

# FSC Future Leaders Award

October 2017



## A Holistic Strategy for Retirement

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Yash Sodhi

## **Abstract**

The current range of MySuper products are not sufficiently flexible to meet the needs of an increasingly diverse membership base. The future evolution of the MySuper product range, Smarter Super, will utilise member data to form a holistic picture of each member's financial circumstances. This information will then be used by funds to group members with similar circumstances into cohorts, each having their own tailored investment strategy. The Smarter Super approach will deliver a meaningful increase in member retirement incomes whilst at the same time, drive stronger engagement through personalising the super experience for members. It will deliver broad commercial and policy benefits, including improved member retention for funds and easing of the age pension burden for the Government. Smarter Super represents the next generation of investment strategy, providing the 80% of Australians invested in a MySuper product the best opportunity to maintain their standard of living in retirement.

## Executive Summary

Julius and Vincent were born seconds apart. Fifty years on Julius is a husband and a father of three with an established career in medical research. His dual income family recently upgraded to a new home. Vincent, his twin brother, is a freelance journalist, single and happy to keep renting. Vincent prefers spending his income on travel rather than being burdened with a mortgage. Whilst Julius and Vincent might be indistinguishable from one another in appearance, should the investment strategy directing their super be identical?

### A ‘one-size-fits-few’ system

The current generation of MySuper products assume investment decisions made for a ‘typical’ member will be appropriate for all fund members. However, just as there is little point in knowing the average depth of Sydney Harbour when it actually varies from 3 metres in some places to 45 metres in others, investment decisions based on the ‘average’ or ‘median’ member will “not necessarily reflect what is optimal for all or even most”.<sup>1</sup>

Today’s MySuper products do not deal with the heterogeneity within the super system or within any one fund, with no two members sharing the same combination of income, relationship status, wealth outside of super or living arrangements (amongst other factors).<sup>2</sup> Recent calls to allocate members to a fund only once upon entering the workforce, potential decoupling of default funds from enterprise agreements and modern awards and the rise of the ‘gig’ economy mean member diversity will continue to gather momentum into the future.<sup>3,4,5</sup>

Super is set to overtake the family home as the largest asset of average Australians by 2029.<sup>6</sup> With over 70% of new members investing in the default MySuper products must evolve to address increasing member diversity.<sup>7</sup>

### Smarter Super of the future

The next generation of MySuper products will be tailored to individual needs and circumstances, providing members the best opportunity to maintain their standard of living in retirement. Funds will learn more and assume less, modernising balanced and lifecycle offerings with a new product which groups members within the same age bracket by their projected retirement income. This novel approach - Smarter Super - will deliver improved risk-adjusted returns and drive stronger engagement by bringing future retirement prospects into the present. Policy and commercial benefits will also flow with improved member outcomes, higher member retention and a more sustainable pension system overall.

#### A. Capturing member information with Big Data

Big data is being used within industry today to better understand customers, improve decision making and create new products and services which respond to customer needs. Within Smarter Super, the fundamental focus will be obtaining member data most pertinent to projecting the member’s income in retirement. Research undertaken by Commonwealth Science and Industrial Research Organisation (CSIRO) identified these factors to be age, gender, relationship status, health status, living arrangements and super and non-super assets.<sup>8</sup> Data will be sourced from centralised and government agencies, including the Australian Tax Office (ATO), state-based departments of birth, deaths and marriages and land titles, and consumer credit reporting agencies. Longer term, other sources of information (e.g. digital health records for better estimating life expectancy) are likely to become available to funds.

	Age and gender	Relationship status	Homeowner or renter status	Super assets	Non-super assets/income	Health status
Source	<ul style="list-style-type: none"> <li>Existing fund information</li> </ul>	<ul style="list-style-type: none"> <li>Registries of Births Deaths &amp; Marriages</li> <li>Department of Immigration and Border Protection</li> </ul>	<ul style="list-style-type: none"> <li>Land title register</li> <li>Consumer credit agencies</li> </ul>	<ul style="list-style-type: none"> <li>Existing fund information</li> <li>ATO</li> </ul>	<ul style="list-style-type: none"> <li>Consumer credit agencies</li> <li>ATO</li> </ul>	<ul style="list-style-type: none"> <li>Australian Digital Health Agency</li> </ul>
Relevance	<ul style="list-style-type: none"> <li>Estimating longevity</li> </ul>	<ul style="list-style-type: none"> <li>Estimating social security entitlements</li> </ul>	<ul style="list-style-type: none"> <li>Estimating social security entitlements</li> <li>Estimating living costs in retirement</li> </ul>	<ul style="list-style-type: none"> <li>Estimating social security entitlements</li> <li>Estimating income</li> </ul>	<ul style="list-style-type: none"> <li>Estimating social security entitlements</li> <li>Estimating income and expenditure</li> </ul>	<ul style="list-style-type: none"> <li>Enhanced longevity assessment</li> </ul>

