

Super funds are being asked to reduce fees at a time when market forces are pushing the costs of running a fund in the other direction. Some funds have been forced to raise administration costs to levels that better reflect the time and effort they're spending on member education and communication, and more are expected to follow suit. As the industry searches for ways to cut the average super account fee by around 20 per cent, funds management and commissions on advice have been identified as the areas containing the most 'fat'. But what part can funds mergers play? And is cheaper necessarily better? KRISTEN PAECH reports.

Superannuation funds are experiencing negative asset growth and negative member growth for the first time since the compulsory superannuation system's inception.

The combination of these two forces is putting pressure on the fixed costs of running a super fund, and in turn pushing up fees at a time when the Government has thrown down the gauntlet to super funds to reduce the average super account fee from 1.25 per cent to 1 per cent or less.

Further adding to the conundrum funds face is the fact that members are arguably more engaged with their superannuation than ever before. Ostensibly, this is a positive for the industry, which has been espousing the benefits of super to members for many years, and encouraging greater awareness of the importance of retirement savings.

However at a time when super balances are plunging, increased engagement could act as a double edged sword; with members acutely aware of their negative returns, they are likely to question the fees they are paying for the privilege.

According to research from consultancy Chant West, industry funds returned -15 per cent over the 12 months to March 31, 2009, while master trusts returned -21.9 per cent.

While super is a long term game, this is little consolation for members approaching retirement with a significantly smaller retirement nest egg, and for those who fail to understand (despite your best efforts) the ups and downs of market cycles.

There has been strong downward pressure on super fees for some time now, with Rice Warner's *Superannuation Fees Report 2008* revealing the average fee has fallen from 1.26 per cent as a



Nick Sherry...
legislating to cap fees is not an option

percentage of assets under management in 2006 to 1.21 per cent in 2008. (Senator Nick Sherry, Minister for Superannuation and Corporate Law, puts the average fee at around 1.25 per cent.)

However a number of industry funds are bucking this trend, raising administration fees by up to 50 basis points.

Rice Warner believes that the re-investment in systems and the broader services provided by some industry funds today is increasing the underlying cost structure of these funds.

The \$28 billion AustralianSuper increased its administration fee from \$1 to \$1.50 per week from January 1, 2009, while the \$2.75 billion Westscheme is raising its administration fee from \$1.25 to \$1.50 per week from July 1 this year.

Ian Silk, chief executive officer of AustralianSuper, stresses the fee hike is not a knee-jerk reaction to the current investment environment. The percentage increase looks significant on the back of a very low starting point, he adds.

"The core administration fees of the predecessor funds hadn't moved for 20 years since they were established, so in real terms, adjusting for inflation, the fee had dramatically reduced and the breadth and quality of services that we provided had increased exponentially," Silk says.

"I got to the point where there was a looming mismatch between our costs on the one hand and the fees we were charging on the other, so we increased it. The most important thing is that we are committed to our fees matching our costs, and that's not an approach that's universal throughout the industry."

In its March newsletter to members, Westscheme said the 25 basis point increase would allow it to meet the increasing costs of super regulation and services to members and employers.

At the end of the day, cost isn't everything. I would be very happy to pay an extra 50 or 100 basis points per year to get quality advice around my portfolio of affairs, because peace of mind is worth a lot. Others may not. It's simply a matter of giving people the visibility on these things so they can make informed choices.

For those who have been members for five years or more, the fee reduces to \$1.40 per week, and those who have been members for 10 years or more pay just \$1.30.

WHERE'S THE FAT?

It is fair to assume that many more funds will be forced to raise their fees in 2009, potentially pushing the average super account fee even higher.

So how then can the industry realise Sherry's aim to cut the average super fee by around 20 per cent?

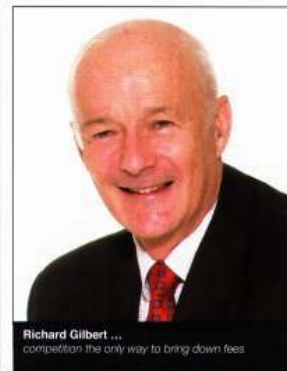
Is this a realistic goal given the tougher market environment, and if so, where is the 'fat'?

Each segment of the industry has a different view on where the fat lies within super fees, but one thing is clear; if the target has any hope of being achieved, the industry is going to have to work together.

