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MySuper Fees

Financial System Inquiry

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Table of Contents

1. Executive Summary

Superannuation funds in Australia have been required to direct default contributions to a complying MySuper product since 1 January 2014. Despite this, there is little research to show the impact that MySuper has had on fees. This report sets out the impact MySuper has had on fees as well as additional commentary on:

- Average MySuper fees
- The split between fixed dollar and variable fees
- Fees on a $50,000 balance
- The impact of asset allocation and passive investing on fees
- The distribution of assets and members in current MySuper products.

1.1 MySuper fees

An analysis of fees shows the average (member and asset-weighted) MySuper fee at the time of writing is $70 p.a. + 0.80%, which is lower than average measured fees at 30 June 2011 of $63 + 0.92% (for the previous default products for funds now offering a MySuper product). The average MySuper fee by sector is given in Table 1.

Table 1. MySuper fees 2014

Average MySuper fee by account balance					
Segment	Average $ per member fee	Average % of assets fee	$5,000	$20,000	$50,000
2014					
Corporate	89	0.77%	127	242	473
Retail	72	0.96%	120	263	551
Industry	73	0.78%	112	229	464
Public Sector	34	0.84%	76	202	454
All sectors	**70**	**0.80%**	**108**	**222**	**450**

Fees have reduced predominantly in the retail sector, this can be attributed to:

- changes in asset allocation
- reductions in product margins, and
- removal of advice from default products.

We project that over the next five years fees will converge on 1.0% of assets across the industry due to the effects of fund consolidations, the transition of remaining ADAs to MySuper and increased average balances. This projection does not take into account other factors which may also effect fees.

Table 2. Projected average fees – APRA regulated funds only

Year	Average account balance (APRA regulated funds)	Fee Rate
2013	36,000	1.20%
2014	40,000	1.15%
2015	44,000	1.06%
2016	48,000	1.04%
2017	52,000	1.01%
2018	57,000	1.00%

1.2 Impact of asset allocation on fees

MySuper has seen two big changes to the asset allocation of superannuation funds:

- Introduction of lifecycle funds
- Increase in the level of passive investments held by funds.

It is difficult to measure the impact (if any) of lifecycle funds on investments due to the following:

- Many providers charge the same fee across all life stages (despite the legislation allowing for four distinct pricing points).
- Overall allocations to growth assets in lifecycle funds remain high; indeed many young members in lifecycle funds now have higher allocations to growth assets than in previous defaults which counterbalance the decrease for older members.
- Retail funds are the biggest providers of lifecycle options, however, not all accrued default amounts (ADAs) have been transferred to MySuper products.

Passive investment has resulted in a measured reduction in fees. Average fees for investments passively managed are given in Table 3.

Table 3. Impact of passive asset allocations on fees (sample of leading funds)

Passive Allocation	Retail average investment fee
>75%	0.39%
50% - 75%	0.50%
25% - 50%	0.59%
<25%	0.84%

1.3 Distribution of assets and members

The distribution of assets by product is positively skewed i.e. there are many funds with a small level of assets in their MySuper products. This arises because many retail funds have not transferred all ADAs to MySuper compliant products. Funds with a large amount of assets in MySuper tend to come from the not-for-profit sector. This is because many of these funds have simply rebadged their previous defaults.

The distribution of members is similar to that of assets. However, because we have been unable to estimate members for retail funds due to the MySuper assets being primarily made up of default contributions rather than ADAs, this means that average balances in previous products are unlikely to be a reliable indicator of the number of members in the product.

This report was prepared and peer reviewed for the Financial Systems Inquiry by the following consultants.

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2. MySuper

2.1 Background

MySuper is the result of the Super System Review's proposal for a simple, low-cost *default* option to be used for the 80% of employees who are deemed to be *disengaged* with their superannuation fund. Funds have been able to offer a MySuper product since 1 July 2013. It is now over a year since many MySuper products have been on the market. Despite this, reliable statistics showing fees for MySuper are only now becoming available.

MySuper will have a profound impact on fees within the superannuation industry and will commoditise superannuation products. This will arise from a number of mandated features of a MySuper product, including:

- A single default investment strategy 'MySuper' (members who instead wish to elect an alternative strategy will need to hold a Choice product).
- Standardised fees for all members within a MySuper product (which employers may subsidise). Employers may negotiate a discounted fee for their employees who are members if this can be justified.
- Basic default death and TPD insurance on an 'opt-out' basis.
- Removal of commissions to advisers (as part of the FOFA reforms).
- Large employers (500+ employees) may negotiate a tailored MySuper product.
- MySuper does not apply to defined benefit divisions or retirement products.

Despite MySuper being for the *disengaged member*, funds are able to build intra-fund advice into their fees and MySuper members are also allowed to apply for additional insurance without being Choice members.

Employers have been required to make default contributions on behalf of their employees to a MySuper product since 1 January 2014 and funds have been able to offer the products since 1 July 2013.

2.2 Impact on fees

The introduction of MySuper led to significant margin compression on the retail funds. Most have settled on asset-based fees of just under 1% a year which is more expensive than the large industry funds, but much less than their previous products (which also included the cost of advice).

Many funds have introduced lifecycle investments which could also help to curb fees (MySuper legislation allows four different pricing points for these products). This downward pressure on fees occurs as lifecycle investments typically have higher allocations to defensive assets as a member ages (and the member's balance grows). Given defensive assets are cheaper to manage, in principle fees should decrease; however, on observation we have noticed that many funds have chosen to charge all MySuper lifecycle members the same fee for each life stage which negates much of this impact.

Apart from different investment structures, the other areas of product differentiation between funds are:

- Sophisticated advice models
- Life insurance
- Member services – which depend in part on the quality of administration platforms e.g. member segmentation, tailored projections etc.
- Introduction of member-directed investments as a defence against members shifting to the SMSF segment.

We have also seen the beginnings of member analytics (which enables funds to better understand their members and target their marketing and communications) as funds start to shift to a member-centric world.

At the time of writing, APRA lists 118 authorised MySuper products of which 80 are Public Offer funds and 38 are Non Public Offer. The number of authorised products is much lower than the 200 that APRA predicted when the legislation was initially drafted.

We have examined the change in fees for 101 of these MySuper products as at the time of writing this report. This analysis is an update to similar work we performed for the Financial Services Council (FSC) earlier this year.

We were unable to capture the full market due to an absence of data in 2011 for some tailored large employer funds.

