

The 26th Colloquium on Pensions and Retirement Research
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When boards use related parties: outsourcing and superannuation fund performance

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Research Objective

Research Question

What is the impact of **related-party outsourcing** and **trustee director affiliation** on superannuation fund investment performance?

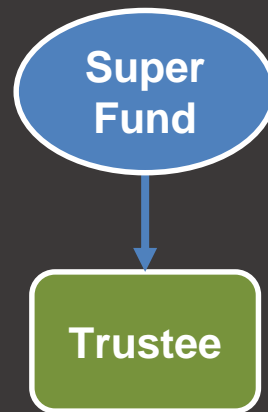


Background & Motivation

Background

While Superannuation trustees are ultimately responsible for fund operations, they are legally permitted to, and often outsource important fund functions to external service providers.

Background



Background

- Superannuation funds typically outsource key fund functions to external service providers → they play a crucial role in fund operations and have a significant influence on costs/performance
- Related-party service providers (RPSP): multiple layers of principle-agent relationships (Liu, 2013), imperfect monitoring (Ryngaert and Thomas, 2012) non arm's length negotiations, little risk of being dismissed for poor performance (Freeman et al., 2008)

Motivation

- RPSPs tend to charge higher outsourcing fees than unrelated service providers (Liu and Arnold, 2010; Liu and Arnold, 2012)
- However:
 - Higher fees may be justified by superior investment performance
 - Or relatedness and affiliation may reduce investment performance
- We are motivated to extend prior analysis and examine the impact on investment performance (at both the fund and investment option level)

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**Literature
Review and
Hypotheses**

Literature Review

- Different models of service provider usage in not-for-profit and retail funds:
 - Need to access expertise and economies of scale/scope vs. business model of vertically-integrated financial institutions (Liu, 2013)
 - Retail funds tend to use more RPSPs, and they tend to charge higher outsourcing fees (Liu and Arnold, 2010)
 - Potential conflicts of interest in these arrangements add to existing concerns of competing obligations (conflicts of duties) reducing performance
- *H1: Superannuation fund performance is negatively associated with the use of related party service providers in retail funds.*

Literature Review

■ Trustee-director affiliation

Trustee-director affiliation (to fund service providers) can create conflicts such as:

- Preferential hiring (Kuhnen, 2009)
- Lack of replacement (Fricke, 2015)
- Excessive fees and sub-optimal service quality (Kang et al., 2014)
- These issues are more likely to occur in large conglomerate groups with more business lines (Jian and Wong, 2003)
- *H2: Superannuation fund performance is negatively associated with trustee-director affiliation to service providers in retail funds.*
- *H3: There is a more severe negative relationship between superannuation fund performance and trustee-director affiliation in funds belonging to a vertically integrated conglomerate group.*

Related-party Service Provider

A service provider that is a connected entity or a related body corporate within the group, i.e.

- i. The service provider is the **parent company** of the RSE licensee, or
 - ii. The service provider is a **subsidiary** of the RSE licensee, or
 - iii. The service provider and the RSE licensee are **within the same conglomerate group**.
- This definition **includes joint ventures** that are collectively owned by multiple industry funds with or without a controlling entity in the structure

Affiliated Trustee Director

A trustee director is deemed 'affiliated' if the trustee director is also:

- i. A *director, executive* or *employee* of a service provider, or
- ii. A *director, executive* or *employee* of a connected entity or a related body corporate within a service provider group

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**Data &
Variables**

Data and Sample

- Sources:

2015-2016 s29QB statutory disclosure documents, and APRA superannuation fund-level & MySuper publications

- Sample:

- 101 Funds (114 MySuper products)
- \$1,093 billion Total sample fund assets
- 170 Service providers in 5 outsourcing areas (administration, asset consulting, custodian services, insurance services and auditing)
- 1,878 Outsourcing arrangements
- 860 Trustee-directorships
- 729 Trustee-directors

Investment performance

- **Gross/Net Return**
- **Gross/Net Value Added**, i.e. Over-benchmark return – control for asset allocation
- **Gross/Net RAVA** (Risked Adjusted Value Added) – control for both asset allocation and risk
- **MySuper Net return** – product level (default product) investment performance measure

Related-party Service Provider Trustee-director Affiliation

- **RPSP-Retail** (A binary variable equal to 1 if a retail fund uses a related party service provider)
- **RPSP-NFP** (A binary variable equal to 1 if a not-for-profit fund uses a related party service provider)
- **% Affiliated – Retail** (Proportion of affiliated trustee-directors on a retail fund board)
- **% Affiliated – NFP** (Proportion of affiliated trustee-directors on a not-for-profit fund board)