Jeff Bresnahan, managing director of SuperRatings, says the fat is in the investment fees and salaries paid to funds managers.

He says the superannuation "pie", which includes mainstream costs such as administration, investment, insurance, auditing and asset consulting, is finite, and is currently sliced the wrong way.

"That's impacting on administration



Richard Gilbert...
competition the only way to bring down fees

and asset consulting services, which traditionally have been dollar-based costs and basically have been underfunded, restricting future development," he says.

"Trustees have screwed administrators and asset consultants down every time... the investment managers have gotten away, up until 2007, with a 100 per cent increase in revenue without doing any additional work."

Bresnahan says super funds need to bring more pressure to bear on investment managers to lower fees, and take a stand against the level of salaries in the asset management industry.

"The question is: are the levels of remuneration currently offered in the asset management industry fair and reasonable?" he says.

"Does it take five times the resources to manage \$5 billion from \$1 billion? The whole concept of percentage-based charging needs to be reviewed; it's not intrinsically linked with expenditure."

In late March, the Australian Shareholders Association released a new, tougher policy on executive remuneration after the market downturn highlighted the weak relationship between pay and performance.

Among the enhancements, the ASA will require that long-term incentives are not paid to executives unless they have met performance criteria over at least four consecutive years.

The new policy should go some way to holding company executives to account, but super funds too can play a bigger role here by taking real action to address governance issues within the companies in which they invest.

With so many fund managers struggling to stay afloat, it seems inevitable that salaries will have to come down, but it remains to be seen how much slack managers are willing to give when it comes to mandates.

After all, there are few super funds



who are not already agitating for the best deal possible from the managers they enlist to invest their assets. And those that push too hard risk receiving a poorer level of service as a result.

There are likewise potentially negative implications of a reduction in fees for member services.

"You could find that people will provide statements less often, have a minimalist call centre, not do any development in areas like member education and limited advice," Rice says.

"Anything that's not compulsory they'll slash to get within the cost structure."

Regardless of the perceived risks, it is vital that the industry heeds the Government's call to action and finds a way to lower the average fee paid by members.

A perception by members of static or rising fees coupled with falling super fund balances could fuel an exodus to the self-managed super fund (SMSF) market, further compounding the negative asset and member growth being experienced by funds.

With fees and statements assuming greater focus in this negative return environment, the SMSF industry poses a significant threat to the livelihood of mainstream superannuation funds.

Research conducted earlier this year by research firm Investment Trends and endgame communications revealed four in 10 investors no longer trust fund managers and many plan to manage their own investments in future.

Mark Johnston, principal at Investment Trends, says he expects a significant surge in SMSF establishment over the coming years, which would be consistent with the last bear market.

According to statistics from the Australian Taxation Office (ATO), based on information available as at June 2008, assets held in SMSFs climbed to \$358 billion, largely as a result of Simpler Super.

Andrew Bloore, chief executive officer of SMSF administrator Smartsuper, says one of the biggest reasons people get out of other sectors and into SMSFs is to take control of when and how they spend money on their assets.

The average administration cost for an SMSF is \$2600 per fund, and the average size of an SMSF is \$880,000, equating to 0.3 per cent as a percentage of assets.

In addition to that, trustees pay broking fees when they buy and sell

Fee ultimatum

Senator Nick Sherry, Minister for Superannuation and Corporate Law, has told the superannuation industry in no uncertain terms: reduce the average super account fee from 1.25 per cent to 1 per cent or less.

Sherry says he wants to see the reduction within the next three to five years, and has made it a central part of his review of the super industry.

The average super fee has not come down in any significant way in the last decade, despite the compulsory superannuation pool growing to more than \$1 trillion in assets.

"Why do I believe [the average fee] should come down? It's barely moved in the last 10 years; assets under management have quadrupled over that 10-year-period, and all pension theory and practice in other countries with compulsory DC systems [reveals that] total fees have come down over time as assets go up," Sherry says. "An average [fee] of 1.25 per cent when your average long term rate of return is 5 per cent - obviously diverting more into return will leave individuals better off in terms of their total savings."

It's important to note that many of the industry funds who have raised fees recently are still sitting below Sherry's target.

But for those that are well above it, in part due to the fact that they include the cost of advice or commissions within their overall charge, reducing fees will be no mean feat.

According to Rice Warner, the average fee as a percentage of assets for a \$50,000 account ranges from 0.69 per cent for public sector funds to 2.04 per cent for corporate super master trusts, which include the cost of advice within the total fee.

