RESEARCH CENTRE

Aggregate administration and investment costs in the superannuation industry

Ross Clare
ASFA Research Centre

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Federal Secretariat

Level 19
Piccadilly Tower
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 1005
Tel: (02) 9264 9300
Fax: (02) 9264 8824

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290
ASFA Website: www.superannuation.asn.au

Aggregate administration costs

Table 1 below uses data from the 2001 ASFA survey of fund administration and investment costs, together with other available data and estimates, to give an overall picture of administration costs in the superannuation sector. The data suggest that aggregate administration costs for superannuation in 1999-00 were of the order of $2.45 billion. While this is a considerable sum it has to be seen in the context of the 21.7 million accounts in superannuation funds and the $477 billion in assets in funds as at June 2000.

Table 1 Aggregate administration costs by type of fund, June 2000

Type of fund	**Members at June 2000 (million)**	**Annual administration costs per member ($)**	**Total administration costs ($ million)**
Industry	6.545	54	350
Corporate	1.437	147	210
Public sector	2.722	60	160
Retail (excluding RSAs and ERFs)	8.3	160(a)	1330
Retirement Savings Accounts	0.3	90(b)	27
Eligible Rollover Funds	2	15(c)	30
Small funds	0.415		400(d)
Annuities	0.25	150(d0	40
Total	**21.727**		**2550**

(a) estimated on the basis of June 1997 ISC estimates for master trusts, adjusted for both inflation and increased competition
(b) estimated by ASFA Research Centre
(c) APRA Bulletin December quarter 1998, adjusted for inflation
(d) Estimated by ASFA Research Centre

While retail funds of various types account for over half of the estimated administration costs of superannuation, this is largely a function of there being over 8 million retail accounts out of the total 21.7 million member accounts. The administration costs of Eligible Rollover Fund accounts are very low at around $15 per account per year, but the average administration costs of other retail accounts are higher than the average for the sector as a whole.

The higher costs of the bulk of the retail sector do not necessarily reflect any inefficiency given that the administration in most instances is carried out by the same or similar organisations that provide administration services for other categories of superannuation funds. However, providers of retail products take their profit in part by a margin on administration costs, and there also are the costs of maintaining a sales network for a large part of the retail product range. Master trusts also generally offer a greater range of investment choices and can provide a higher level of reporting and transaction capabilities than other funds that are commonly used.

At an average cost per account of $110 per year and given multiple account holdings, which are common in the current system, costs can mount up for individuals and society as a whole. However, it should be noted that around 2 million of these multiple accounts are in Eligible Rollover Funds where the administration cost per member per year is only around $15. A significant proportion of multiple accounts are also in the relatively low cost industry fund sector. That said, consolidation of accounts has the potential to significantly reduce aggregate costs and to increase the retirement savings of individuals. Recent initiatives to improve the operation of the Lost Members Register and to aid the consolidation of account balances are to be welcomed.

Aggregate investment costs

The cost of investment management (expressed in terms of a percentage of assets) generally decreases with the total assets of each corporate, public sector and industry fund, although investment mix will also have an impact.

Table 2 uses a range of available data and estimates to give an overall picture of investment management costs in the superannuation sector. The data suggest that aggregate investment management costs for superannuation in 1999-00 were of the order of $3.1 billion.

Table 2 Aggregate investment management costs by type of fund, June 2000

Type of fund	**Assets at June 2000 ($ billion)**	**Total investment costs ($ million)**
Industry	36.6	145(a)
Corporate	77.3	390(a)
Public sector	110.4	380(a)
Retail – personal super	89	1510(b)
Retail – employer group plans	44	400(c)
Retirement Savings Accounts	0.5	5(d)
Eligible Rollover Funds	2	15(d)
Small funds	67.8	230(e)
Total	**427.3**	**3075**

(a) estimated using average MERs reported in survey, adjusted for under-reporting of costs of managed investments and for reported operating expenses in APRA quarterly bulletin. Assumed MER for industry funds is 40 basis points, for public sector funds it is 35 basis points, and for corporate funds 50 basis points.
(b) estimated on the basis of average investment costs of 1.7% per annum
(c) estimated on the basis of average investment costs of 0.9% per annum
(d) estimated by ASFA Research Centre
(e) estimated on the basis of average investment costs of 35 basis points per annum. The average reflects self managed fund use of both low cost direct asset holdings and relatively high cost retail investment products.

