

Information Cost and Member Choice in the Australian Superannuation Industry

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Research Questions

- The **Product Disclosure Statement (PDS) disclosure practice** of Australian superannuation fund families.
- Whether **performance** affects superannuation fund families' strategic use of **PDS disclosure**
- Does the **extent/readability of PDS** facilitate **member choice** in the Australian superannuation industry?

Why Australian Superannuation?

- Economically and socially significant
 - Large and growing superannuation asset (\$2.05 trillion asset base with 10% annual growth)
 - Principal retirement saving vehicle
- Superannuation investors differ from managed funds investors, but under-researched
 - Broader cohort of superannuation investors
 - Mandated Superannuation Guarantee contribution can only be directed to one superannuation family
 - Benefits cannot be withdrawn until preservation age
 - Less financially sophisticated and less actively involved

Why Member Choice?

- Active choice underpins a competitive and efficient market
 - 'Choice of Fund' (2005)
- Increasing investment responsibility for individual superannuation members
 - Defined Contribution Plan dominates (85.4%)
- Superannuation entities strive to win business from peers
 - Fund manager compensation structure
 - Persistence of superannuation investment flow

Why Member Choice? Cont.

- Changing member default behavior
 - Early evidence: choice inertia, explicit switching rate of 5%
 - Recent survey evidence: only 30% of members default
- Previous net fund flow measure fails to capture members' active choices

$$NetFlow_{i,t} = \frac{TNA_{i,t} - TNA_{i,t-1}(1 + R_{i,t})}{TNA_{i,t-1}}$$

- Compulsory Superannuation Guarantee contributions
- Pension benefit payments
- Flows due to funds wind up

These are not active choices initiated by individual members

Why Information Costs?

- Superannuation members are ill-equipped to handle their increasing financial responsibilities due to **limited financial sophistication, an overwhelming array of family and fund choices and complicated superannuation regulations.**


High information costs

- Lower information costs are associated with more investment inflows (Sirri and Tufano, 1998, Jain and Wu, 2000, Massa, 2003, Nanda et al., 2004)
- Mechanisms to decrease information costs

Why Information costs? Cont.

- PDS readability/content?
 - PDS conveys the most basic but most important information, and is often one of the first sources a potential investor or a financial adviser uses
 - Too long and too complicated – ‘information overload’



‘Short PDS Regime’ (2011)

- Liability minimisation exercise? Highly standardised PDS?
- Useful information that helps reduce both information interpretation costs need to (1) be presented in an easy-to-understand manner, and (2) contain all important information

Hypotheses

- Corporate voluntary disclosure incentive
 - More forthcoming in disclosure when performance is good to signal their type, but underplay negative information.
- However,
 - fund family level performance is not directly comparable
 - disclosure of past performance is not compulsory
 - PDS disclosure practice tends to be persistent
 - superannuation is a long-term investment
- Fund manager's compensation is determined by asset under management – still need to compete for new investments
- **H1: *The extent/readability of PDS disclosure is positively associated with superannuation fund family's profit performance.***

Hypotheses cont.

- A PDS that is informative and easy-to-read may attract investors sufficiently to make them seek more information about the fund while a poor quality PDS may deter investors from choosing or switching to the fund family.
- ***H2: The level of superannuation fund family inflow is positively associated with the extent/readability of PDS disclosure .***

- **Sample: APRA-regulated superannuation families**
 - Public-offer, defined contribution fund families with year-end of 30 June from 2012 to 2015
 - Two major types of superannuation families: Industry and Retail
- **Data source**
 - Australian Prudential Regulation Authority (APRA) publications, Superannuation Reporting Forms (SRF)
- **Unit of analysis: fund family**
 - Central interest of superannuation entities lies in the aggregate flow to the entire family
 - Investor choice usually starts with family brand recognition
 - Superannuation entities coordinate actions at family level: e.g., PDS disclosure decision
 - Competition at family level encouraged by regulators

Key Variables

- Main choice variable: member-initiated transfer
 - APRA-reported rollover from one superannuation family to another family, after adjusting for transfers from funds winding up
- Fund performance
 - APRA-reported fund family performance
 - Publicly available and widely used by superannuation comparison agents
- Other control variables
 - Net asset under management (Size), number of investment options (Huang et al., 2007), proportion of members above the age of 50, year effects and fund family type

Key Variables Cont.

