



IFSA 2009
International
superannuation &
pension fund fees



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21 September 2009

Dear John

Re: IFSA 2009 International Superannuation & Pension Fund Fees Report

We are pleased to enclose the IFSA 2009 International Superannuation & Pension Fund Fees Report produced by Deloitte.

International comparisons of superannuation fund fees are complex due to different regulatory environments (in Australia, areas such as member protection, licensing costs of trustees), different investment allocations (growth, active vs. passive, alternatives), the scale of different markets, defined benefit vs. defined contribution nature of the arrangements, treatment of advice, disclosure regimes, and so forth.

Our major conclusion is that, after allowing for structural and other differences including a differentiated approach to investment management, the larger Australian funds in each sector are broadly competitive globally on administration and investment fees. It is also clear that the regulatory regime in a country has a major impact on the structure and therefore the costs of that country's pension system.

This is the first time a survey of this nature has been conducted in Australia and the exercise has highlighted the difficulty in identifying and ratifying appropriate data to enable meaningful comparisons. Nevertheless, despite having to make some compromises, we believe this study will provide a strong platform for future studies of the competitiveness of Australian superannuation funds.

We commend the report to IFSA and your members and will be happy to discuss any aspects of the report at your convenience.

Yours sincerely

Michael Monaghan
Partner
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Executive summary

IFSA has commissioned Deloitte Actuaries and Consultants to compare the fee structures of Australian superannuation funds with the fee structures of similar organisations in different parts of the world. This benchmarking provides insights into the effectiveness and efficiency of the local industry – and of the impact of the regulatory environment.

In making our comparisons, we have made use of academic, commercial and government research – as well as looking at the fees charged by well known institutions in different countries. In obtaining and interpreting the data, we have liaised with Deloitte offices in a number of overseas countries. We have selected OECD countries where private retirement funds play a similar role in the economy and in the delivery of retirement incomes to Australia: the USA, UK and Japan have bigger industries because of their larger populations, but Canada and the Netherlands are similar in size to Australia, while Denmark is smaller.

Comparisons have been made much more difficult by significant differences in the structure of superannuation industries in different countries and the absence of accurate national average charges. We were unable, for instance, to find any comparable survey to that commissioned by IFSA for the Australian market.

The major comparison challenges can be summarised as:

- regulatory differences, where Australia is quite different to most countries, e.g. Australia's licensing regime for superannuation funds is not mirrored in other countries, so we would expect to see increased costs (and possibly fees) relative to other markets
- a surprising lack of reliable data in most countries and therefore the need to compare data from different years across countries
- confusion between fees and costs
- non-disclosure of fees and costs, especially investment fees which tend to be netted off performance in some countries, leading of course to significant understatement
- employer subsidies of costs for standalone corporate funds are very difficult to estimate but are significant
- non-existence of sectors in other countries, specifically the SMSF sector and lack of a developed corporate master trust sector in any other country
- maturity of funds, measured by average balance per member, can severely distort comparisons of fees measured as a percentage of assets/member balances, not only between countries, but also between sectors within countries
- key differentials of administration costs being transaction volumes and scale, where Australian funds incur significantly higher transaction volumes.

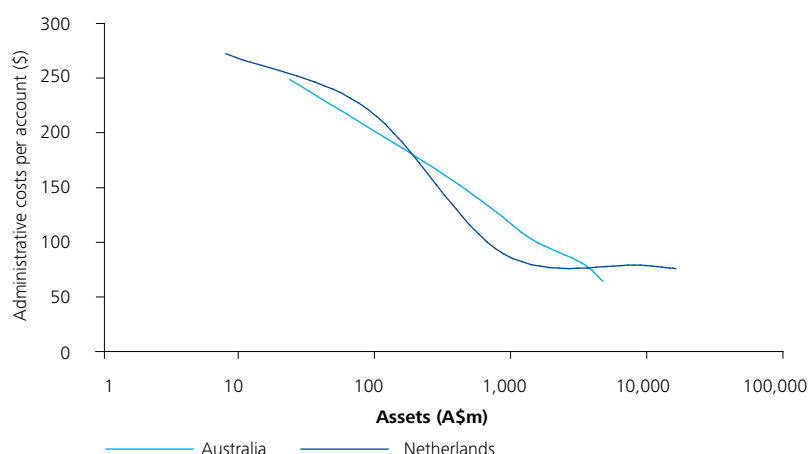
Our study does however find that the most efficient of Australian funds compare favourably with the most efficient funds internationally. This appears to be true for most types of funds and for administration and distribution (including advice) fees, as well as for investment management fees, once adjustments are made for asset allocation (including allocations to alternative asset classes), active/passive management and scale differences.



Industry funds

Large Australian industry funds' administration fees appear to be competitive with the lowest cost funds in the world when the comparison is based on actual costs per member rather than as a percentage of assets. Clear scale benefits exist in this sector in each country.

The chart below compares the absolute costs per member for administration for Dutch and Australian industry funds. Even allowing for the fact that the data relates to different years, the chart clearly demonstrates the scale benefits in both countries together with the competitiveness at all size levels of the Australian industry funds.



Sources: Rice Warner, Dutch Central Bank, Deloitte analysis.

Note: the administration fees have been smoothed to take out the effects of the different funds and their pricing anomalies.

The Netherlands and Denmark, two countries where industry-wide funds are in fact the dominant sector, appear to have been more successful in eliminating inefficiencies caused by lack of automation and duplicate accounts – it is estimated that the resulting legislated member protection costs in Australia amount to around ten basis points per annum in additional fees.

Industry fund investment costs are generally higher in Australia than in the Netherlands and Denmark. The latter countries typically have more than 50% of assets in (passive) fixed income strategies and very little in alternative/unlisted assets. Australian industry funds have until recently adopted more active management approaches in most asset classes and have relatively high weightings to alternative and unlisted assets.

Corporate funds and corporate master trusts

It is difficult to make comparisons with corporate funds because this is one area where the level of employer subsidies of costs varies enormously, not only by fund but also across countries. In Japan, employers typically pay all the administration costs.

Nevertheless, based on our research, there are clear scale benefits in every country for corporate funds and this is also the case in Australia.

The table below shows our estimates of the average fees for corporate funds in the countries we surveyed (Denmark has very few corporate funds). The fees are for defined benefit and defined contribution plans in the US and Japan. UK and Netherlands funds are predominantly defined benefit. Australian standalone plans and corporate master trust sub-plans are either defined contribution or hybrids of defined benefit (mostly closed to new members) and defined contribution.

Country	Admin fees	Investment management fees	Total
USA – defined benefit	0.38	0.39	0.77
USA – defined contribution	0.01	1.01	1.02
Japan – defined benefit	0.04	0.15 – 0.46	0.19 – 0.50
Japan – defined contribution	0.32	0.20 – 1.50	0.52 – 1.82
UK	0.40	0.20 – 0.50	0.60 – 0.90
Netherlands	0.19	0.20	0.39
Australia – stand alone	0.24	0.47	0.71
Australia – large corporate master trusts	0.20	0.56	0.76

Note: All fees above are expressed as a percentage of assets. Sources: ICI Perspective (December 2008), 401ksource.com (2008), Deloitte Japan, Deloitte UK, Bikker (2006), Rice Warner (2008).

The administration fees are similar across a number of countries, with apparent anomalies in the US and Japan. In Japan this is reflecting the fact that most of the funds are defined benefit and most of the fees would be paid by the employers. The US numbers for the costs of 401(k) providers reflect a clear pricing structure differential where most of the cost is attributable to the investment management charge and what seems like a minimal allocation to administration costs. This may be due to scale differences as well as reflecting that many of the services classified as administration in other countries may be supplied by the mutual fund providers, with whom a large proportion of the assets are invested. In addition there would still be significant costs borne by US employers as these are predominantly stand-alone 401(k) plans.

Australian standalone corporate funds, particularly the larger ones, appear to be globally competitive both in terms of administration and investment when the comparison is made as a percentage of assets. This is partly because our corporate funds tend to have a high average balance per member and also because corporate plans may have a more similar investment profile, at least with UK and USA plans, even though they have a higher defined benefit orientation.

We also compared larger corporate master trusts against fees for corporate funds. In the IFSA Australian fees study, these are categorised as sub-plans within corporate master trusts with more than \$10 million of assets. We know from our role running tenders for corporate clients that this is one of the most competitive parts of the Australian market – the result is that large corporate master trust fees are globally competitive on pretty much any scale.

At the smaller end, Australian corporate master trusts are comparable with the retail sector.

Retail funds

The retail sector was the most difficult sector for which to find data of a comparable quality overseas.

Direct comparisons of retail funds need to address the exclusion or inclusion of advice fees. In a number of countries, the trend is to separate advice fees from product fees. A further difficulty is that we were unable to identify other countries where it is common to charge a separate fee for platform costs as in Australia. For the total retail fees including advice we compared Australia and the UK and found broadly that the total cost is comparable, with Australia slightly higher due to platform fees.

However the UK regulators introduced stakeholder pensions in 2001. These are essentially a low cost, no-frills, highly focused product for low income members. These are subject to maximum fees of 1.5% p.a. of the account balance, but the major providers typically offer fees of 1% p.a. or less.

The US retail market is dominated by individual retirement accounts, with 40% of American households owning one. Typically these exclude advice and provide a very broad range of other services. Fees vary from as low as 0.20% p.a. for fully passive offering, with the average fee being around 1.2% p.a. of the account balance.

We believe that there is the potential for a new product set to emerge in Australia for the retail market with lower fees, streamlined services, more online features and with advice provided separately. This is likely to be an attractive product in the future for Generation X and Y consumers – they already control 47% of the pre-retirement superannuation asset pool in Australia.

Some major providers have recently launched similar products into the Australian market, although we understand take-up by consumers has been somewhat mixed to date. Added impetus will be driven by the recently released IFSA Superannuation Charter.

Administration costs

It has been difficult to source data on administration costs, rather than fees charged. We obtained some information from a benchmarking study conducted for large pension/superannuation providers in different countries by CEM Benchmarking.

It is apparent that the key differentials are transaction volumes and scale. Australian superannuation funds incur significantly higher transaction volumes than other countries, possibly reflecting our defined contribution environment. Also, US plans in the sample averaged 2.5 times the size of Australian plans and therefore would be expected to have higher economies of scale.

Investment management

Conventional wisdom is that investment management costs for Australian superannuation funds are higher than in other countries. In absolute terms, we believe that this is generally the case, but when the comparisons are normalised to take account of differences in approach, Australian investment management costs are comparable with those in other countries.

The main reason for higher investment costs in Australia is that we have a much higher proportion of defined contribution assets than any other country. These plans are typically return seeking in the pre-retirement phase.

Many plans and the bulk of assets in other countries are still defined benefit plans which use asset liability matching strategies or liability driven investment strategies which tend to have a high fixed income component and a high passive component. In addition, many of the defined benefit plans around the world have a large population of pensioners already, leading to even more significant differences in investment strategy relative to Australia.

The four major drivers of differences as a result are:

- higher asset allocation to growth assets in Australia than in Europe (the average Dutch and Danish plans have more than 50% in fixed income assets)
- UK, European and Japanese plans have significantly higher use of passive investment strategies
- in most sectors, there is much higher use of alternative assets in Australia than any of the other countries
- scale benefits exist for large funds in Australia but apply even more for the very large funds in the US, Japan and Europe.

A further difficulty arises with investment fees and costs because of poor disclosure of investment costs in published data in most countries. Whilst still having some shortcomings, Australia has a better disclosure regime (via the Product Disclosure Statement) than a number of the other countries.

Conclusions

- Australian funds, especially the larger funds in each sector, are broadly competitive globally on administration and investment fees, allowing for a differentiated approach to investment management and also the fact that we will always have some scale disadvantages because of our small population relative to the European countries, UK, Japan and the USA
- the regulatory regime in a country has a major impact on the structure and therefore costs of that country's pension system. All of the countries surveyed maintain highly regulated pension systems
- scale is critical to achieving lower fees in any superannuation system and across most sectors. The rationalisation of the superannuation industry which has occurred in Australia over the last five years has certainly delivered scale benefits and lower fees to most members. However there are sectors, particularly the corporate and industry fund sectors, where further rationalisation will provide more benefits
- there is still plenty of room for efficiency gains in Australia with further automation and elimination of duplicate accounts in our system
- international comparisons are complex and need to be viewed with an understanding of the difficulties, and lack of comparability of data in certain areas
- comparing fees as a percentage of a member's assets/account balance is the most common method used. However, average assets per member varies widely and therefore comparisons based on fees as a percentage of assets can be misleading especially for administration fees. This reflects that most administration costs are related to the fund and the number of members, not the value of the fund's assets.

We recommend that IFSA, other industry bodies, government and regulators join forces to improve the quality and measurement of fees and costs data in Australia as well as initiating discussion with their counterparts around the world to encourage a better measurement regime of fees and costs in their pension funds so that we can begin to generate a more rigorous international comparison.

A key component of this will be ensuring that there are consistent data collection regimes and measurement methods around the world. This will give us the ability to benchmark the Australian system with world's best practice. Deloitte will be happy to assist in this process.

International comparisons of superannuation fund fees are difficult due to different regulatory environments (in Australia, areas such as member protection, licensing costs of trustees), different investment allocations (growth, active vs. passive, alternatives), the scale of different markets, defined benefit vs. defined contribution nature of the arrangements, treatment of advice, disclosure regimes, and so forth.