There are significant differences between wholesale and retail management expense ratios and investment charges. A large retail fund may have a considerable amount of assets in aggregate, and is in a position to achieve relatively low investment costs through use of in-house or external investment managers. However, it is customary for investment charges deducted from account balances to be based on individual account balances. Where a master trust is delivered on an individual basis through direct distribution or by way of a financial planner generally a higher percentage charge is made than when an employer based, corporate master trust arrangement is used. However, the rate charged in regard to assets invested through a corporate master trust is variable, both between providers and between customers of the one provider. Published rates are often the starting point for negotiations when an employer approaches or is approached by a master trust provider. The larger the amount of contributions and assets the more negotiable are the outcomes. The approach taken by an employer to negotiations and the testing of other providers can also have an impact on the fee structure.

Aggregate administration and investment costs

On the basis of the preceding analysis aggregate investment and administration costs for superannuation funds were of the order of $5.6 billion a year as at June 2000 (Table 3). The table also calculates costs as a percentage of assets under management. Care should be taken in interpreting these percentages. Use of a particular type of fund does not necessarily lead to the specified percentage costs applying. For instance, the industry funds provide a very cost effective product for low balance accounts with regular modest contributions seeking a competitive return on the investment.

Lower charges might be possible in an ERF, but such funds do not offer scope for regular contributions and offer relatively low rates of returns in order to cover the costs of a large number of low balance accounts. Corporate and public sector funds may have lower cost ratios, but by definition such funds are not open to a range of employers and employers, and they also benefit from higher average account balances compared to industry funds. It is also important to note that larger balance accounts in industry funds will achieve a cost ratio lower than the average for the industry funds. The reason for this is that as the balance of an account grows, the fixed administration charge becomes a smaller proportion of the account balance.

Equally, while many retail products are relatively high cost for both low and high balance accounts, retail products provided on a group basis through an employer can be relatively cost competitive. On the other hand, a significant number of smaller self managed funds will not achieve costs of less than 1% of assets of the fund because of the relatively high fixed costs associated with such funds. As with a number of the other types of funds, a relatively high average account balance is necessary to obtain a modest or low level of costs in terms of a percentage of assets.

Table 3 Aggregate administration and investment costs by type of fund, June 2000

Type of fund	Assets at June 2000 ($ billion)	Average account balance ($)	Costs as a percentage of assets	Total costs ($ million)
Industry	36.6	5,590	1.35	495
Corporate	77.3	53,800	0.78	600
Public sector	110.4	40,550	0.49	540
Retail	133	18,350	2.4	3240
Retirement Savings Accounts	0.5		0.65	32
Eligible Rollover Funds	2		0.23	45
Small funds	67.8	180,300	0.93	630
Total	**427.3**		**1.29**	**5625**

Aggregate employment in the sector

Administration

Somewhat surprisingly given that there is some $500 billion invested through superannuation funds and around $5.6 billion in aggregate costs per year, there are no official or indeed otherwise published estimates of employment in the superannuation sector or the proportion of the nation's GDP accounted for by superannuation services.

The ABS publishes estimates of those employed in the finance and insurance sector, but does not provide any further disaggregation. According to the ABS Labour Force, Cat No 6291.0, as at August 2000 there were 329,600 persons employed in the finance and insurance sector, around 3.6 % of the 9.1 million in the labour force at that time. This percentage dropped from 3.9% five years earlier. Consolidation of the banks over that period together with considerable job shedding would have contributed to that outcome.

