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**An uncertain future – projecting fees,
benefits, compliance costs and market
structure**

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1. Introduction

Clearly I have been very, very bad in my current or a previous life, because as part of my current duties I was given the task of designing and supervising the implementation of ASFA's two web based calculators. These are the ASFA Super Smart Planner and the Fund Fee Calculator. Both are easily accessed (and used) from the ASFA website, www.superannuation.asn.au.

I also have had a fair bit to do with the Westpac/ASFA Retirement Living Standard, which involves, amongst other things, a calculator on the Westpac website (<http://www.westpac.com.au/internet/publish.nsf/Content/PBISPR+Increase+your+retirement+income#>) providing retirement budgets for both comfortable and modest lifestyle making use of different cost levels for each State and Territory capital, and for different cost levels in major regional areas of Queensland and Western Australia.

There also have been a number of other exercises involving fee and benefit illustrations, although not necessarily directly involving web calculators. These incidents include a rather vigorous debate with Treasury and associated competing calculations in the context of the then Senate Select Committee on Superannuation Inquiry into Superannuation and Standards of Living in Retirement in 2002. There also has been involvement in the development of ASFA's proposed standardised fee illustration following the call earlier this year by the Ross Cameron, Parliamentary Secretary to the Treasurer.

ASFA also has its own intergenerational model, the ASFA-Access Economics Intergenerational Model (<http://www.superannuation.asn.au/policy/Intergenerational-Modelling.pdf>), which we have used to prepare a range of macroeconomic and other projections, along with a detailed report on the implications of Australia's ageing population structure. We have not put this calculator on the web, as it is a 16mb spreadsheet which grinds many computers to a halt, and there are about only three of us in Australia who know how to drive it.

I also have been doing some unpaid consultancy suggesting improvements and corrections to the ASIC fee and benefit calculator (www.fido.asic.gov.au), which is already up to about its fourth iteration in about as many weeks.

I even try to help Treasury with some helpful advice from time to time about takeup rates for various government initiatives in the superannuation area, and their likely budgetary costs. In this regard, see for instance my 2002 Colloquium paper which amongst other things was spot on in regard to the takeup rate of kiddies superannuation accounts. ASFA did eventually get documented evidence of a kiddies superannuation account, but given that this was in a self managed fund where generational transfers and estate planning tend to be common, this was rewarded with only a very indifferent bottle of wine from the ASFA kitchen cupboard which was leftover from the ASFA Christmas cocktail party several years earlier.

Along with developing a range of twitches and other behavioural oddities (such as a minor alcohol problem) as a result of these processes, I have learnt a lot about how to get calculators and projections wrong, and even a bit about how to get them right. This

paper provides an opportunity to share these lessons with the wider superannuation community.

2. The role and uses of web calculators and fee and benefit illustrations

2.1 Policy uses

Benefit projections for various sets of individual and family circumstances can be a very useful tool for assessing the likely success (or lack thereof) of policy settings for achieving required or desired standards of living in retirement. Governments are very fond of using such cameos to demonstrate the benefits of specific policies. The Commonwealth Treasury Retirement Income Modelling Unit also has generated a range of such cameos in the context of the Intergenerational Report and the Select Committee on Superannuation Inquiry into Superannuation and Standards of Living in Retirement. Quite a few ministerial statements are also littered with such cameos covering outcomes over one or more years for representative (and sometimes not very representative) individual and family circumstances.

ASFA also has used benefit projections based on the circumstances of various categories of superannuation fund members, including those on around average or median earnings and/or with broken employment patterns, to bolster its case for a reduction in contribution taxes, an enhancement in the co-contribution and for additional contributions to superannuation more generally.

Fee projections and illustrations tend to be used in a policy setting for either justifying current fees, expenses and charges of superannuation funds or specific classes of such funds, or for criticising one or more categories of funds. At the political level the use made has varied both between political parties and over time, depending on the context of policies at any given time.

2.2 Personal uses

Superannuation calculators, typically accessible online, are mathematical tools that allow consumers to input various facts such as estimated future contributions and estimated retirement age. The calculator then derives an estimated final superannuation lump sum or pension, based on assumptions relating to matters such as future fund earnings and inflation. Benefit projections are based on projected contribution rates, investment returns and fees and charges).