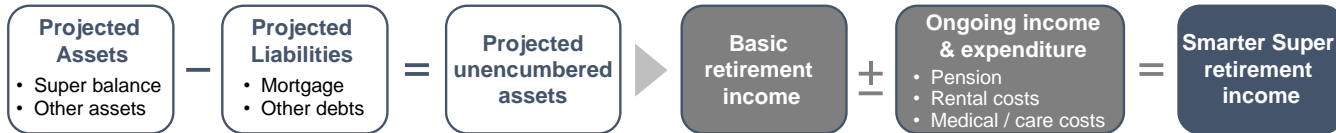
Funds must have access to more comprehensive data to adequately fulfil their fiduciary obligations to members. It is therefore reasonable for member’s to grant funds permission to access their data as the ‘default’ setting, whilst retaining the choice to opt-out. Recently announced reforms aimed at strengthening the design of MySuper products highlight the Government’s willingness to support change which improves member outcomes.<sup>9</sup>

Furthermore, industry experience suggests individuals are willing to share personal data in exchange for benefits<sup>10</sup>, and will have a tendency to stick with the ‘default’ option as a matter of trust.<sup>11,12</sup>

It will be critical to ensure funds and other administrators within the super system educate members on how their data is being used and employ robust safeguards to maintain their trust and confidence.

**B. Translating member data into Smarter Super retirement income projections**

Funds will build upon existing calculators and tools to translate member data into retirement income projections. Unlike retirement income estimates proposed by the *Financial System Inquiry*, the Smarter Super retirement income will consider a broad range of factors, including those outside of the super system. Smarter Super will also consider member circumstances on a household basis, recognising differences which may arise between couples and singles (e.g. pension eligibility and entitlements). The following equation illustrates how the Smarter Super retirement income will be determined.



**C. Grouping members into holistic retirement cohorts**

Today, MySuper products offered by some funds bundle young members entering the workforce with those nearing retirement. Others cluster together members based on age alone. Smarter Super, in contrast, will group similar members based on projected retirement income and age to form holistic retirement cohorts. This will result in a larger number of smaller cohorts, each with little variability in terms of the financial circumstances of members.

**D. Investing for holistic retirement cohorts**

Funds will develop investment strategies which are customised for each cohort, thereby fully appreciating the significance of the heterogeneity which exists between members. This approach will maximise investment returns whilst managing risks including market, inflation, longevity, liquidity and sequencing risk. For example, it might be appropriate for a cohort representing individuals with a high projected retirement income to invest in a high proportion of growth assets even as members approach retirement. By comparison, members with a lower projected retirement income might have a smaller allocation to growth assets as they age to better manage sequencing risk as retirement approaches.

Funds will also employ a greater diversity of investment strategies customised to the risk-return profile of each holistic retirement cohort. For example, within the growth allocation it may be appropriate for more affluent cohorts to have an exposure to hedge fund, private equity and value strategies. Others might have a larger allocation to absolute return strategies, property and infrastructure investments which have more predictable investment return profiles.

Under the current MySuper product range, a significant proportion of members are either too aggressively or too conservatively invested. With Smarter Super, investment strategies are optimised for a significantly broader cross-section of members. The following illustrates how the current MySuper balanced and lifecycle strategies would compare for a 55 year old member relative to Smarter Super based on holistic retirement cohorts.

55 year old member	Current Defaults		Smarter Super (illustrative holistic retirement cohorts)		
	Balanced funds	Lifecycle funds	Cohort A	Cohort B	Cohort C
Distribution of members based on retirement income (p.a.)					
AA optimised for RI level	~\$70k p.a.	~\$40k p.a.	~\$45k p.a.	~\$55k p.a.	~\$65k p.a.
Asset Allocation	80% growth / 20% defensive <sup>13</sup>	50% growth / 50% defensive <sup>13</sup>	55% growth / 45% defensive	60% growth / 40% defensive	70% growth / 30% defensive
Growth strategies	<ul style="list-style-type: none"> <li>Single diversified portfolio</li> </ul>	<ul style="list-style-type: none"> <li>Single diversified portfolio adjusted based on age</li> </ul>	<ul style="list-style-type: none"> <li>Absolute return</li> <li>Small-caps</li> </ul>	<ul style="list-style-type: none"> <li>Value</li> <li>Long/short</li> </ul>	<ul style="list-style-type: none"> <li>Hedge funds</li> <li>Private equity</li> </ul>

Aggressive asset allocation for projected RI
  Optimal asset allocation for projected RI
  Conservative asset allocation for projected RI

## **E. Implementation and regulatory considerations**

Relative to today, funds will manage a larger number of holistic retirement cohorts and require automation to efficiently allocate investments in line with their investment philosophy. Funds will also dynamically re-allocate members to the holistic retirement cohort meeting their needs should their circumstances change. By building on existing linkages between government agencies and funds, the investment required to implement Smarter Super can be contained.

Implementation will also require current regulation, which limits the prescribed factors a fund might consider when designing MySuper compliant products, to be broadened to include the member's projected retirement income as reasonably determined by the trustee.