Steve Tucker, chief executive of

investments, and if they are invested in a wholesale managed fund, they pay another 0.7 per cent in fund manager fees.

"The SMSF space is probably under the 1 per cent anyway," Bloore says.

"With an SMSF, people tend to go into them once they get to \$200,000 or \$250,000, and the average establishment of an SMSF is about \$250,000. But the average size of an SMSF is about \$880,000 so the cost of fees proportional to the account comes down significantly."

However Rice warns SMSF fees

MLC, says it's essential to separate the cost of advice from the product to ensure a fair comparison between different super funds.

"If you take the commission costs aside, which we recommend people do, because that is a cost for advice, not for supporting a superannuation product, then most clients are already paying less than 1 per cent," he says.

"If we can clearly separate the costs of funds management, the cost of the administration service or platform and the cost of advice, and each part of the value chain can articulate the value they bring for the price they charge, then the client can make an informed decision as to whether they want to pay for all or some of those things.

"At the end of the day, cost isn't everything. I would be very happy to pay an extra 50 or 100 basis points per year to get quality advice around my portfolio of affairs, because peace of mind is worth a lot. Others may not [be willing to pay extra]. It's simply a matter of giving people the visibility on these things so they can make informed choices."

When talking about averages, Sherry is quick to stress that there'll still be a range of fees - potentially between 0.5 and 1.5 per cent - depending on the fund.

"I accept you're not going to get everyone on 1 per cent unless you legislate to do that," he says, adding that mandating a cap on fees is not an option he's considering.

However he believes there is wriggle room - or fat - within all four "cost centres" that contribute to the overall fees charged by the superannuation industry: funds management, distribution, advice (both general and specific) and administration.

"In terms of funds management costs, scale is important in super," he says.

often creep up above 1 per cent, by the time accounting and audit fees are taken into account.

"And many of them are invested in cash, and the retail CMTs tend to have a fee of about 1 per cent," he adds.

"So people will tell you that they have an SMSF and it doesn't cost anything but when you add it all up, unless the fund has half a million or more, typically the fee is 1 per cent or more."

COMMISSIONS

Commissions have long been con-

"You can generally get a better price as a consequence of scale. We've announced policy to encourage fund mergers through the waving of the capital gains tax (CGT) requirements for two years. At the moment the CGT issue is the major barrier to funds when they want to merge."

"On the issue of administration, in our devolved system where we have around 600 entities, administration costs have generally been increasing and that's an outcome of two issues; one is choice of fund, greater transactions and movements, and secondly the complexity of our system... there are a whole range of electable decisions which add to administration cost. We still have a job to do in simplifying the electable options within our system, and that's for the Henry Tax Review to consider. Each fund looks at administration issues from the fund point of view and I think we need to shift the solution to administration from the total focus on the fund solution to a system-wide solution."

On advice and distribution, Sherry says it's important to separate intra-fund advice (for example advice on contributions and investment options within a fund) from distribution advice (advice on which fund to join).

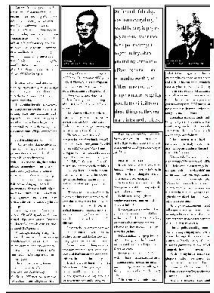
"In part we've started to tackle the issues of the compliance cost of the disclosure requirements, so that's part of the cost issue, but the other much more complex and controversial area is the conflicts of interest, and that's an issue for renovating the house," he says. "The other issue is distribution advice. In a compulsory system, why should members be paying for distribution advice, because they have to belong, and that also begs a question about what is in members' best interest in terms of distribution and how that test is applied?"

derned by industry funds as the bulk of the fat within the super industry.

David Whiteley, executive manager of Industry Super Network, believes that commissions paid on compulsory contributions are "the most egregious example of the conflicts of interest and inappropriate practice in the super industry."

Furthermore, he says the problem is not just the cost of the commission, but the underperformance of the fund being "sold" by the financial adviser.

Modelling by Access Economics on



behalf of ISN and the Australian Institute of Superannuation Trustees (AIST) revealed that reducing inefficiencies, including commissions, across the superannuation industry could not only reduce charges but boost compulsory super contributions to almost 12 per cent.

