

# Superannuation fund expense analysis

Research undertaken for ASFA  
by Rice Warner Actuaries

October 2011

Association of Superannuation Funds of Australia

ASFA

Level 6  
66 Clarence Street  
Sydney NSW 2000

PO Box 1485  
Sydney NSW 1005  
Telephone: +61 2 9264 9300  
Fax: +61 2 9264 8824 or 1300 926 484

Outside Sydney  
1800 812 798

Website: [www.superannuation.asn.au](http://www.superannuation.asn.au)

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

This material is copyright. Apart from any fair dealing for the purpose of private study, research, criticism or review as permitted under the Copyright Act, no part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission. Inquiries to be made to The Association of Superannuation Funds of Australia Ltd.

© ASFA 2011

TABLE OF CONTENTS	
<b>1. Executive summary</b>	4
1.1 Objectives	6
1.2 Background	6
<b>2. Operating expenses</b>	7
2.1 Categories of operating expenses	8
2.1.1 Distribution of major operating expense components	8
2.1.2 Administration expense components	9
2.1.3 Distribution of administration expense components	10
2.1.4 Administration expenses per transaction	10
2.1.5 The impact of outsourcing	11
2.1.6 The impact of scale	12
2.2 Investment expense components	13
2.2.1 Investment expense components	13
<b>3. The impact of scale</b>	14
3.1 Operating expenses and scale	14
3.1.1 By broad size category based on number of members	14
3.2 Investment expenses and scale	16
3.2.1 Introduction	16
3.2.2 Data sources	16
3.2.3 Investment expenses by fund size	16
Investment expense components by fund size	18
3.2.4 Asset consulting expenses by fund size	19
3.2.5 Custody expenses by fund size	19
3.2.6 Investment management expenses by fund size	20

## 1. EXECUTIVE SUMMARY

- This report summarises the results of research into the cost structure of superannuation funds carried out for ASFA by Rice Warner Actuaries. The research is based on a survey of superannuation funds conducted by Rice Warner in late 2010 and also on fund level data published by the Australian Prudential Regulation Authority (APRA).
- The intention is to undertake this research annually to provide a longitudinal study of expenses. Rice Warner has already contacted funds to collect the 2011 data.

### *Components of operating costs*

- In regard to the components of operating costs, the costs related to the category 'administration' together with 'trustee support/general management', make up the bulk of operating costs. Costs associated with 'technology infrastructure' are also substantial.
- Defined benefit funds have higher unit costs for operating expenses than other funds. However, these costs are effectively paid for by employer sponsors rather than by fund members.
- Administration expenses have a number of components. The largest components relate to contribution processing and member contact centres, which together make up around half of fund administration expenses.
- The costs of contribution processing can be as low as \$2.85 a member per year, while the highest recorded figure was \$21.20. On average the cost was around \$8.90 per member per year. There was also a significant variation in the cost of member contact centres.
- The results indicate that insurance administration can involve substantial amounts per claim (typically in excess of \$2,000), and pension administration is more costly than contribution processing.

### *Impact of outsourcing*

- Many funds outsource part or all of their administration service provision. Most of the differences between the operating costs of outsourced funds and the self-administered are not statistically significant, particularly given that self-administered funds are more likely to be defined benefit funds than outsourced funds. The notable exception is in regard to technology infrastructure. This is likely to be due to information technology (IT) systems costs being relatively high.

### *Impact of scale*

- Fund size has a notable impact on the per member cost of administration. Each component of administration expenses tends to decrease as fund size increases.
- Funds with less than 25,000 members commonly, but not always, have significantly higher expenses than larger funds. The bulk of the reduction in operating expenses flowing from scale is generally achieved with a fund membership of 500,000 or more.
- Funds above \$10 billion in assets have lower investment expenses than smaller funds.

### *Investment expenses*

- More than half of investment expenses are fees paid to external fund managers.
- There are scale benefits in the areas of custodian and asset consultant services.
- There appear to be scale benefits from leveraging fund size in negotiating fees for the management of listed shares (both Australian and overseas), but no such benefits are obvious for the other asset classes examined.