The results of our analysis are given in Table 4. We have weighted average results by assets and estimated member numbers as at 31 March 2014. We have combined fees for Retail products and large Corporate Super Master Trusts under the heading 'Retail'.

Table 4. MySuper product fees – 2014 vs. 2011

Average MySuper fee by account balance (percentage % of assets)					
Segment	**Average $ per member fee**	**Average % of assets fee**	**$5,000**	**$20,000**	**$50,000**
2011					
Corporate	47	0.62%	77	170	355
Retail	64	1.61%	144	385	867
Industry	68	0.76%	106	220	449
Public Sector	28	0.58%	57	144	317
All sectors	**63**	**0.92%**	**109**	**248**	**525**
2014					
Corporate	89	0.77%	127	242	473
Retail	72	0.96%	120	263	551
Industry	73	0.78%	112	229	464
Public Sector	34	0.84%	76	202	454
All sectors	**70**	**0.80%**	**108**	**222**	**450**

Average fees have come down overall due to a reduction in asset based fees; however, dollar based fees have increased for all sectors. Fees for Corporate and Public Sector funds have increased overall, which is likely due to increased costs e.g. compliance costs, product design, systems upgrades. Given these providers are not-for-profit and are often not public offer there is little reason for funds to not increase fees in line with costs.

Fees for industry funds have also risen marginally given that they are not for profit and have no shareholder capital which can be used to absorb additional costs. These funds are often public offer and are under more competitive pressure to keep fees stable. Indeed, many funds simply rebadged their existing default products resulting in fees remaining the same. This explains why the change in fees is marginal for this sector.

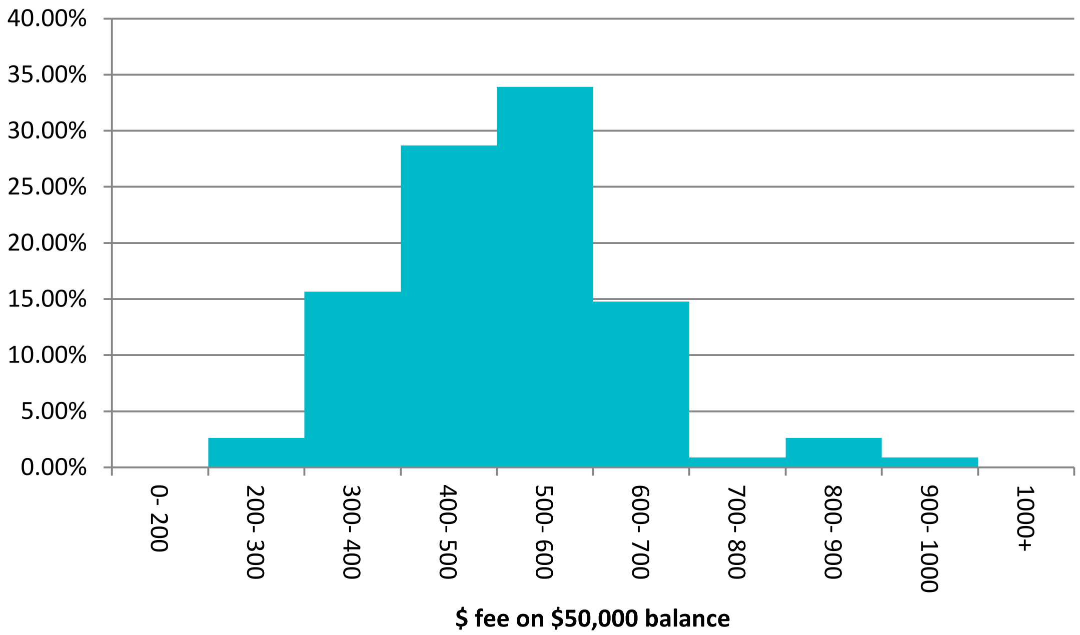
Retail funds experienced the biggest fall in fees. This can be attributed to the fact that these funds are under the most competitive pressure to reduce fees (as their fees were higher than other sectors pre-MySuper). In addition, advice has been removed from many of these products and retail providers are able to absorb short term increases in cost given that they have shareholder capital.

We estimate that the removal of advice has resulted in a 25 basis point reduction in fees for members in MySuper products. The transition of accrued default amounts to these products up to 2017 will continue to cause reductions in fees for members.

2.3 Distribution of fees

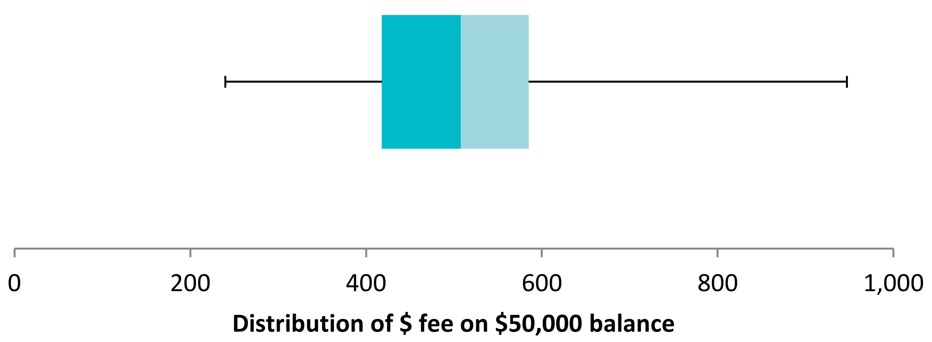
The distribution of MySuper fees captured varies considerably. Graph 1 shows the results on a $50,000 balance. The analysis is based on APRA published data as at 30 June 2014. The fees for a member aged 45 have been taken to represent a typical member where lifecycle options are in place.

Graph 1. Distribution of total MySuper fees on $50,000 balance ($ p.a.)



Graph 2 shows the same distribution as a boxplot. The boxplot shows that 50% of funds charge fees between $400 - $600 p.a with a lower limit on fees of $200 p.a. and an upper limit of circa $1,000 p.a.

Graph 2. Boxplot of MySuper fees on a $50,000 balance ($ p.a.)



3. Asset Allocation and MySuper

3.1 Growth defensive split

The introduction of MySuper has led to an increase in the number of funds offering *lifecycle* investment options. Lifecycle investing involves reducing the allocation to growth assets (which tend to be more expensive to manage) and increasing the allocation to defensive assets as a member ages. This has led to a variety of pricing points within MySuper investment options (legislation limits this to four pricing points) which make MySuper products difficult to compare against each other. Fees should generally be lower as the member is receiving an asset allocation that is cheaper to manage.