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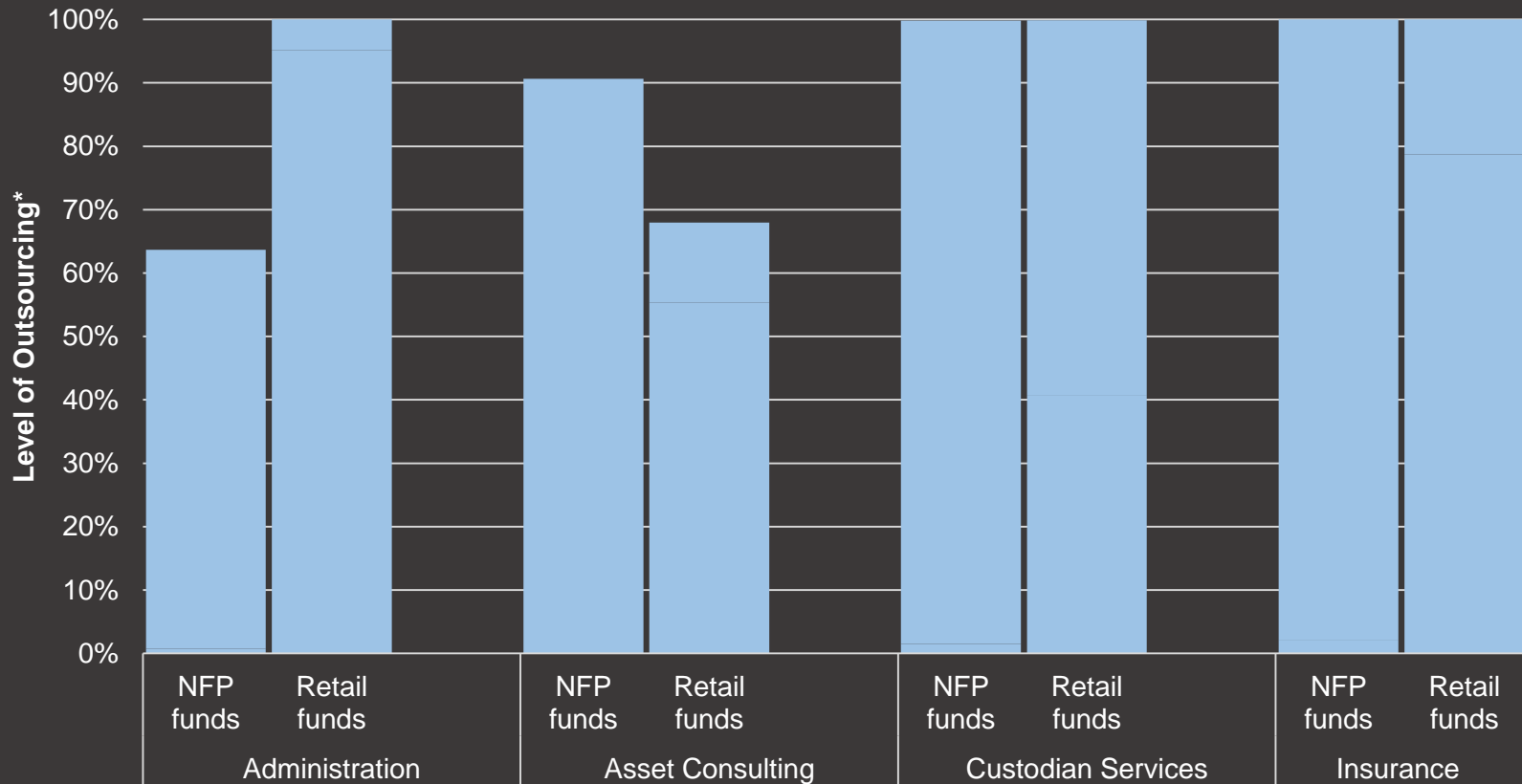
**Key
Results**

The related-party outsourcing landscape

Service provider (RPSP)	No. of Corporate funds	No. of Industry funds	No. of Public Sector funds	No. of Retail funds	Total
Number of funds	14	42	10	35	101
Administration	13 (1)	32 (0)	5 (0)	35 (24)	85 (25)
Asset Consulting	11 (0)	39 (4)	9 (0)	24 (15)	83 (19)
Custodian Services	13 (2)	41 (0)	10 (0)	35 (8)	99 (10)
Insurance	14 (2)	42 (0)	10 (0)	35 (12)	101 (14)
Auditing	14 (0)	42 (0)	10 (0)	35 (0)	101 (0)