### **Superior outcomes for members**

Smarter Super will represent a meaningful step-change in the way funds invest on behalf of the 53% of Australians who have never saved for retirement outside of compulsory super.<sup>14</sup>

#### **A. Enhancing risk-adjusted returns for members**

The average MySuper account balance is 45% lower than the system average.<sup>7</sup> Even a small increase in retirement incomes can deliver a meaningful improvement in the member's quality of life in old age. Research by Trustee Tailored Super has shown that cohorting MySuper members with similar balances has the potential to increase returns by around 1% per annum whilst decreasing sequencing risk as retirement approaches.<sup>15</sup> For someone entering the workforce today, this translates to a 35-40% cumulative increase in super balance at retirement and a 5-10% uplift in annual retirement income.<sup>16</sup> By cohorting members based on a comprehensive prediction of retirement income, Smarter Super has the potential to deliver improvements in risk-adjusted returns of a similar magnitude, if not greater.

#### **B. Driving engagement through personalisation**

Smarter Super will deliver on consumer demands for customisation and will personalise communication to drive stronger member engagement for MySuper members, who collectively hold almost 15 million accounts.<sup>17</sup> One element of this will be to redesign the member annual statement to give all members an individualised vision of their retirement. Statements will focus on the more comprehensible retirement income projection with less emphasis on the closing balance. Statements will include a gauge tracking the member's progress to maintaining their standard of living in retirement. This gauge will compare the projected retirement income with the member's current income (as adjusted with a replacement ratio determined by trustees). Should members be falling behind, the statement will also include illustrative strategies to help the member get back 'on track' (e.g. increasing super contributions or savings).

Painting a detailed picture of the member's expected lifestyle in retirement will assist Smarter Super to overcome 'present bias' which traditionally has detracted from member engagement. Improved retirement income projections, easy to understand visual aids and specific calls to action will help to make the member's retirement both tangible and relatable.

### **Policy and commercial benefits**

Smarter Super represents part of the solution for shifting Australia's pension system onto a more sustainable footing. With the World Economic Forum predicting Australia's pension deficit to balloon to \$9 trillion by 2050, there is considerable urgency to identify new ways to help Australians to self-insure a greater proportion of their lifestyles in retirement.<sup>17</sup> Improved investment returns coupled with stronger engagement might also reduce ongoing government 'tinkering' of super policy which has eroded member confidence in the system.

Funds will benefit from Smarter Super with more engaged members and higher average balances creating demand for broader financial services, including advice. Those funds which deliver the best outcomes will be better placed to attract and retain members, including wealthier members contemplating establishing a self-managed super fund. Australia's asset managers, having a deep understanding of the needs of members and enduring client relationships, will be in a prime position to market existing strategies and develop new strategies specifically designed for the various holistic retirement cohorts.

## **Conclusion**

A renewed approach to investing will be the keystone to a more engaging and sustainable super system. By focussing on the needs and circumstances of members, Smarter Super will deliver members superior risk-adjusted returns leading to higher income for retirement. As the drivers behind member heterogeneity accelerate, the approach to investing within super must adapt to ensure it can provide both Julius and Vincent the best chance to maintain their quality of life into their golden years.

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## References

- <sup>1</sup> Productivity Commission, How to Assess the Competitiveness and Efficiency of the Superannuation System, Research Report, Canberra; 2016.
- <sup>2</sup> Drew M, Walk A. Governance: The Sine Qua Non of Retirement Security. The Journal of Retirement. 2016;4(1):19-28.
- <sup>3</sup> Productivity Commission, Superannuation: Alternative Default Models, Draft Report, Canberra; 2017.
- <sup>4</sup> Deloitte Access Economics. Choice and competition in the Australian default superannuation system. Sydney: Financial Services Council; 2017.
- <sup>5</sup> Deloitte Access Economics. The Future of Work: How Can We Adapt to Survive and Thrive?. Sydney: Chartered Accountants Australia and New Zealand; 2016.
- <sup>6</sup> Melbourne Institute of Applied Economic and Social Research, The Household, Income and Labour Dynamics in Australia (HILDA) Survey: Selected Findings from Waves 1 to 14. Melbourne: The University of Melbourne; 2016.
- <sup>7</sup> Australian Prudential Regulation Authority (APRA), June 2016 Statistics, Annual Superannuation Bulletin. APRA; Canberra; 2017.
- <sup>8</sup> Stephenson A, Zhu Z, Toscas P, Reeson A, Koo B, O'Hare C, Cox D. Household Assets Among Australian Age Pensioners: A preliminary analysis of data from the Department of Human Services. Sydney: CSIRO Risklab Australia; 2017.
- <sup>9</sup> Treasury, Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017, Canberra; 2017.
- <sup>10</sup> Medcraft G, Chairman, Australian Securities and Investments Commission (ASIC), Driving better consumer outcomes in the era of big data and artificial intelligence. Speech presented at Corporate Governance Discussion Group; 2016; Sydney.
- <sup>11</sup> Behavioural Insights Team, EAST: Four Simple Ways to Apply Behavioural Insights. London; 2014.
- <sup>12</sup> Centre for International Finance and Regulation (CIFR), CIFR Submission to Productivity Commission - Superannuation: Alternative Default Models. Melbourne; 2016.
- <sup>13</sup> Rice Warner. Lifecycle MySuper Product Fees. Sydney: Australian Institute of Superannuation Trustees (AIST); 2016.
- <sup>14</sup> HSBC Bank Australia Limited. Australians face a 13-year shortfall in retirement funding: HSBC research. 2015.
- <sup>15</sup> Fiduciary's Friend Pty Ltd, Submission in Response to Productivity Commission Issues Paper – Superannuation Competitiveness and Efficiency (March 2016). Sydney; 2016.
- <sup>16</sup> Change in retirement income projection based on Australian Securities and Investment Commission (ASIC) Retirement Planner calculator. Retirement planner | ASIC's MoneySmart [Internet]. Moneysmart.gov.au. 2017 [cited 27 August 2017]. Available from: <https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/retirement-planner>
- <sup>17</sup> World Economic Forum. We'll Live to 100 – How Can We Afford It? May 2017.