After attempting to equalise for those impacts, our conclusion is that Australian fees are broadly consistent with those charged internationally, especially for the larger funds in each sector

1 Background to assignment

IFSA has commissioned Deloitte Actuaries and Consultants to compare the fee structure of Australian superannuation funds with fee structures for similar organisations in different parts of the world.

This benchmarking of the fees of Australian superannuation funds against those in other countries is expected to provide insights into the effectiveness and efficiency of the local industry – and on the impact of its regulatory environment.

The 'Superannuation Fees Report 2008: Market Segment Analysis at 30 June 2008', commissioned by IFSA, and prepared by Rice Warner (IFSA 2008 Fees Report), estimated that the total Australian superannuation industry incurred costs of some \$14bn in 2008 – or 1.21% of superannuation assets in that year. This is consistent with Ellis *et al* (2008), who acknowledge that they have not adjusted APRA data for embedded charges. The total is equivalent to a little more than 1% of GDP or 2.5% of household expenditure.¹ This compares with 7% of total household expenditure consumed by financial services in total.

1.1 Methodology and data

Charges can be measured in a variety of ways. As discussed in more detail in Section 1.4, the charges made to members and the underlying expenses incurred may have a relatively loose relationship.

Most comparisons of fees express the annual charge as a percentage of account balances as being readily understandable and easy to compare. We have used this method for the most part in this study, however it has a number of shortcomings when comparing administration fees in particular, so where appropriate we have used different approaches, such as amount per member per annum.

We used the analysis of expenses in the IFSA 2008 Fees Report as the basis for Australian fees for our research, so we are endeavouring to make comparisons across the different categories of private sector funds used in that report, specifically:

Wholesale	Corporate
	Corporate super master trust (large)
	Industry
Retail	Corporate super master trust (small)
	Personal superannuation

The study did not extend to post retirement products or the small retirement savings account and eligible rollover funds segments. Likewise we were unable to find any directly comparable segment to self managed superannuation funds in other countries.

Questionnaires were sent to Deloitte offices in seven countries. We had hoped to be able to access similar industry wide surveys or public data to evaluate the costs of superannuation schemes, but have been unable to find adequate sources in any country. We could not identify in any country a report even slightly similar to the IFSA 2008 Fees Report. We have however accessed:

- a variety of academic, commercial and government research
- subject matter experts in Deloitte offices who have well developed views and representative data which has enabled a compilation of some of the data in this report
- commercially available fee surveys in some market niches in some countries as well as from the OECD.

This has enabled us to make comparisons, but with limited ability to cross-check accuracy across sources. Even in Australia it is challenging to source robust data. The Australian Prudential Regulation Authority (APRA) publishes detailed statistics of superannuation and life insurance entities, but it is still not possible to determine and accurately allocate the total charges. Asher (2008) discusses the problem and attempts to calculate total charges, but has to estimate a number of significant variables, for example costs charged by life insurers and investment managers that are netted off investment income and not explicitly shown in superannuation fund/member accounts.

¹ When compared to the totals reflected in ABS report 5206.0 Australian National Accounts: National Income, Expenditure and Product

The IFSA 2008 Fees Report has addressed the same problems by a detailed examination of marketing disclosures and other company information.

These appear to be universal problems and mean that many comparisons need to be treated with caution.

1.2 International models and regulatory regimes

There is a variety of superannuation and social security arrangements for retirement around the world, each with an assortment of different components. Of interest to this study are funded arrangements, particularly those that allow for a significant defined contribution (DC) component, with freedom of investment allocation. This therefore excludes government funded arrangements. We also restrict ourselves to OECD countries that are likely to have similar cost structures to Australia, not least because their pension systems are of similar size relative to GDP.

Table 1: Global pension assets

	2008 assets (US\$bn)	2008 assets/ GDP (%)	Size relative to Australian assets
US	12,439	87	1732%
Japan	2,731	56	380%
UK	1,746	63	243%
Netherlands	867	95	121%
Australia	718	67	100%

Source: Global Pension Assets Study by Watson Wyatt Worldwide January 2009

In this report, we have used the following exchange rates for the purpose of converting local currency amounts into Australian dollar terms:

AUD	USD	CAN	Euro	Japanese Yen
1.00	0.73	0.88	0.59	80

Section 2 of this report is a summary of the regulatory environment and the public and private sector pension tiers in each of the countries included in the comparison study. The regulatory environment has a significant impact on the structure of the private sector market, particularly in relation to the types of funds which have been established, the sectors which have flourished as a consequence and therefore the costs of the private pensions sector.

The development of the industry wide plans in Denmark as the dominant form of provision in that country is a good example of this phenomenon.

It also highlights why no market has developed in exactly the same way as any other country. Australia and Denmark stand out from the other countries surveyed in one characteristic, which is the relative lack of importance of the stand alone corporate funds sector. Government policy in both countries has led to the dominance of multi-employer and industry-wide funds. This compares with corporate funds being the dominant paradigm in the majority of countries surveyed.

In addition, Australia's licensing regime for superannuation funds is not mirrored in other countries, so we would expect to see increased costs (and possibly fees) relative to other markets.

1.3 Defined benefit versus defined contribution funds

The other characteristic which tends to distinguish Australia from the majority of countries is the dominance of defined contribution plans relative to defined benefit plans. Australian companies/ governments have moved much more quickly than other markets to devolve defined benefit plans and, in addition, the massive expansion of coverage of superannuation in Australia which began in the late 1980's with industry superannuation and was cemented in place by the Superannuation Guarantee introduced in 1992, was all premised on a defined contribution basis (although existing defined benefit arrangements may have incorporated these changes on either a defined benefit or defined contribution basis, or a hybrid of both). The following charts clearly illustrate the dramatic differences between Australia and most other OECD countries.

Chart 1.1: DB/DC asset split by country – change over the 10 years to the end of 2008



Whilst there has been a secular switch from DB to DC in aggregate, within individual countries large corporate contributions to DB plans may explain shorter term instability. The same may result from differential asset allocations between DB and DC assets.

Both at the end of 1998 and 2008, Australia had the highest proportion of total pension asset in DC plans (76% in 1998 to 88% in 2008).

Of the P7 markets, Switzerland fills the second position (57%) and US, the third position (56%) in terms of the proportion of total assets in DC plans at the end of 2008, up from 50% and 43% respectively in 1998.

However, the biggest changes can be seen in the UK and the Netherlands. Since 2003, UK pension funds have experienced an important shift in DC, jumping from 15% in that year to 39% in 2008. Similarly, in the Netherlands, 9% of assets are in DC, up 8 percentage points from 1% in 2003.

Japan remains the country with the lowest proportion of pension assets in DC.

Source: Global Pension Assets Study by Watson Wyatt Worldwide January 2009

This is significant when comparing fees as fees are not relevant to a defined benefit member, whereas they have a significant effect on defined contribution accumulations when (typically) deducted from the member's account.

1.4 Fees versus costs

Costs and fees are two very different concepts in relation to this study. For the purpose of this report, 'costs' refers to the actual expenses incurred in running a fund, whereas 'fees' refers to the fees which are charged to the fund or to members.

The IFSA Australian study is of fees charged by funds to members and this study is attempting to compare fees charged to members as well.

Where possible we have collected data on fees charged to members by different types of funds or in some cases by service providers to funds. This has been one of the most difficult aspects of the study and an area where there is much propensity to mistakenly compare apples with oranges.

Many costs are effectively hidden, being borne directly by the employer

The problem emerges because in many countries, stand alone corporate plans, often defined benefit, do not calculate or disclose fees at the member level or the fund level. Many costs are effectively hidden, being borne directly by the employer (e.g. through employing some of the staff who manage the fund or by paying some or all of the fund's direct running costs) and not passed through to the fund. It is also relatively common for investment fees to be netted off performance and not actually disclosed at all, leading to a degree of understatement when quoting averages.

Very large funds in most countries (which are typically not-for-profit or public sector) tend to employ all their own staff for many functions including part of the investment management. It is extremely difficult to find data on their costs or fees (if any), although we have made some observations in Section 6.

1.5 Definitions

We have used the following definitions in analysing fees into those that relate to administration, investment, distribution and advice. It is apparent from the results that differences in classification of costs in different countries and by different providers is another source of difficulty in making realistic and fair comparisons across borders.

- administration charges cover the costs of collecting contributions, record keeping, unit pricing, benefit payment, communications, regulatory compliance, accounting and so on. For retail business, the more direct costs of advice and distribution are included under distribution expenses, but individual arrangements for the more sophisticated 'platform' administration required are included in administration charges. Likewise, marketing, distribution and advice costs (if any) for industry, corporate and public sector funds are typically covered by administration fees
- investment fees cover the costs of economic and investment research, asset consulting and portfolio management, which includes the costs of asset management and custodial services. We have excluded investment transactions costs (including buy/sell spreads) such as brokerage and stamp duty as they are typically netted off performance and not reported
- advice and distribution charges are those that are paid to financial advisors, salespeople or brokers for their work in providing advice or canvassing for new funds or fund members. Their direct support costs are also included. In Australia, UK and some other countries, fees and commissions for these services are largely based on the account size. Advice will normally cover products, recommended contribution levels, choice of investment options and insurance cover levels, and tax.

1.6 Reliances and limitations

As discussed above, we experienced difficulties in obtaining adequate information regarding the breakdown of costs of superannuation schemes in the different countries covered. In particular, reliance was placed on the following items:

- a variety of academic, commercial and government research
- subject matter experts in Deloitte offices who have well developed views and representative data which has enabled a compilation of the data in this report
- commercially available fee surveys in some market niches in some countries as well as from the OECD.

We have relied on the accuracy and completeness of all data and other information provided to us for the purpose of this report. We have not independently verified or audited the information, but we have reviewed it for general reasonableness and consistency, with limited ability to cross check accuracy across sources. It should be noted that if any data or other information is inaccurate or incomplete, our report may need to be revised.

This report has been prepared for the sole use of IFSA for the purpose stated in Section 1. No other use of, or reference to, this report should be made without prior written consent from Deloitte, nor should the whole or part of this report be disclosed to any other person.

The report should be considered as a whole. Members of Deloitte staff are available to answer any queries, and the reader should seek that advice before drawing conclusions on any issue in doubt.

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2 Public & private pension systems

This section sets out a summary of the regulatory environment and the public and private sector pension tiers in each of the countries below

This section sets out a summary of the regulatory environment and the public and private sector pension tiers in each of the countries included in the comparison study:

- USA
- UK
- Japan
- Netherlands
- Denmark
- Australia.

2.1 USA

The US pensions system is comprised of three main pillars and totaled \$16.9 trillion² as of 30 June 2008, the highest among all nations.

The Social Security system

The public pension benefit, known as social security, provides a progressive benefit formula as well as a means-tested top-up payment for low-income pensioners. Benefits are based on career average earnings for the 35 highest years of earnings and are indexed to the rate of inflation.

Social security is funded through dedicated payroll taxes, called FICA, of 6.2% of gross compensation, which is paid by workers and employers on annual income up to \$102,000.

Regulatory environment

The US pension system is relatively highly regulated, with three key pieces of legislation (each amended periodically):

- the Revenue Act, which was amended in 1978 to establish what is now the dominant form of employer sponsored defined contribution plan – the 401(k) plan.
- the 1974 Employee Retirement Income Security Act (ERISA) which regulates defined benefit pension plans and established the Pension Benefit Guaranty Corporation (PBGC), which pays benefits in the case of financial failure of complying defined benefit funds. PBGC receives no funds from general tax revenues. Its operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans
- the 1947 Labour Management Relations Act (the Taft-Hartley Act) which includes guidelines for multi-employer funds administered jointly by employer and employee representative trustees.

Employer based retirement plans

Defined benefit employer plans can be sponsored by a single employer, government or multiple employers, such as Taft-Hartley funds. If an employer offers a plan, participation is automatic and thus compulsory for covered employees. Employees do not usually contribute to these plans.

401(k) plans are defined contribution plans which allow employees to make pre-tax contributions from their salaries and are the dominant form of defined contribution plan. Employers are required to match employee contributions according to an agreed formula, subject to maximum contributions of USD\$42,000 or 25% of salary, whichever is lower.

Private retirement savings

Individual employees and the self employed may establish Individual Retirement Arrangements (IRAs) through a contract with an IRA provider. IRAs are a tax advantage method of retirement saving, originally created under ERISA but with various versions added over time. Small employers can also use IRAs for their employees. Approximately 40% of US households held an IRA in 2007.

² ICI Research Fundamentals (Vol. 17, No. 3-Q2, December 2008)

2.2 UK³

The UK pensions system has five tiers, of which three tiers are state-provided, and two tiers are provided by the private sector.

State pensions

The state provided component has three tiers:

- the Basic State Pension, which is a flat-rate basic pension (about 25–30% of average earnings), paid for by contributions to social security through National Insurance and general taxes. Qualification for the basic state pension is based on the number of years social security contributions have been made
- the State Second Pension (S2P, previously known as State Earnings Related Pension or SERP), which is an earnings-related additional pension. It is compulsory for employees to contribute to either the S2P or to an alternative private pension plan. Some 48% of employees are 'contracted out' of the S2P
- a means tested income support component.