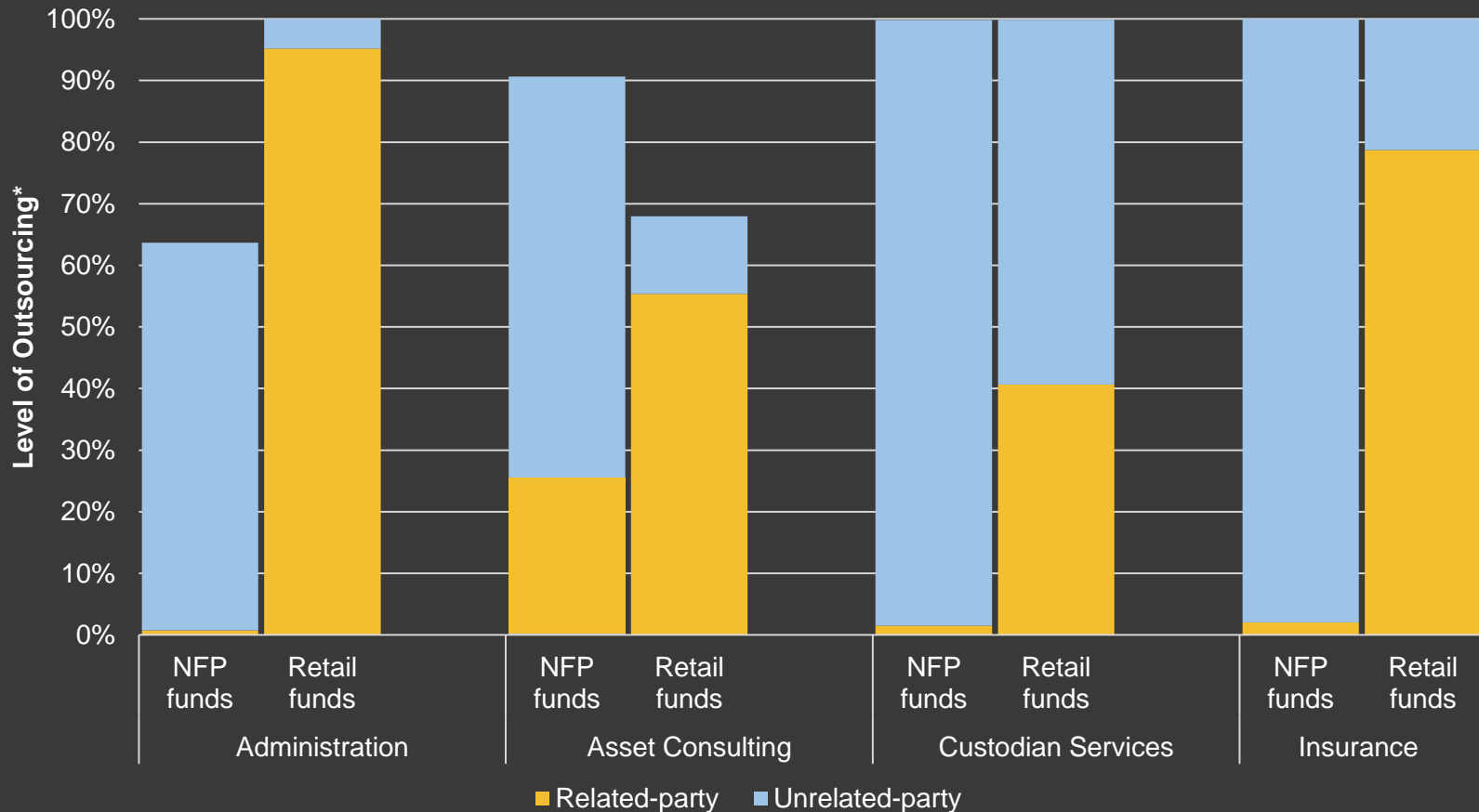
The related-party outsourcing landscape

Related-party vs. Unrelated-party by outsourcing function and fund type (2016 - Total fund assets)



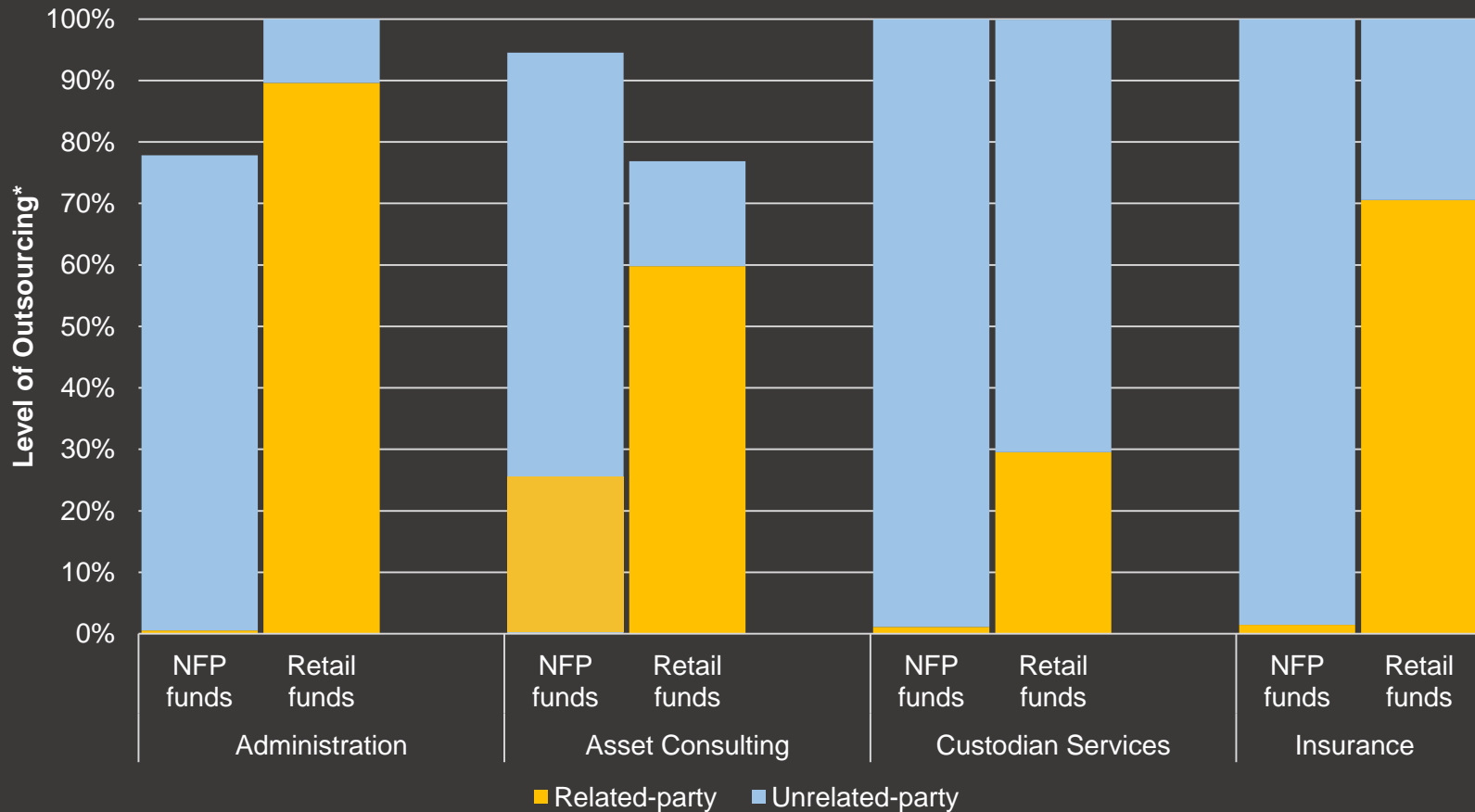
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Related-party vs. Unrelated-party by outsourcing function and fund type (2016 - Total fund assets)



The related-party outsourcing landscape

Related-party vs. Unrelated-party by outsourcing function and fund type (2016 - MySuper assets)



H1 results

H1: Superannuation fund performance is negatively associated with the use of related party service providers in retail funds.

