Superannuation Fees and Performance

ING DIRECT

Sydney
Level 1
2 Martin Place
Sydney NSW 2000
T +61 2 9293 3700
F +61 2 9233 5847

Melbourne
Level 20
303 Collins Street
Melbourne VIC 3000
T +61 3 8621 4100
F +61 3 8621 4111

ABN 35 003 186 883
AFSL 239 191

ricewarner.com

Table of Contents

1. Executive Summary

1.1 About this report

ING Direct has engaged Rice Warner (Rice Warner) to analyse trends in superannuation fees, paying particular attention to investment management fees and their impact on balances across age cohorts at retirement.

The analysis in this report is based on data sourced from Rice Warner's proprietary databases and published APRA statistics, and supplemented by superannuation fund Product Disclosure Statements, annual reports and superannuation fund surveys conducted by Rice Warner. We have also collected fees from legacy retail products directly from financial institutions. However, Self-Managed Super Funds (SMSFs) are excluded.

We define superannuation fees to be amounts charged to members for the costs of managing the fund. Several items are excluded, including:

- Taxes and insurance premiums.
- Fee subsidies made by employers and not charged to the fund.
- Fees for personal financial advice which are paid direct by members and not taken out of fund fees.
- Tax credits for deductions on fees and insurance premiums which some funds retain in a separate reserve rather than crediting back to members.

1.2 Key findings

1.2.1 Total fees and MySuper

We estimate that overall fees for the whole superannuation industry, expressed as a percentage of assets, averaged 1.15% (or 115 basis points [bps]) for the year to 30 June 2014 (on assets of $945 billion as stated in the 2013 APRA statistics). This represents a slight reduction on 2013 fees (1.20%), with retail funds attracting the highest average fee (1.57%), compared to public sector funds which are the sector with the lowest average fee of only 0.60%.

While many large industry funds continue to invest actively and have not materially altered their strategic asset allocations, the percentage of assets passively managed by retail funds is close to 50%.

1.2.2 Impact of fees on projected balances

Our analysis and stochastic modelling show the impact that fees can have on projected retirement balances, across different age groups and account balances. High fees have a larger impact on younger members.

Table 1 illustrates the impact that fees can have on retirement balances for different members (from those aged 30 through to 60), other things being equal.

Table 1. Projected retirement balances

	Age			
	30	40	50	60
Retirement balance with nil fee				
Male	511,000	440,000	359,000	275,000
Female	473,000	356,000	254,000	208,000
Retirement balance using lowest fee: 0.51%				
Male	459,000	404,000	339,000	269,000
Female	425,000	328,000	241,000	203,000
Retirement balance with lower quartile fee: 0.93%				
Male	421,000	377,000	232,000	264,000
Female	390,000	307,000	230,000	199,000
Retirement balance with weighted average fee: 1.15%				
Male	402,000	364,000	315,000	261,000
Female	373,000	297,000	225,000	197,000
Retirement balance with upper quartile fee: 1.57%				
Male	370,000	340,000	301,000	256,000
Female	343,000	278,000	216,000	194,000
Retirement balance using highest fee: 2.33%				
Male	319,000	301,000	276,000	248,000
Female	296,000	248,000	200,000	187,000
Retirement balance with Industry MySuper fee: $70 pa + 0.80% fee				
Male	429,000	383,000	326,000	265,000
Female	397,000	311,000	232,000	200,000

A summary of assumptions used in these projections is given in Section 4.1.

As employers often subsidise fees for Corporate and Public Sector funds, these funds have consequently been excluded from the analysis.

This report was prepared and peer reviewed for ING Direct by the following consultants.

Prepared by

Salvador Saiz
Senior Consultant
Telephone: (02) 9293 3738
Salvador.saiz@ricewarner.com

Peer Reviewed by

Michael Berg
Senior Consultant
Telephone: (02) 9293 3724
michael.berg@ricewarner.com

Nathan Bonarius
Consultant – Head of Market Insights
Telephone: (02) 9293 3738
Nathan.bonarius@ricewarner.com

January 6, 2015

2. Total superannuation fees

2.1 Total fees and the overall trend

We estimate that overall fees for the whole superannuation industry, expressed as a percentage of assets, averaged 1.15% (or 115 basis points [bps]) for the year to 30 June 2014. This represents a total fee of approximately $14.9 billion based on assets of $1.3 trillion as stated in the 2014 June Fund Level Performance APRA statistics (excluding SMSFs).