They are useful educational tools as they can help illustrate the beneficial effects of making regular contributions over a long period of time or salary sacrificing into superannuation. They also can be a useful tool for considering whether adjustments to retirement plans should be made. These adjustments can involve additional (or reduced) contributions, earlier or later retirement, changes to investment asset allocations, or revision to expectations concerning the standard of living in retirement. Even if no adjustment is made to any of these behaviours or settings, benefit projections can assist fund members in understanding whether they are on track to achieve the retirement income they expect.

Fee projections and illustrations usually involve long term estimates of the total fees and expenses that a member will pay as a result of belonging to a fund and receiving the benefits and services provided by the fund. They sometimes involve an online calculator, but sometimes are in the form of an illustration dealing with a specified account balance and/or contribution pattern. The projections generally include not just amounts actually paid in direct fees deducted from a member's account but also returns foregone as a result of money being taken to pay fees and charges rather than left in the fund to grow. Benefit projections are necessary to calculate the total cost of returns foregone, because a one year "snapshot" of fees and expenses will not capture this effect.

Fee projections and illustrations are important at the personal level for a number of reasons. As a basic issue of consumer sovereignty, fund members need to know, or be able to find out, what they are paying for the financial service of superannuation fund membership.

Fee projections also can be an important input into decisions about which superannuation fund to contribute to, and in regard to choice between investment options and contribution and exit fee options. Given the complicated and cumulative effect of most fund fee structures, a formalised projection or illustration is needed for an individual to make sense of a given fee structure. They are not calculations that can be done as mental arithmetic, and even some financial analysts and actuaries can struggle to get the calculation right. As well, given differing fee structures and fee levels some sort of common framework or tool is necessary if consumers are to compare funds.

Whether many consumers actually compare funds on a cost basis is an empirical question for which there is not much evidence available. However, having that information available could be regarded as a basic requirement for the operation of an informed and effective market. In this context, the development of fee illustrations and fee calculators was a political and practical pre-requisite for the passage of choice of fund legislation through the Australian Parliament, or more specifically, the Senate.

3. Regulatory requirements in regard to fee and benefit projections and calculators

There are currently regulatory requirements in regard to what funds and others can do by way of projections. There also are current and proposed requirements as to what they must do.

3.1 ASIC guidance on superannuation calculators

The introduction of the Financial Services Reform Act regime in full on 11 March 2004 saw most web based benefit calculators pulled off websites, particularly the websites of organisations that provide financial products. The worry for such providers was that a web based calculator could be regarded as providing personal advice of some kind, and that a web based approach would not comply with requirements for providing personal advice.

In May 2004 in Information Release 04-17 ASIC provided some general guidance on the application of the financial services licensing regime to providers of superannuation calculators. ASIC is of the view that the mere provision of a superannuation calculator

does not mean the provider will always need an AFS licence or authorisation under the Corporations Act. However, ASIC considers that it is important that consumers are made aware of their limitations, and that calculators satisfy a range of specified requirements.

In administering the law, ASIC accepts that superannuation calculators can often be provided without a licence or authorisation, particularly where all of the following are satisfied:

- The calculator allows the consumer to alter all 'default settings' for the various assumptions;
- any default settings are based on industry-wide rather than fund-specific information ;
- the calculator is accompanied by a clear explanation of its purpose and limitations, including an explanation of the assumptions (including the limitations of those assumptions) and a clear statement that the calculator is intended to illustrate the broad impact of consumer choices and is not a prediction of a consumer's final superannuation benefit;
- the calculator is accompanied by a clear statement to the effect that the calculator is not intended to be relied on for the purposes of making a decision in relation to a financial product, including a decision in relation to a particular superannuation fund or strategy, and that consumers should consider obtaining advice from an AFS licensee before making any financial decisions; and
- the calculator forms part of, or is linked to, other educational material and is distinct from any fund's promotional or marketing material.

On the other hand, a licence or authorisation is more likely to be required if, the calculator is intended to, or might reasonably be regarded as intended to encourage consumers to make a decision about a particular financial product or strategy.

Some calculators are starting to reappear, see for instance www.arf.com.au. However, the industry wide assumptions are still not quite there. Hopefully this paper will help in the development of a set of industry wide assumptions.

3.2 Government proposals regarding fee and benefit projections and illustrations

The Government recently decided against mandating the inclusion of benefit/fee projections in a generic superannuation fund Product Disclosure Statement (Cameron, 2004). The Government believes that this information is best provided to consumers by financial advisers or through interactive websites, rather than in the PDS provided to prospective fund members.