## Arnold

- Well educated
- High income
- Careful with expenditure
- Significant savings



## Danny

- Did not complete high school
- No (legal) source of income
- Exorbitant expenditure
- On the run from debt collectors

**Different** incomes, **different** assets, **different** savings habits, **different** prospects for retirement

**Same** investment strategy?

# A key issue facing today's super system

Today's MySuper products do not tailor **investment strategies** to meet the **diverse** needs and circumstances of members



Members

- Sub-optimal **investment outcomes**



Super funds

- Products which do not to meet member **needs**



Government

- Left to **pick up the tab** - US\$9tn pension deficit expected by 2050<sup>1</sup>

1. World Economic Forum, We'll Live to 100 – How Can We Afford It?, May 2017.

# Smarter Super\*

Investing **tailored** to the **needs** and **circumstances** of members based on a **holistic picture** of their retirement

*\*Clearly, I don't work in Marketing*

# Smarter Super

A new take on tailoring

Balanced

Lifecycle

Lifetime

Lifestyle

# Smarter Super



Today

Tomorrow

# The Future



# Agenda

## Topics

1 **What is Smarter Super?**

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2 **How would Smarter Super be applied by funds?**

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3 **Key benefits of Smarter Super**

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4 **Making Smarter Super a reality**

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**By the end of the presentation, we should...**

- Recognise how Smarter Super addresses the key issue
- Understand the Smarter Super innovation
- Have a desire to work together to implement the idea!

# **What is Smarter Super?**

# What is Smarter Super?

## Today

### Balanced fund Lifecycle strategy

- “**Typical member**”<sup>1</sup>
- **Minimal** member data
- **Few** investment cohorts
- **Sub-optimal** outcomes<sup>2</sup>



## Future: Smarter Super

### Holistic Retirement strategy

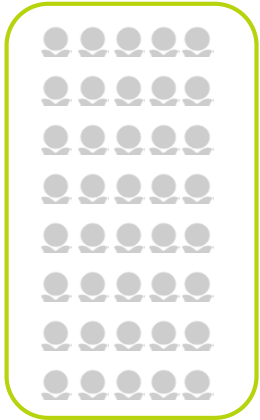
- **Tailored** to member needs
- Data **driven**
- **Numerous** investment cohorts
- Risk-adjusted returns **maximised**

1. Butt et al, MySuper: A Stage in an Evolutionary Process, December 2014.

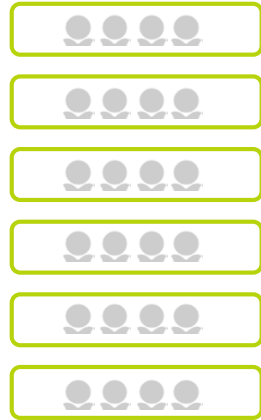
2. CIFR, Submission to Productivity Commission review into “Alternative Default Models”, October 2016.