This is a slight reduction on 2013 fees (1.20%), with the retail funds attracting the highest average fee (1.57%), compared to public sector funds with an average fee of only 0.60%.

Fees have been impacted by a number of factors over this period. Some factors serve to decrease fees which include:

- A number of mergers between industry funds and some between retail corporate master trusts resulting in greater economies of scale.
- Continuation of the outsourcing of superannuation for larger companies and the winding up of smaller corporate funds. There is keen competition amongst the specialist multi-employer funds to win this business. The new arrangements are usually struck at an MER some 10 to 30 bps per annum lower than the standalone corporate fund.
- A reduction in the number of accounts in the system, due to an element of increase in consolidation of accounts as well as transfer of small lost accounts to the ATO.
- Greater awareness of advice fees.
- Increased average account balances with high market returns.
- Lower investment costs due to increased investment in passively or indexed portfolios, which cost less than actively managed equivalent portfolios. In particular, a number of low cost personal superannuation products have now accumulated significant funds under management which is now having a material impact on average fees in that segment. For these products, the cost of advice has been removed (as separate fees for advice are charged where applicable) and investment management fees are lower, reflecting higher allocations to indexed investment.

Other key drivers influencing fee increases over the last four years are:

- Higher advertising and marketing expenses as a result of competition between funds as more become public offer.
- Higher investment fees due to performance related charges by fund managers. Performance based fees have become more common and many active managers have been able to outperform the index.
- A shift in investments to higher cost asset classes, including direct investments in infrastructure, private equity, hedge funds and other international assets.
- Significant growth in member engagement and financial advice services, marketing and advertising, particularly by not-for-profit funds.
- Substantial investment in modern administration platforms.
- Increased compliance costs with the introduction of new legislation as part of the Stronger Super reforms.

2.2 Variations by sector

Although fees as a whole have broadly decreased over time, the experience across sectors does vary. Table 2 expresses the average fees charged by each sector, in basis points (bps).

Table 2. Average fees by sector

Segment	Fee rate (bps)										% change over 10 years
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014#	
Corporate	77	78	76	73	77	80	79	79	78	69	-9.8%
Retail	198	189	185	181	183	185	170	164	157	157	-20.7%
Industry	116	113	110	107	117	126	113	110	107	93	-19.6%
Public Sector	68	70	70	69	75	81	82	79	76	60	-11.8%
Total excluding small funds	**142**	**139**	**127**	**132**	**136**	**140**	**129**	**124**	**120**	**115**	**-19.2%**

Weighted average fee based on our 2014 fee research. The numbers are estimates only. Fee rates for retail are assumed to be the same as the 2013 figure due to lack of data.

Over the ten year period to 2014, average fees have reduced by 42 bps for Retail providers and 23 bps for Industry funds. For both of these sectors, the above reductions represent about 20% of the fees that applied in FY2005.

Note that total fees by sector for 2014 are high level estimates only. These are based on the weighted average per member administration fee and asset-based fee for each sector in our database and the total number of members and total assets as reported in the 2013 APRA statistics.

2.2.1 Corporate

A corporate fund is an employer-sponsored superannuation fund managed under its own trust deed. It is sponsored by a single employer or several closely related employers.

The administrative and legal requirements of the current superannuation regime include APRA RSE licences. These factors have added significant complexity and compliance risk for corporations, and many have wound up their funds and transferred members and assets into other funds.

This has reduced the number of corporate funds and, as it is the smaller funds which have exited first, the average size of the remaining funds has increased. This has led to a modest decrease in total fee for this section of 9.8% over the past 10 years.

Many corporate funds have a reasonable size defined benefit (DB) component, which is often closed to new members. The total fee associated with this component, such as the cost on triennial actuarial reviews, is typically stable in dollar terms even though the assets have been reducing as members leave the DB arrangement or as lifetime pensions are paid out. This reflects the costs of dealing a combination of increasingly stringent regulation and periods of market volatility. As a result, the total fee for the corporate segment did not change as much as other sectors.

2.2.2 Retail

Retail funds include Master Trusts and other retail funds.