	Gross Return	Gross Value Added	Gross RAVA	Net Return	Net Value Added	Net RAVA
RPSP-Retail	-0.0139***	-0.0075***	-0.0823***	-0.0129***	-0.0132**	-0.1479**
RPSP-NFP	0.0061	0.0031	0.0388	0.0062	0.0032	0.0354
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

* p<0.10, ** p<0.05, *** p<0.01

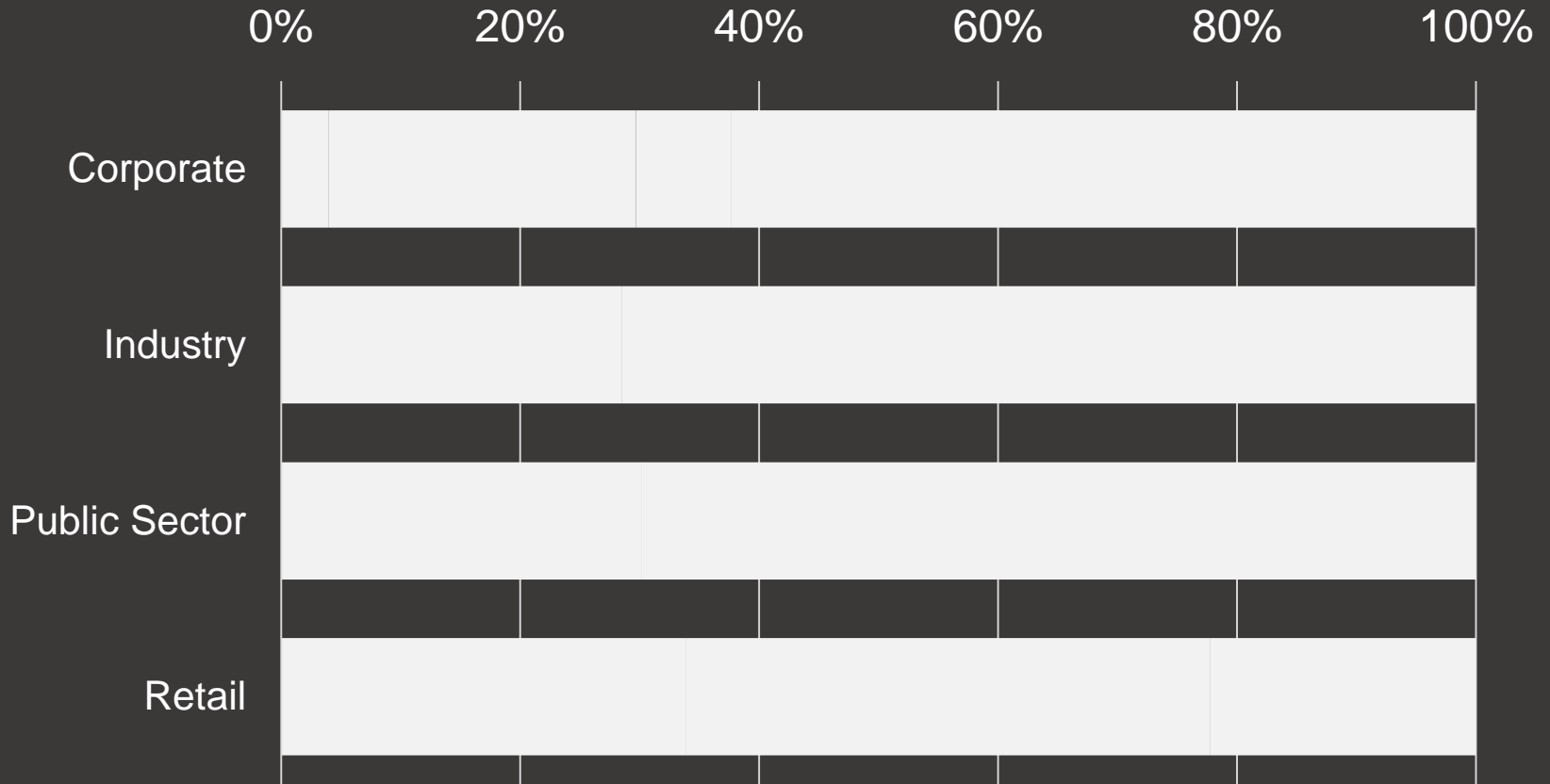
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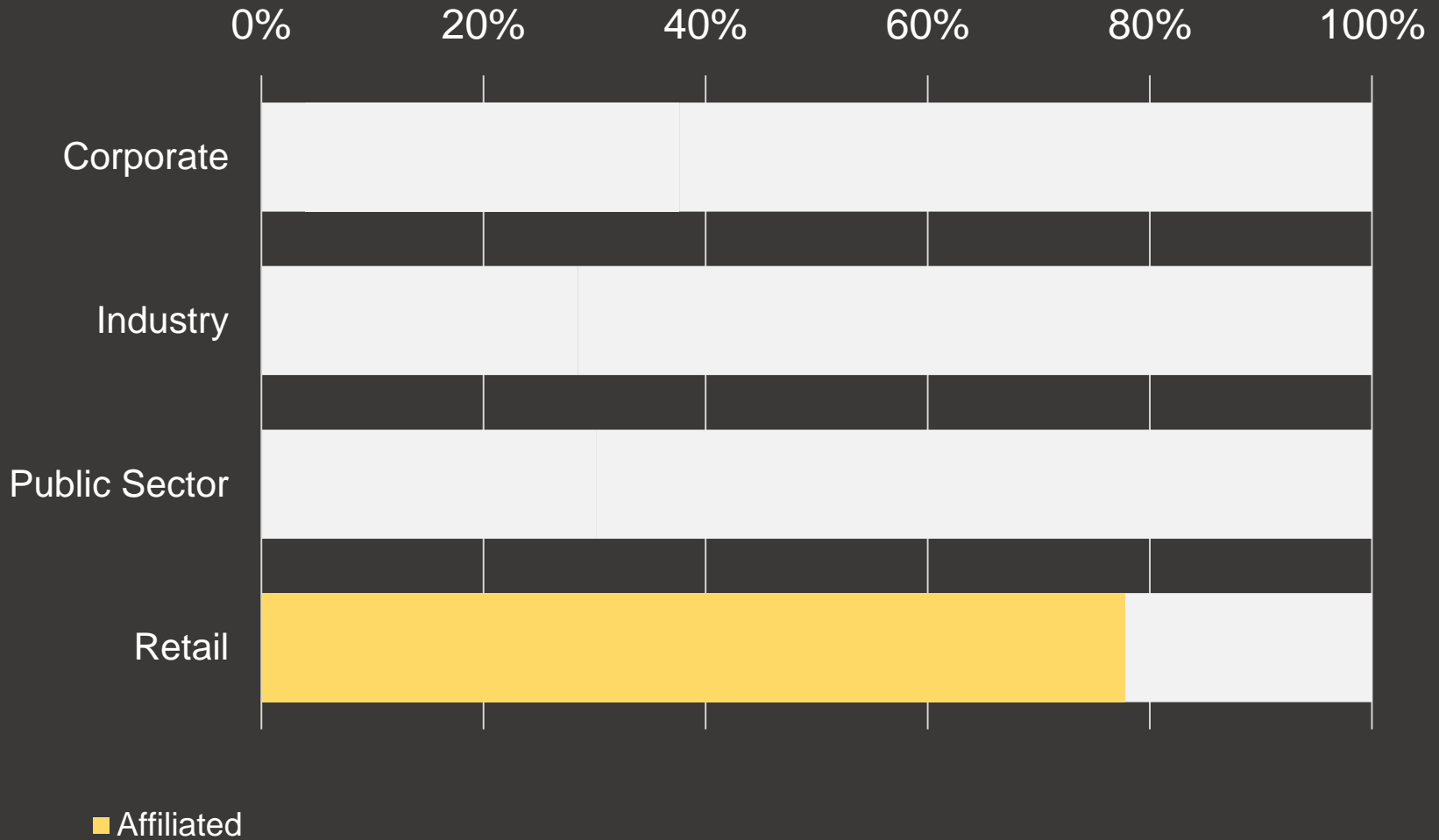
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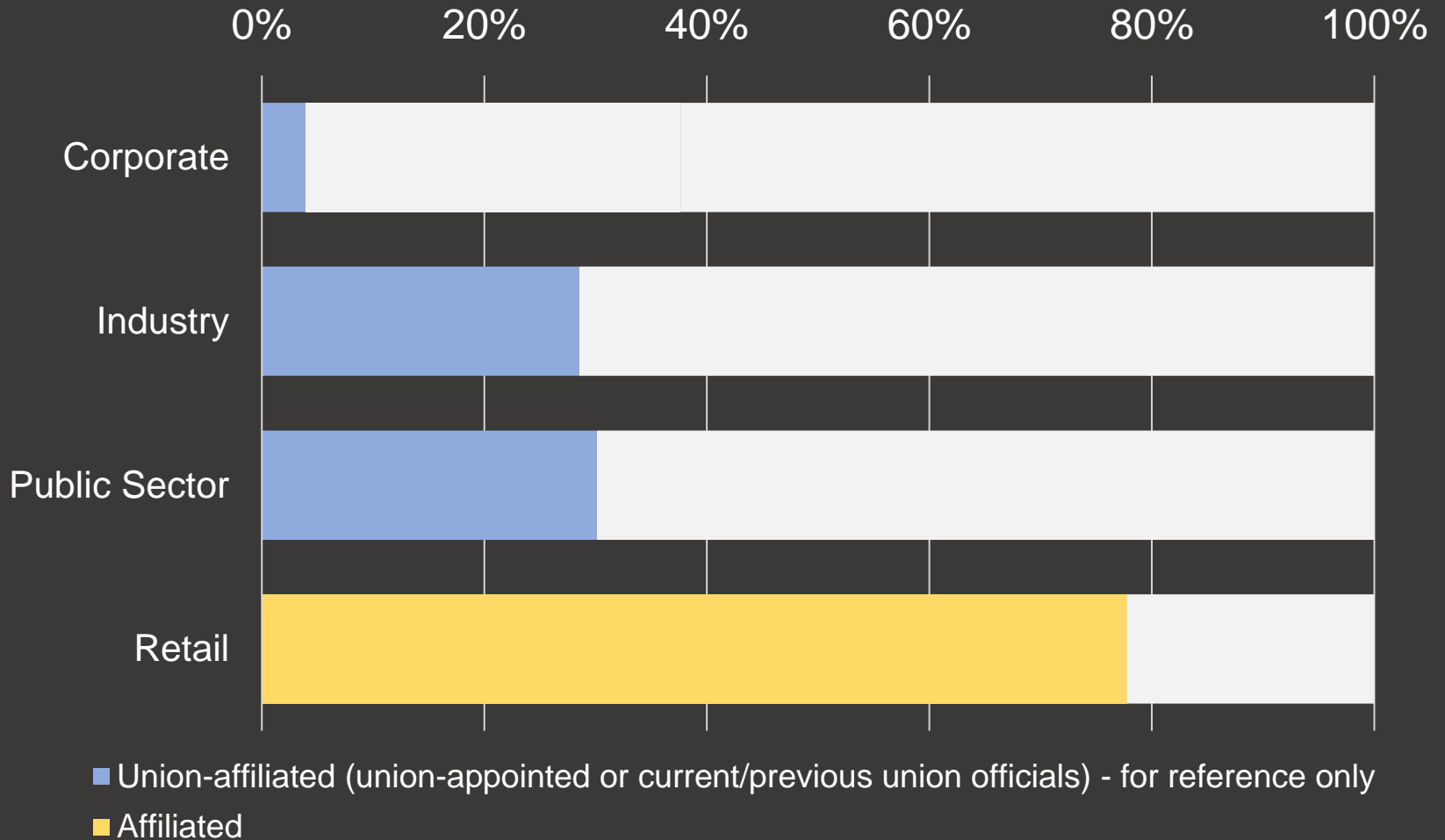
Trustee-director affiliation landscape