■ PDS Readability

- $$Fog = 0.4 * \left[\frac{words}{sentences} + 100 * \left(\frac{complex\ words}{words} \right) \right]$$
- $$Flesch\ Score = 206.835 - 1.015 * \left(\frac{words}{sentences} \right) - 84.6 * \left(\frac{syllables}{words} \right)$$

■ PDS Content Score

- Based on Corporations Amendment Regulations 2010 (No.5) Schedule 10D, the Australian Securities and Investment Commission (ASIC)'s Regulatory Guide 168 and Information Sheet 155, the Financial Services Council (FSC) standard risk measure guidance and Super System Review Chapter 4.
- 10 Parts and 111 line items.
- Validated by experts from the ASIC

Example of PDS content scoring

- See example

Regression models

- Impact of performance on PDS disclosure:
 - panel data analysis with fixed year and family type effects:
$$\text{Content Score / Readability Score}_{i,t} = a + b_1 \text{Perf}_{i,t-1} + b_2 \text{LnTNA}_i + b_3 \text{InvOpt}_{i,t} + b_4 \text{TOE}_{i,t} + b_5 \text{PerCon}_{i,t} + b_6 \text{TotNew}_{i,t} + \varepsilon_{i,t}$$
- Simultaneous equations model to test the relationship between better disclosures and investment inflows (3-stage-least-squares)
- First equation: the cause of disclosure
- $$\text{Disclosure quality}_{i,t} = a + b_1 \text{Inflow}_{i,t} + b_2 \text{Perf}_{i,t} + b_3 \text{LnTNA}_{i,t-1} + b_4 \text{TOE}_{i,t} + b_5 \text{PerCon}_{i,t} + b_6 \text{TotNew}_{i,t} + \varepsilon_{i,t}$$
- In the second stage: the consequence of disclosure
- $$\text{Inflow}_{i,t} = a + b_1 \text{Disclosure quality}_{i,t} + b_2 \text{Perf}_{i,t} + b_3 \text{LnTNA}_{i,t-1} + b_4 \text{LnInvOpt}_{i,t} + b_5 \text{TOE}_{i,t} + b_6 \text{DefAsset}_{i,t} + b_7 \text{Above50}_{i,t} + \varepsilon_{i,t}$$

Key findings

- The overall reading ease of the PDSs analysed is acceptable (Mean Fog Score: 12.43) but industry fund families' PDSs are becoming alike (decreasing variation in readability and content).
- No significant relation between performance and the quality PDS disclosure.
- Superannuation fund families provide more readable PDSs when there are more inflows, but there is only weak evidence for the overall sample that investors are attracted to superannuation families because of the ease of reading of PDSs.
- More inflows encourage superannuation families to provide more and better information in the PDS, especially the industry families.
- The quality and extent of PDS disclosure is positively associated with fund inflows. This relation is especially strong for the retail families.

Contributions

- Investigates a large sample of the actual disclosure documents and (prior studies use experiments to manipulate the information disclosed).
- Uses superannuation PDS disclosure as a measure of reduction in information costs (prior studies use general fund characteristics, e.g., marketing expenses, size, to proxy for information costs)
- Provides implications for investors and regulators with regards to the current and contentious issue of superannuation fund disclosure's transparency and informativeness.
- Provides understanding as to retail superannuation investors' behaviour and adds a new perspective to examine fund families' managerial incentives (the use of PDS disclosure to attract investors).

Thank you!