Over the years, retail funds have been criticised as being more expensive than industry funds and in combination with the FoFA reforms have made a substantial effort to reduce fees to members. Our research shows that total fees have been reduced by approximately 21% from 2005 to 2014, which has led to a convergence between retail and industry funds fees.

2.2.3 Industry

Similarly to corporate funds, the number of industry funds is gradually declining as larger funds search for growth in an environment of negative member growth and as smaller funds face growing administration burdens as a result of the Stronger Super reforms. APRA statistics show that there were 50 industry funds at 30 June 2014 with total assets of $324.0 billion. This compares with 67 funds as at 30 June 2011 with assets of $249.7 billion.

As assets under managed increase mainly due to mergers and acquisitions, industry funds are able to take advantage of economics of sale and purchasing power granted by large size. This has helped them to reduce total costs to members by approximately 20% since 2005.

2.2.4 Public Sector

Public sector funds are funds operated for the benefit of the employees of Government departments and agencies. There is a strong trend away from defined benefit plans, many unfunded, to defined contribution plans, particularly for new employees.

Most funds are open to public sector employees only. As a result, management of some aspects of these funds is relatively simple (e.g. they do not have to contend with multiple pay centres) and the corresponding fees are therefore lower. However, this is starting to change with some large funds moving to public offer status.

Further, some funds have complicated benefit designs that can lead to higher costs.

Over the ten years to 2014, fees for Public Sector funds declined by 11.8%.

2.3 MySuper fees

Employers have been required to make contributions to compliant MySuper products since 1 January 2014. MySuper product average fees as at 30 June 2014 are given in Table 3.

Table 3. MySuper product fees - 2014

			Average annual fee by account balance (% of assets)		
Segment	**Average annual $ 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
Total	**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
Total	**70**	**0.80%**	**108**	**222**	**450**

Although overall fees have reduced since 2011, some sectors have experienced a slight increase in fees.

3. Investment management fees

3.1 Fees by asset class

Investment management fees vary significantly by asset class. We have performed an analysis of fees based on a simple average of available sector options in our database. The results of this analysis are given in the tables below.

Table 4. Fees for single asset class options – includes active and indexed options

Single asset class options	Base fee			Performance base fee		
	Minimum	Average	Maximum	Minimum	Average	Maximum
Australian equities	0.20%	0.94%	3.65%	0.00%	0.04%	0.43%
International equities	0.20%	1.04%	3.19%	0.00%	0.04%	0.59%
Property	0.15%	0.77%	2.88%	0.00%	0.01%	0.25%
Fixed interest	0.10%	0.58%	2.75%	0.00%	0.00%	0.08%
Cash	0.00%	0.17%	0.80%	0.00%	0.00%	0.10%
Alternatives	0.40%	1.42%	2.70%	0.00%	0.00%	0.00%

Table 5. Fees for single asset class options – active options only

Single asset class options	Base fee			Performance base fee		
	Minimum	Average	Maximum	Minimum	Average	Maximum
Australian equities	0.25%	0.96%	3.65%	0.00%	0.04%	0.43%
International equities	0.26%	1.05%	3.19%	0.00%	0.04%	0.59%
Property	0.15%	0.86%	2.88%	0.00%	0.02%	0.25%
Fixed interest	0.10%	0.60%	2.75%	0.00%	0.00%	0.08%
Alternatives	0.40%	1.41%	2.70%	0.00%	0.00%	0.00%

Table 6. Fees for single asset class options – indexed options only

Single asset class options	Base fee			Performance base fee		
	Minimum	Average	Maximum	Minimum	Average	Maximum
Australian equities	0.20%	0.57%	1.33%	0.00%	0.00%	0.00%
International equities	0.20%	0.79%	1.84%	0.00%	0.00%	0.00%
Property	0.24%	0.43%	0.84%	0.00%	0.00%	0.00%
Fixed interest	0.20%	0.47%	1.74%	0.00%	0.00%	0.00%

3.2 Active and passive fees

Pressure to reduce headline fees for MySuper products has led a number of funds to do this by employing passive strategies or reducing or removing exposure to more expensive alternative strategies.

With the introduction of MySuper our research indicates that:

- Many large industry funds continue to invest actively and have not altered their strategic asset allocations.
- Some smaller industry funds have increased the proportion of passively managed assets in their portfolios to reduce costs.
- There is an emerging trend towards medium and large industry funds bringing more of the management of their assets in-house.
- A representative basket of leading retail funds found the average percentage of assets passively managed has almost doubled, 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 7. This shows that those funds with a greater use of passive strategies attract lower investment costs.

