke MySuper benefits and the spin off cost savings.

3. Stakeholder consultation, implementation and evaluation

The implementation of MySuper was the subject of a regulation impact statement (found here: http://ris.finance.gov.au/files/2011/10/03-Stronger-Super-RIS.pdf). However, that regulation impact statement did not consider the tailored MySuper provisions. Instead, the Government provided a dispensation from the need to prepare a regulation impact statement for the tailored MySuper provisions. As a result of this, a post implementation review must be undertaken under the best practice regulation guidelines. The government committed to undertake a review of the tailored MySuper approval process. In the revised Explanatory Memorandum to the Superannuation Legislation Amendment (MySuper core provisions) Bill 2012 pertaining to tailored MySuper, paragraph 3.49 states that:

> Treasury will conduct a review of the authorisation process within two years of the commencement of the MySuper regime on 1 July 2013 to assess the efficiency of the authorisation process. The review will examine any impacts on commercial tender processes and the time taken by APRA to assess and decide applications for tailored MySuper products.

In addition, as a matter of best practice regulation, Treasury has extended this review to cover all aspects of the implementation of tailored MySuper more generally.

As part of the process of preparing this Post-Implementation Review, Treasury circulated a short survey to a number of bodies, with questions about issues which included:

- the design of the tailored MySuper provisions;
- the reasons why tailored MySuper products are being offered;
- barriers to setting up tailored MySuper products; and
- the 500 employee threshold.

Treasury received responses from APRA, Australian Super, the Australian Institute of Superannuation Trustees, Industry Super as well as two confidential responses. The survey responses have been incorporated through this paper.

Moving forward, Treasury is in regular contact with APRA, ASIC, superannuation funds and their representatives, so the operation of the tailored MySuper provisions will continue to be monitored.