“What we’re saying is if you increase efficiency across the sector by 0.75 per cent it is roughly equivalent to increasing contributions and in fact it adds revenue to the government whereas increasing Superannuation Guarantee (SG) will cost the government because of the tax concession,” Whiteley says.

He wants the government to ban commissions across the superannuation and post-retirement sectors, and says that financial advice and product sales should be disaggregated so that financial planners can act in the best interests of their clients, rather than being held in a “vice-like grip” by retail funds.

This is a view that’s vehemently opposed by Richard Gilbert, chief executive of the Investment and Financial Services Association (IFSA).

“Don’t worry about the

various components, worry about the total,” he says. “It’s what the consumer is paying that’s important – the rest of it is a smokescreen.”

Gilbert believes allowing competitive market forces to operate without interference is the only true way to bring down fees.

He does not agree with the Australian Industrial Relations Commission’s decision not to run a competitive tender before choosing a range of default super funds for employers covered by modern awards.

“One way to [reduce fees] is to allow competition in the default fund space instead of allowing monopolies and oligopolies,” Gilbert says.

“Monopolies have never been known to reduce fees. The fat is in – it’s called monopoly rent. I’ll challenge you to name a retail fund that has increased its fees in the last two years, but it’s easy to find a couple of industry funds that have increased their fees.”

While some commentators have called for a ban on commissions on SG contributions, Gilbert says this misses the point.

“I didn’t see any commission payments in the AIRC default fund outcomes in the

30 funds that were named, and that’s where the great bulk of SG is going to be determined,” he says.

“Furthermore, if and when retail funds are given a chance to compete again and not be locked out, I wouldn’t expect them to be offering commissions, and those figures of 58, 60 and 70 basis points [offered by some retail funds] – there are no commissions in them. So there’s a lot of spin around this, and it certainly hasn’t come from us.”

Sherry will not be drawn on the solutions being considered as part of his review of the superannuation industry, which he refers to as “renovating the house”. But he does point to the need for more effective remuneration structures, and to distinguish between commission-based selling and commission-based advice.

On the debate around competition within the default fund market, he queries how it’s possible to have competition when members aren’t making a choice.

“It’s a default system, so it seems to me you can’t have market competition operate because the member’s not mak-



ing a decision," he says.

"Secondly, yes, default fund issues should be considered as part of renovating the house, because I would argue there's a strong duty of care on government in a compulsory system, [and] there's an even stronger duty of care where a member doesn't make any decision, but however the default fund decision is exercised for a person that doesn't choose a fund – and we know the majority don't – we need to make sure the way in which that decision is exercised is in the best interest of the member and no-one else."

PRICE VS VALUE

At a time when negative returns are the norm rather than the exception, fee reductions can have a material impact on the end result for members.

According to Bresnahan, a 1 per cent reduction in fees is the same as earning 1 per cent extra per year for the duration of a member's super fund.

In other words, he says, if you're 40-years-old, it's probably going to make around 30 per cent difference to your end benefit.

However in debating what fee is appropriate for the super industry to



Wayne Walker ...
cost savings come with size

charge, it is perhaps more pertinent to ask 'is the member getting value for money?', rather than 'is the member paying too much?'

"You really have to burrow into the offering and critically scrutinise whether real value is being obtained," Australian-Super's Silk says.

"Some of the more expensive offerings are providing poor outcomes for their members. In our case, the standard account balance is \$50,000. At the moment we're already under that 1 per cent figure and we're looking to further improve that.

"There's no question that it can be

achieved. It's easy enough to get under it; you also want to be providing high quality service and performance at the same time."

Michael Rooney, general manager of operations at Media Super, which was created last year after the merger between the industry funds for journalists/entertainers and printers, agrees.

Members of Media Super pay \$1.10 per week plus 10 basis points, which was the existing fee structure of the larger fund, Print Super.

Prior to the merger, JUST Super members were paying \$1.50 per week plus 35 basis points for administration.

"Cheaper is not always better," Rooney says. "You have to be careful that you [don't] put so much pressure on cheapness that you actually stop providing a service and a good mix of investments to provide that discounted rate, which ultimately is at the detriment to the member because the member ends up with a lower benefit than what they would have got if you were willing to pay a bit more for better services and better options."

Rationalisation within the superannuation industry is an anticipated by-product of the financial crisis, and will

further aid the Government's efforts to bring down fees.