Table 7. Impact of passive asset allocations on fees (sample of leading funds)

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

Retail fund MySuper products exhibit a larger degree of variation in the use of active or passive investment strategies, when compared to industry funds. Industry funds' MySuper products generally have a 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 different levels of passive or active management. As outlined in Table 3, this has resulted in different fees for different MySuper products that reflect the degree of active or passive management.

If only the passively managed options are considered, the investment fees for single asset class options are reduced significantly.

Table 8. Fees for single asset class options – indexed options only

Single asset class options	Base fee
Australian equities	0.57%
International equities	0.79%
Property	0.43%
Fixed interest	0.47%

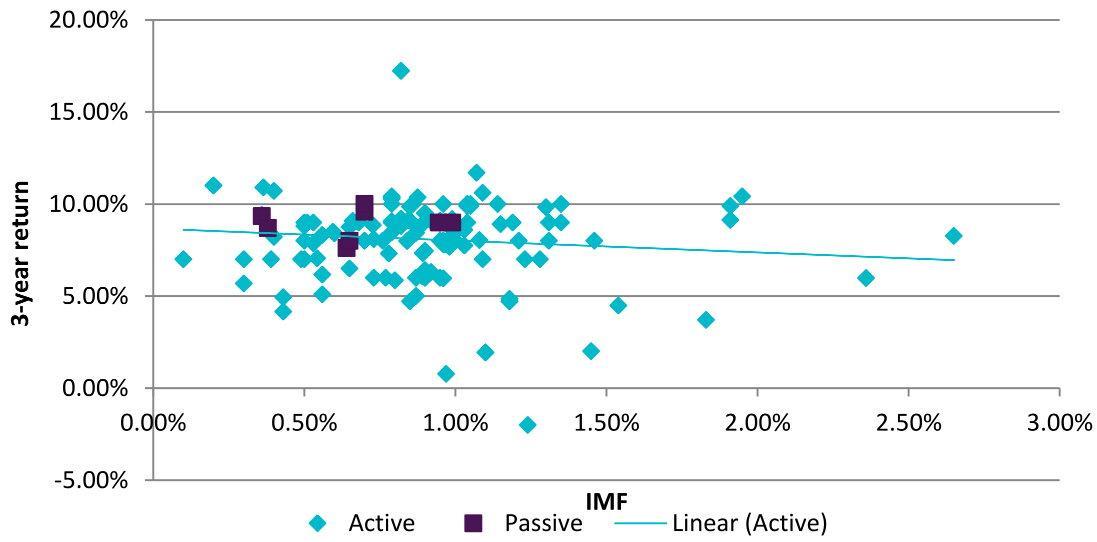
The most significant decreases in base fees between active and passive management are for property, Australian and international equities (over 25 basis points).

3.3 Fees vs. performance

The following analysis aims to identify if there is a relationship between investment management fees and the performance of multi-sector options.

For this analysis, we have focused on the 3-year annualised return to 30 June 2013. The results are shown in Graph 1.

Graph 1. Multi-sector investment options – Growth exposure between 50% and 80%



Investment returns are net of tax and fees.

In general, investment options employing a greater use of active management strategies, as well as alternative assets, are more costly. In return for higher compensation, it is expected that these strategies/investment managers will be able to add value, diversify across a wider range of assets, and outperform benchmarks or other objectives.

However, Graph 1 provides no clear indication of higher fees paid for active strategies leading to better overall net performance over three years, for our sample of options. (This naturally does not rule out specific strategies and/ or specific funds adding value on a net of fees basis.)

4. Impact of fees on projected balances

4.1 Impact of fees on retirement savings

We have modelled the impact of various levels of fees on different cohorts of members by age and gender. As employers often subsidise fees for Corporate and Public Sector funds, these funds have consequently been excluded from the analysis. As a result, the scenarios we have used are given in Table 9, using average balances for Industry and Retail Sector members, as measured in our 2013 projections report.

Using the below return assumptions and applying the strategic asset allocation of the ING DIRECT Living Super Balanced Fund for comparability, we compared the impact of fees across the different scenarios.

Members are assumed to receive only superannuation guarantee contributions into superannuation and do not receive additional voluntary contributions.