Private sector pensions

The private sector has two tiers, both of which are voluntary, namely occupational (employer approved) schemes and personal pensions.

Regulatory environment

The UK market is relatively highly regulated with a variety of legislation covering social security pensions, pension schemes, tax and welfare reform. The earliest legislation was the 1834 Superannuation Act.

Occupational schemes

Occupational schemes were traditionally defined benefit, but there has been rapid growth since the mid-1980s in defined contribution plans; there were still 14.2 million members in DB plans in 2006 compared to 2.4 million in DC plans. The majority of plans are classified as Exempt Approved Plans, which means amongst other things that most contributions and investment income are tax free.

Around 70% of organisations with 20 or more employees make pension provision for employees whereas only 36% of smaller organisations do so. Employers can establish their own pension plan, or contribute to a Group Personal Plan or to a Personal Pension on behalf of employees. Most larger and medium sized employers offer a Group Personal Pensions plan, where employer and employee contributions average 9%, compared to around 16% for Defined Benefit plans. A very small number of industry funds exists.

From 2012 Personal Accounts will be introduced. Employees without a 'good' workplace pension will need to be auto-enrolled into Personal Accounts contributing 4% of their remuneration, with employers contributing 3% and tax relief accounting for 1% – i.e. total contribution of 8%. Employees may opt out.

Personal pensions

Personal pensions were introduced in 1988, giving the private sector a greater role within the overall framework. Since their introduction they have proved very popular as they do not tie people to employers and also attract significant tax relief. These are defined contribution arrangements and can be established for a variety of purposes, including by the self-employed, who are excluded from the S2P.

Personal pensions which meet certain conditions can be designated as Stakeholder Pensions. These are targeted at those earning between £10,000 and £20,000 per annum, but are available to almost everyone. Stakeholder pensions must satisfy a number of minimum government standards to ensure that they offer value for money and flexibility. These standards include:

- annual management charges are capped at 1.5% for the first 10 years, and then reduced to 1% (except the maximum annual charge for members who purchased their stakeholder pension scheme before 6 April 2005 will remain at 1% for as long as they remain in the scheme)
- the stakeholder pension contract must not have charges for members transferring into or out of the stakeholder pension scheme
- all stakeholder pension schemes must accept contributions of £20 or more, though some may accept lower payments.

³ Pensions at a Glance: Public Policies Across OECD Countries 2007

2.3 Japan⁴

Japan has a three-tier pension system. Persons aged between 20 and 60 who are residents in Japan are required to join and contribute to Japan's national pension scheme.

Regulatory environment

Japan has a fully regulated pensions system with three key pieces of legislation:

- the Employees' Pension Insurance Act, amended in 1965 to allow partial contracting out of the public Employees' Pension Insurance Scheme
- the 2001 Defined Contribution Occupational Pensions Act, enabling the establishment of both 'corporate-type' and 'personal defined' contribution plans
- the 2001 Defined Benefit Occupational Pensions Act which established two new types of defined benefit plan – 'fund-type' (stand alone pension fund) and 'contract-type' (implemented through a contract with a trust bank or life insurance company) – which effectively replace by 2012 all existing Tax Qualified Pension Plans (TQPPs).

Overview of the public pension system (Tier one & two)

As of 31 March 2003, the number of public pension beneficiaries amounted to 30.76 million. The Basic Pension (BP) is the first tier of the Japanese pension system, which provides a flat rate benefit for every elderly person. In order to finance the BP, tax revenue equivalent to one-third of the actual benefit expenditure is transferred to this scheme by the central government.

The second tier comprises earnings related public pension schemes:

- the Employees' Pension Insurance (EPI) for private sector employees
- the National Pension Fund (NPF) for the self employed, farmers and others
- Mutual Aid Associations for public sector employees.

The EPI covers most of the employees in the private sector. The contribution to the EPI is 14.6% of annual earnings (2006), shared evenly by employers and employees. The second tier earnings-related pension benefits are proportional both to the number of years of contributions and the average level of earnings.

Overview of the private pension system (Tier three)

There are five types of private pensions in Japan: three defined benefit and two defined contribution. Employer-provided pension plans are usually based on collective bargaining with their employees and, whilst predominantly single-employer, can also be multi-employer funds.

Employees' Pension Funds (EPFs) are established to partially contract out of the public earnings-related pension scheme (i.e. EPI). A rebate in the total employer and employee contribution to the EPI of between 2.4% and 5% is granted.

Fund-type and Contract-type defined benefit plans are additional to the EPI benefits and are typically single employer focussed.

Corporate-type Defined Contribution plans have been permitted since 2001, but have been relatively slow to take off.

Self employed persons or employees of an employer that does not sponsor a pension plan may utilise Personal Type Defined Contributions plans, managed by the National Pension Fund Association (NPFSA).

⁴ Ministry of Health, Labour and Welfare (2004)

At the end of 2007, Dutch pension funds managed some €763 billion in pension capital for around 6.3 million active members

2.4 Netherlands⁵

The Dutch pension system is built on three tiers. At the end of 2007, 700 pension funds served the Dutch market. In total they managed some €763 billion in pension capital for around 6.3 million active members, 2.4 million pensioners and 8 million inactive participants (from a population of around 16 million).

Regulatory environment

There is a variety of legislation but the key pieces are the Pensions and Savings Fund Act and the Industry Pension Funds Act.

The state old age pension (AOW)

The first tier is the AOW, which is the statutory old age pension scheme of the Netherlands under the Old Age Pensions Act. It provides residents of the Netherlands at the age of 65 with a flat rate pension benefit that guarantees 70% of the net minimum wage. There is no means test for the eligibility of benefits. Benefits are funded by the government using the pay-as-you-go method, with current AOW pensions paid from current contribution income.

Occupational and private tiers

The second tier is comprised of occupational pension funds. In the Netherlands, three major types of pension funds can be distinguished: company funds, industry-wide funds, and professional group funds (including non-academic occupational groups). These schemes are funded arrangements and employees' membership is compulsory. Usually employers and employees are required to pay contributions, but with employers having the greater burden. Most schemes operate as defined benefits (97%).

Industry funds are based on a collective labour agreement (CLA) between an industry's companies and the labour unions, representing the employees in this industry. There are two types of industry-wide pension funds: compulsory funds and non-compulsory funds. Compulsory funds are based on a CLA making participation mandatory for all employers and employees working in the respective industry.

Finally, professional group funds offer pension schemes to specific professional groups (e.g. general practitioners, public notaries). In contrast to company and industry funds, professional group funds deal directly with workers and not with employers.

The third tier comprises tax-supported schemes which people arrange individually in addition to the first and second tier schemes. Such schemes are usually undertaken through annuity or endowment insurance.

⁵ DNB Working Paper August 2006

2.5 Denmark⁶

The Danish pension system is a four tier system with very high coverage. It is universal in the public (first) tier and the second tier, which is the mandatory supplementary pension (ATP), reaches 80% of the labour force under occupational plans – the third tier, and is close to 40% in the fourth, voluntary tier. It is estimated that over 90% of workers participate in either a third or fourth tier plan.

The aggregate assets of the four pension tiers at the end of 2004 amounted to DKK 1,822 billion (€ 244 billion). This corresponded to 125% of GDP, up from 83% in 1995. The supplementary pension funds (ATP, SP (Special Pension Savings Scheme) and the LD scheme (Employees' Capital Pension Fund)) within the second tier accounted for 23% of total assets, while 77% belonged to third and fourth tiers.

Regulatory environment

There is a variety of legislation covering the pensions industry including various Taxation Acts, the Consolidated Insurance Business Act and the Consolidated Supervision of Company Pension Funds Act. Private sector pension plans are regulated according to the same legal rules as mutual life insurance companies and can be operated on a with-profit or not-for-profit basis. The majority of pension plans are not-for-profit.

The social pension

The first tier is an unfunded social pension scheme that pays a universal flat pension to people over 65 subject to residency and employment earnings tests. The social pension is financed from general tax revenue. In addition to the flat universal pension, a supplement, which is also financed from general tax revenue, is paid to qualifying people subject to an income test.

The Danish ATP

ATP – the Danish Labour Market Supplementary Pension Scheme – is an independent, self-supporting institution which is operated jointly by parties to the labour market. It is part of Denmark's overall social security scheme. ATP covers all wage earners in Denmark. It is financed by contributions which are paid by both employees and employers. Members pay contributions during the years they are actively participating in the labour market.

Occupational pension plans

The third tier comprises occupational pension plans that are semi-mandatory and nearly universal. Most are industry-wide plans that have been established by collective labour agreements between employers and labour unions. The vast majority of these operate as defined contribution plans. The total employer and employee contribution rate varies between 5% and 15% of salary depending on plan rules with employers usually covering two thirds of contributions.

A major exception to the prevalence of funded defined contribution plans is the civil service pension scheme, which is an unfunded defined benefit plan that is covered from the government's budget.

Voluntary personal pension plans

The fourth tier comprises voluntary personal pension plans. These are offered by life insurance companies and banks. Fourth tier plans are usually taken up by persons not covered by occupational pension plans or for beneficial tax considerations. Plans can be established across professions, but these are not so common.

⁶ Pensions at a Glance: Public Policies Across OECD Countries 2007

Australia has a three tier retirement system, comprising a means tested flat rate age pension provided by government, a mandatory employer funded superannuation guarantee and a voluntary tier

2.6 Australia

Australia has a three tier retirement system, comprising a means tested flat rate age pension provided by government, a mandatory employer funded superannuation guarantee paid into a regulated superannuation fund and a voluntary tier subject to contribution limits.

Tier one is the government provided age pension. This is maintained at about 25% of male average weekly ordinary time earnings, subject to means testing via an income test and an assets test.

Tier two is the superannuation guarantee. All employers are required to make contributions of 9% of ordinary time earnings for all employees earning above A\$450 per month into a complying superannuation fund. The superannuation guarantee is capped at contributions of A\$13,129 per annum (based on earnings of A\$145,880).

Tier three is voluntary contributions by individuals to a complying superannuation fund, which can be on a pre-tax basis or post-tax. There are limits on pre-tax contributions for employees and the self-employed (\$50,000* for those under age 50, \$100,000* above age 50) as well as on after tax contributions – generally limited to A\$150,000 per annum. Post-tax contributions by lower income earners can attract a co-contribution by the government on a 1.5:1 basis up to a maximum of A\$1,500 (reduced from 1 July 2009).

* These amounts have been halved from 1 July 2009

Regulatory environment

There is a variety of legislation covering superannuation funds in Australia with the main acts being as follows:

- 1993 Superannuation Industry (Supervision) Act, which makes provision for the prudent management of superannuation funds and for their supervision by the Australian Prudential Regulation Authority, Australian Securities Investment Commission and the Australian Taxation Office
- 1992 Superannuation Guarantee (Administration) Act which forms the basis for the superannuation guarantee system.

Superannuation funds

The main types of superannuation funds are:

- public sector funds
- employer-sponsored superannuation funds that are only available mainly to employees of the sponsoring employer
- industry superannuation funds which originally were open to members of a specific industry or industries but are now generally open to any member of the public
- retail funds which are open to the public at large
- self-managed superannuation funds, with fewer than five members, where each member is also a trustee of the fund. These funds are regulated by the Australian Taxation Office.

3 Fee comparisons for corporate funds & corporate master trusts

3.1 Corporate master trusts

To the extent that they exist in other countries, if at all, there is no data available with which to directly compare Australian corporate master trusts. At the very small end, they are comparable with the retail sector, and at the very large end with the industry fund sector. They also have distinct similarities with the stand alone corporate sector because for the most part, the employer sub-plan still closely resembles the stand alone fund from which it came, particularly for the larger sub-plans. Accordingly, this report considers them primarily in comparison to standalone corporate plans, but the larger sub-plan components (where fees to members are not distorted by platform and adviser costs) are also compared briefly in Section 4 dealing with industry funds.

3.2 Disclosure of fees and costs

One of the difficulties in making comparisons across countries for corporate funds is that in every case there will be a degree of subsidisation of the fees by the employer. This may be limited to one or two staff members or it may incorporate a significant pension or superannuation administration department internally, paid for by the employer, and in some cases the employer may simply pay the administration cost of the fund in total. Therefore there is a need to treat these figures with some caution.

The 2008 Capita Hartshead Pension Scheme Administration Survey which covers 271 UK pension schemes with 6.1 million members and £222 billion assets (about 20% of total UK pension assets) made the following comment on this point:

“For many years, since this series of surveys began in 1994, there was no noticeable improvement in the number of in-house administered schemes measuring the cost of their pension scheme administration. ...The position is now much improved, with over 8 out of ten in-house administered schemes being aware of their total administration and management costs. However a sizeable proportion remains where costs are unclear.”

Bikker (2006) makes similar comments in relation to company funds in the Netherlands:

“...about 12% of company funds do not report any administrative costs at all. ...Furthermore, as much as 65% of company funds do not report wage costs.”

Rice Warner (2008) makes similar comments in relation to Australia:

“Many services are subsidised for larger funds. For example the time spent by trustees and the fund secretary will be donated by some organisations and some costs and insurance premiums are also paid by some funds.”

The Australian fees reported in the 2008 IFSA Survey are not adjusted for these subsidies. Clearly this makes comparisons across countries even more difficult.