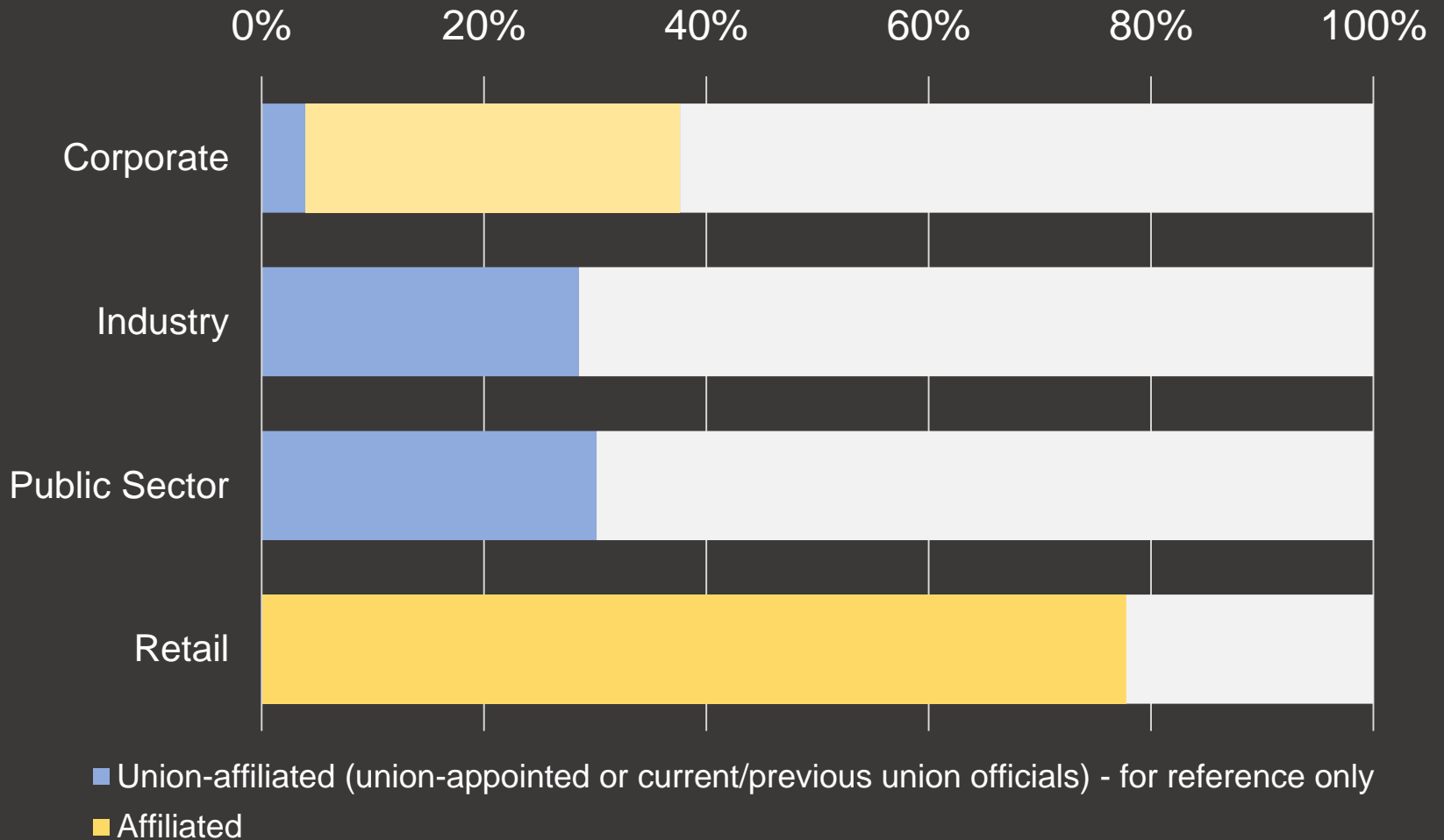
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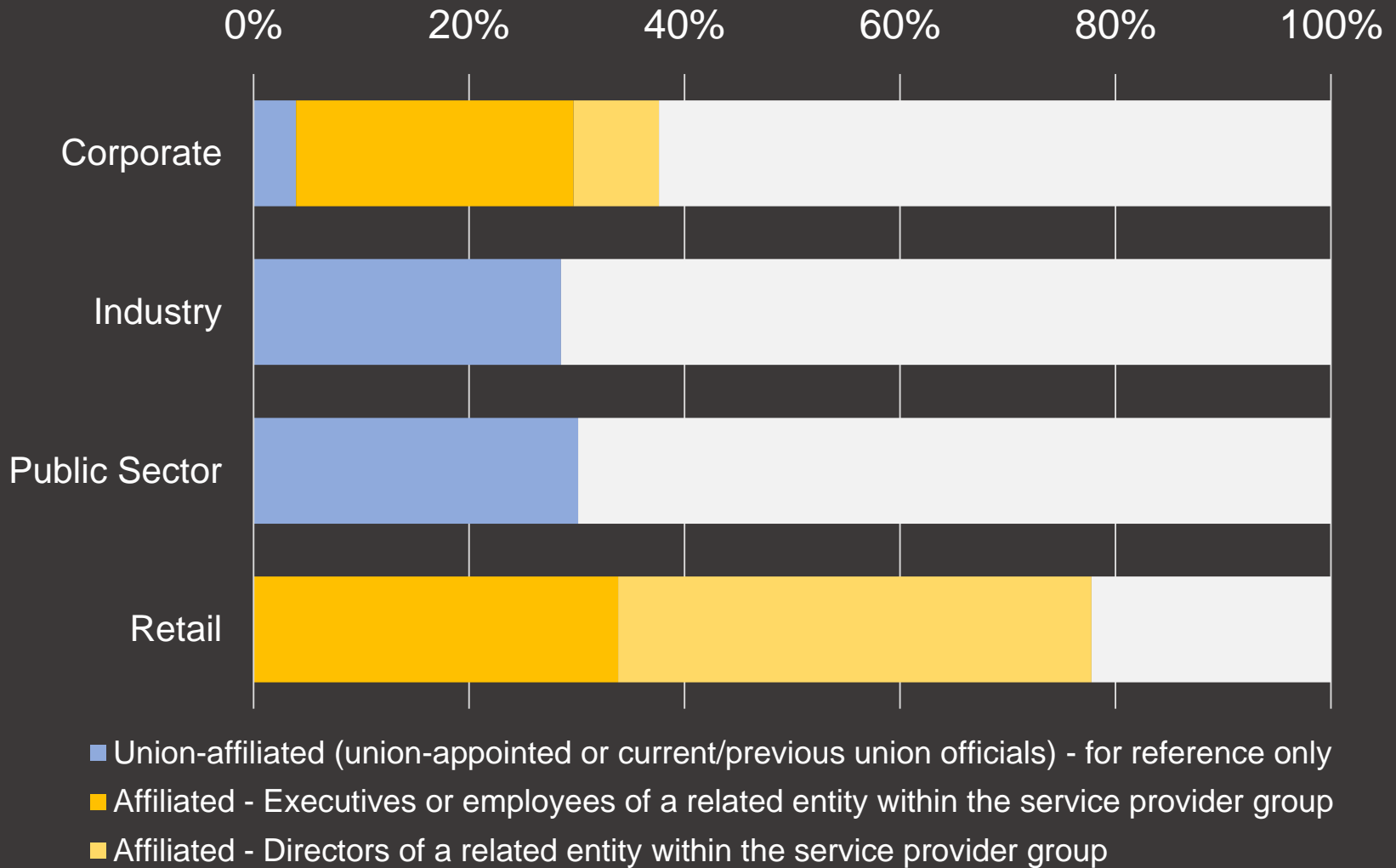
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