However, while the Government will not require this information to be provided, it proposes that consumers be referred to the ASIC calculator through a boxed consumer advisory warning. Further, the Government has acknowledged that it will still be possible for funds to provide this type of information to prospective members via

websites, with financial advice or even elsewhere in a PDS provided that appropriate warnings are given and necessary disclosures are made.

Set out below are the fee comparison table proposed to be mandated by the Government, along with its proposed boxed consumer advisory warning.

THE FEE COMPARISON TABLE

Hypothetical Fund

EXAMPLE – the Balanced Investment Option		BALANCE OF \$50,000 WITH CONTRIBUTIONS OF \$5,000 DURING YEAR
Contribution Fees	0 - 4%	For every \$5,000 you put in, you will be charged between \$0 and \$200.
AND Management Costs	1.6%	Plus , for every \$50,000 you have in the fund you will be charged \$800 each year.
EQUALS Cost of fund		<p>If you put in \$5,000 during a year and your balance is \$50,000, then for that year you will be charged fees of between:</p> <p style="text-align: center;">\$800 to \$1,000*</p> <p style="text-align: center;">What it costs you will depend on the investment option you choose and the fees you negotiate with your fund or financial adviser</p>

* Additional fees apply: About a page of footnotes here for many funds.

The Fee Comparison Table is intended by the Government to provide consumers with a ‘snap shot’ of the bottom line cost of being in a superannuation fund during a single year. Where a fund offers different investment options, the Table is proposed to be based on the fees and costs that apply to a balanced investment option (70 per cent growth assets and 30 per cent defensive assets).

The terminology used to describe the fees and costs is intended to be consistent with that used in the ASIC fee template (which is a complete listing of all possible fund fees in a standard format) (http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/04-192+ASIC+releases+revised+fee+disclosure+model?openDocument). Presumably the intention also is that both the fee comparison table and the boxed consumer warning are also consistent with the ASIC Superannuation Calculator to which consumers are to be

referred (www.fido.asic.gov.au). However, that calculator does not produce the numbers in the table for the example given, even over a one year period. The table above appears to suggest that all the transactions occur on the last day of the financial year, with no asset based fee levied in effect on the investment earnings of the account concerned. Most calculators rightly assume there will be an opening and closing balance, with contributions spread over the year.

A more fundamental problem is that the Government has indicated that Management Costs in the fee comparison table will be calculated using the Total Expense Ratio (TER) that has recently been published by the International Organisation of Securities Commissions (IOSCO, 2004). It appears that Australia is likely to be the first jurisdiction to adopt this new international standard.

The IOSCO measure has some advantages. In particular it is very inclusive of all fees, charges and expenses and it does use standardised definitions. However, the problem with using the IOSCO TER measure is that the TER is defined as the ratio of the fund's operating costs to its average net assets. For a fund where the average account balance is more or less than \$50,000, the TER measure will not be indicative of the actual level of fees and expenses applicable to the example in the table. For instance, the TER will generally overstate the fees applicable to a \$50,000 balance in an industry or other fund where there is a combination of a \$ per year fee and percentage of assets fees and costs. It is not unheard of for an industry fund to have a TER of 1.3%, generated by a \$52 a year fee plus expense recovery of 0.8% of assets. Using the TER for a \$50,000 example can be very misleading.

Such problems were recognised by the Investment and Financial Services Association in the development of its MER and OGFPM standards, but do not get recognition in the IOSCO standard. Accordingly, as things stand the Government's proposed table will be misleading to a greater or lesser extent for most consumers, in that it will not reflect the actual fees and charges applicable to \$50,000 balance and \$5,000 contribution.

One approach to dealing with this problem would be to add yet more footnotes to the table to explain the problem. This is unlikely to be very helpful for consumers, but might just pass a literal test for not misleading careful readers of the table and accompanying material.

BOXED CONSUMER ADVISORY WARNING

DID YOU KNOW?

Studies show that small differences in both investment performance and fees and costs can have a substantial impact on your long term returns.

For example, total annual fees and costs of 2% of your fund balance rather than 1% could reduce your final return by up to 20% over a 30 year period

(e.g. reduce it from \$50,000 to \$40,000).

You should consider whether investment features – for example, superior investment performance, provision of better member services, or ethical and social considerations* – justify higher fees and costs.

You may be able to negotiate to pay lower contribution fees and management costs. Ask the fund or your financial adviser.