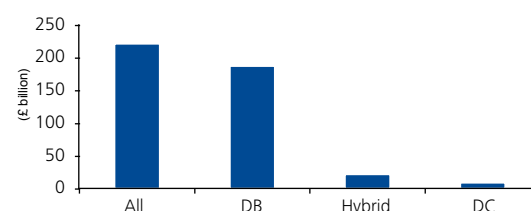
3.3 Corporate fund comparisons

3.3.1 United Kingdom fees

The makeup of the UK market as represented by the total assets of the schemes covered in the Capita Hartshead survey is shown in Charts 3.1 and 3.2. Note: The sample represents schemes holding around one fifth of total pension fund assets.

Chart 3.1:

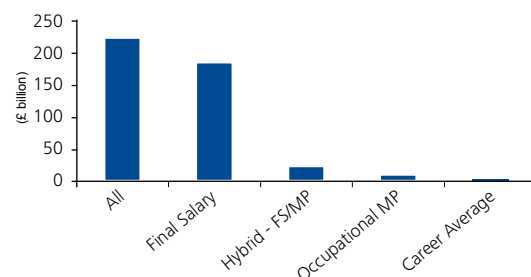
Total assets of schemes covered by survey



Source: Capita Hartshead Fifteenth Annual Pension Scheme Administration Survey, May 2008.

Chart 3.2:

Total assets of schemes covered by survey



Source: Capita Hartshead Fifteenth Annual Pension Scheme Administration Survey, May 2008

The vast bulk of the UK schemes are defined benefit pension schemes, although the majority of these in the private sector are closed to new members and only 23% of members are still actively employed by the sponsor.

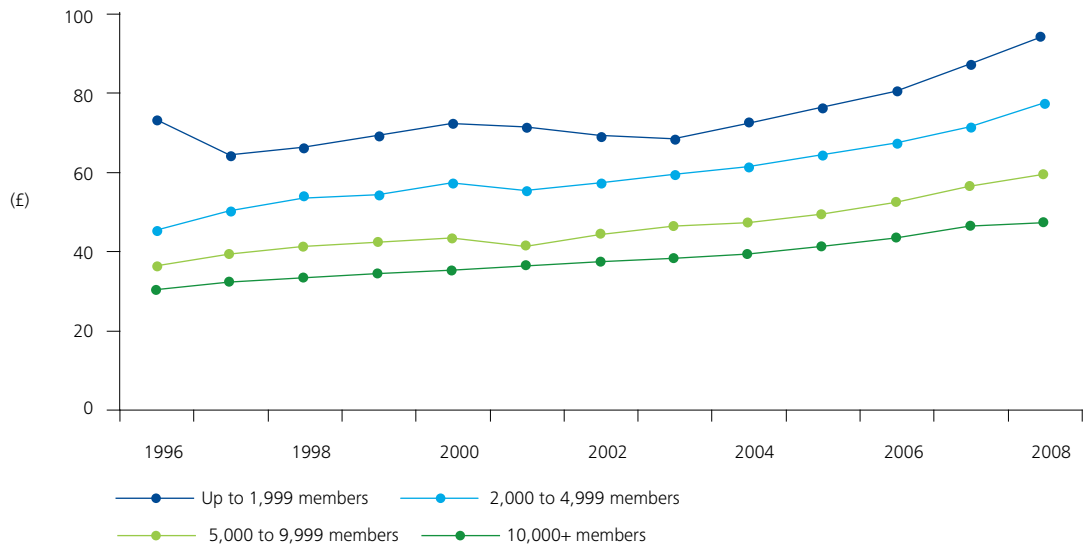
Scale benefits exist in the UK, with administration costs for schemes with more than 50,000 members between £10 and £25 per member per annum, up to more than £500 in some cases with less than 250 members.

On the other hand, 78% of respondents to the survey have established a defined contribution scheme, over half in the last 5 years. Combined median employer contributions (7%) and employee contributions (4%) are 11% of earnings.

Very few companies separately identify costs of DB and DC components of their schemes, but most schemes in the UK reported administration costs increasing at a faster rate than general business costs, with two of the key reasons being professional fees and compliance costs.

The survey also found 33% of employers offer a stakeholder scheme, although these will be replaced by Personal Accounts in most cases from 2012.

Chart 3.3: Annual cost of administration per head



Source: Capita Hartshead Fifteenth Annual Pension Scheme Administration Survey, May 2008.

This chart shows administration costs in the UK for stand alone funds over the last 13 years.

Table 3.1 below was provided by Deloitte UK as an estimate of fees for different sized plans. The investment fees appear relatively low. This reflects the fact that the majority of the assets are in large defined benefit plans. Traditionally these plans invested in balanced funds, but during the 1990s they moved into more specialist approaches (such as core/satellite structures). During this shift, there was a huge influx into index fund management by UK pension schemes, driven by low costs and lack of performance at that time of active managers. In addition over the last twenty years the proportion of assets allocated to equities has dropped from 80%+ to around 65%. This trend is continuing with more fixed income based investment driven by asset liability modelling and the emergence of liability driven investment.

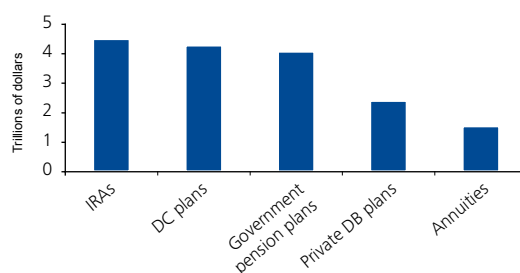
Table 3.1: UK corporate funds – fees as % of assets

	Administration	Investment	Advice	Total
Small (under £25m)	0.6	0.3	0.5	1.5
Large (above £1bn)	0.3	0.1	0.1	0.5
Average	0.4	0.2	0.2	0.8

3.3.2 USA Fees

The following chart shows the breakdown of assets in the US pension system at the end of June 2008. It is significant that in the private sector, IRAs and defined contribution plans outweigh the assets of private sector defined benefits plans by a factor of 3.6 times.

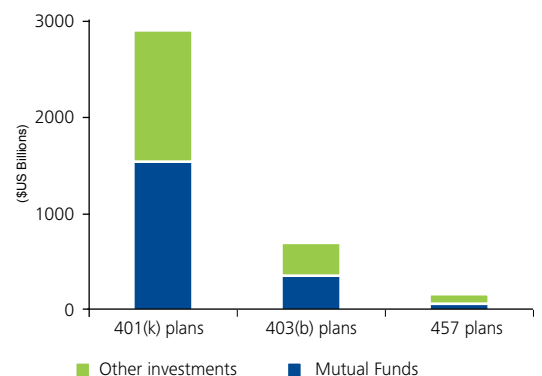
Chart 3.4: US retirement assets – \$16.86 trillion in total – 2008, second quarter



Source: ICI Research Fundamentals, Dec 2008, Vol. 17, No. 3-Q2

We do not have meaningful investment fees/cost data for the defined benefit plans (although see Section 7), but there is more information available for the defined contribution plans – predominantly 401(k) plans. The following chart illustrates how the defined contribution plans are invested:

Chart 3.5: US DC fund assets (Q2 2008)

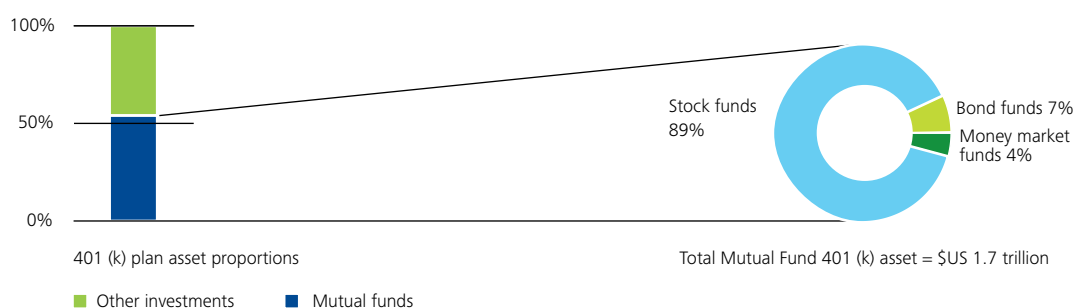


Source: ICI Research Fundamentals, Dec 2008, Vol. 17, No. 3

52% of the assets are invested in mutual funds. For the 403(b) and 457 plans, a large proportion of the remaining assets are invested in annuities with life insurance companies. Most 401(k) plans offer a variety of mutual funds and separately managed accounts, but can also include guaranteed investment contracts, shares in the sponsoring employer and a brokerage window providing access to direct investment in share, bonds and other securities. In addition some plans provide loan processing and insurance and annuity services. It is likely that the costs of the non-mutual fund assets of 401(k) plans will be higher than the mutual fund costs because in most cases the member will not have access to the same scale buying power that is available for mutual funds.

The mutual fund assets are invested as follows, with relatively high average weighting to equities of 89% at the end of 2007. Around 15% of the mutual fund assets are in index funds.

Chart 3.6:



Source: ICI Research Fundamentals, Dec 2008, Vol. 17, No. 5

The average total expense ratio incurred by 401(k) investors in 2007 is shown in Table 3.2. On an asset weighted basis, the average, based on the above asset allocation, would be about 71 basis points. Unfortunately we cannot break down this average by size of plan, but it would undoubtedly show significant scale benefits for very large 401(k) plans, but somewhat higher fees for smaller plans.

Table 3.2: The economics of providing 401(k) plans services fees expenses

	2007	2007	2007
Expense ratio	Industry simple avg	Industry weighted avg	401k asset weighted
Stock mutual funds	1.46%	0.86%	0.74%
Bond mutual funds	1.09%	0.67%	0.56%
Money market mutual funds	0.62%	0.39%	0.40%

Source: ICI Research Fundamentals, December 2008, Vol 17, No. 5

It is difficult to get a breakdown of costs into administration and investment as the way these services are provided by the range of service providers is different from the categorisation used in Australia. A greater percentage of the total costs appears to be bundled in the investment fee, and there is a significant percentage of plans where the record keeping fees are paid by the plan sponsor. The effect is that pure administration fees appear low by international standards, even for smaller plans.

The full range of services to be provided for 401(k) plans includes:

- administrative services such as record keeping, transaction processing, plan establishment and updating, and trustee services
- member services including communication, education, limited advice and investment choices/management
- regulatory and compliance services, such as documentation, consulting, accounting and audit, legal advice and so on.

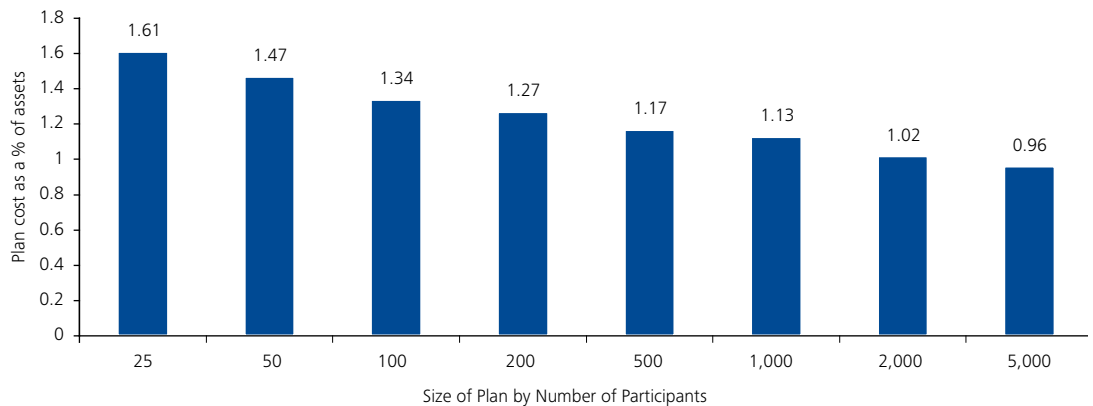
Forman states that most studies find fees associated with 401(k) plans average just over 1% of assets, of which the largest part is the investment fees (accounting for 84% for very small plans up to 98% for larger plans). Around 24% of mutual fund investments may also incur up front fees of 1%, but these are usually waived by mutual fund providers.

Actual fees paid by members vary widely outside these averages depending on the degree of subsidisation by the employer, the maturity of the plan (average member balance), the size of the employer and the plan and the number and types of investment and service options available to the members.

Chart 3.7 is based on the 401(k) Averages Book and gives a good indication of the costs of running a fully outsourced plan for different sized employers. These costs include trustee and plan administration costs, member record keeping, distributions, loan setup and maintenance and investment costs.

The chart is based on an average balance per member of US\$50,000. The totals tend to bear out the comments by Forman that total costs average around 1% of assets. Another commentator noted that it may not be economical to establish and maintain a 401(k) plan for less than about 100 employees because of the fixed costs. Smaller employers may prefer to use employer funded IRA's for their employees. This chart would tend to validate this view.

Chart 3.7: Average total plan costs



Source: 401k Averages Book, 9th Edition, 2008

3.3.3 Netherlands

The table below shows the make up of the Dutch pension market over the past decade. The striking feature is the inexorable decline in the number of corporate pension plans. The vast bulk of these plans are types of defined benefit plans.