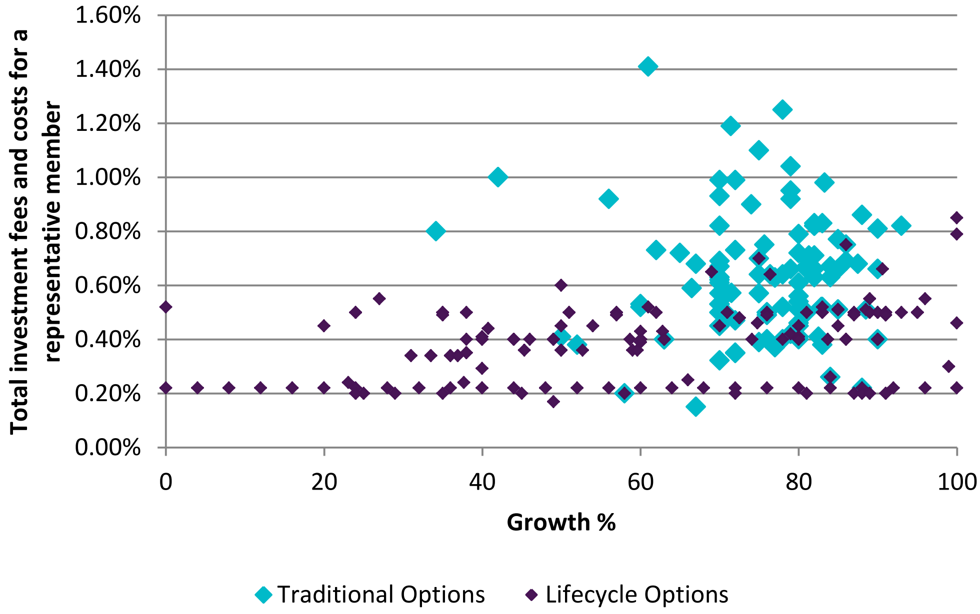
Common arguments for and against lifecycle funds include:

- For
  - Age is a good approximation for the risk tolerance of a member.
  - The global financial crisis (GFC) had a negative impact on member sentiment for superannuation funds as members did not realise the level of risk they were exposed to. Lifecycle options may partially protect members from event risks.
  - May better align with member expectations.
- Against
  - Age is not the only relevant factor. Other factors include total assets, retirement age, risk preferences and the expected retirement lifestyle aspirations of the member.
  - Tailored advice is the better option; lifecycle options can prevent members from seeking advice.
  - It does nothing to address sequencing risk i.e. if the market crashes today and the member moves to a more defensive allocation they may miss out on the recovery.
  - Members at retirement still have a considerable time over which to remain invested (more than 20 years) and require protection against inflation risk.

The distribution of pricing points for a sample of MySuper options plotted against growth allocations is given in Graph 3. It is difficult to measure the overall impact of lifecycle investing on the market as the majority of assets have not yet moved to lifecycle funds (due to retail funds maintaining Accrued Default Amounts (ADAs) in existing options for the time being).

Interestingly, the graph shows that for MySuper, many lifecycle providers do not provide members with lower fees when growth asset allocations fall.

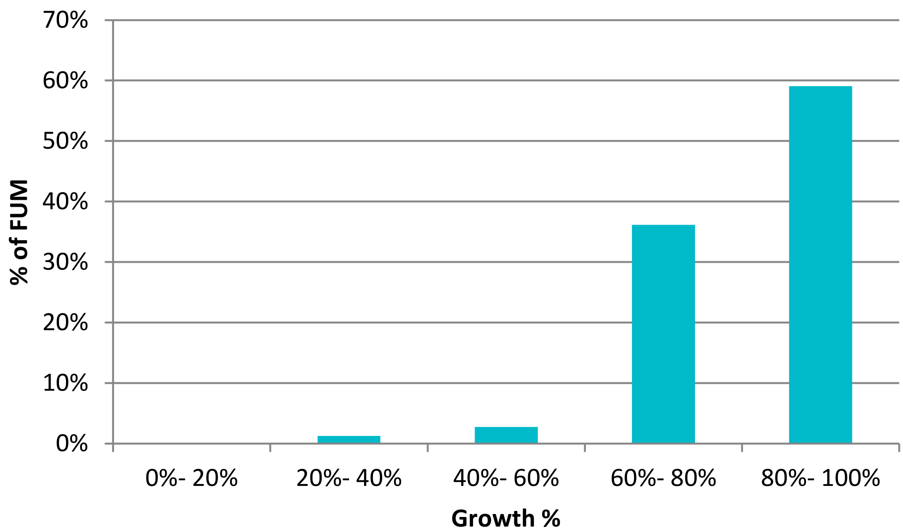
Graph 3. Investment management fees vs. growth allocations



3.2 Distribution of MySuper FUM by growth %

Graph 4 shows the distribution of MySuper assets by the growth percentage of the investment option. The graph shows the majority of assets are invested in relatively high growth investments, which means that the introduction of lifecycle options has not resulted in a large shift in the overall asset allocation of default assets across the industry.

Graph 4. Distribution of MySuper assets by growth %



3.3 Passive investments

Pressure to reduce the headline fee of MySuper products has caused some funds to invest some of their assets passively rather than with active managers.

Passive and active management approaches can be differentiated as follows:

- Passive management means the investment manager attempts to achieve close to the same performance as the benchmark or market.
- Active management involves the investment manager attempting to outperform the market return by holding higher allocations to individual investments that they expect to perform well.

Passive management is a less expensive way to manage assets given that there is less time spent by the investment manager analysing the market, in addition to a lower number of trades being placed. Further, it is possible to purchase an indexed fund where the fund purchases and holds the individual stock (or indexed based derivatives).

With the introduction of MySuper our research indicates that:

- Many large industry funds continue to invest actively and have left their allocations unchanged.
- Some smaller industry funds have increased the proportion of passively managed assets in their portfolios to reduce costs.
- Of a representative basket of leading retail funds the average percentage of assets passively managed has increased from 24.0% in 2011 to 46.6% in 2013.
- Corporate and public sector funds have largely left their allocations unchanged.