# What is Smarter Super?

Today

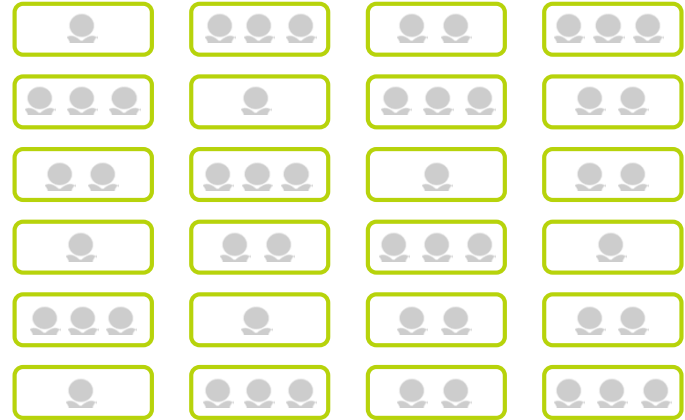


**Balanced**  
No tailoring  
**HESTA**



**Lifecycle**  
Tailored by age  
**AMP**

Future: Smarter Super



**Holistic Retirement**  
Tailored by age and  
projected retirement income

**How would Smarter Super  
be **applied** by funds?**

# How it would be applied by funds

## Four step process



**1. Data capture**



**2. Retirement income projection**



**3. Invest for Holistic Retirement cohorts**



**4. Communicate and engage**

# How it would be applied by funds

## Four step process



**1. Data capture**



**2. Retirement income projection**



**3. Invest for Holistic Retirement cohorts**



**4. Communicate and engage**

# 1. Data capture

## Seamless and secure access to member data

### Key Information Required

- Super assets and non-super assets
- Earnings history
- Age and gender
- Relationship status
- Living arrangements





# 1. Data capture

## Bringing member data within the ecosystem of funds

Leverage **technology** to link funds to key sources of member data

Seamless member experience – making access the **default** setting

Implementation considerations:

- Reliance on **publicly** available data
- Educate members on **benefits**
- Addressing **privacy** concerns

# How it would be applied by funds

## Four step process



1. Data capture



2. Retirement income projection



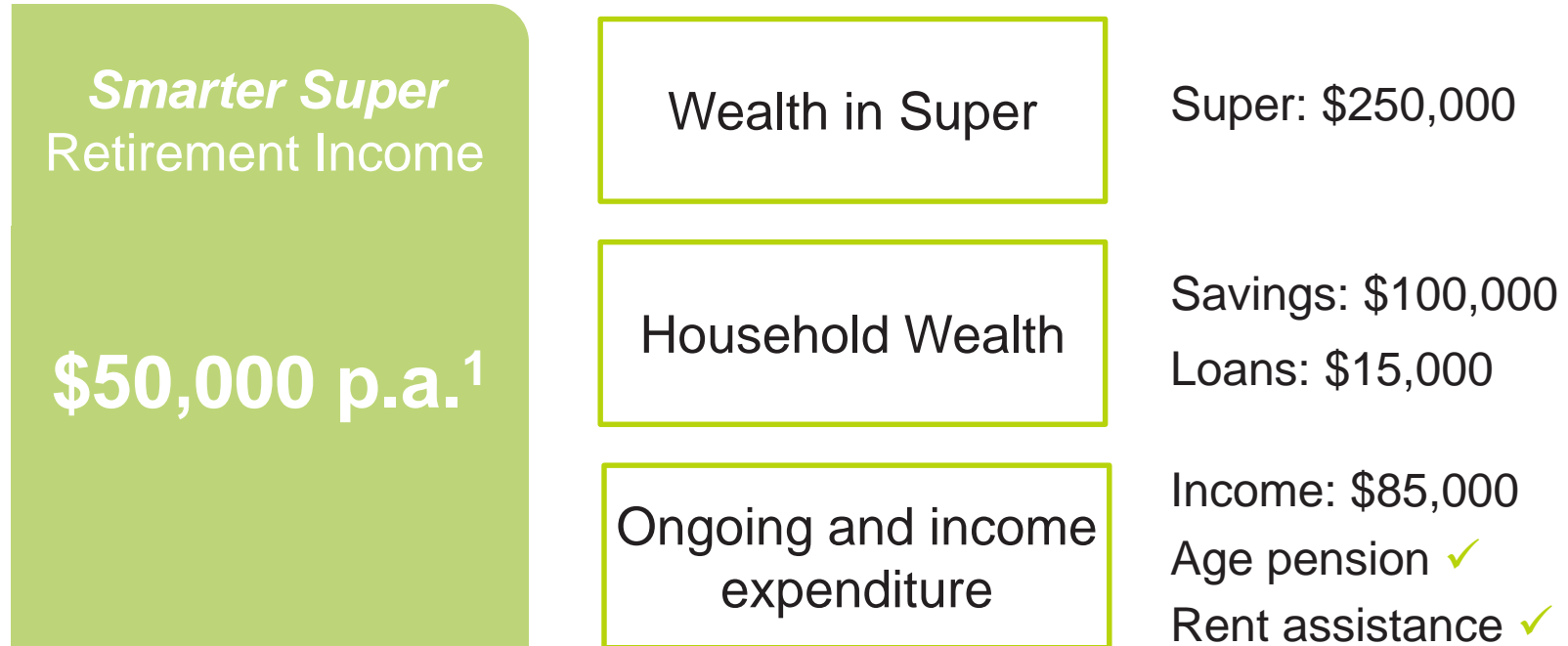
3. Invest for Holistic Retirement cohorts



4. Communicate and engage

# 2. Retirement income projection

## Retirement income measured in a new way



Note:

1. Illustrative estimate based on analysis undertaken on ASIC's Money Smart retirement planner tool.

# How it would be applied by funds

## Four step process



1. Data capture



2. Retirement income projection



3. Invest for Holistic Retirement cohorts

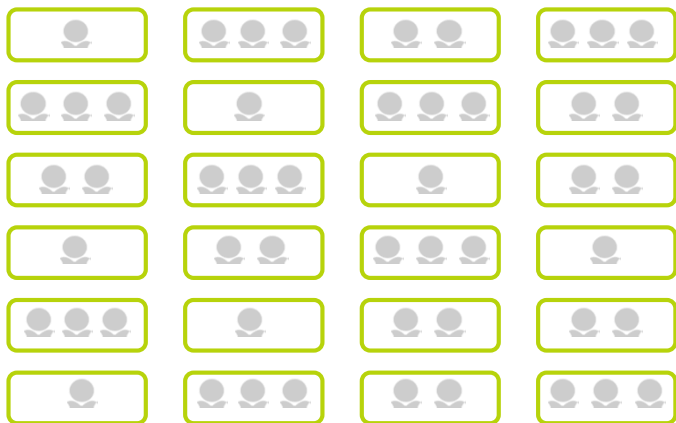


4. Communicate and engage

# 3. Invest for Holistic Retirement cohorts

## Investing tailored for each Holistic Retirement cohort

### Future: Smarter Super



### Holistic Retirement

Tailored by age and  
projected retirement income

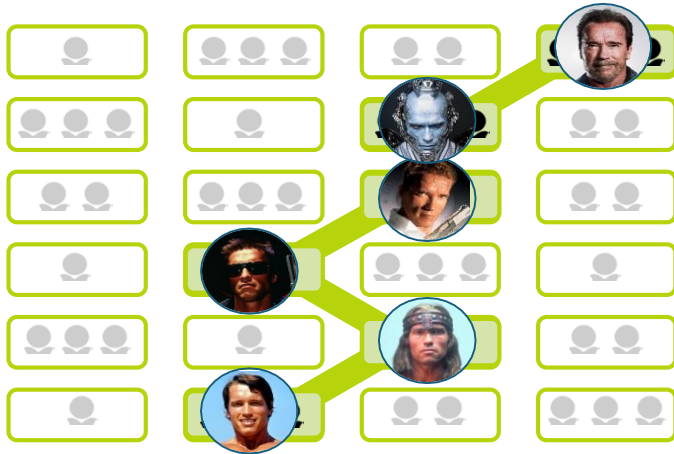
### Smarter Super investing

- Investment consideration:
  - Adequacy of retirement income
  - Investment horizon
  - Risk profile
- More than growth vs. defensive
- Customised by underlying exposure

# 3. Invest for Holistic Retirement cohorts

## Investing tailored for each Holistic Retirement cohort

### Future: Smarter Super



### Holistic Retirement

Tailored by age and  
projected retirement income

### Smarter Super investing

- Dynamic and automated reallocation to cohorts
- Tailored investment glidepath for each member

# How it would be applied by funds

## Four step process



1. Data capture



2. Retirement income projection



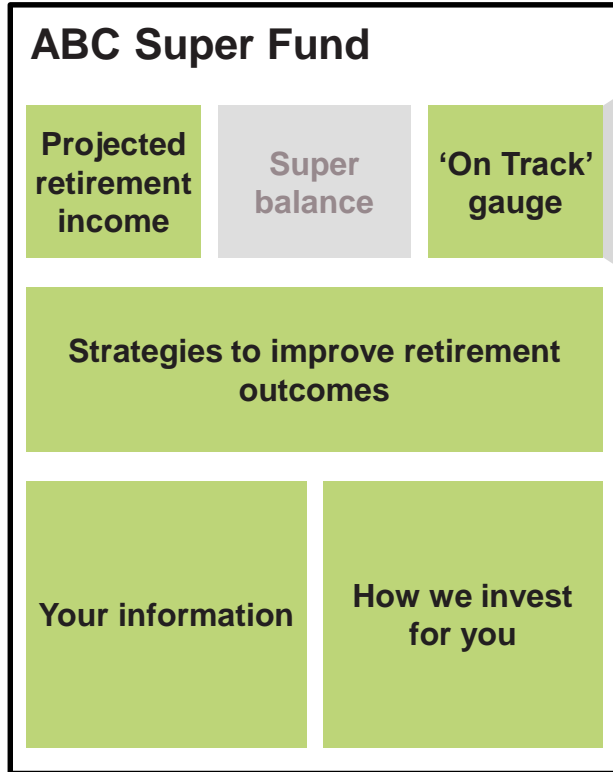
3. Invest for Holistic Retirement cohorts