TO FIND OUT MORE

If you would like find out more, or see the impact of the fees based on your own circumstances, the **Australian Securities and Investments Commission (ASIC)** website (www.fido.asic.gov.au) has a Superannuation Calculator to help you check out different fee options, or phone 1300 300 630 for more information.

* The extent to which ethical and social considerations are taken into account by the fund are described at p.X of the PDS.

The percentage effect of fees referred to in the box is consistent with some spreadsheet calculations that have been undertaken by a range of researchers, but the ASIC calculator actually shows for its default example a 15% decrease from a one percentage point increase in fees. This appears to be due to the assumptions in the calculator about contribution patterns and the discounting of future dollars. The compounding effect is not as bad when a real discount rate is used.

It should be interesting to observe what scripts corporate, industry and public sector funds will develop for dealing with consumers wishing to negotiate down the management costs of the fund. Most retail funds also are not keen or able to enter into such negotiations, leaving it more as a matter for consumers and advisers to negotiate over rebating amounts paid on an upfront or ongoing basis to the adviser.

4. Assumptions for web calculators for superannuation funds

ASIC has suggested that default settings be related to industry wide information rather than fund specific information. Set out below are my suggestions for default settings based on industry wide information and industry best practice.

4.1 Employer contribution rate

This is a fairly easy one. Calculators designed for use by the general public should assume as a default assumption that compulsory employer contributions are made at the rate of 9% of wages or salary, the current rate of the Superannuation Guarantee. Calculators should also allow users to set a higher contribution rate in order to project the effect of actual or proposed salary sacrifice contributions. It may be desirable for accompanying explanatory material to indicate the maximum quarterly earnings base for compulsory contributions, which is \$32,180 a quarter (equivalent to \$128,720 per year).

Explanatory material for the calculator also should indicate the difference between personal and employer contributions, and the different tax treatment of each. In regard to the latter, the standard practice of funds is to tax net contributions at the standard rate of 15% when they are received by the superannuation fund. Accordingly, this would be a sensible assumption for a calculator, but there are examples (such as the ASIC calculator as at 30 June 2004) which deduct some or all of fund expenses before determining the deduction of tax from each contribution.

4.2 Personal contributions

Preferably calculators should provide a capacity to factor in personal, undeducted contributions. Even more functionality would be provided if the government co-contribution entitlement was also automatically factored in on the basis that the income entered into the calculator amounted to the total assessable income and reportable fringe benefits of the individual entering their details.

However, as will be noted below, it is difficult to build a co-contribution with legislated parameters and maximum payment set in nominal dollars into a calculator which attempts to produce results in real rather than nominal dollars. Again, the ASIC calculator struggles with this challenge.

4.3 Entry fees

This is problematic to set on an industry wide basis given the wide variety of practices. Accordingly, if a fund does not have an entry (or exit) fee, then it would be fair enough to not include a default setting for an entry fee in the fund's calculator. To do otherwise might be potentially misleading or confusing. On the other hand, when a fund has an entry fee and this is typically charged in whole or part, then in order not to be misleading the default assumptions should reflect such a fee. The question then is whether this should be the maximum entry fee allowed under the trust deed, with the capacity for the user to set a lesser entry fee when they anticipate this can be negotiated, or whether the default setting should be the most common entry fee for the fund. In either case a clear footnote would be needed.

On balance, and in light of ASFA's experience in developing fee illustrations, best practice might be to use the most common entry fee as the default setting. This approach gains some support from the default setting of ASIC calculator which (again at 30 June 2004) had a default setting of a 2% entry fee for balance transfers (but zero for ongoing contributions). This inconsistency in the ASIC approach also illustrates the challenges of trying to develop a calculator relevant to members of all types of

accumulation funds. I have some sympathy for them given the challenges involved, but still am prepared to point out any inconsistencies.

4.4 Earnings rate of the superannuation fund

It would be appropriate to adopt a default assumption for the rate of investment earnings which is consistent with the long term average for a balanced fund (with around 70% growth assets and 30% interest bearing assets) given that 80% or more of accumulation fund members have such an investment mix by default or by choice. The Institute of Actuaries of Australia (IAA) in its Report to the Senate Select Committee on Superannuation in September 2002 recommended a best estimate assumption of 7% nominal per annum after fees and taxes, with a low of 6% per annum and high of 8% per annum. Some web calculators have erred on the side of caution and have gone for 6%, ASFA itself has gone for 7% nominal, and a few have gone for a higher figure. In regard to the latter, ASIC in its calculator has a default based on a growth portfolio, leading to a 7.5% or so default investment return. However, given that the ASIC calculator deducts the same costs twice (both from the gross investment return and from the account balance) their default setting is not far off 7% nominal.