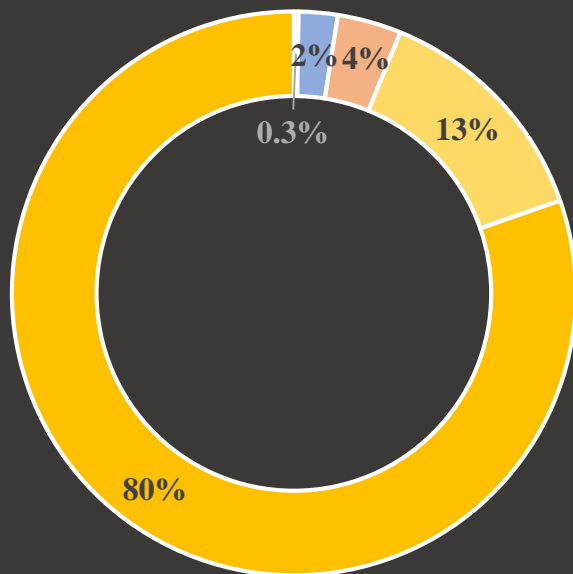
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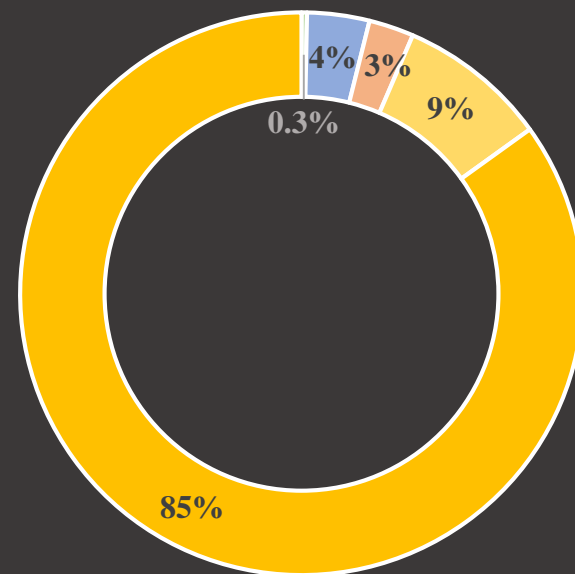
Trustee-director affiliation landscape