Table 3.3.3: Supervised pension funds

	Numbers at end of period										
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Compulsory industry-wide pension funds	67	66	66	67	70	71	75	78	78	78	71
Optional industry-wide pension funds	15	19	27	25	30	31	28	24	25	25	25
Company pension funds	957	938	904	877	843	804	753	714	676	643	597
Company savings funds	9	6	6	6	7	7	6	8	7	7	7
Occupational pension funds	11	11	11	11	11	11	11	13	12	12	12
Special legislation	1	2	2	2	2	2	2	2	2	2	1
Total	1060	1042	1016	988	963	926	875	839	800	767	713

Source: Dutch Central Bank (DNB)

The break up of assets between the different types of funds is as follows:

Table 3.4: Pension funds in the Netherlands (end of 2007)

	Number of funds (%)	Assets (%)	Active participants (2006) (%)
Company pension funds	84.7	26.0	12.3
Industry-wide	13.6	71.3	87.0
Occupational pension funds	1.7	2.7	0.7
Total	100%	100%	100%
Total (absolute numbers)	705	763 (bn €)	5,849,000

Source: Dutch Central Bank (DNB)

The Netherlands, like Denmark, has moved in the same direction as Australia in favouring multi-employer and industry wide funds. Bikker provides some useful information on administration and investment fees, albeit company and industry funds are mixed together.

Table 3.5: Administrative costs by size classes (2004)

Size classes based on:	Administrative costs per participant (euros)	Administrative costs/total assets (%)	Total assets per participant (euros)	Pension funds reporting zero wage costs (%)	Total number of participants (1,000)	Number of pension funds
Number of participants						
<100	927	0.59%	157	88	2	56
100 – 1,000	302	0.46%	66	82	104	225
1,000 – 10,000	156	0.23%	68	55	809	264
10,000 – 100,000	86	0.17%	50	18	2,774	87
100,000 – 1 million	28	0.24%	12	30	7,146	20
>1 million	33	0.07%	46	0	5,611	3
Average/total	48	0.15%	33	61	16,446	655
Total assets (million €)						
0 – 10	159	1.23%	13	85	37	105
10 – 100	129	0.55%	23	71	508	289
100 – 1,000	51	0.28%	18	45	3,532	209
1,000 – 10,000	45	0.17%	27	23	4,929	44
>10,000	43	0.10%	45	25	7,439	8

Source: Bikker (2006)

Table 3.5 above gives an indication of the administration fees by number of fund members as well as by size of assets. The line for <100 members corresponds to the small corporate type master trust arrangements in Australia, with relatively high fees per member at €927 (about A\$1570).

The corporate funds are probably represented in the first three or four lines of the table. Rather than just look at costs as a % of assets it is useful to compare the absolute amounts of fees by size. We have produced a table in A\$ to enable this.

Table 3.6: Administrative costs (AUD) by size classes (2004)

Size classes based on:	Administrative costs per participant (AUD)	Total assets per participant (AUD)	Pension funds reporting zero wage costs (%)	Total number of participants (1,000)	Number of pension funds
Number of participants					
<100	1,571	266	88	2	56
100 – 1,000	512	112	82	104	225
1,000 – 10,000	264	115	55	809	264
10,000 – 100,000	146	85	18	2,774	87
100,000 – 1 million	47	20	30	7,146	20
>1 million	56	78	0	5,611	3
Average/total	81	56	61	16,446	655
Total assets (million A\$)					
0 – 17	269	22	85	37	105
17 – 170	219	39	71	508	289
170 – 1,700	86	31	45	3,532	209
1,700 – 17,000	76	46	23	4,929	44
>17,000	73	76	25	7,439	8

Source: Bikker (2006)

Bikker also provides an average cost for company funds of €138 (A\$235) per member or 0.15% of assets – based on average assets per member of approximately A\$120,000 (compared to about A\$96,000 per member account for corporate funds in Australia).

It is more difficult to compare investment fees for Dutch funds due to a relatively high degree of non-disclosure of investment fees by corporate funds, possibly by just reporting net returns or allocating the costs in some other way.

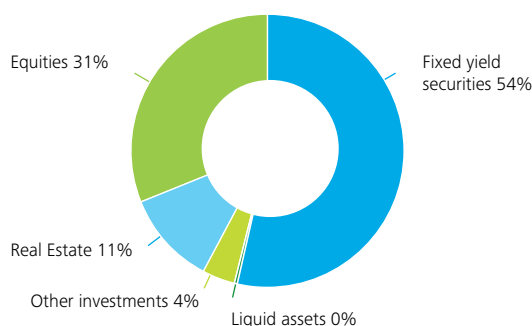
Table 3.7: Investment costs by size classes (2004)

Size classes based on:	Investment costs per participant (AUD)	Investment costs/total assets (%)	Total assets per participant (AUD)	Funds that do not report costs (%)	Total number of participants (1,000)	Number of pension funds
Number of participants						
<100	458	0.13%	353	52	1	27
100 – 1,000	171	0.14%	122	33	75	151
1,000 – 10,000	164	0.14%	120	21	672	209
10,000 – 100,000	76	0.11%	69	13	2,469	76
100,000 – 1 million	22	0.13%	17	10	6,847	18
>1 million	66	0.08%	78	–	6	3
Average/total	53	0.10%	53	26	15,676	484
Total assets (million A\$)						
0 – 17	42	0.15%	29	53	16	49
17 – 170	53	0.14%	37	28	418	209
170 – 1,700	42	0.14%	31	14	3,163	179
1,700 – 17,000	41	0.10%	41	7	4,809	41
>17,000	66	0.10%	69	25	7,270	6

Source: Bikker (2006)

Even allowing for the underreporting of costs, the investment costs for Dutch pension funds are very low. The following statistics from the DNB help explain this:

Chart 3.8: Asset allocations of Dutch pension funds



Source: Dutch Central Bank (DNB)

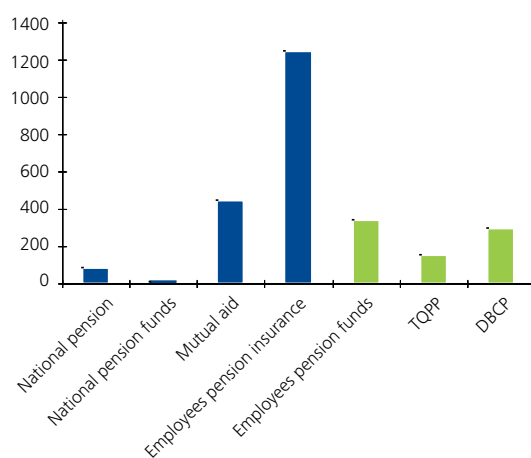
Whilst this chart covers all Dutch funds, it is probably representative of typical asset allocations as virtually all funds are some type of defined benefit. The key characteristic is that more than 50% of assets are in fixed income investments, with only 30% in equities and a very small allocation to alternative investments (4%), most of which is probably by the very large funds. There is also likely to be a significant proportion of passive investment in the equities and fixed income asset classes.

3.3.4 Japan

The following charts indicate the structure and progress of the pensions market in Japan.

Chart 3.9:

Asset size (USD\$ billions)

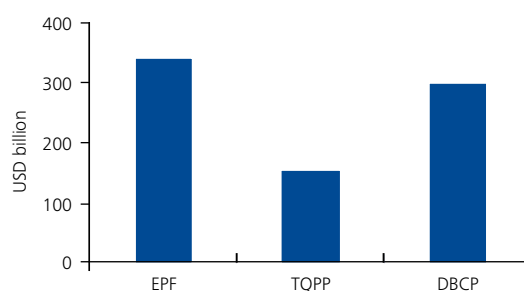


Source: Data of EPF, TQPP and DBCP are from 2006. Other data from 2002. Deloitte Japan. TQPP: Tax qualified pension plan. DBCP: Defined benefit corporate pension

The Employees' Pension Insurance is an employer funded but government provided scheme, which together with the Mutual Aid pensions covers all employees.

Chart 3.10 below shows the relative sizes of the private sector components. Defined Contribution plans were only introduced in 2001, but many companies are now establishing them, whilst closing or capping their EPF type plans, by transferring assets and the corresponding liabilities back to the EPI scheme. Tax Qualified Pension plans will disappear by 2012, with most of the assets moving to the Defined Benefit Contract type plans (DBCP). Chart 3.11 demonstrates these trends.

Chart 3.10:



Source: Deloitte Japan, Japanese Pension System, 2008

Chart 3.11:



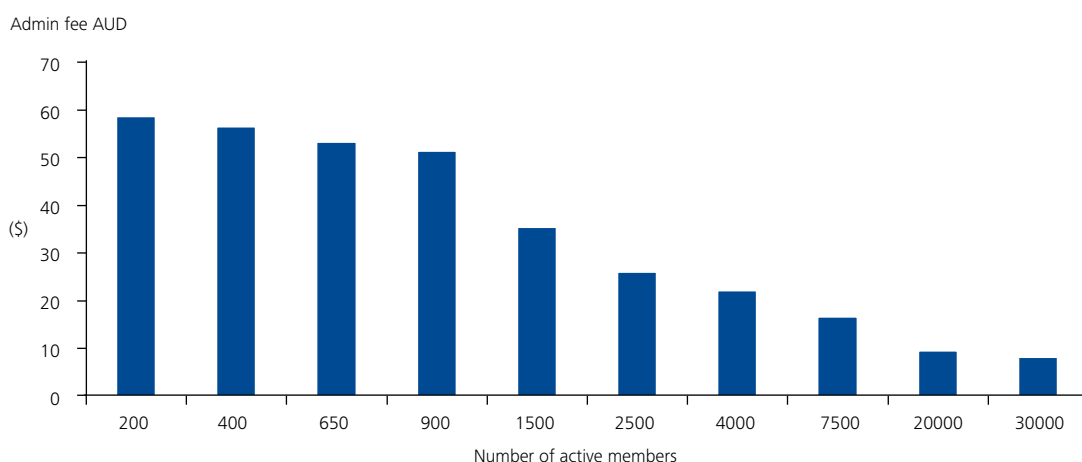
Source: Deloitte Japan, Japanese Pension System, 2008

Even though they are growing quickly, the total assets of defined contribution plans still only amounted to about US\$25 billion at the end of 2007.

For the purposes of comparing fees, Deloitte Japan has provided us with some representative tariffs for the different plan types.

Administration fees are virtually always paid in full by the sponsoring employer, so the comparisons may not be that meaningful. The administration costs are very low, reflecting that the plans are mainly defined benefit and typically large.

Chart 3.12: Administration fees table



Source: Deloitte Japan

Investment of Japanese pension funds has traditionally been dominated by trust banks and life insurance companies, who typically provide a bundled service. Hence the costs are relatively low, even for non-index options, reflecting large scale of the providers and the cost benefits of typically just a single manager. As in the UK in the 1990's, more funds now are using external managers and as this occurs, costs will increase.

Table 3.8 below shows typical costs for active and passive management by trust banks for defined benefit funds (typically these would also include any administration costs not paid by the sponsoring company). The asset allocation of Japanese EPF's is also more conservative than Australian funds, with just over 50% of assets in equities.

Table 3.8:

Asset under management (A\$m)	Active fee
13	0.500%
25	0.440%
38	0.400%
63	0.355%
125	0.315%
250	0.285%
375	0.265%
625	0.250%
1,250	0.230%
2,500	0.220%
3,750	0.210%
4,000+	0.200%

Asset under management (A\$m)	Passive fee
13	0.217%
25	0.212%
38	0.206%
50	0.196%
>50	0.186%

Source: Deloitte Japan

The corresponding costs for defined contribution plans in Japan are approximately as follows:

Table 3.9: Administration fee

AUD per member	Bank	Life insurance	Securities
Initial cost	14	18	8
Annual running cost	64	43	48

Source: Deloitte Japan

Table 3.10: Investment cost

Balanced type fund	Equity 30%	0.23%
	Equity 50%	0.24%
	Equity 70%	0.25%
Domestic equity fund	Active managed	1.63%
	Passively managed	0.20%
Global equity fund	Active managed	1.83%
	Passively managed	0.23%
Domestic fixed income fund	Active managed	0.58%
	Passively managed	0.17%
Global fixed income fund	Active managed	1.00%
	Passively managed	0.22%
Real estate fund	REIT	1.00%

Source: Deloitte Japan

3.3.5 Comparisons with Australian plans

Table 3.11 sets out our estimates of the average fees for corporate funds in the countries we surveyed (Denmark has very few corporate funds). The fees are for defined benefit and defined contribution plans in the US and Japan. UK and Netherlands funds are predominantly defined benefit. Australian standalone plans and corporate master trust sub-plans are either defined contribution or hybrids of defined benefit (mostly closed to new members) and defined contribution.

Table 3.11: Corporate funds

Country	Admin fees	Investment management fees	Total
USA – defined benefit	0.38	0.39	0.77
USA – defined contribution	0.01	1.01	1.02
Japan – defined benefit	0.04	0.15 – 0.46	0.19 – 0.50
Japan – defined contribution	0.32	0.20 – 1.50	0.52 – 1.82
UK	0.40	0.20 – 0.50	0.60 – 0.90
Netherlands	0.19	0.20	0.39
Australia – stand alone	0.24	0.47	0.71
Australia – large corporate master trusts	0.20	0.56	0.76

Sources: ICI Perspective (December 2008), 401ksource.com (2008), Deloitte Japan, Deloitte UK, Bikker (2006), Rice Warner (2008).
 Note: All fees above are expressed as a percentage of assets.