Where a fund has ongoing fees significantly greater than the 1% per year or so implied by a 7% nominal after fees and taxes return, then there may be a case for adjusting the default setting for net investment return downwards. On this approach the default rate should be decreased if the fund concerned has ongoing fees for a balanced portfolio higher than 1%, and increased to the extent that all fees, including any external fees and charges affecting investment returns, are less than 1% per annum. However, it would be unwise to attempt to build in too much precision into what is necessarily a broad assumption. One approach might be to have such decreases and increases in the default earnings rate rounded to the nearest 0.5%. For instance, for a fund with ongoing fees of 1.8% the default earnings rate should be 6% per year, with the same rate applying to a fund with ongoing asset based fees of 2.2% per year.

As well in order not to be misleading a fund might wish to set a lower earnings rate as a default in cases where the only investment option available in the fund is a cash fund or guaranteed investment which is likely to deliver a lower earnings rate than 7% nominal.

4.5 Price indices or deflators

Using nominal dollars for long term projections of fees and/or benefits runs the risk of generating numbers of telephone number length which have little meaning for users. Most calculators and illustrations (certainly the better ones) provide projections in real dollars, or provide the option to produce projections in real dollars. In doing this there is a choice between use of CPI and growth in average earnings. Some calculators allow the option of choosing between deflators, others implicitly allow this for permitting variations from the default setting.

In regard to an appropriate default setting for movement in the Consumer Price Index, the IAA along with practically all constructors of calculators in Australia currently assume growth in the CPI over the longer term of 2.5% per annum.

When long term projections or adjustments of benefits and living standards are involved most commentators and analysts (ASFA, IAA, NATSEM, SPRC, ASIC) use growth in

average earnings as the appropriate deflator. Treasury continues to use CPI even for long term projections, and appear unrepentant about this despite sustained criticism and the lack of anyone else endorsing their approach.

Best practice in calculators providing projections over a period greater than, say, five years would be to use growth in average earnings. Care needs to be taken when policy settings such as the co-contribution are projected forward.

Most analysts use projected growth in earnings of between 3% and 4% per year, with best practice in the range 3.5% to 3.75% per year.

4.6 Estimating income streams in retirement

Any calculation of an allocated pension income stream should reflect the lower taxation and generally lower fees applying to such an investment. For example, for a fund with an ongoing fee of 1% per annum, a 7.5% nominal earnings rate for the account might be appropriate, compared to 7% in the accumulation phase for a similar fee level. This rate is higher than for the accumulation phase because no tax is paid on investment earnings supporting an allocated pension. As with the earnings rate for the accumulation phase, it might be best practice for funds with higher or lower fees than 1% per annum to adjust the default assumption in line with their fee structure. The possibility, subject to the social security asset and income test and other qualifying criteria, of obtaining the Age Pension or other social security benefit, should be explicitly taken into account in any projection of retirement income or at the very least be clearly noted.

5. Projecting the impact of choice of fund on employees, employers and superannuation funds

Forecasting the impact of choice of fund is not an easy task, as it is has only recently legislated, and it will not take effect until July 2005. That said, the Regulation Impact Statement which forms part of the explanatory memorandum for the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2003* makes a number of assessments of the costs and benefits of the legislation. Some of these assessments appear to be very durable, in the sense that identical assessments and numbers have been attached to assorted iterations of the Bill over the preceding couple of years.

5.1 Impact on employers

The explanatory memorandum claims that some 654,000 employers will be affected by the legislation. This estimate appears consistent with previously published ATO estimates of the number of employers required to make contributions under the Superannuation Guarantee legislation. However, it is claimed that 500,000 of these will not be covered by workplace agreements (the latter will largely exempt an employer from the choice of fund requirements).

The assumption that some 150,000 employers will make use of agreements of some kind may be on the high side given the takeup rates to date for AWAs and other agreements, and the extent to which such agreements have and will cover superannuation. However, the choice of fund legislation could well provide an incentive for employers to enter into agreements with employees on either a collective or individual basis. The estimate might also be implicitly taking into account the impact of State awards and agreements, including Western Australia where all State awards dealing with superannuation now provide for choice of fund. There also is some anecdotal that in the lead up to choice of fund some major employers have been more inclined to agree to superannuation being included in a workplace agreement.