### *Policy and other implications*

- Initiatives to reduce administration costs, such as the SuperStream proposals relating to contributions and rollover processes, have the potential to significantly reduce the cost of processing contributions and rollovers. However, such costs only form a part of overall administration costs and only a relatively small proportion of overall fund expenses.
- The considerable variability in operating costs between specific funds is a topic deserving further investigation. While some of the variability is likely to be explained by differences in benefit design and the level of services provided, there are also likely to be differences in the levels of cost efficiency between funds.
- Call centres and member communication form a large part of fund operating expenses. Fund expenses are likely to increase if there is greater provision of intra-fund and scalable advice through call centres and the like.
- Fixed costs associated with IT provision are significant. Outsourcing administration appears to be one way that a smaller fund is able to reduce costs in this area.
- Costs such as those relating to trustee and general management support and compliance and risk management appear to not vary much with the size of a fund. Fund mergers offer potential cost savings in these areas for funds.
- Many of the benefits from increasing scale appear to be achieved in regard to operating expenses when a fund has more than 500,000 members, and in regard to investment expenses when it has more than \$10 billion in assets under management. The greatest cost savings from fund mergers are likely to be obtained when they involve funds with member numbers or assets under those amounts. However, some smaller funds have cost levels which are competitive with those of larger funds and in these cases, the pressures for mergers on cost grounds alone are less.
- Currently, funds are not required to report much detail on investment expenses to APRA and a large part of investment expenses are netted off investment returns rather than forming part of the detail in the financial accounts of funds.

## 1.1 Objectives

The objectives of this report are to explore:

1. What are the major components of the costs of superannuation funds.
2. What are the factors associated with different expense rates.
3. The costs of providing advice and member education in different types of funds.
4. The impact of scale on superannuation fund expenses, including the size of any scale economies.

## 1.2 Background

In April 2011 ASFA commissioned Rice Warner to prepare a report which examined the cost structure of superannuation funds. Amongst other things, ASFA requested that the report examine the impact of scale on the level of costs of funds. Also to be examined were the differences in costs that might be attributable to providing defined benefits rather than accumulation benefits, in-sourcing administration rather than using a third party administrator, and differences in costs related to service provision, including provision of advice services.

In June 2011 Rice Warner provided its report to ASFA. This summary document draws on that more detailed report.

Two main sources of data were used by Rice Warner in preparing the analysis:

- The inaugural Rice Warner *Superannuation Expense Survey* as at 30 June 2010. This survey covers 43 funds on an aggregated basis, 26 of which provided detailed expense analysis.
- The APRA fund-level performance and profile statistics as at 30 June 2010 (published on the APRA website).

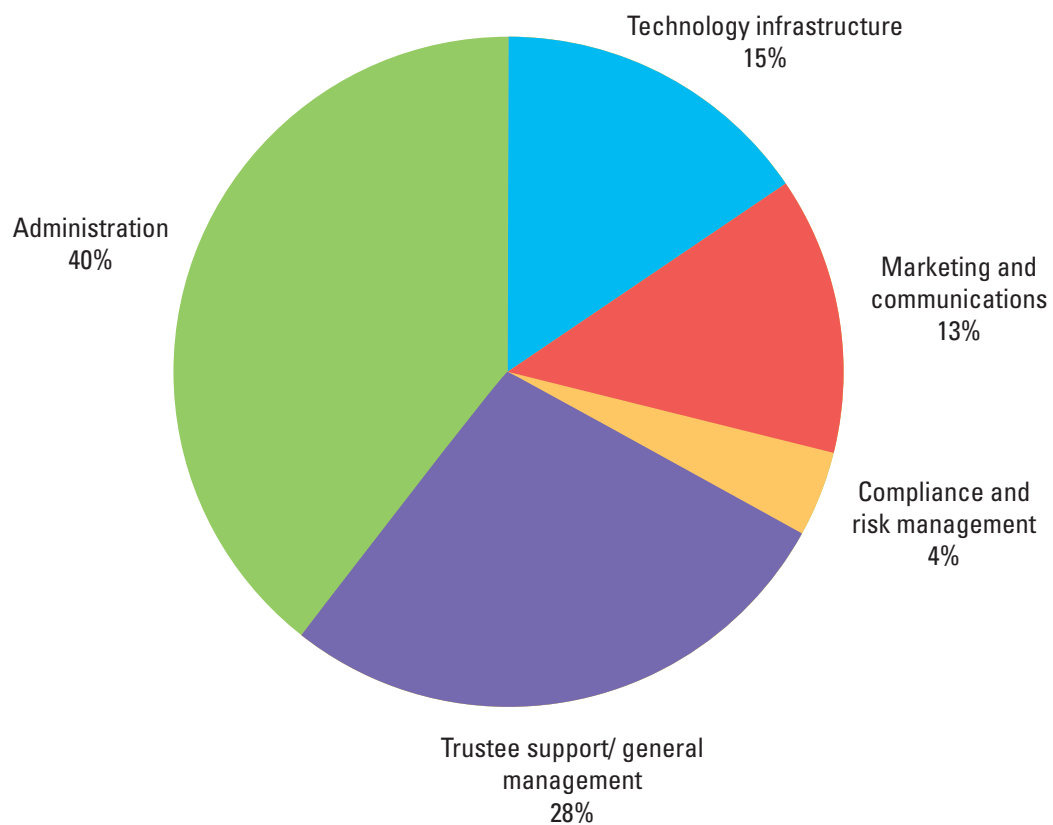
In the analysis that follows, allowance is made for the differences in reporting approaches between the two sources of information where possible.