Table 9. Projection assumption – account balance and salary

Scenario	Gender	Age	Account balance	Annual salary
1	Male	30	24,000	75,000
2	Male	40	68,000	85,000
3	Male	50	121,000	100,000
4	Male	60	191,000	120,000
5	Female	30	21,000	70,000
6	Female	40	45,000	75,000
7	Female	50	65,000	90,000
8	Female	60	137,000	110,000

Table 10. Projection assumption – investment option and return – ING DIRECT Living Super Balanced

Asset class	Real return (p.a.) net of tax and CPI*	Asset allocation
Cash	1.2%	50%
Aus Shares	5.8%	30%
Intl Shrs (unhedged)	5.4%	10%
Intl Shrs (hedged)	5.8%	10%
Portfolio return (p.a.)	**3.46%**	**100%**

* CPI of 2.8% has been applied

Based on ING DIRECT Living Super's Balanced Fund, which has no administration or management fees, and assuming a member's assets are all invested in this option (which has 50% of its assets in an ING cash account and the other 50% in shares), their retirement balance for a retail male member under scenario 1 would be $511,000 in today's dollars. This projected balance would reduce with the introduction of fees.

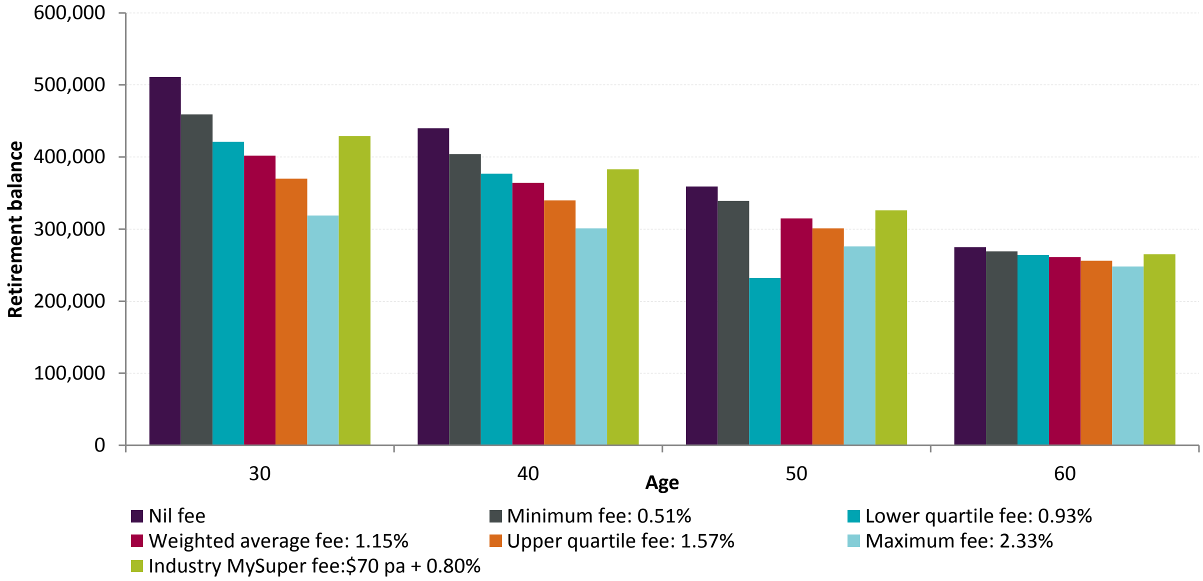
RICEWARNER
Insight like no other

Table 11. Note: current fees for the ING Select range of managed investments are an investment fee of 0.25% p.a. and an administration fee of 0.50% p.a. with a cap on the administration fee of $1,000 p.a. Projection results – Male, age 30

Scenario	Account balance at retirement
Assumptions	
Age	30
Account balance	$24,000
Annual salary	$75,000
Projection results	
Nil fee	$511,000
Minimum fee of 0.51%	$459,000
Lower quartile fee of 0.93%	$421,000
Weighted average fee of 1.15%	$402,000
Upper quartile fee of 1.57%	$370,000
Maximum fee of 2.33%	$319,000
Average MySuper fee of $70 pa + 0.80%	$429,000

A summary of results for all scenarios is detailed in the graphs and table below.