4. Communicate and engage

# 4. Communicate and engage

## Personalisation drives stronger member engagement

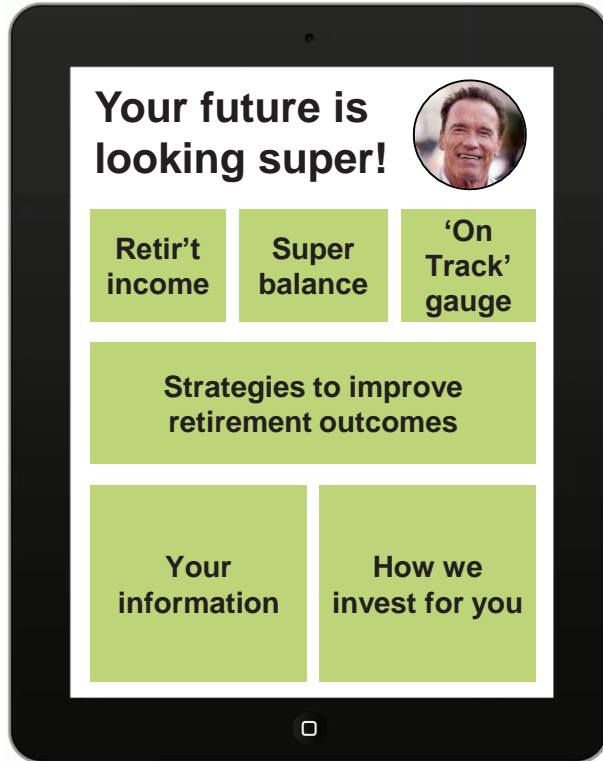


- Compares projected retirement income with current income, adjusted using an appropriate replacement ratio



# 4. Communicate and engage

## Ongoing driver of engagement and information flow



Is my information **up to date**?

Can I speak to an **adviser**?

Do I have adequate **insurance**?

Are my investments **performing**?

What's going on in my **suburb**?

# Key **benefits** of Smarter Super?

# Key benefits of Smarter Super?



Members



Super funds



Government

# Key benefits of Smarter Super?



Members



Super funds



Government

- **Transparent, relatable** and **tangible**
- Improved **investment outcomes**
  - 35 to 40% increase in super balance<sup>1</sup>
  - 5 to 10% increase in annual retirement income<sup>2</sup>

Note:

1. Trustee Tailored Superannuation, Submission to Productivity Commission review into "Efficiency and Competitiveness of the Superannuation System".
2. Based on analysis undertaken on ASIC's Money Smart retirement planner tool.

# Key benefits of Smarter Super?



Members



Super funds



Government

- Meet needs of a **diversified membership base**
- Response to regulatory and government **pressures**
- **Commercial benefits**
  - Fees and profits
  - Member retention

# Key benefits of Smarter Super?



Members



Super funds



Government

- **Create a more sustainable pension system**

# Making Smarter Super a reality

# Execution strategy

Smarter Super can become a reality in the next 6 years

**Test and  
validate**

**Stakeholder  
engagement**

**Implementation**

**Optimisation**

*Duration: 1 Year*

*2 Years*

*3 Years*

*Ongoing*

- Develop processes
  - Lookback and member testing
  - Ongoing validation during subsequent phases
- Industry bodies to advocate for change
  - Member engagement and education
- Technology implementation
  - Government engagement
  - Product transition
- Refining data inputs and investment algorithms