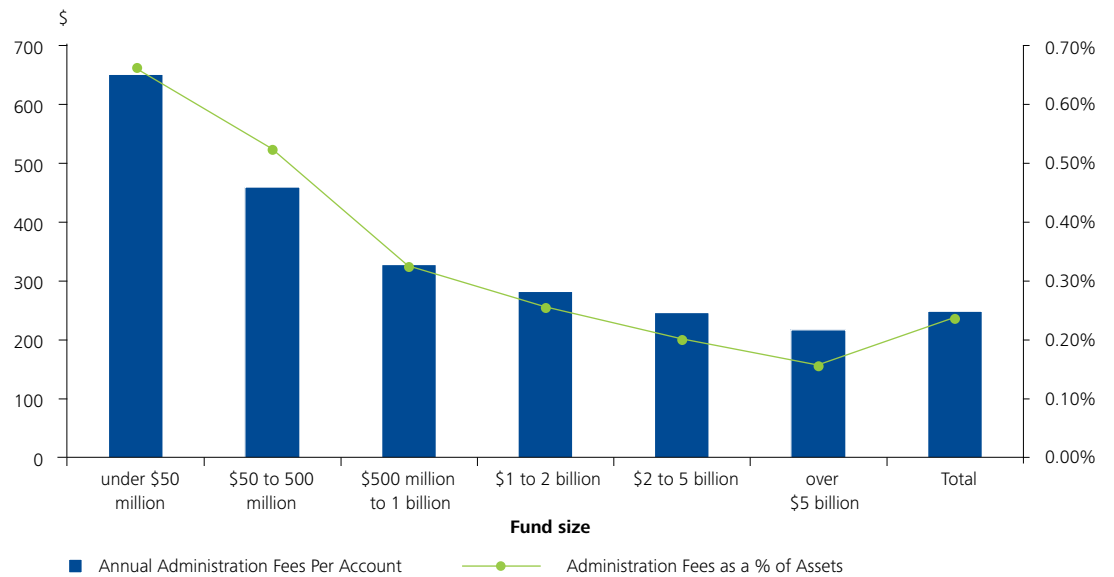
The administration fees are similar across a number of countries, with apparent anomalies in the US and Japan. In Japan this is reflecting the fact that most of the funds are defined benefit and most of the fees would be paid by the employers. The US numbers for the costs of 401(k) providers reflect a clear pricing structure differential where most of the cost is attributable to the investment management charge and what seems like a minimal allocation to administration costs. This may be due to scale differences as well as reflecting that many of the services classified as administration in other countries may be supplied by the mutual fund providers, with whom a large proportion of the assets are invested. In addition there would still be significant cost borne by US employers as these are still stand-alone 401(k) plans.

It appears from the statistics for standalone corporates, which is one area where we have been able to get a reasonable range of comparisons, that Australian funds are quite competitive both in terms of administration fees as well as investment management fees with plans from most other countries.

It is difficult to be definitive about the reasons for this, but it would partly reflect that a higher proportion of Australian stand-alone funds are still defined benefit and therefore we are making a more consistent comparison with stand-alone funds in other countries. Secondly, the Australian standalone funds tend to be efficiently run with sophisticated levels of outsourcing, enabling them to effectively access scale for most of their operations.

Chart 3.13: Corporate – Australia

Corporate funds – administration fee



Source: Rice Warner (2008)

Despite this, the scale benefits of larger plans are still evident and there must be pressure continuing on those funds with assets less than A\$500m to move into master trust or industry fund arrangements.

A similar phenomenon is occurring in the UK and US with more widespread uses of small group stakeholder pensions in the UK and use of employer funded IRA's by small employers in lieu of establishing a separate 401(k) plan in the US. Anecdotal evidence suggests this is more cost effective in the US for employers with up to 100 employees.

Comparisons of administration fees for small employer master trusts in Australia are complicated by the inclusion of advice fees, so we have considered them as retail products.

Turning to investment management fees, this is the sector where there are most likely to be more comparable approaches to investment management taken by funds in Australia and the other countries. Corporate funds around the world, particularly in the UK and the Netherlands, probably tend to use more active managers and are invested more in growth style assets and alternative assets which are more expensive, although even here there is some evidence of significant predilection for passive investment.

Equally it is the case that Australian corporate funds have not invested as much in alternative and unlisted assets as, for example, industry funds, and therefore incur lower average investment fees – for example 47 basis points for corporate funds compared to 67 basis points for industry funds according to the Rice Warner IFSA 2008 Fees Report.

We conclude that for medium and larger sized plans, both stand alone corporates and those sub-plans within corporate master trusts, Australia compares very favourably. This reflects:

- the small number of larger plans in Australia, which are well established and generally efficiently run, leveraging scale by appropriate outsourcing of scale based functions
- intense competition for these types of employers in the corporate master trust and industry fund sectors by the most efficient operators in these segments, and the benefits of scale delivered by a multi-employer plan.

Turning to investment management fees, this is the sector where there are most likely to be more comparable approaches to investment management taken by funds in Australia and the other countries

4 Fee comparison for industry funds

The countries in this study where industry funds are common are Australia, the Netherlands, Denmark and the USA

The countries in this study where industry funds are common include Australia, the Netherlands, Denmark and the USA. We were unable to find any fees data on Taft-Hartley funds in the US. However even these funds are not directly comparable with Australian industry funds as, like the Netherlands, they are defined benefit funds. However good quality data was available from the Netherlands and Denmark.

Table 4.1: Industry funds

Country	Administration fees	Investment management fees	Total
Australia	0.38	0.67	1.05
Netherlands	0.13	0.13	0.26
Denmark	0.14	0.16	0.30

Note: All fees above are expressed as a percentage of assets.

Sources: Rice Warner (2008), Dutch Central Bank (DNB) (2006) and Deloitte Denmark.

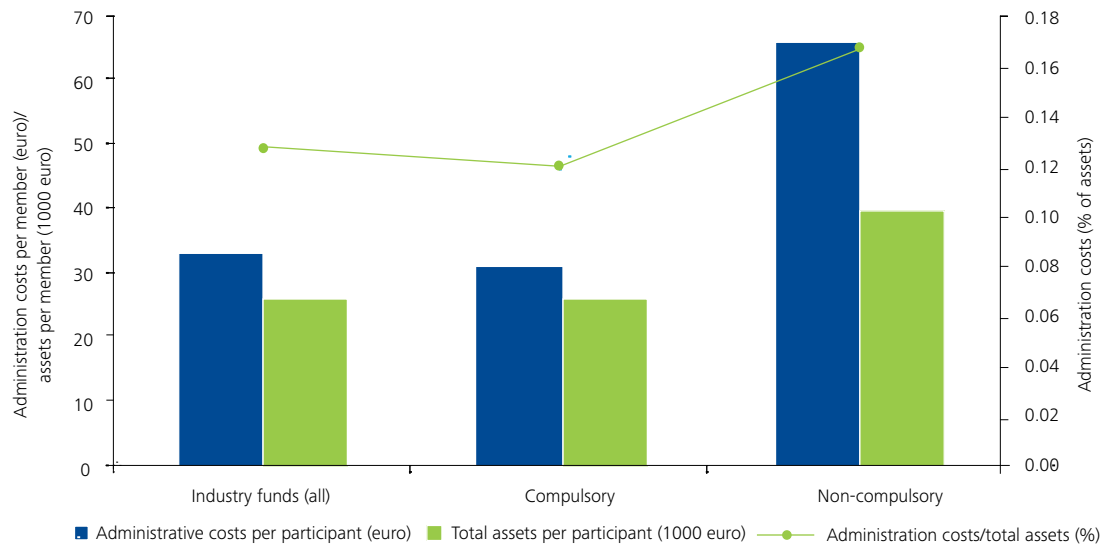
It can be seen from Table 4.1 that the average administration fees for Australian industry funds appear to be higher than those in the Netherlands and Denmark. There are a number of reasons that can be ascribed to this including compliance costs for the public offer funds in Australia, marketing expenses with choice of fund, lower average balances in Australia, the cost of member protection and a higher level of manual transactions. Denmark at least has a high level of automated transactions.

The majority of the Dutch funds are defined benefit, which accounts for part of the difference (higher average balances and fewer member transactions to record). The Danish funds tend to have relatively simple benefit design with limited options for members. In both countries, the funds are large.

However, the following chart and table from Bikker give an illustrative breakdown of the Dutch pension system costs, from which we can draw some different conclusions.

Table 4.1: Industry funds – Netherlands

Compulsory vs non-compulsory



Source: Bikker (2006)

Table 4.2: Administrative costs by governance and pension plan (2004)

Type of pension fund	Administrative costs/total assets (%)	Administrative costs per participant (euro)	Total assets per participant (1,000 euro)	Total number of participants (1,000)	Number of pension funds	Average number of participants (1,000)
Industry funds (all)	0.13	33	26	14,072	95	148
– Compulsory	0.12	31	26	13,557	76	178
– Non-compulsory	0.16	66	40	515	19	27
Company funds	0.19	138	71	2,167	524	4
Professional group funds	0.10	221	221	71	11	6
Average/total	0.15	48	33	16,446	655	25
Plan type						
Mainly DB	0.14	49	34	15,516	590	26
Mainly DC	0.37	25	7	672	51	13
Other	0.33	37	11	228	14	16

Source: Bikker (2006)

The following observations can be made on the basis of this table (tempered by the difference in years of measurement with the Australian data):

- the Dutch administration costs for mainly DC plans (0.37%) are similar to the average of Australian industry fund costs (0.38%). The average member balance for the Dutch DC plans is €7,000 (about \$11,900), compared to the average Australian industry fund balance per member of just under \$10,000
- there is a significant difference between the costs of compulsory and non-compulsory funds in the Netherlands (€31 vs €66 per member) although this difference is not reflected in the administrative costs as a percentage of assets (0.12% compared to 0.16%) due to the larger average balances in the non-compulsory funds

- maturity of the funds can make a big difference to these comparisons. For example if the average industry fund in Australia had the same average balance per member as either the Dutch compulsory funds (about \$44,000) or the non-compulsory funds (about \$68,000), the administration costs would be calculated as 0.09% and 0.06% respectively.

The relative maturity of the Australian industry funds is distorted by a number of inefficiencies which result in lower average balances and costs of member protection (estimated by Rice Warner to be 0.10% of assets). It is clearly desirable that changes are made to the system in Australia such that the high level of manual transactions, and the prevalence of members having multiple small accounts in different funds are eliminated. With these changes one would expect to see average balances in Australia rise significantly, leading to more realistic comparisons with other more mature systems.

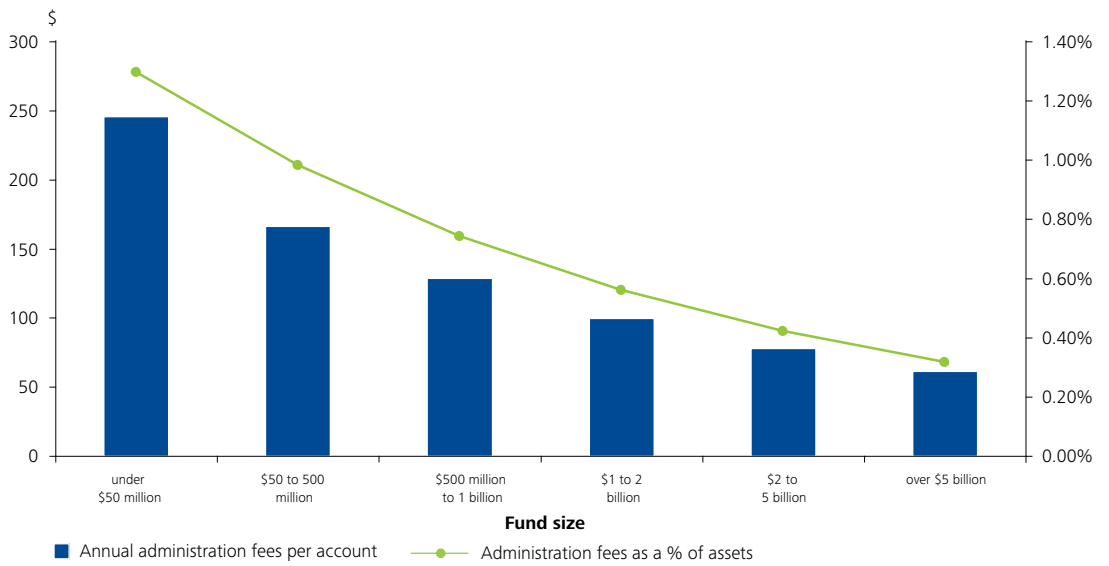
Table 4.3: Australia – Industry funds expense rate* (%) – year to 30 June 2008

Fund Size	Investment			Total
	Administration	Management	Adviser	
under \$50m	1.30	0.71	0.02	2.02
\$50m - \$500m	0.98	0.70	0.02	1.70
\$500m - \$1bn	0.74	0.69	0.02	1.45
\$1bn - \$2bn	0.56	0.68	0.02	1.26
\$2bn - \$5bn	0.42	0.67	0.02	1.11
over \$5bn	0.32	0.66	0.02	1.00

* Expressed as a % of *average* Industry Fund assets over the year to 30 June 2008.
Source: Rice Warner (2008)

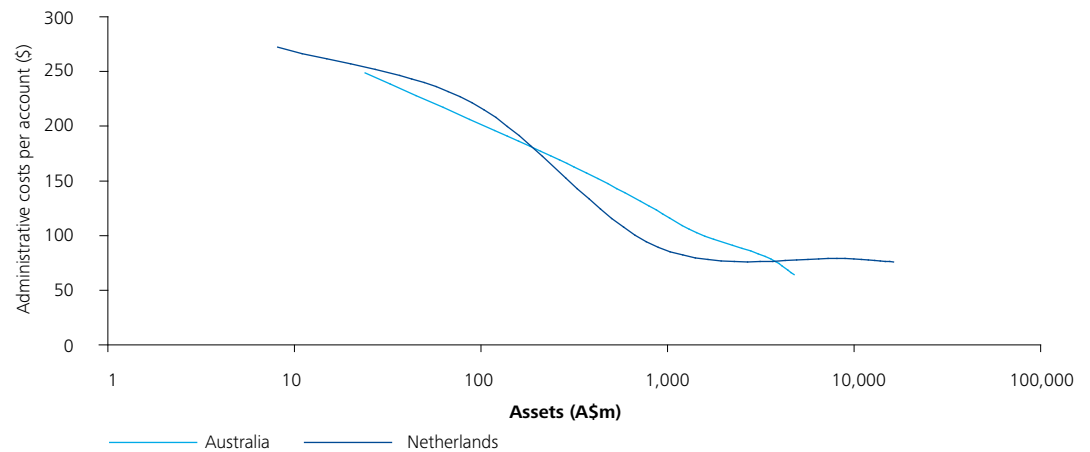
Chart 4.2: Australia – Industry funds – administration fees

Industry fund expenses per member:



Source: Rice Warner

Chart 4.3: Industry funds – administrative costs



Sources: Rice Warner, Dutch Central Bank, Deloitte analysis.