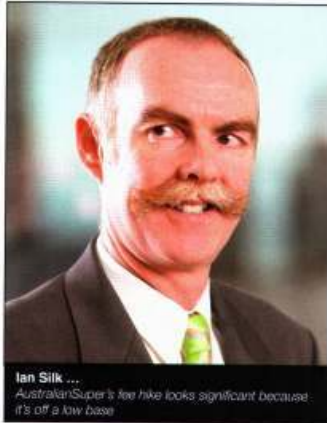
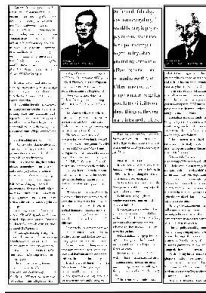
As smaller funds crumble under the weight of rising costs, which they are no longer able to subsidise via investment returns, they could look to increase efficiencies through scale.

Rice Warner expects the number of industry super funds to reduce to around 25 within the next five years. Theoretically, a large part of the consolidation should happen before June 30, 2010, which is the deadline for CGT Rollover Relief.

Andrew Proebstl, chief executive officer of Legalsuper, which is set to merge this year with two small funds in the legal sector, says increases in product development and communication and member education are all putting upward pressure on costs.

"We're in the process of finalising our budget for the next financial year and once we do that we'll have a good idea of where our member fees sit but I do notice that quite a number of funds have been increasing their fees in recent times and in many cases much larger funds than our fund," he says.

"HostPlus is the only one – they've agreed to freeze fees at a certain level for



Ian Silk ...
AustralianSuper's fee hike looks significant because it's off a low base

a couple of years – so there's been a bit of movement in fees across the funds and it does generally tend to be upward rather than downward."

There is compelling evidence to show that costs for both administration and investment reduce as both membership and fund assets increase, which ought to translate into lower fees for members.

Research from Deloitte titled *The efficiency of the superannuation industry* reveals that the median investment cost for an industry default fund with \$10 billion under management is around 30 per cent lower than that of a fund with

\$1 billion under management.

The average investment cost ranges from 0.75 per cent for the lower asset bracket down to 0.57 per cent for the higher asset bracket.

Furthermore, the median administration cost of an industry default fund with 500,000 or more members is half that of a fund with less than 50,000 members.

Deloitte found administration costs, expressed as a weekly dollar figure per member, were as high as \$2.18 for the lower membership bracket and as low as \$1.08 for the higher membership bracket.

The research, which covered 60 industry funds and excluded defined benefit funds, which typically have greater administration costs, was based on data collected by Deloitte for the year to June 30, 2008. The data was taken from publicly available information on websites and in annual reports.

"I think that says that there are scale economies in super, and they're not a death sentence for smaller funds, but they do mean that the smaller funds need to deliver value, and that might be because they're closer to the members [or] it's a more personalised service,"

says Wayne Walker, partner at Deloitte Actuaries & Consultants.

"You can't ignore the realities that there are some savings that come with size."

Silk says AustralianSuper, which was created in July 2006 on the back of a merger between Australian Retirement Fund and Superannuation Trust of Australia is still in the process of harvesting all the benefits, but points to increased services, a significantly enhanced insurance offering and an expanded in-house investment team as some of the benefits realised so far.

"It's enabled us to spread our marketing costs across a wider membership base than we had previously," he adds.

"We had three high level objectives; increasing services, [putting] downward pressure on fees and costs, [and] enhancing the promotion of our brand, and all of those we've been able to do."

Rooney says Media Super has also realised significant cost savings for members on things like auditing and regulatory fees, because APRA levies are based on funds under management but capped at a certain level.

"There are a lot of cost savings for the members both directly and indi-

rectly," he says.

"A lot of the costs Senator Sherry is talking about are direct costs, but there are also a lot of indirect costs, for example we're expecting a significant reduction in our insurance premiums. Over time the costs of investment management fees will reduce as well because you have greater purchasing power if you're offering a lot of money when you're looking at investment managers."

However mergers are not for everyone. Silk says it's up to each trustee to look at their own fund and ask themselves whether they're providing the maximum value available to their members.

And Bresnahan says there'll be cases where merging just doesn't make sense.

"There are certainly synergies there between the right funds," he says.

"I think there's a risk that some funds will merge for mergers' sake and that the demographic and styles of the two funds won't necessarily yield much by way of reduced costs, but there are other examples where there are glaringly obvious merger opportunities that need to be taken and probably haven't been taken for a series of reasons." ■