A demonstration of the impact of passive investments for a representative basket of funds for which passive asset allocation percentages were available is given in Table 5 which shows how fees can be relatively cheaper for passive funds (up to 20bps for each 25% increase in allocation to passive assets as opposed to actively managed assets).

Table 5. Impact of passive asset allocations on fees (sample of leading funds)

Passive allocation	Retail average investment fee
>75%	0.39%
50% - 75%	0.50%
25% - 50%	0.59%
<25%	0.84%

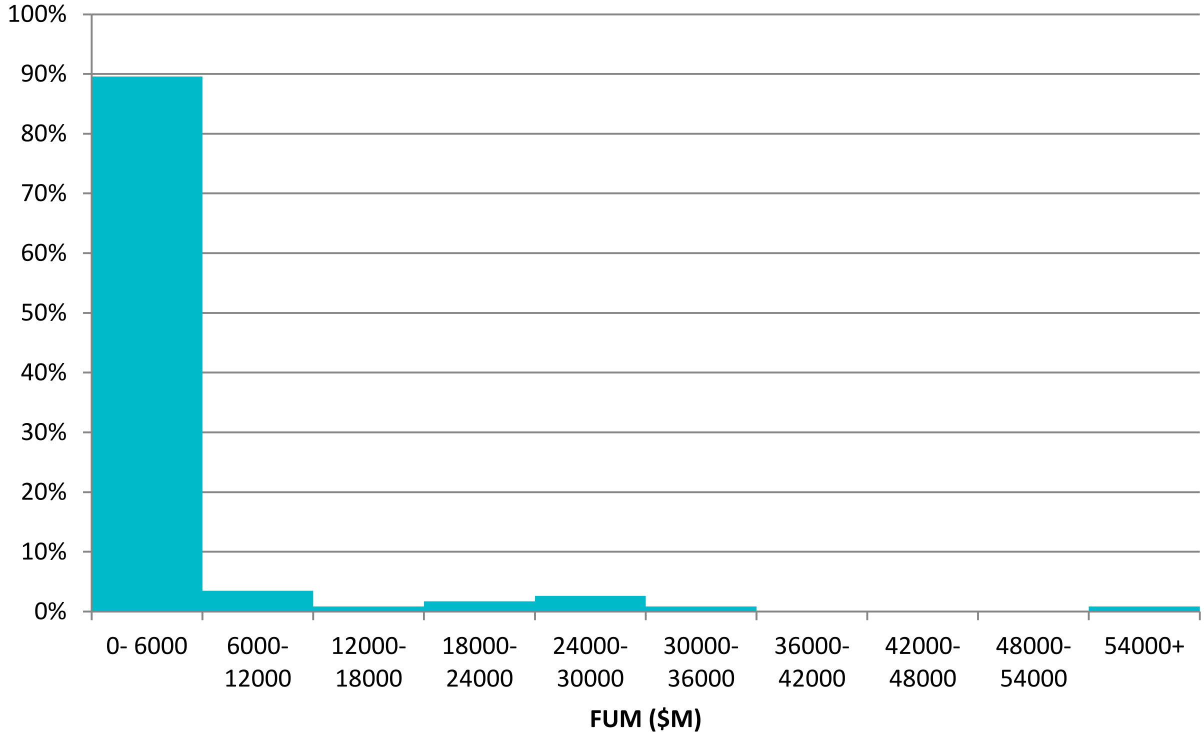
There is a greater degree of variation in allocation to active or passive funds management within the MySuper products of retail funds than industry funds. Industry funds' MySuper products generally have a very low degree of passive allocation. Retail funds, however, have designed new products in response to the perceived competitive tension in the default market by designing a range of MySuper products with significantly varied levels of passive or active management. As outlined in Table 5, this has resulted in different fees for different MySuper products that reflect the degree of active or passive management (which could be expected to generate different rates of return between these products over time).

4. Assets and membership of MySuper

4.1 Distribution of assets

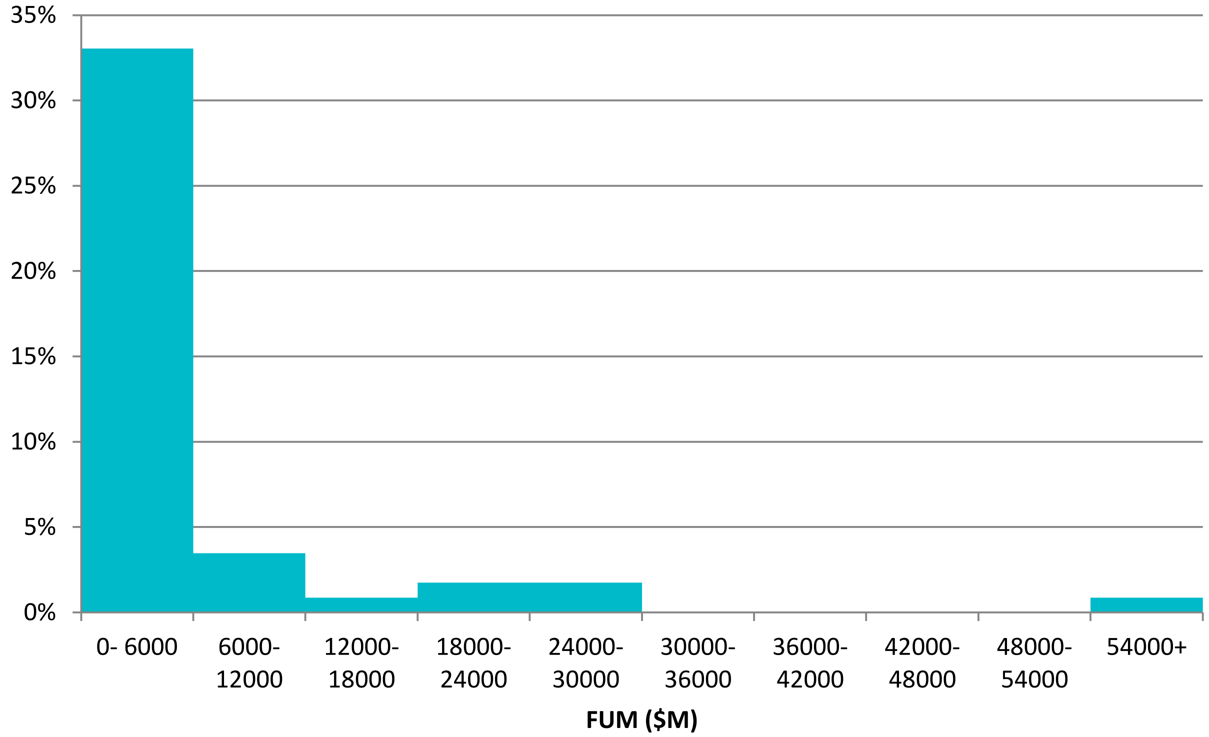
Graph 5 shows the distribution of FUM across licensed MySuper products. The majority of products have less than $6 billion in FUM. A more detailed breakdown of the distribution of funds with less than $5 billion is given in Graph 8. The distribution is positively skewed reflecting a large number of MySuper products with a low level of FUM. This is partly reflective of the fact that many retail providers have not yet transferred all Accrued Default Amounts (ADAs) to MySuper products. The transfer of theses balances is required by 30 June 2017.