An estimate of the number of persons employed in fund administration can be derived from information available on the average number of member accounts per person employed in different types of administration operations. For smaller corporate funds there generally are around 1,000 accounts per person employed in administration. For larger corporate funds this figure can increase to around 1,400 accounts per employee. For public sector funds, particularly those with a large number of inactive accounts, that ratio can increase to nearly 2,000 accounts per employee. For ERFs, that ratio can be an even greater multiple, reflecting the low incidence of member contact and transactions, and the use of automated processing.

Based on these ratios, there is likely to be about 5,000 employees involved in industry fund administration, 1,400 in corporate fund administration, 1,700 in public sector fund administration and around 10,000 in retail funds, including life company personal products, ERFs and RSAs. (Each of these figures includes both direct employment by funds and contracted out administration activities). In total there are likely to be around 18,500 to 20,000 employees directly involved in administration, with another 5,000 or so involved in support activities that are purchased from third party providers, such as information technology, communication and professional services. There is anecdotal evidence that employment in superannuation administration has been relatively flat in recent years, in contrast to the significant redundancies in some parts of the financial sector such as banking.

These employment estimates are consistent with the overall cost estimates for the sector set out in Table 1. They also are consistent with enrolments in ASFA education and training courses. Around 1,100 new enrolments are received each year for the entry level course offered by ASFA. The number of accounts is growing by around 10% per year, with likely growth in the number employed in administration in the order of 1,000 to 1,500. Not all of these employees would require specific training in superannuation given that a significant proportion would be involved in more generic office tasks, but there also would be a need to train replacements for the employees who left the industry on resignation or retirement.

Both profit margins and aggregate profits in administration are relatively slim. Corporate, industry and public sector funds that self administer are by definition non-profit. Of the remainder, the evidence available suggests that profit margins for third party provision of administration services are relatively low. While the profit margin on

gross revenue in the finance sector is generally of the order of 25%, for administration the margin is likely to be at or below the 9% margin that applies on average for all industries. In recent years a number of providers of administrative services to superannuation funds have merged with other providers or withdrawn from the market in response to market pressures. Not only have third party administrators had to compete with providers who have sought to use economies of scale to cut costs and expand their market share, they have had to compete with non-profit, in-house administration by funds. Third party administrators have to be very good and/or very large in scale to compete in such a market.

Remuneration levels for superannuation funds administration tend to be relatively modest by the standards of the financial sector. A Hays Personnel survey for 2001 indicates that the typical salary for a trainee/graduate is around $30,000, rising to around $33,000 for an administrator, $38,000 for a senior administrator, and around $65,000 for an administration manager. Salaries in Sydney and Melbourne tend to be higher than in the other capital cities.

Investment management

It is difficult to translate the $3 billion of investment management costs into aggregate employment and profits. A significant proportion of this total is likely to be accounted for by profits. The profit margin on gross revenues, to which the $3 billion figure more or less relates, is in excess of 25% for the finance and insurance industry as a whole. Funds managements would be at the high margin end of the market, at least for the larger players in terms of funds under management. Significant economies of scale apply, with, say, a ten fold increase in funds under management involving no where near as much an increase in costs.

APRA figures indicate that around 30% of assets are directly invested, 40% are placed with an investment manager, and around 30% are invested in life office statutory funds.

Around 80% of the activity of life insurance companies is attributable to superannuation, and so around 80% of the profits of such entities are also likely to be attributable to superannuation.

For funds managers the level of revenue (and costs) varies with the style and category of investments. Fees are relatively modest at the wholesale level for large investments by a fund. Passive, index like investment management has fees between 10 and 20 basis points, while for actively managed portfolios the range is between about 35 and 70 basis points.

At the retail level, investment management fees can be as high as 1.8% or 2%, with entry fees as well. The difference between these fees and the underlying wholesale investment fees are basically distribution costs and profits. A significant proportion of the employment and profit in the financial planning sector is funded out of the fees charged by investment managers.