Note: the administration fees have been smoothed to take out the effects of the different funds and their pricing anomalies.

Chart 4.3 above compares the absolute costs per member for administration for Dutch and Australian industry funds. Even allowing for the fact that the data relates to different years, the chart clearly demonstrates the scale benefits in both countries together with the competitiveness at all size levels of the Australian industry funds.

One conclusion from this data is that there would appear to be a case for rationalisation of the industry funds sector to deliver more scale benefits to more members. Of course, fees/costs are only one criterion to be taken into account in looking at the structure of the industry. In addition, elimination of system inefficiencies due to lack of automation and duplicate accounts have the potential to make the Australian system a global leader.

Table 4.4: Corporate super master trust expense rate* (%) – year to 30 June 2008

Employer Plan Size	Administration	Investment Management	Total
>\$50m	0.17	0.54	0.71
\$20m – \$50m	0.22	0.57	0.78
\$10m – \$20m	0.32	0.58	0.90

* Expressed as a % of *average* Corporate Super Master Trust assets over the year to 30 June 2008.

Source: Rice Warner (2008)

Table 4.4 illustrates these points. The medium to larger corporate clients are competed for very aggressively by the Corporate Master trusts and a number of the industry funds because they have high average balances and can be administered much more efficiently, even if there is a high degree of customisation for the corporate and its employees.

Interestingly, the trend in Denmark is for smaller pension companies and group administrators to offer more modernised products with more choice to clients, in particular for those clients who have larger balances and need advice. This may well see fees in that segment of the market move closer to the Australian market, as the requirements of the members for more sophisticated offerings increases.

The other area of major difference is in investment management fees. The reasons, as discussed later in this report, are likely to result from differences in scale and maturity, even for the larger Australian funds, active versus passive management and asset allocation choices. Australian industry funds have embraced a high degree of active management in most sectors and have also invested heavily (in some cases up to 50% of total assets) in alternative and unlisted asset classes, which tend to have significantly higher fees. In the Netherlands and Denmark on the other hand, there is a high degree of passive investment and, in the Netherlands in particular, most of the funds are defined benefit and have a higher allocation to fixed-income securities (more than 50%).

In addition, Bikker states that there is a high degree of underreporting of investment fees in the Netherlands – 24% of the funds in their study reported no investment costs at all. The main explanation for this appears to be that many funds just deduct investment expenses from returns directly without reporting them. A similar phenomenon is observed by Rice Warner in Australia, but they have increased the Australian costs in their report to compensate for this.

Conclusion

- administration fees for larger Australian industry funds are very competitive with European funds, particularly after adjusting for member protection costs
- benefits of scale are clear in the Netherlands and Denmark as well as in Australia, making a strong case for further rationalisation of the sector in Australia
- removal of unnecessary inefficiencies in relation to transaction processing and especially duplicate member accounts will make a material improvement to the efficiency of the Australian industry.

5 Fee comparison for retail funds

Retail superannuation and pension products are offered by a wide variety of institutions in different countries around the world

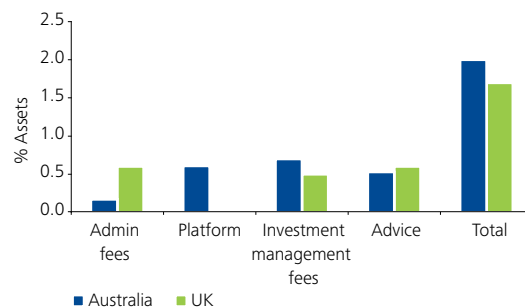
Retail superannuation and pension products are offered by a wide variety of institutions in different countries around the world. They include full administration services, communication, some education and a variety of insurance and investment options. They are usually open to anyone who is legally able to contribute and participants are typically self-employed people and employees of small businesses which enter small-group pension arrangements.

The Rice Warner 2008 Report for IFSA outlined a range of different charging methods that are typically employed in the retail segment, including entry fees based on the amount contributed, administration and account keeping or member fees, which might be a dollar amount per annum, management and other charges based on the size of the account, switching charges and possibly withdrawal or termination charges.

International comparisons of these products are complicated by these. Nevertheless we have produced some comparisons of Australian personal superannuation products with individual pension products in the UK and the US.

Chart 5.1 below compares UK and Australian fees for the personal segment when fees for advice are included:

Chart 5.1: Retail funds – fees including advice

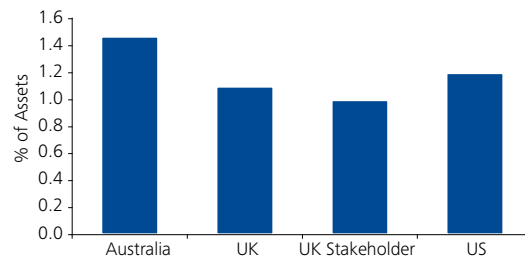


Source: Rice Warner (2008), Deloitte UK

The slightly higher Australian fees include separate platform fees which probably include an element of distribution costs. If we could properly adjust for this, the result is that administration plus platform fees would be comparable, as would advice fees, leaving the difference as investment management fees, where some of the effects noticed in other sectors are probably also present.

The comparisons are complicated by the typical inclusion of fees/commissions for advice in the Australian and UK products. The US and UK markets offer products with no advice in this segment, hence we have produced the chart below excluding the advice component from the Australian and UK products.

Chart 5.2: Retail funds – fees excluding advice



Source: Rice Warner (2008), Deloitte UK, 401ksource.com

It is difficult to make a proper comparison of these products with the Australian retail products, because the latter include advice costs

It is difficult to make a proper comparison of these products with the Australian retail products, because the latter include advice costs, but deducting these still leaves an average cost of 1.46%. It is apparent that there is a small premium to the US – probably due to larger scale and possibly less regulatory costs in the US, but a larger margin to compare with UK costs, especially the Stakeholder Pensions. Part of this will be attributable to more active investment and higher growth allocations in the Australian market than in the UK.

The FBT exemption for eligible work-related items will be amended to limit the exemption to items used primarily for work-related purposes.

In looking at this sector, it is worthwhile making observations about what is happening in the UK with stakeholder pensions and the US with individual retirement accounts. In most cases these products are provided on a no advice basis but with a reasonable level of education from the product provider.

UK

Stakeholder pensions were introduced in the UK in 2001 by the government with the objective of providing a kind of default pension arrangement with fees to be capped at 1% per annum of the member's account. Subsequently, the maximum fee was lifted to 1.5% per annum for the first 10 years of membership (thereafter reduced to a maximum of 1% per annum).

In practice a significant number of the major providers have products available which have the maximum fee capped at 1% per annum and in fact provide significant discounts (up to 20%) if the member transacts online. So the fee could be as low as 0.8% per annum of the member's account balance and in some cases there are further discounts for larger accounts.

Typically there is no advice provided for the member with these pension products, although the web sites of the providers have a significant amount of education material to assist the member with decisions about how they should invest and so on. There is also a default investment option, usually in funds managed by the product provider.

The majority of these plans have a reasonable degree of investment choice, although nowhere near as much as a traditional individual pension, which might have as many as a thousand investment options available to a member. However the web sites of the major providers indicate that there are typically 20 to 40 investment options available, usually in funds managed by the provider institution.

These pensions are also targeted to small employers (but also available to large employers) and can be operated as small-group stakeholder pension plans on behalf of an employer. The cost structure is similar to that for an individual and compares very favourably for example with the costs of small corporate master plans in Australia.

We have not examined how successful the take-up of these products has been, but it is clear that in terms of product simplicity and targeting of the product directly to the needs of the member, it has been possible to reduce the cost quite significantly to a level which is really a new paradigm.

At these levels, individual stakeholder pensions in the UK demonstrate lower fees than the smaller industry funds in Australia.

US

Turning to the US market, 40% of households hold an individual retirement arrangement (IRA), with USD\$4.5 trillion of assets under management as at 30 June 2008. There is a variety of these known as traditional IRAs, Roth IRAs and so forth, depending on whether the contributions are from pre-tax or post-tax income.

The costs of IRAs vary depending on the type of structure that exists but from the major providers, investors can buy an IRA with no account fees, no up front fees and a wide range of investment choices. Even without advice, there is a significant amount of education on the providers' websites and if need be they can have access via a call centre to a relevant specialist.

Typically investors will have access to a very broad range of funds from multiple providers, access via the phone to specialists, free (independent) research and guidance on how to choose investments, free portfolio reviews, 24 x 7 customer service, significant websites and a range of planning tools available free.

The cost of these offerings ranges from as low as 0.2% per annum (for completely passive investments) up to around 2%, depending on investment options chosen, but the average according to Lipper Inc, (as quoted on Vanguard's website), is 1.19% per annum – not too much higher than the stakeholder pension offerings in the UK.

As financial planning and possibly regulation in Australia develops with a continuing trend away from commission and towards separation of the fees for advice from product and platform fees (so called 'fee for service' models, where the financial planning firm charges its fee directly to the client), we will be able to make more direct comparisons between the pure product and platform costs in Australia with the likes of the UK stakeholder pension plans, where the main difference in the product will be the range and type of investment choice available, together with perhaps other options, like insurance.

We do not have enough data for the UK or the US to make definitive statements about the value of the different services. However, we expect that a model with more choice will be somewhat more expensive on average as many of the broader choices will be more expensive investment options with more active management or more expensive asset classes.

It may be that an opportunity exists for a new range of products to emerge in Australia with the simplicity of the stakeholder pensions in the UK, with a similar pricing point, and delivered largely on-line. This is likely to be an attractive product for Generation X & Y consumers in future – they already control 47% of the pre-retirement superannuation asset pool in Australia.

Some major providers have recently launched similar products into the Australian market, although we understand the take-up by consumers has been somewhat mixed to date. Added impetus will be driven by the recently released IFSA Superannuation Charter.



6 Large plan administration costs comparisons

We have not attempted to directly compare public sector and other very large funds in Australia with similar funds overseas, primarily because the data to do this are not publicly available.

However, we have received the summary below from CEM Benchmarking of administration costs benchmarked for 79 large pension/superannuation providers in different countries. CEM conducts a very detailed survey of costs for these providers who generally run their administration in-house (and so can accurately account for costs).

This is the only data on costs we have been able to obtain – the other material in this report covers fees charged to members or by service providers for different types of funds. This information is interesting in that it is one of the few sources that looks at the determinants of cost and the levers which make the most difference. The CEM note summarises these levers as the services that are provided, complexity of the plans, volume of transactions and scale.

Comments on the international comparisons from the CEM Benchmarking Pension Administration Benchmarking Survey – based on 2007 data.

The following table is based on pension administration data from CEM Benchmarking Inc.'s 2007 database.

This database includes data from 79 retirement administrators from 5 countries. CEM collects data using a survey of approximately 250 questions that focuses on administration costs and the quantifiable factors that can impact costs: service, plan complexity, transaction volumes and the effects of scale, as they relate to the core pension administration activities such as Paying Pensions and Member Telephone Calls.

Total service score

Service is defined as 'anything a member would like before considering costs'. The weights given to the activities in the Total Service Score are an approximation of the importance of an individual service element. The Total Service Score is an absolute score out of a possible 100 points.

Total complexity score

This is a relative score that ranks all participants from relatively least to relatively most complex on a scale of 0 to 100. Complexity is generally caused by two factors: multiple member groups with different rules sets and complex plan rules.

Transaction volume score

The Transaction Volume Score summarises more than 80 different pension administration transaction types into a single number. It is higher cost to do more transactions per member.