Graph 5. Distribution of MySuper FUM – 30 June 2014

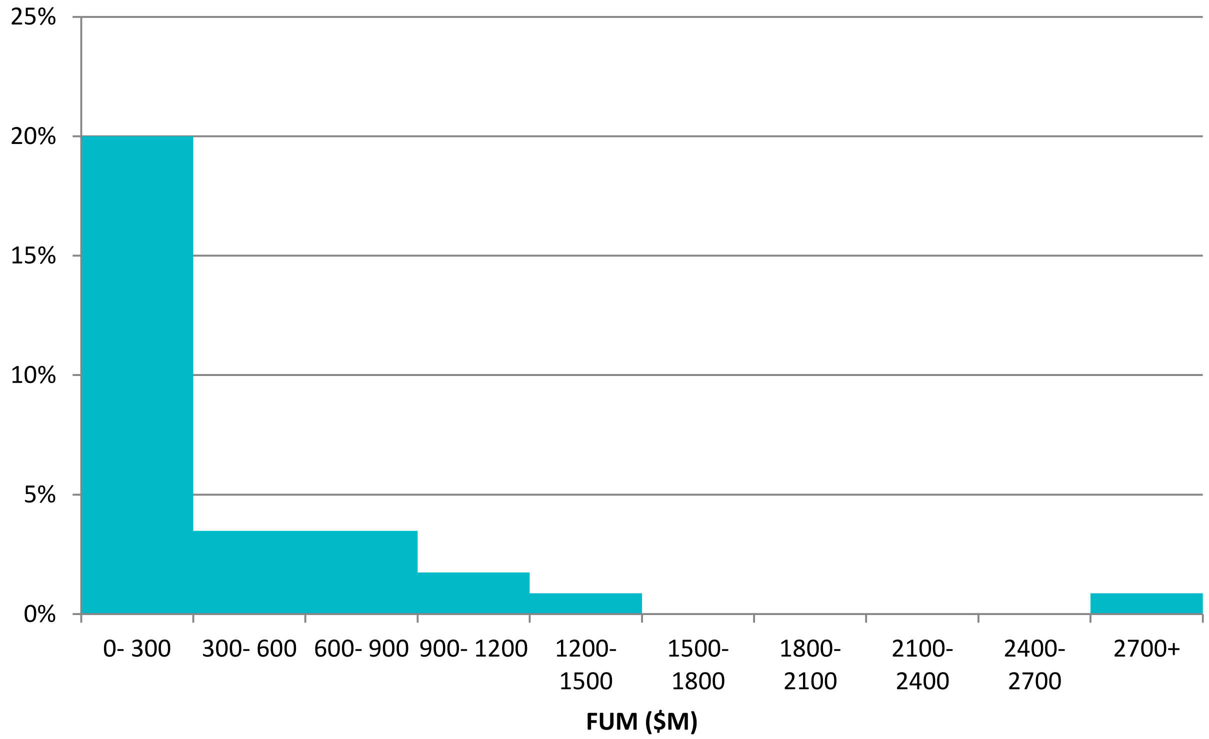


A separate distribution of FUM for Industry, Retail and funds with less than $5b in assets is given in Graphs 6, 7 and 8.

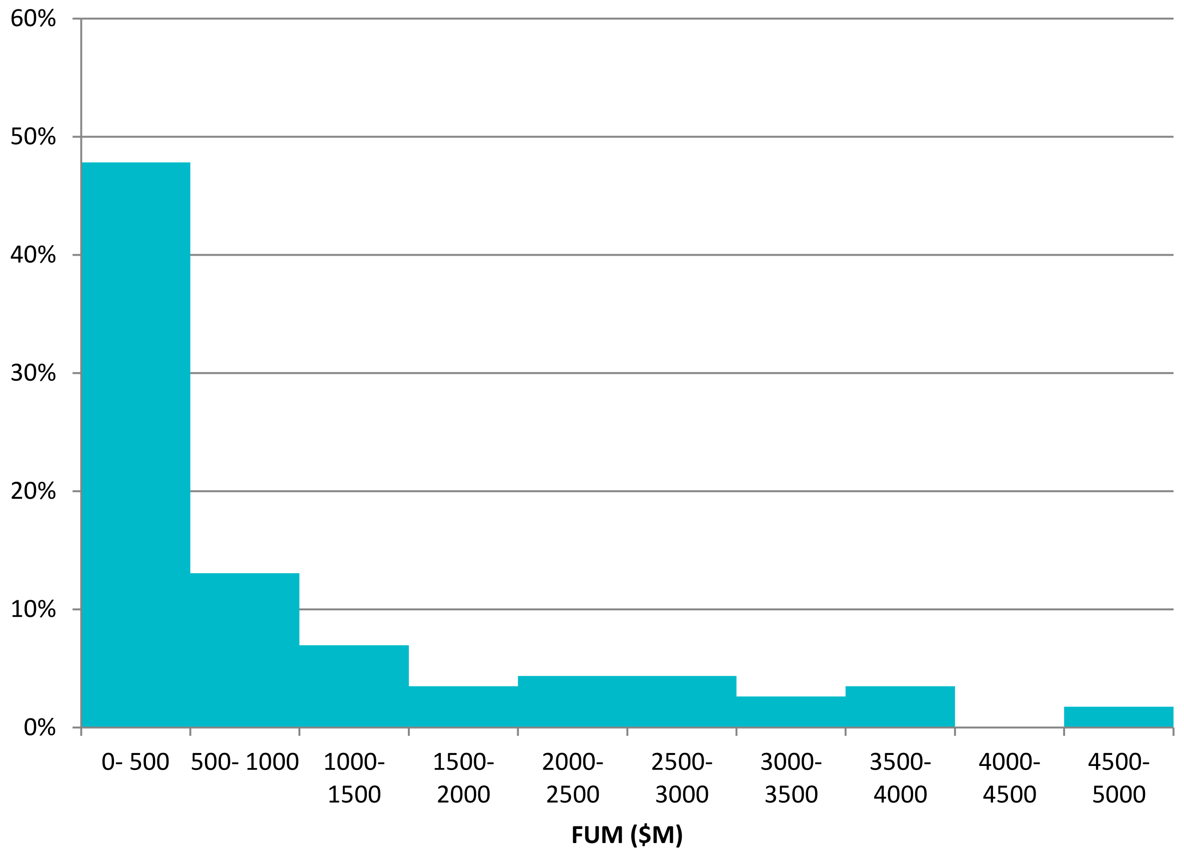
Graph 6. Industry funds: Distribution of MySuper FUM – 30 June 2014