Graph 2. Retirement balance – Male



Graph 3. Retirement balance – Female

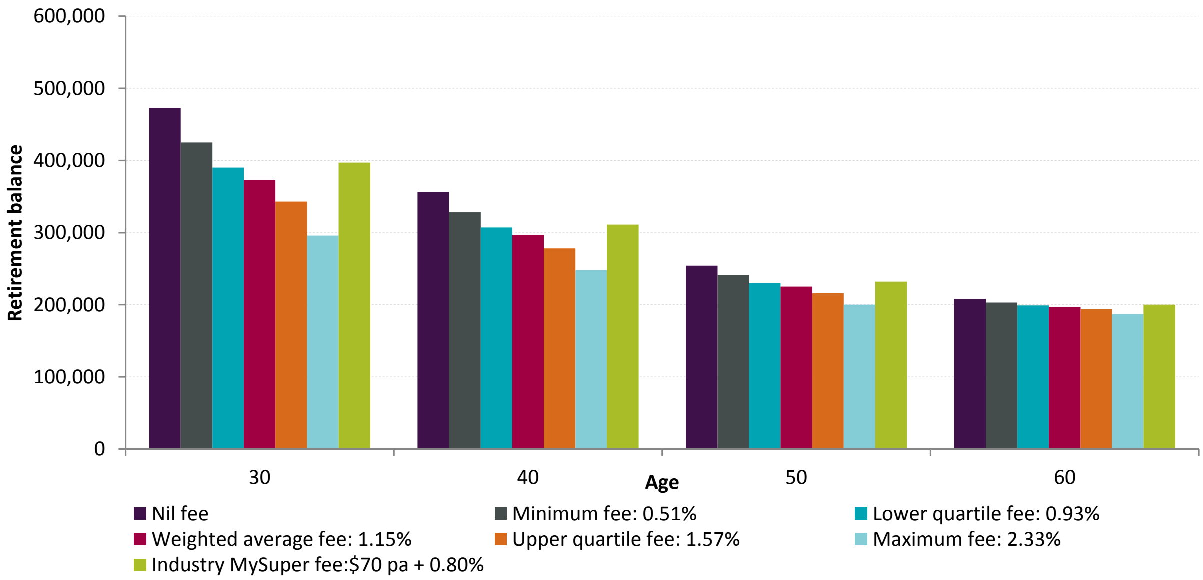


Table 12. Projected retirement balances

	Age			
	30	40	50	60
Retirement balance with nil fee				
Male	511,000	440,000	359,000	275,000
Female	473,000	356,000	254,000	208,000
Retirement balance using lowest fee: 0.51%				
Male	459,000	404,000	339,000	269,000
Female	425,000	328,000	241,000	203,000
Retirement balance with lower quartile fee: 0.93%				
Male	421,000	377,000	232,000	264,000
Female	390,000	307,000	230,000	199,000
Retirement balance with weighted average fee: 1.15%				
Male	402,000	364,000	315,000	261,000
Female	373,000	297,000	225,000	197,000
Retirement balance with upper quartile fee: 1.57%				
Male	370,000	340,000	301,000	256,000
Female	343,000	278,000	216,000	194,000
Retirement balance highest fee: 2.33%				
Male	319,000	301,000	276,000	248,000
Female	296,000	248,000	200,000	187,000
Retirement balance with Industry MySuper fee: $70 pa + 0.80% fee				
Male	429,000	383,000	326,000	265,000
Female	397,000	311,000	232,000	200,000

Note that the above projections include MySuper and that the cost of any insurance has been ignored from this analysis.

4.2 Benefit of reviewing superannuation funds & consolidation

The average Australian superannuant has 2.1 accounts. Some of these accounts serve deliberate purposes such as diversifying investments or retaining insurance cover. However, a large number of them have arisen from members not consolidating their accounts when changing employers. By consolidating multiple superannuation accounts into one fund, members can avoid paying multiple sets of administration fees, investment management fees and insurance premiums for different accounts they have.

This report's analysis provides further evidence of the need for superannuation members to review their superannuation arrangements, either themselves or by seeking the help of a financial adviser, with a view to:

- Identifying the investment strategy/option most suitable to the member's individual circumstances.
- Reducing costs by switching to a fund with lower fees (without sacrificing investment performance and/or consolidating funds).
- Obtaining cheaper insurance cover by moving to another fund or switching between fixed and unitised cover.