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25 August 2014

Mr David Murray AO
Chairperson
Financial System Inquiry

Dear David

FSI INTERIM REPORT – SUPERANNUATION EFFICIENCY

I am a Superannuation Trustee, a Part-Time Member of the Superannuation Complaints Tribunal and an Actuary with over 40 years' experience in Australian superannuation and investment.

I attended your 14 August 2014 Melbourne Public Forum. During question time you encouraged me to further expand on my views in relation to superannuation fees and costs by means of this written submission.

The preliminary assessment of the FSI Interim Report was:

> *There is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards. This indicates there is scope of greater efficiencies in the superannuation system.*

In forming your view that "*operating costs and fees appear high by international standards*", I have no doubt that the Australian superannuation fees and costs that you have allowed for would have included "Administration" and "Investment" fees and costs, and perhaps "Advice fees". "Administration" fees would cover all trustee, compliance, regulatory, accounting, taxation, member recording keeping, marketing, contribution and benefit costs.

You then compared the above against International pension costs and drew on work by the Grattan Institute. I have two significant problems with regard to these international costs:

1. My experience with international (primarily UK, USA, Europe and Canada) pension costs is that their published fees often cover **only direct "Investment" costs**. I understand that their exclusion of administration and advice costs arises because it is common practice for their employer sponsors to subsidise all administration and advice costs. Their exclusion of indirect investment costs arises because these costs are usually absorbed within unit prices.

2. Another aspect that makes a huge difference is that overseas costs are often expressed as a percentage of assets. These overseas systems are usually **many times more mature** than ours and average member account balances are therefore much higher. Thus when their costs are expressed as a percentage of the high average assets the resultant rates appear to be low compared with Australian costs.

These two problems are not minor distortions – taken together they could distort the comparisons by a factor of say 10:1 (i.e. ten times) or more. There are also other reasons why the comparisons are unfair - such as Australian taxation assessment costs relate to **frequent** contribution and investment transactions (and are **born by funds**) whereas the overseas equivalent relates to relatively **infrequent** benefit payments (and are **born primarily by members**).

The preliminary assessment of the FSI Interim Report also states "*there is little evidence of strong fee-based competition in the superannuation sector*". Based on my experience, I believe that there is quite strong fee based competition in the sector but it is not effective.

The key reason for this inefficiency is that the Australian superannuation fee and cost disclosure regime fails the first principle of effective fee and cost comparisons. The first principle is that superannuation cost comparisons should start with separation of administration, investment and advice fee components. The MySuper SIS definitions require separation of these components but the Corporations Act and Regulations focus incorrectly on **total** fees and costs. For "Choice" products the SIS and Corporations Act requirements both incorrectly focus on **total** fees and costs.

The attached appendix contains some relevant extracts from the Actuaries Institute submission of 12 February 2014 in response to the Government's Discussion Paper on better regulation and governance, enhanced transparency and improved competition in superannuation.

Yours sincerely

COLIN GRENFELL

APPENDIX

This appendix contains some extracts from the Actuaries Institute submission of 12 February 2014 in response to the Government's Discussion Paper on better regulation and governance, enhanced transparency and improved competition in superannuation. The extracts relate to why Australian fee-based competition in the superannuation sector is not effective.

Page 3

MySuper and Choice dashboards should **compulsorily** include standardised administration, advice and investment fees and costs for two representative members in a simple table such as the following:

Statement of annual fees and other costs		
	Member with a $10,000 account balance	Member with a $50,000 account balance
Administration	**$xxx**	**$yyy**
Advice	**$ccc**	**$ddd**
Investment	**$aaa**	**$bbb**
Total	**$TTT**	**$SSS**

The amounts $aaa and $bbb should be included on the dashboard for all investment options.

Pages 12 to 14

Fee and cost disclosure

The Institute believes that administration and advice fees and costs of one fund can only be properly compared to the fees and costs for another fund **separately from investment fees** and must take into account the level of the administration and advice services provided and the quality and timeliness of these services. We recognize that it is difficult to compare administration service (and the quality) of these services. However, if a service provider wishes to differentiate their product by adding different services or ensuring higher service levels (e.g. by providing a more personal website experience) it is important that dashboard reporting requirements do not reduce the possibility that members will have access to these additional services. Similarly it is only possible to compare investment options if investment fees and costs are separately disclosed from total fees and costs.