Distribution of retail fund assets and member accounts by level of trustee director affiliation and fund type

Total Assets - Total Fund



Number of Member Accounts - Total Fund



- Affiliated Director (less than 25%)
- Affiliated Director (25% - 49%)
- Affiliated Director (50% - 74%)
- Affiliated Director (75% and above) Retail Other
- Affiliated Director (75% and above) Retail Conglomerate

Affiliated Trustee Director Usage and Related-Party Service Provider Usage

	RPSP Usage	RPSP Usage	Num of RPSPs Used	Num of RPSPs Used
Prop. of Affiliated Director - Retail	3.5730***		3.1463***	
Prop. of Affiliated Director - NFP	1.9988***		1.0016***	
Majority of Directors Affiliated - Retail		3.2594***		2.4137***
Majority of Directors Affiliated - NFP		1.9196***		0.9080***
Controls	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

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H2 results

H2: Superannuation fund performance is negatively associated with trustee-director affiliation to service providers in retail funds.

	Gross Return	Gross Value Added	Gross RAVA	Net Return	Net Value Added	Net RAVA
Panel A						
% Affiliated - Retail	-0.0163***	-0.0105***	-0.1180***	-0.0157***	-0.0099***	-0.1148***
% Affiliated - NFP	0.0028	0.0094	0.0595	0.0056	0.0122*	0.0895
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

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% Affiliated - NFP	0.0028	0.0094	0.0595	0.0056	0.0122*	0.0895
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Panel B						
Maj. Affiliated - Retail	-0.0136***	-0.0069***	-0.0785***	-0.0141***	-0.0075***	-0.0880***
Maj. Affiliated - NFP	0.0014	0.0070	0.0438	0.0038	0.0094	0.0688
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

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Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Panel B						
Maj. Affiliated - Retail	-0.0136***	-0.0069***	-0.0785***	-0.0141***	-0.0075***	-0.0880***
Maj. Affiliated - NFP	0.0014	0.0070	0.0438	0.0038	0.0094	0.0688
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

* p<0.10, ** p<0.05, *** p<0.01

H3 results

H3: There is a more severe negative relationship between superannuation fund performance and trustee-director affiliation in funds belonging to a vertically integrated conglomerate group.

	Gross Return	Gross Value Added	Gross RAVA	Net Return	Net Value Added	Net RAVA
Maj. Affiliated – Retail Conglomerate	-0.0211***	-0.0102***	-0.1225***	-0.0261***	-0.0110***	-0.1364***
Maj. Affiliated – Retail Other	-0.0085***	-0.0048***	-0.0488***	-0.0129**	-0.0050***	-0.0554***
Maj. Affiliated - NFP	0.0020	0.0073	0.0471	0.0044	0.0097*	0.0724
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

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Maj. Affiliated – Retail Other	-0.0085***	-0.0048***	-0.0488***	-0.0129**	-0.0050***	-0.0554***
Maj. Affiliated - NFP	0.0020	0.0073	0.0471	0.0044	0.0097*	0.0724
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

* p<0.10, ** p<0.05, *** p<0.01

MySuper performance

		Net Return (2004-2016)	MySuper Net Return
Panel A	RPSP-Retail	-0.0077***	-0.0171**
	RPSP-NFP	0.0032	0.0098
Panel B	% Affiliated - Retail	-0.0146***	-0.0362***
	% Affiliated - NFP	0.0222***	0.0082
Panel C	Maj. Affiliated - Retail	-0.0078***	-0.0274***
	Maj. Affiliated - NFP	0.0171***	0.0078
Panel D	Maj. Affiliated – Retail Conglomerate	-0.0245***	-0.0389***
	Maj. Affiliated – Retail Other	0.0013	-0.0230***
	Maj. Affiliated - NFP	0.0169***	0.0084

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Panel A	RPSP-Retail	-0.0077***	-0.0171**
	RPSP-NFP	0.0032	0.0098
Panel B	% Affiliated - Retail	-0.0146***	-0.0362***
	% Affiliated - NFP	0.0222***	0.0082
Panel C	Maj. Affiliated - Retail	-0.0078***	-0.0274***
	Maj. Affiliated - NFP	0.0171***	0.0078
Panel D	Maj. Affiliated – Retail Conglomerate	-0.0245***	-0.0389***
	Maj. Affiliated – Retail Other	0.0013	-0.0230***
	Maj. Affiliated - NFP	0.0169***	0.0084

Robustness Checks

Results are robust to the inclusion of additional governance variables:

- Proportion of trustee-directors affiliated with a trade union
- Independent chair
- Total number of female trustee-directors
- Average age of trustee-directors
- Average remuneration of trustee-directors
- Proportion of trustee-directors with investment/other (accounting, legal etc.) expertise
- Board meeting attendance

Key results

- Retail funds that use related party service providers and affiliated trustee-directors significantly underperform their not-for-profit & retail peers
- A higher level of trustee-director affiliation on retail fund boards is associated with lower investment performance
- Retail funds belonging to vertically-integrated conglomerate groups and with higher trustee-director affiliation are associated with more severe underperformance

Thank you

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