Graph 7. Retail funds: Distribution of MySuper FUM – 30 June 2014

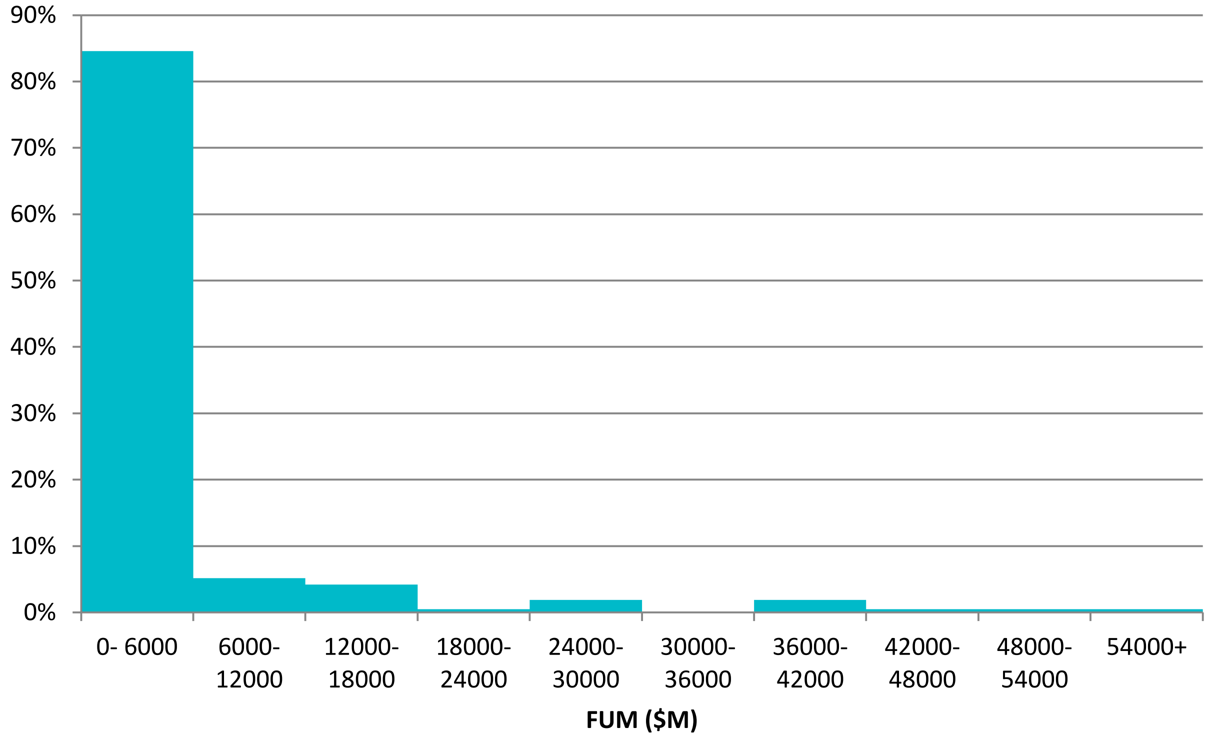


Graph 8. Distribution of MySuper FUM (funds less than $5b) – 30 June 2014



For comparison, the distribution of total assets of all 214 APRA regulated RSEs at 30 June 2013 is given in Graph 9. The graph is very similar to the distribution of MySuper assets by license Graph 5.