# Conclusion

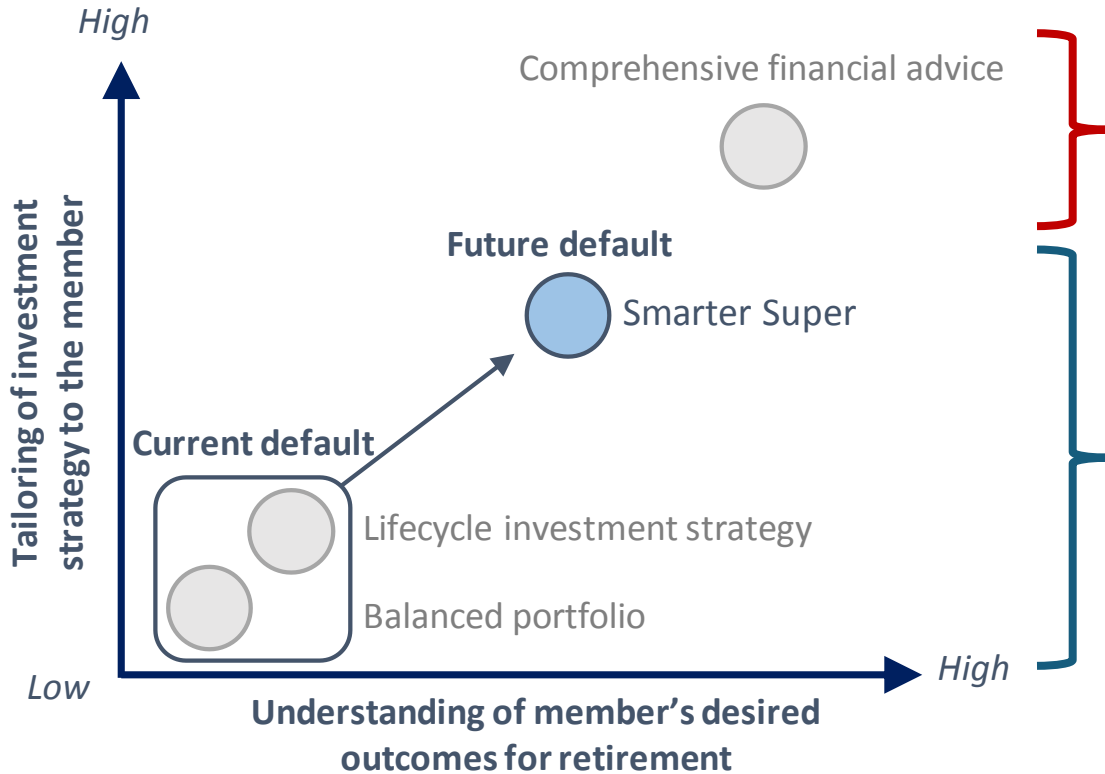
## Smarter Super should be the future

- Next generation MySuper product
- Holistic approach to investing
- Real benefits for key stakeholders – members, super funds and the Government
- Can be implemented in the near term
- Sustainable retirement solution for Australia





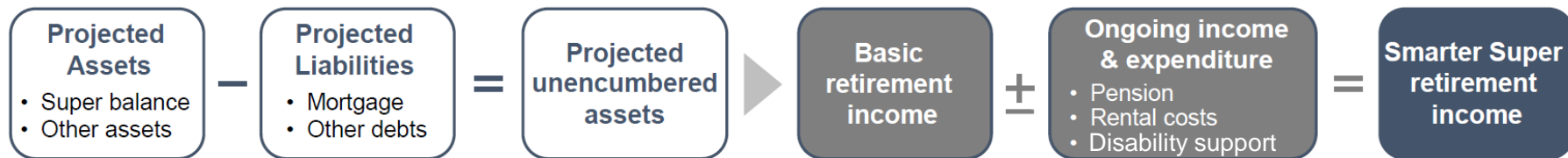
# Smarter Super



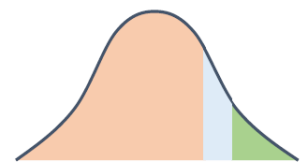
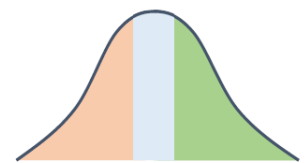
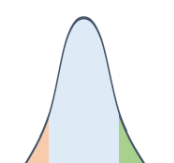
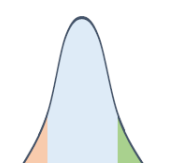
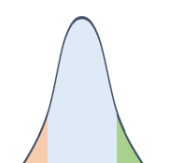
**Addresses super, estate planning, tax planning, investment strategy, etc.**

**Addresses super**

# Smarter Super Retirement Income equation



# Smarter Super vs. current MySuper range

55 year old member	Current Defaults		Smarter Super (illustrative holistic retirement cohorts)		
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Aggressive asset allocation for projected RI
  Optimal asset allocation for projected RI
  Conservative asset allocation for projected RI

# Smarter Super - process in detail

## COHORTING

1. Collect data to establish a holistic picture of the member's financial circumstances
  - Captured on the basis of the individual for singles and households for couples
2. Utilising data collected, generate a Smarter Super retirement income projection
  - Incorporating factors such as household assets, pension, rent assistance, disability pension allowances, etc.
  - Again, determined on the basis of the individual or couple
3. Compare the retirement income projection against the fund's determined target retirement income (for singles and couples, respectively) to estimate a shortfall or surplus
  - For couples, the shortfall or surplus will be halved
4. For each member, the fund will now have an estimated retirement income shortfall or surplus, used to allocate the member to an appropriate holistic retirement cohort

## INVESTING

5. The fund will then develop an investment strategy for each cohort, applying the following constraints:
  1. Member retirement income shortfall or deficit relative to target
  2. Member's investment horizon (estimated by the fund, based on number of years to retirement); and
  3. Member risk tolerance (estimated by the fund)
6. Investment strategy for each cohort will consider the appropriate risk-return profile for various asset classes and strategies

# Superannuation Industry (Supervision) Regulations 1994

## Section 29TC

(2) A **lifecycle exception** is a rule under the governing rules of the fund that allows gains and losses from different classes of asset of the fund to be streamed to different subclasses of the members of the fund who hold a MySuper product:

- (a) on the basis, and only on the basis, of the age of those members; or
- (b) on the basis of the age of those members and other prescribed factors; or
- (c) on the basis of the age of those members and other prescribed factors in prescribed circumstances.

### 9.47 Other factors that may be used for a lifecycle MySuper product

For paragraph 29TC(2)(b) of the Act, the factors are:

- (a) the member's:
  - (i) account balance; and
  - (ii) contribution rate; and
  - (iii) current salary; and
  - (iv) gender; and
- (b) the time remaining, in the opinion of the trustee, before the member could be expected to retire.