We note that our suggested table above discloses the **total** of the fees and costs. We have included the totals because we believe that it is currently the view of APRA that total fees and costs must be shown. However, the Institute believes that, at least for Choice products, the total of administration, advice and investment fees and costs has little comparative value for a member and should not be a compulsory inclusion in the table. We believe the total of these fees and costs is likely to mislead members unless they pay close attention to all the specific administration, advice and investment features which underlie the total fees and costs, to ensure they are comparing like-with-like.

Excluding the total fees and costs also reduces and simplifies the volume of information disclosed, particularly for Choice products with many investment options - for most Choice products (which have the same administration and advice fees for all investment options) it also can avoid unnecessary repeats of the administration and advice and total fees for every investment option.

A member, particularly a member considering a Choice product, should consider the relative value and costs of the administration, advice and investment services separately.

Experience since the latest fees and costs template was introduced in 2004 has also highlighted that market competition has been affected by the inclusion of passive, indexed based, investments. These assets will normally attract lower total fees and costs. In these cases, where currently only the total of all fees is quoted on the Dashboard, the total fees disclosed is reduced substantially because of the lower fees incurred with passive investments. Members, who can only compare total fees, may select lower cost funds without considering the impact of passive investments on their overall net investment return.

Further, if the administration and advice fee component is "standardised" for only a $50,000 balance, it will still be potentially misleading for the vast majority of "non-standardised" members. Calculations made by the Institute have demonstrated that deducting administration and advice fees and costs from the investment return may mislead members who expect to have low account balances throughout their membership. As the Net Return is based on a $50,000 balance, this Return may incorrectly indicate the attractiveness of some funds for members with lower account balances. If this is the case, these funds may unfairly attract members who expect to have lower account balances prior to their retirement. A related problem arises with the "Statement of [total] fees and costs" displayed on the MySuper dashboard because only one [total] standardised result is shown.

The problems addressed in the two preceding paragraphs arise primarily because Australian accumulation-based superannuation funds express their administration fees and costs in one of the following formats:

A. Solely as a dollar amount per member (11 out of 100 Funds), or
B. Solely based on account balances (34 out of 100 Funds), or
C. Partly as a dollar amount per member and partly based on account balances (54 out of 100 Funds), or
D. Zero, because administration fees and costs are payable by the employer (1 out of 100 Funds).

[The above numbers are sourced from the August 2013 Chant West Super Fund Fee Survey, adjusted for known changes in late 2013].

The impact of administration fees and costs on the overall return to a member depends on the member's account balance. A simple way to alert members to this is to illustrate the annual administration and advice fees and costs for two representative members with, we suggest, account balances of $10,000 and $50,000 (and annual contributions, if relevant for Choice products, of $1,000 and $5,000 respectively).

Why do we suggest two representative members?

1. For Type A funds the administration fee and costs for the two representative members will be the same,
2. For Type B funds the administration fee and costs for the second representative members will be five times the first.
3. For Type C funds the administration fee and costs for the second representative members will be between one and five times the first.
4. For Type D funds the administration fee and costs will be (or should be) zero if paid by the employer.

Further, **the growth in the impact of administration and advice fees and costs is important.** The growth in administration and advice fees and costs of a Type A member is significantly different to that of a Type B member. **To properly address this requires a projection but having two representative members will help to indicate that further information, and perhaps a projection, might be desirable.**

We also note that the investment fees and costs are typically a percentage of assets. Disclosing these fees and costs for only one balance may mislead a member with larger account balances if they do not read the "small print" relating to the $50,000. Disclosing these fees and costs for two members with different account balances will immediately highlight the impact of the size of a member's balance on the investment fees.

[Actuaries Institute submission of 12 February 2014 in response to the Government's Discussion Paper on better regulation and governance, enhanced transparency and improved competition in superannuation]