The Explanatory Memorandum claims that the cost to business from choice will be \$27 million in initial costs and \$18 million in recurrent costs. This is estimated by multiplying the 500,000 employers by \$54 each for initial costs and \$36 each for ongoing costs.

While the requirements on employers are not as onerous as contained in previous versions of choice of fund, the estimated costs to employers have not been revised downwards. This is just as well, as the estimates could be on the low side. For instance, once an employer identifies a likely default fund, the employer has to consider whether it meets the minimum requirement for default funds.

As well, the impact statement appears to ignore the obligation for every employer to give to each relevant employee a standard choice form before 29 July 2005 and thereafter give such a form within 28 days of an employee starting work. Where employees respond to this opportunity the employer will need to evaluate the member's choice. This might involve determining whether a fund is a public offer fund able to receive any employer contribution, or whether the fund is an industry fund for which the employer would need to become a participating employer, or whether a self managed fund is indeed a complying fund. In other cases the employer might find that the fund is non-complying or for some other reason is unable to receive the employer's contribution.

Employers would need to put in place systems and procedures aimed at ensuring that choice of fund is offered where appropriate, and that any employee response is recorded and acted upon as required. The timing of each of these steps would also need to be recorded. For a large or even a small employer the ongoing cost is likely to exceed \$36 a year on average.

A number of employers will also incur legal and other costs in entering into Australian Workplace Agreements or other agreements so as to cover their superannuation obligations. .

Assuming that all these changes by employers are achieved at the modest cost of \$5 an employee, **the initial cost to employers would be some \$25 million, and around \$5 million annually assuming 20% a year labour turnover.**

Employers will also be required to provide additional information to employees where the employer's contributions are being made to a defined benefit fund. The Explanatory Memorandum indicates that there are some 575 defined benefit funds with 482,000

members, and that there are an additional 592 hybrid schemes. These APRA numbers are actually very dated, with there now being some 280 defined benefit funds and 385 hybrid schemes (with numbers likely to fall even further). Most of the pure defined benefit schemes and members would be in the various unfunded public sector schemes not affected by the choice legislation. On the other hand there are some 3.3 million members of private sector hybrid schemes, but the proportion of these members in divisions with a defined benefit element is not known on the basis of current APRA statistics.

Given the large membership base of the various types of schemes with a defined benefit element, the initial cost of offering choice for such schemes might well exceed \$5 million, assuming a cost of \$10 an employee for providing the additional information required.

There also would be costs to employers from the need to make contributions to an increased number of funds. Greater use of electronic commerce will assist in keeping costs down, but there will be increased costs for businesses unable or unwilling to use such mechanisms. Small business in particular may have to incur additional administrative costs and/or make use of clearing house type processes. While the costs of clearing houses for forwarding superannuation contributions are relatively modest, they will add up. There are likely to be in excess of 20 million compulsory superannuation contributions in 2005-06. Clearing house charges in Western Australia (which already has choice of fund under State awards) are, for one relatively low cost provider, \$5 for each time the clearing house is used and \$1 for each contribution (plus GST).

All up, the costs to employers in the first year would be likely to exceed \$60 million in aggregate and could well be higher, rather than the \$27 million estimated in the explanatory memorandum. Ongoing costs are also likely to be substantially higher than the estimated \$18 million, depending on the number of additional payments being made by employers and the cost of each such payment.

5.2 Impact on superannuation funds

The explanatory memorandum claims that choice would involve initial costs of \$7 million for funds and RSA providers, apparently to cover the costs of providers updating their technology to receive contributions from a wider range of employers. Information technology consultants will be amused to know that the memorandum assumes that the average systems development cost for a fund to comply will be \$54 initially, and \$18 annually thereafter. This would not even cover taxi fares for an initial IT consultation. Based on the published material it appears that some 130,000 funds are expected to incur such costs.

If this were the only cost for funds from choice, it could be an overestimate. There currently are only about 340 retail and industry funds that take employer contributions from more than one employer, and most if not all of these are set up to take contributions from any employer who wishes to participate. System changes would not generally be required, but there are indications that some funds are set up so that they need a separate cheque for each member contribution. Changes to systems to allow

more consolidated payments, including from clearing houses, and by way of electronic transfer would become more urgent for such funds if choice of fund were introduced.

Of the 2,000 (and falling) corporate schemes currently in place, they almost exclusively take their contributions from one employer or employer group of companies. Choice will not mean that they accept contributions from other employers as their trust deeds will not permit this.

