Superannuation fund operating models

What is right for your fund, your members and your future?

Changes to the superannuation landscape are compelling fund executives to reconsider their operating models. How can a fund ensure its target operating model best aligns to strategic priorities that deliver and drive optimal member outcomes?

The superannuation industry continues to be in a state of flux. Legislative change, fund consolidation, a shift to cloud-based technology, demands of service providers and intense regulator scrutiny are all challenging existing strategic priorities. All these factors are leading fund executives to question how to holistically structure their operations to deliver optimal member outcomes, while balancing benefits, costs and risks.

This is a complex consideration that is dependent on a fund's unique circumstances. Our experience has identified some factors that drive this review of their operating model overall, or its unique components:

Mergers

While scale matters, the economies of scale are more important to realising the full member benefit of mergers. Either before or after a merger, fund executives must understand how a fund's operating model and its unique cost structure are placed to reap the benefits of scale.

Digital and technology transformation

Increasingly funds are looking to the benefits of cloud computing and investing in digital and technology platforms to provide self service capabilities for members. The focus is on providing more personalised and straight-through member servicing with funds also considering member segmentation as a further means of tailoring their engagement strategy. Funds must consider their operating model service provision and technology structure in order to realise this transformed future.

Cost efficiencies

Digital and technology transformation as well as the emergence of new technology-enabled and specialist service providers who provide strong servicing at lower base can, in some instances, generate material cost savings. While funds need to deeply consider the benefits and risks associated with cost savings, they do enable the fund to potentially obtain lower fees for members and therefore higher retirement savings. The importance of lower fees has been highlighted by the advent of the APRA performance test, whereby any improvement in a fund's cost base and subsequent fee reduction will have an immediate positive effect on performance test results.

No matter the driver for change, all funds are seeking to refine their strategic imperatives and understand the unique cost structures inherent within their existing operating model – ultimately for the betterment of members.

A look back...

Historically, superannuation funds have tended to utilise either a fully outsourced or fully insourced operating model.

The market for outsourced administration services has been dominated by a few providers who are challenged to meet evolving fund expectations. Pain points observed by funds with this model include limits to competition, little scope to differentiate, difficulties in partnering to innovate and produce market-leading ideas, and the high cost of technology services. Other challenges include complying with legislative change, limited direct access to fund data and integration challenges between in-house fund operations and external administration platforms. In today's environment the traditional fully bundled outsourced service model, and the fund expectations of this model, have never been more complex.

For insourced operating models, a fund retains control of its end-to-end systems and service offering. However, with ever increasing compliance and regulatory requirements, member engagement expectations and technological advancement, there is constant pressure to adapt, remain competitive and sustainable, while managing risk and cost and delivering quality member outcomes.

Over the years, both models have serviced the industry and its members well. However, both these traditional models are being disrupted by an industry in consolidation and by new providers. All funds are looking to tilt their strategic priorities and transform towards a technology-enabled and sustainable future. Within this context, the main administration providers are reacting, but significant change and adaptability is still needed. In the case of superannuation target operating models – one size does not meet all fund needs.

What's the alternative?

The superannuation industry is seeing the continuing emergence of various hybrid operating models. These are evolving based on the growing needs of transformational business strategies but also due to the emergence of new administration providers, specialist service providers and advanced technology offerings.

In this context, funds are conducting a review of their operations, looking at all components of their service delivery. They are assessing whether the owner of each function should be the fund, a traditional provider or a specialist third-party provider.

Target Operating Model: A consideration of who owns what within a superannuation fund?

core registry & administration
advice delivery
mail house
Operating functions
data & analytics
insurance & complaints
contact centre
key employer management

Central to this assessment is consideration of the key pillars of benefit, cost and risk. Historically, this consideration occurred with an administration focus and was typically restricted to assessing:

- Functions that have a member facing component that enabled the fund to better control and influence its engagement and delivery strategy.
- Back-office functions to obtain benefits of scale, automation and straight-through processing advancement, integration and efficiencies through provider solutions and offering.
- Functions that providers could bundle with administration services (for instance legal services and compliance).
- How to best deliver different levels of advice.

The evolving hybrid operating model involves adopting a segmented view of overall service delivery. Some functions we observe being transitioned to specialist providers and/or internally include contact and call centre operations, data and analytics functions, and other transactional trustee functions.

Key to unlocking this evolving hybrid model is understanding and unbundling current external and internal costs for the provision of a particular service. In order to adequately decouple operations, funds require a technological ecosystem that enable providers to "plug and play" various functions.

Funds, traditional administration providers and newer technology-driven service providers are each at different stages of this journey. Regardless, these emerging models are and should be front of mind for funds with straightforward operating models as well as for other funds that have grown rapidly through mergers or have the challenge of operating complex administration systems. For the latter, it will be important to review and consolidate their own systems initially.

For all funds, the target operating model journey begins with reviewing the various service delivery functions to ensure they are fit for purpose and sustainable into the future.