Graph 9. Distribution of total assets – all APRA regulated RSEs 30 June 2013

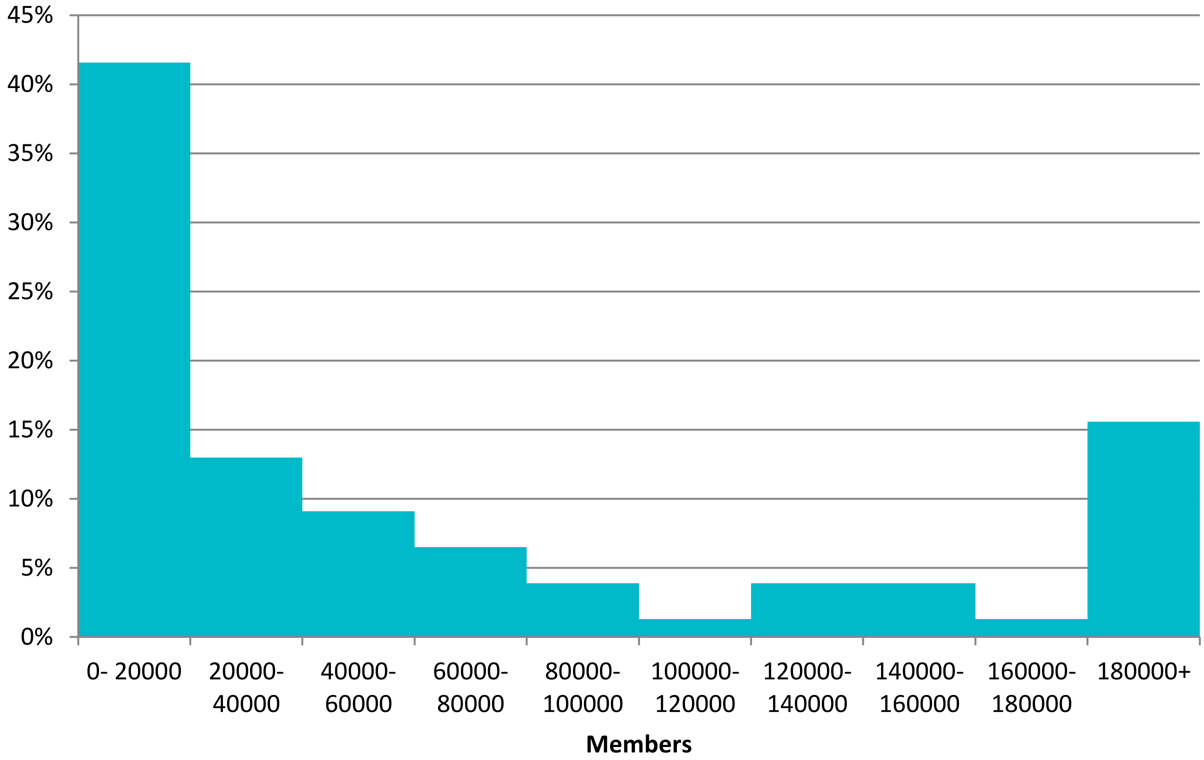


4.2 Distribution of members

The distribution of members in MySuper products has been estimated using average fund balances in the APRA Fund Level Profiles and Performance as published at 30 June 2013. We have not estimated members for retail funds as many retail funds have not transferred existing ADAs to MySuper meaning that average fund balances are unlikely to be a good estimate of average MySuper balances.

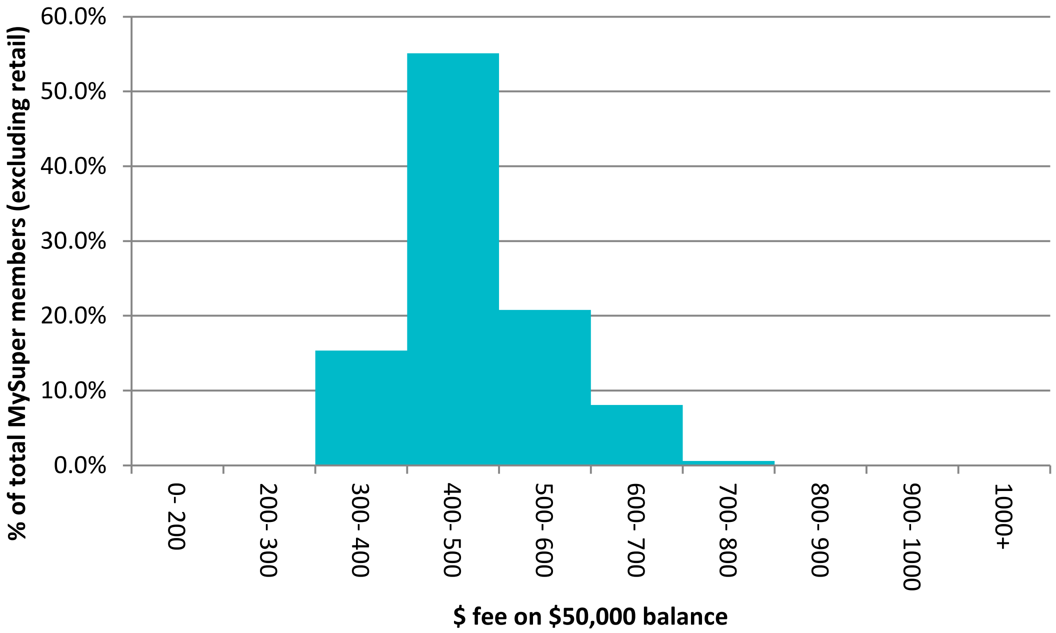
The results of this analysis are reflected in Graph 10. The distribution is similar to the one for assets given in Graph 6 but is slightly less skewed.

Graph 10. Distribution of MySuper accounts (excluding retail)



Graph 11 shows the distribution of fees on a $50,000 balance by members. Note this distribution is much narrower than the equivalent in Graph 1 which is weighted by the number of funds and also includes retail providers. We estimate nearly 60% of members pay between $400 – $500 p.a. within MySuper.

Graph 11. Member weighted distribution of fees on a $50,000 account balance – excluding retail



5. Fees from 2013

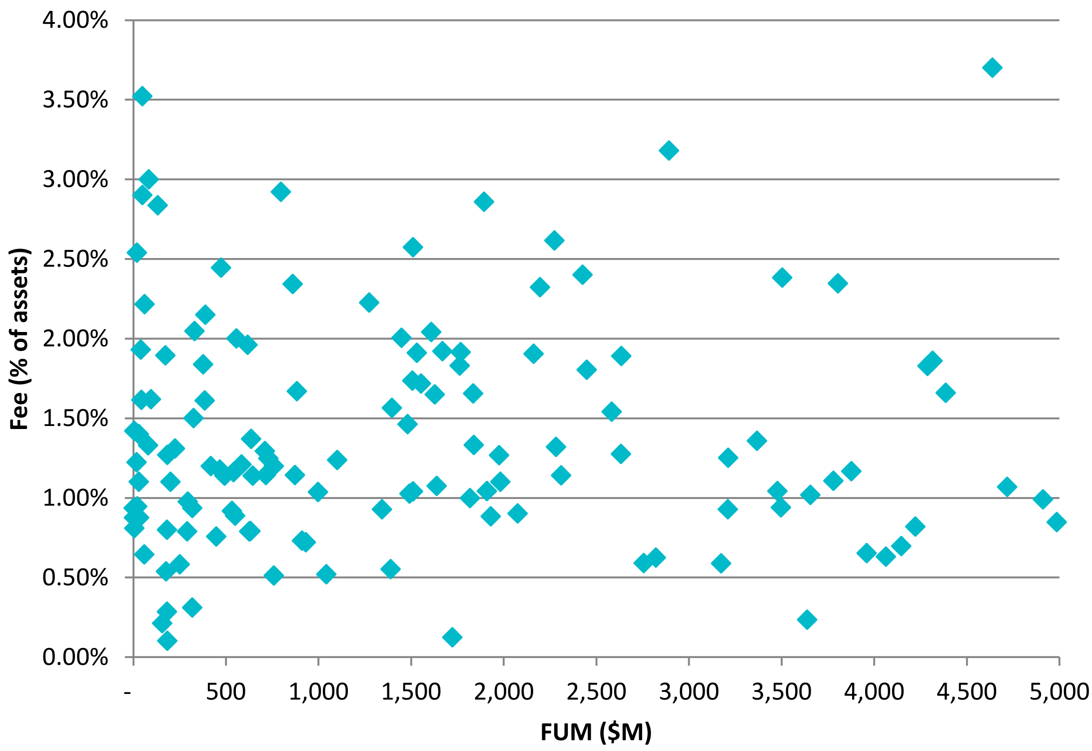
5.1 Fees vs. FUM

Graph 12 and Graph 13 show a scatterplot of fees (expressed as a percentage of assets) vs. total assets as at 30 June 2013. The scatterplots use data from Rice Warner's *2013 FSC Superannuation Fees Report* and are based on an estimate of actual fees charged to members, note that the sample:

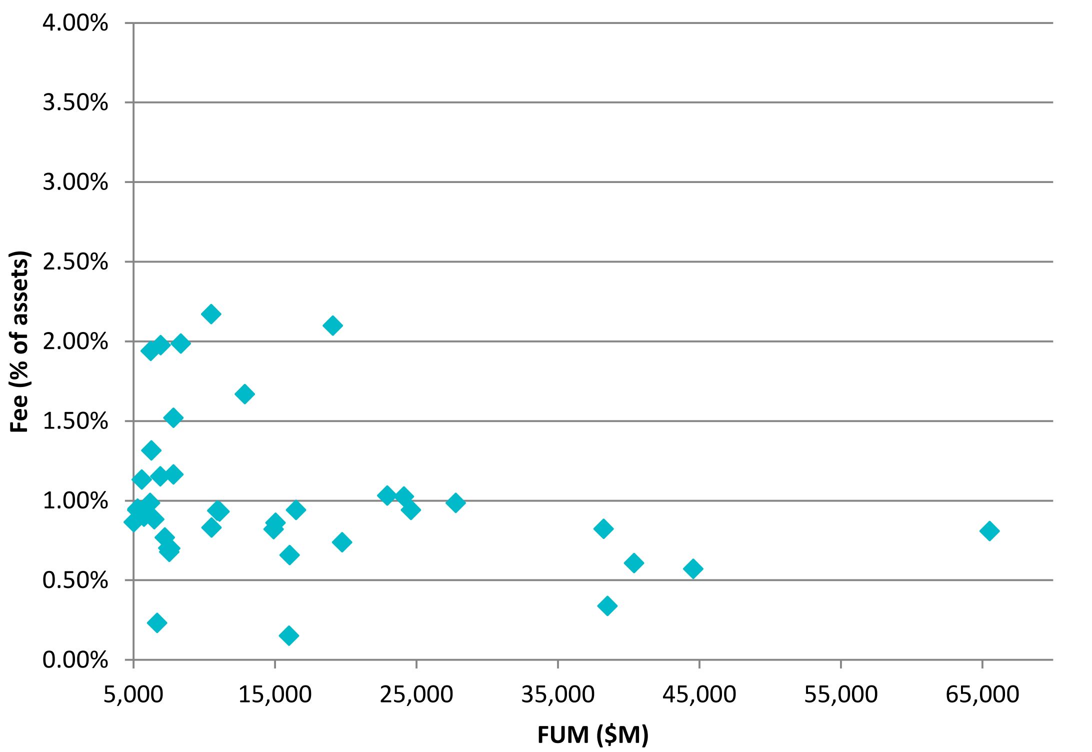
- Is based on actual membership and assets at 30 June 2013, therefore two funds with equivalent PDS fees could have a different result based on the fund's average balances.
- Includes ERFs which typically have higher fees when expressed as a percentage of assets and may appear as outliers.
- For retail funds is based on actual fees charged for the year to 30 June 2013 by product (rather than whole of fund averages) these fees include:
    - Any costs of advice charged to members.
    - Any appropriate discounts provided to large employers in corporate super master trusts.
- Fees are based on the default accumulation product for all other sectors and do not take into account member choice.
- Is at 30 June 2013 and excludes any fee reductions implemented since then and the impact of MySuper.

The scatterplots are divided into funds below $5billion (Graph 12) and above $5billion (Graph 13) for clarity. The results show a wide variation in fees for funds below $5billion in assets. Above $15 billion in assets most funds appear to keep total fee rates below 1% of FUM.

Graph 12. Scatterplot of fees by fund size 30 June 2013 (funds under $5 billion)



Graph 13. Scatterplot of fees by fund size 30 June 2013 (funds above $5 billion)



5.2 Projected fees

We project that fees will converge on 1% over the next five years. The results of our projections are given in Table 6. The projections allow for increases in average account balances which may result in a technical reduction in fees when reported as a percentage of assets, transitions of accrued default amounts to MySuper by 30 June 2017 and consolidations of funds resulting in lower costs for funds with greater scale.

Table 6. Projected average fees – APRA regulated funds only

Year	Average account balance (APRA regulated funds)	Fee Rate
2013	36,000	1.20%
2014	40,000	1.15%
2015	44,000	1.06%
2016	48,000	1.04%
2017	52,000	1.01%
2018	57,000	1.00%

The projection is simple and is based on the following assumptions:

- The fee rate in 2013 is taken from the *2013 FSC Superannuation Fees Report* produced by Rice Warner for the FSC.
- The rate in 2014 is estimated from PDS rates contained in Rice Warner's research databases.
- Average fee rates (unchanged throughout the projection) of:
  - $70 + 0.80% p.a.for MySuper assets (in line with this report).
  - As estimated from Rice Warner's research databases for Choice assets.
- Average account balances increase as estimated in Rice Warner's *2013 Superannuation Market Projections Report* and are given in Table 6.
- MySuper assets (as a proportion of total APRA assets) as given in APRA's June 2014 Quarterly *MySuper statistics* and *Quarterly Superannuation Performance statistics.*
  - We assume that assets for retail funds will move to the estimated level in Rice Warner's *2013 Superannuation Market Projections Report* by 30 June 2017.
- The effect of fund consolidations relies on estimates from Rice Warner's *2013 Superannuation Market Projections Report* and *Superannuation Fees* report produced for the Financial Systems Inquiry (FSI) including:
  - 181 funds remaining at 30 June 2018 (from superannuation projections).
  - A reduction in member accounts in line with superannuation projections.
  - Estimating the impact of increased member scale from the *Superannuation Fees* report produced for the FSI.
  - A reduction in member accounts in line with Rice Warner's superannuation market.

The projection assumes no further changes in fees (e.g. arising from competition, changes in asset allocation etc.). Consequently, this projection could be considered conservative.