An indeterminate number of Self Managed Funds are likely to begin receiving employer contributions as a result of choice, but the number concerned would be in the order of tens of thousands rather than hundreds of thousands. As well, given that such funds have 4 or fewer members they do not to update technology to accept contributions from a wider range of employers (one rather than none?). A new page in the ledger, or a new worksheet in the accounting package would suffice.

However, funds are likely to have substantial additional costs as a result of choice of fund legislation. Many industry and retail funds will undertake substantial marketing campaigns in order to put themselves forward to employers as a suitable default fund and in order to attract employees who are able to exercise choice. **The aggregate increase in the marketing budgets of the 340 retail and industry funds could exceed \$50 million a year assuming a modest \$150,000 increase a fund.**

There also would be substantial increases in the cost of production and distribution of Product Disclosure Statements. Rather than only being sent out after a member has been enrolled, bulk supplies of PDSs would need to be provided to employers by funds that have been nominated as the default fund so that the required information can be provided when the standard choice form is given to employees. Extra copies would have to be printed so that each employer using the fund as a default has a stock of disclosure statements on hand. As well, those employees making their own choice of fund may take the PDS for the default fund but then not proceed to join that fund. The offering of choice to existing employees will require the printing of many millions of extra Product Disclosure Statements.

Assuming an average cost of \$5 per PDS distributed, the initial round of choice could involve costs of \$25 million, with ongoing costs of around \$5 million a year given likely labour turnover.

There would also be increased administrative costs for funds in dealing with contributions forwarded by employers in regard to employees who are not members of the fund nominated by the employee, or cannot be identified on the basis of information supplied, or for one reason or another is ineligible to be a member of the fund. Some retail funds require set minimum initial contributions and/or minimum ongoing contributions. Employers also will incur additional costs in dealing with these errors and inaccuracies which do not currently occur.

In aggregate the increase in costs for funds could be an initial \$75 million or more, with ongoing costs exceeding \$55 million.

5.3 Impact on employees/fund members

The regulation impact statement does not include any estimate of the cost for employees of choice “due to difficulties in predicting how they will react to the measure”. As well, no estimate is made of the value of the likely benefits of choice for employees, the intended main beneficiaries of choice. This is not surprising, as much of the benefit will come from increased control and ownership by fund members, with this being hard to quantify in dollar terms.

However, some estimate of the aggregate costs associated with choice can be obtained by considering plausible movements in the members after choice of fund is implemented.

Table 5.1 provides some estimates of flows in membership which might result from choice. The flows would not occur immediately following choice implementation, but would build up during the first few years. However, the offering of choice to all relevant employees as at July 2005 could lead to some substantial movements during the 28 day period following the offering of choice. That said, the experience of funds with investment choice and the experience of employers who already allow choice of fund but specify a default fund indicate that default options strongly dominate outcomes.

Other forces at work in the market would also tend to accentuate these flows but should not strictly be attributed to choice of fund. For instance, a number of corporate and public sector schemes are being closed to new members or closed altogether due to employer concerns about cost and/or distraction from core business resulting in a shift in members to master trusts and industry funds. APRA licensing requirements which are subject to a two year transition period from 1 July 2004 are likely to accentuate this trend, with APRA itself anticipating only 800 superannuation entities post licensing, compared to over 2,500 now.

Table 5.1: Movement of members after choice of fund implementation(a)

Fund type	Total population (million)	Flow out	Destination
Corporate	1.1	15%	70% master trust, 20% industry, 10% SMF
Industry	7.55	2%	Personal or master trust
Public sector (b)	2.96	10%	70% master trust, 20% industry, 10% SMF
Master trust		5%	Industry fund
RSA		Nil	
Eligible rollover fund		Nil	
Personal retail		2%	Industry fund
Retirement division of retail		Nil	
Self managed fund	0.267	Nil	

Total flows		4.1%	
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- (a) Movements from one sector to another only. Movements from, say, one industry fund to another not included.
- (b) Amount of flows will depend on arrangements for Commonwealth employees and attitudes of State and Territory Governments.

Source: Rice, 1999.

On the basis of these estimates around 4% of total member accounts would move from one type of fund to another, involving a shift of at least 6% or 7% of total superannuation assets, around \$30 billion to \$40 billion in total. This is a not insubstantial amount of assets on the move, but many funds will have flows both in and out. In the case of Self Managed Funds, the flows will almost be inwards, with 50,000 or even more new funds or transfers to existing funds. Self Managed Funds could have inflows of \$20 billion or more, potentially boosting the total amount of assets on the move to \$50 billion or more. Persons establishing SMFs also be definition have substantially higher balances than the average fund member. A not implausible outcome might be a reasonable level of churn within sectors of the superannuation industry, a modest amount of flows between different types of funds, and a significant proportion (even majority) of the asset flows going to SMFs.