Economies of scale

These numbers are based on Total Volume – the number of active members and annuitants. Higher volumes relative to your peers, allows you to spread your costs over a larger base and benefit from lower unit costs.

Costs and Cost Drivers by Country – 2007 medians

	Australia	Canada	Netherlands	U.S.
Cost per active & annuitant (USD)	\$124	\$104	\$112	\$75
Service	68	60	69	72
Complexity	24	13	21	38
Transaction type score	127	84	116	94
Economies of scale (active members & annuitants)	77,900	180,000	74,800	201,400
Number of systems	10	9	15	38

Source: CEM Benchmarking

It is apparent that administration costs for Australian plans are comparable with Canadian and Dutch plans but relatively more expensive than US plans, notwithstanding the greater complexity of US plans (this may be reflecting the greater preponderance of defined contribution plans in Australia vis-a-vis defined benefits plans in the US).

The key differentials however are transaction volumes and scale.

Significantly higher transaction volumes in Australia are probably reflecting our defined contribution environment and significant manual intervention in the recording of transactions on a per member basis vis-a-vis the defined benefit plans common in other countries where this type of activity is not required.

Scale is the other big differential, where the US plans tend to average 2.5 times the size of the Australian plans in this sample and this is clearly the main differentiator. Even in making these comparisons, we need to bear in mind that these costs (USD\$124) are still relatively low.

We cannot easily compensate for the fact that we have a population of 21 million versus Canada with 33 million and the US with 304 million, so scale will always be a differentiator. However, there are clear opportunities to reduce inefficiencies in Australia, where hundreds of thousands (at least) of people have multiple small superannuation accounts.

Eliminating this problem and other inefficiencies should be a high priority for government policy. There is scope for much greater automation of contribution and benefit processing as well as use of electronic communications with members, as automated processes clearly save costs.

Perhaps the most automated and least expensive fund we identified in our research was that run by the Danish ATP Group. This mandatory plan reports annual costs of less than \$10 p.a. per member.⁷ ATP claims that their low costs are a result of:

- simple fixed rate contribution and defined benefit design
- computerised Danish infrastructure (all individuals and companies have a Civil and Business registrar number assigned to them and the national account system allows payments to be made without other information)
- scale
- mandatory contribution
- focus on expenses e.g. move towards electronic customer communications.

While such a high level of automation is not available to all funds, the ATP provides something of an international benchmark for the lowest cost offering.

⁷ The plan covers 90% of the population. Contributions of approximately 1% of income are mandatory and the plan is defined benefit. It is supplementary to the basic state pension. More information can be found at: <http://www.atp.dk/X5/wps/wcm/connect/ATP/atp.dk/tools/language/language>

7 A global comparison of investment management costs

7.1 Introduction

The results shown in earlier sections are mixed but on balance indicate that investment costs may be generally higher in Australia than in other countries.

Intrinsically we felt that the explanation for this was reasonably straightforward, and attributable to four major factors:

- Australian superannuation funds tend to have higher proportions of funds managed actively as opposed to passively than in many countries
- the defined contribution nature of many Australian funds implies a more return-seeking approach and hence higher allocations to growth asset classes (equities and property) than in countries with a greater focus on defined benefit funds – which with asset/liability matching strategies tend to have higher weightings to fixed income assets
- Australian and US funds have developed a greater propensity to invest in alternative/unlisted asset classes such as private equity, hedge funds and unlisted property, all of which tend to be significantly more expensive than sectors like bonds, equities and cash
- scale may be a factor relative to large European and US funds which can partially invest in-house in some asset classes and, when outsourcing, can buy very large mandates. Despite the fact that the Australian market is large, there are still scale disadvantages. Certainly it is the case that for a given sized mandate, an Australian fund typically pays the same price as any other fund with a given investment manager. However, most fund managers use a reducing cost scale which rewards very large mandates with lower costs.

We have insufficient data with which to test our hypotheses above regarding the differences in investment management costs. However an organisation based in Canada, CEM Benchmarking, undertakes benchmarking surveys for very large pension and superannuation funds around the world, including Australia. In October 2006 it published a study which examined the differences in investment management costs drawn from its database of 700 funds, with an average fund size of US\$10.8bn in 2005.

Whilst the CEM study is not necessarily representative of the entire market, it specifically examined three factors – asset mix, fund size and investment style – which cover the factors we have outlined above, attempting to understand the importance of these three characteristics in explaining the differences between countries. What follows is a summary of the results of the CEM work. We emphasise here that in this section we are discussing *costs* as opposed to *fees* of a sample of very large pension funds.

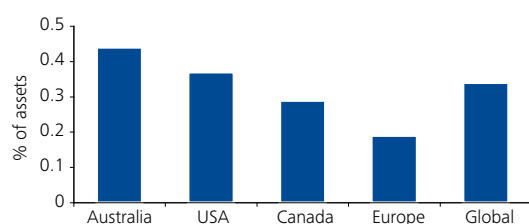
In this section we discuss *costs* as opposed to *fees* of a sample drawn from a database of 700 very large pension funds

The expenses involved in managing investments are generally expressed as a percentage of the total funds under management (often expressed in basis points where one basis point is equal to 0.01%).

Globally, the long-term average annual investment management cost incurred by the sample funds is 34 basis points. However, the investment management costs applying in different countries and regions around the world vary from this overall average.

Chart 7.1: Global investment costs – large funds

Average Investment Management Cost



Source: CEM Benchmarking, The World's Lowest Cost Funds.

The above chart shows that Australian funds pay the highest investment management costs, while European funds spend the least. However, this simple comparison does not allow for regional differences in asset mix, fund size or investment style, each of which may affect the level of investment management costs. A true comparison of investment management costs needs to adjust for these factors.

7.2 Reasons for difference

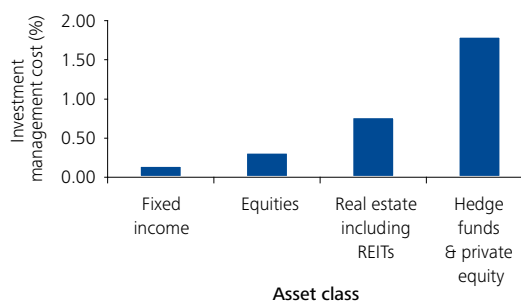
Much of the variation in cost among funds can be explained by the wide range in asset class costs and by regional differences in asset mix and fund size.

7.2.1 Asset mix

Funds with more high cost assets, such as property, hedge funds and private equity, cost more to manage. Therefore, funds with higher weightings in the highest cost asset classes (hedge funds and private equity) and lower weightings in the lowest cost asset classes (fixed income and cash) can be expected to have higher costs than other funds invested more conservatively.

The rationale for investing in more high cost assets is that those funds are generally seeking higher performance. The following chart shows the average costs by asset class from CEM Benchmarking's 2005 survey. This shows the range in costs of low cost to high cost asset classes.

Chart 7.2: Investment management cost by asset class



The following table shows the average asset allocation of funds in each region, based on information collated by CEM Benchmarking in 2005.

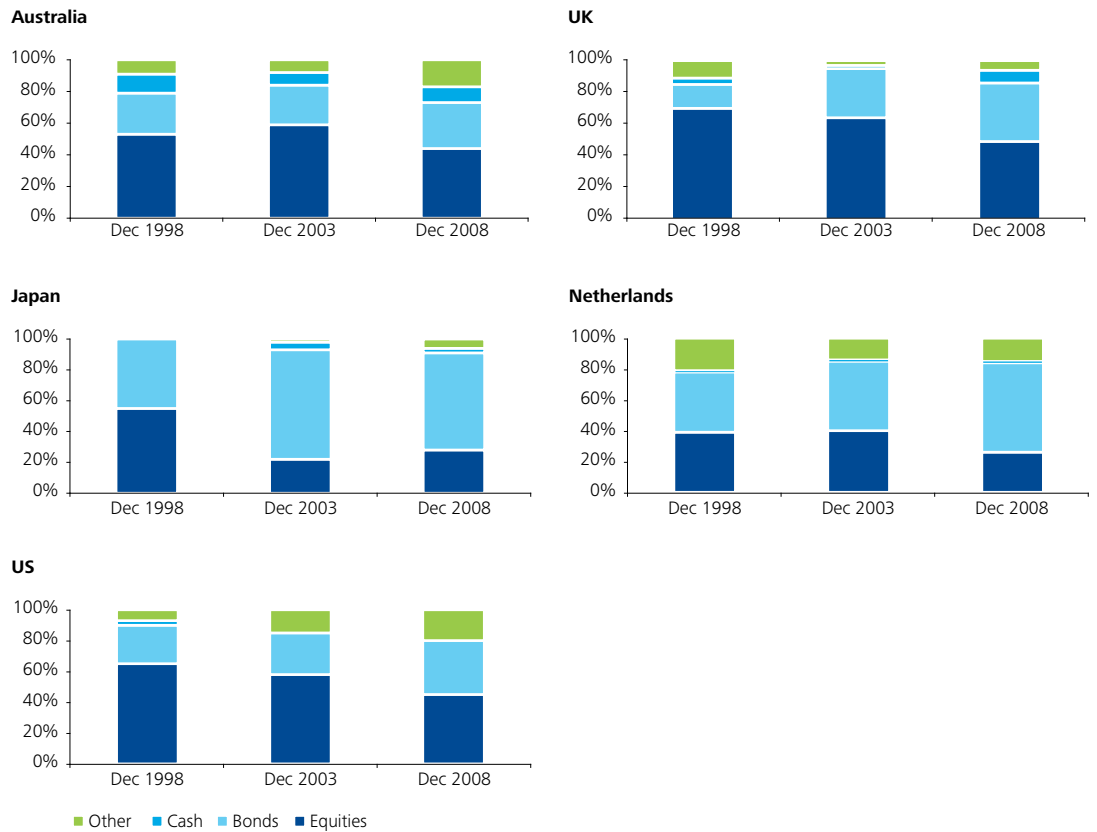
Table 7.1: Average asset allocation by region

Asset class	Australia %	USA %	Canada %	Europe %	Global %
Fixed income & cash	25	30	38	47	34
Equities	53	61	57	46	58
Property	13	5	3	6	5
Hedge funds & private equity	9	4	2	1	3

Source: CEM Benchmarking

Based on the average asset allocations shown in this table, it is to be expected that Australian funds will have higher costs compared to other regions, and European funds will have the lowest costs. This is consistent with the average investment management costs shown above.

The following charts, based on the Watson Wyatt 2009 survey, corroborate the data on asset allocation differences.



Source: Global Pension Assets Study by Watson Wyatt Worldwide, January 2009.

7.2.2 Fund size

Fund size is important because economies of scale drive lower costs in larger funds. In this sample, investment management cost declines by about half from 33 basis points for funds under US\$1 billion to 16 basis points for funds over US\$50 billion.

European funds surveyed have the greatest average size, and therefore benefit the most from economies of scale due to size. In this study, Canada and Australia have the lowest average fund sizes, and therefore have less scope for economies of scale. Average fund sizes by region (based on 2005 data in the CEM database) are shown in the table below.

Table 7.2: Average sample fund size by region

Region	Average fund size (local currency)	Average fund size (in Australian dollars)
Australia	A\$11.4 billion	A\$11.4 billion
USA	US\$14.0 billion	A\$19.2 billion
Canada	C\$3.9 billion	A\$4.4 billion
Europe	€11.5 billion	A\$104.2 billion

7.2.3 Investment style

Funds with more internal and/or more passive management have lower costs. An external active management style results in higher management costs.

As an indicator of style differences, in 2005, European funds, at 47% of total assets, had the lowest proportion of the highest cost external active style compared with Canadian, US and Australian funds at 67%, 73% and 79%, respectively. Accordingly, it is unsurprising that European funds had the lowest investment management costs.

7.2.4 Collective impact

Analysis by CEM Benchmarking has shown that the above variables – asset mix, size and style – collectively account for 61.6% of the variation in investment management costs. The result is based on the regression of investment management cost against asset mix (percent holdings of private equity and hedge funds, property and equities), fund size, and style (percent external active management).

CEM Benchmarking concluded that, adjusting for asset mix, size and style, Canadian funds are the world's lowest cost funds. European and US funds have similar investment management costs (after adjustment for the three factors) and are slightly more expensive than Canadian funds.

CEM Benchmarking did not comment on the relative costs of Australian funds after adjustment. However, based on the above information comparing asset mix, fund size and investment style, our expectation is that the adjusted investment management costs of Australian funds would be at a similar level to those in the US and Europe.

7.2.5 Regulatory structure

Regulations governing retirement plans vary between countries, and fine-tuning continues to occur. Compliance with regulations on vesting, taxation, indexing, and portability usually impacts the administration costs of the funds, rather than the costs of managing the investments.

Some regulations will apply in relation to asset management, such as costs of custody arrangements, and these costs are generally charged as a percentage of assets under management. Specific information regarding such costs is not readily available for different countries. However, we would expect such costs to be fairly similar between countries.

Therefore, compliance with the relevant regulatory structures is not expected to have a significant impact on the differences between investment management costs in various countries.

7.3 Conclusion

A fair comparison of the investment management costs between different countries should be based on the absolute basis points cost, adjusted for factors such as asset mix, size and style.

Given the smaller average size of funds in Australia, and the use of more active investment and higher proportions invested in growth-type assets, it logically follows that Australian funds have experienced higher investment management costs relative to other countries.



Appendix A

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