Connecting operating models to member outcomes

Investigations into alternate operating models must consider a commercial evaluation of risk and benefits (both tangible and intangible) and a deep consideration of costs. This triumvirate of benefit, cost and risk is a key element for funds to consider to ensure they satisfy their Best Financial Interest duties.

In our experience, best practice cost modelling on operating models considers not only a central estimate of costs, but also variations to costs based on several alternate outcomes. This is supported by APRA's recent implementation benchmarking review of Prudential Standard SPS 515 Strategic Planning and Member Outcomes, where it identifies the need for funds to strengthen how strategic objectives link to member outcomes and the need for stress testing of financial projections. Charts 1 and 2 illustrate how cost projections may look at the fund and member level respectively. Chart 3 considers the range of cost outcomes under varying projected growth rates.

Paramount to this financial modelling exercise is the ability for funds to understand and unbundle operating expenses and service provider costs into the relevant function or service delivery component.

Chart 1: Total annual cost savings (relative to current model)

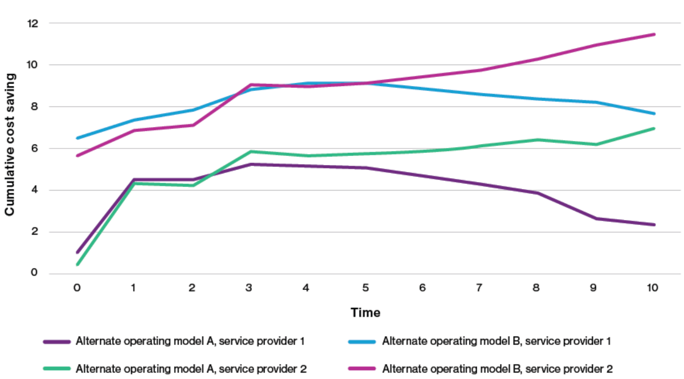
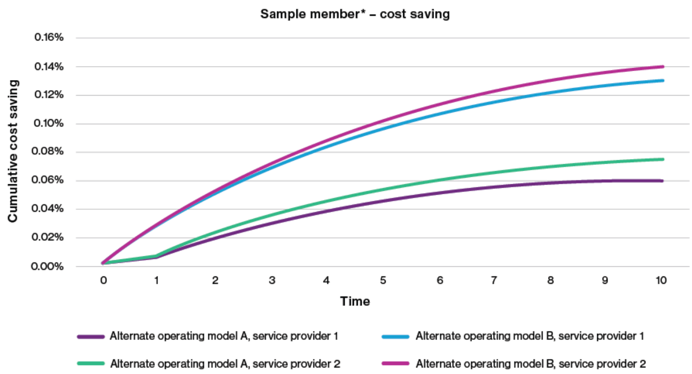


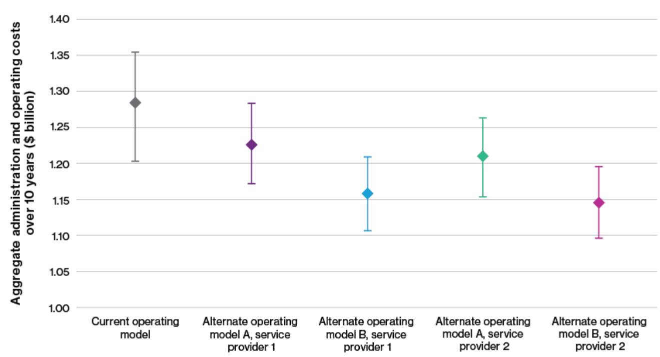
Chart 2: Member level cost savings of alternate operating model and providers (relative to current model)



*Member with a $50,000 opening balance, salary of $60,000 p.a., receiving SG contributions and invested in a Balanced Growth investment option.

Chart 3: Range of 10 year aggregate cost outcomes

The diamond is the base result, and the lines represent the upper and lower ranges of cost outcomes based on high and low membership growth scenarios.



Navigating operational transformation

In our experience, funds that have successfully navigated and implemented operating model changes for the betterment of members are those that have:

- Engaged widely with key stakeholders, within the fund and at the board level.
- Understood their starting trajectory and have a detailed grasp of their existing operating model, its underlying operational strengths, challenges and costs.
- Have a clearly articulated and defined future focused strategy.
- Independently considered risks and benefits.

These funds leave no stone unturned in understanding the operating model that best meets members' needs now and into the future.

Failure to conduct a proper due diligence process or evaluate all available options runs the risk of greater cost and uncertainty in execution, which may result in cost overruns, impacts to member outcomes and a regression in service delivery. A deep consideration of the correct balance of strategic priorities within the operating model and service delivery components can help to expand a fund's offering, improve member outcomes, generate operational excellence, and ensure a fund's sustainable future.

Regardless of your fund's starting trajectory the time to consider your optimal and future state operating model is now.

Find out more

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