On the basis of the assumptions set out above, around half of the movements might be from relatively low cost funds to higher cost funds, leading to about a 1% increase in aggregate superannuation investment and administration costs. This increase in costs could be tempered to some extent by competitive pressures leading to lower personal retail fund charges. The overall increase in costs of the superannuation system would be relatively small, but for some individual accounts the increase could be substantial in percentage terms. However, the individuals concerned clearly would consider that the benefits outweighed the costs, assuming of course that fee disclosure is effective. There also would be cases where individuals would be able to achieve substantial reduction in fees and costs through moving from a high cost fund previously specified by an employer to a lower cost option.

It is also possible that there would be flows in excess of that forecast by Rice. While these estimates are plausible, future outcomes will depend on difficult to forecast behavioural and institutional developments. For instance, if there were a net flow of 10% of industry fund accounts to personal or master trust accounts, then around 6.5% of accounts would have moved. Around 4.5% of accounts would be in higher cost accounts, implying an increase in costs of over 2% for the system as a whole.

The experience of funds in Western Australia, where there has been choice of fund for the 300,000 or so employees covered by State awards for over 5 years, has been that for at least some employers up to 10% of existing employees have already chosen their (different) fund, while more than 50% of new employees coming in will want to stay with the fund they are currently with. This does not necessarily mean a shift from one type of fund to another. For instance, an employee who is already in an industry fund may prefer that fund to an industry fund that is offered as a default option by the employer. Both retail funds and industry funds are continuing to grow in Western Australia, and there is no clear evidence of corporate funds in that State declining in numbers at a rate greater than is the case in other States.

Apart from the impact on administration and investment costs faced by employees, choice of fund also would have some impact on earnings rates and the level of employer contributions received by some members. For instance, it is not uncommon for members of corporate and public sector funds, particularly those funds that are defined benefit, to have contribution rates which exceed the Superannuation Guarantee rate. They also often have compulsory member contribution rate. While some employers might be willing to pay the same superannuation contribution to another fund, many will pay no more than the 9% SG.

On the other hand, it will be entirely rational for members to opt out of defined benefit when they do not believe that they will be members of the scheme long enough to attract a benefit significantly better than would be the case with an accumulation scheme receiving compulsory SG contributions.

6. Projections of superannuation assets

It is now quite a while since the Treasury published any comprehensive tables of projected superannuation assets. Table 6.1 below contains what I understand to be the last such published projections, but I am willing to be corrected on this.

Also in the table are some base case projections extracted from the ASFA-Access Intergenerational Model. Which projections prove to be the more accurate will require the passing of some decades to establish. Perhaps if Phil Gallagher, George Rothman and I by way of some act of bureaucratic cruelty end up in the same Eventide Retirement Home for Superannuation Modellers we will be able to discuss this matter.

For the moment, the ASFA-Access Economics projections have the advantage of extending out for more years. They show a mature superannuation system with the Superannuation Guarantee at 9% topping out with assets of around 130% of GDP. However, with growth in nominal GDP, the total assets under management would continue to grow. These outcomes would be highish by international standards, but there are actually few other jurisdictions with compulsory superannuation or pension contributions and assets equivalent to the Australian system.

In the earlier outyears the Treasury and ASFA-Access Economics projections are remarkably similar. As time progresses the ASFA-Access Economics numbers get bigger, with a higher percentage of GDP, and a higher nominal GDP number.

Year	Treasury total assets all funds \$billion	Treasury assets as % of GDP	ASFA-Access Economics total assets all funds \$billion	ASFA-Access Economics assets as % of GDP
2003			531	69
2005	643	82	650	76
2010	931	96	1,060	95
2015	1,280	107	1,600	110
2020	1,699	117	2,280	122
2025			3,070	129
2030			4,000	132

2035			5,100	132
2040			6,350	129

These projections do not factor in the co-contribution. Higher contributions and/or lower taxes would boost superannuation assets and eventual average retirement incomes. For instance, the ASFA-Access Economics model indicates that increasing the SG to 15% of wages and salaries would lead to superannuation assets peaking at around 195% of GDP.

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