More specifically, the analysis is based on a combination of the Expense Survey data for industry, public sector and corporate funds, together with fee data for the retail components. The retail components are based on fees charged, less an assumed 20 per cent profit margin on operating and investment expenses. The approach adopted is to focus on underlying costs rather than on fees that may be charged to a fund and/or fund members.

## 2. OPERATING EXPENSES

Costs related to the category “administration” together with “trustee support/general management” make up the bulk of operating costs. Costs associated with “technology infrastructure” are also substantial. Further detail on the components of “administration” is provided in the section 2.1.2 below.

**Graph 1: Operating expenses per member by component**



## 2.1 Categories of operating expenses

### 2.1.1 Distribution of major operating expense components

The following table summarises the range of the dollar amounts per member across the major expense components. There is significant variation in the amounts across the funds surveyed as, amongst other things, costs can vary substantially between accumulation and defined benefit or hybrid funds. As will be explored later in this report, the size of a fund can also have a substantial impact on costs per member.

**TABLE 1. DISTRIBUTION OF OPERATING EXPENSE COMPONENTS (ALL FUND TYPES)**

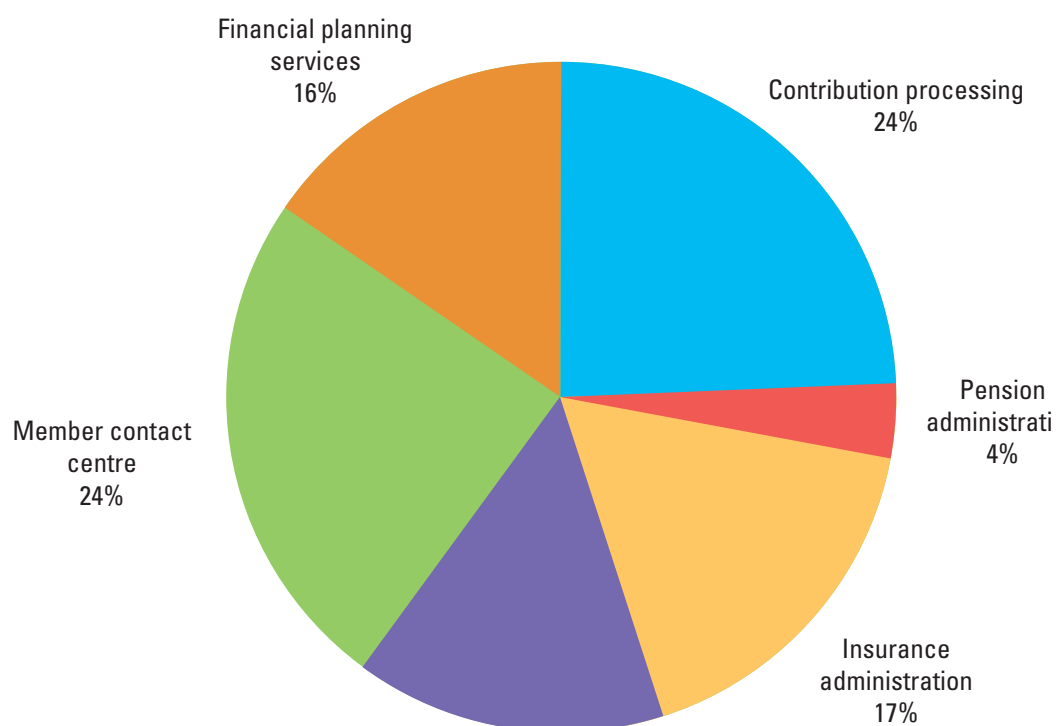
Expense component	Operating expense per member per annum				
	Min.	Lower quartile	Median	Upper quartile	Max.
Technology infrastructure	\$3.97	\$8.89	\$14.11	\$26.62	\$58.04
Marketing and communications	\$1.27	\$5.83	\$11.80	\$16.13	\$22.63
Compliance and risk management	\$0.75	\$2.14	\$6.54	\$13.55	\$27.46
Trustee support/general management	\$7.69	\$19.56	\$23.65	\$43.50	\$80.46
Administration	\$18.70	\$30.92	\$35.84	\$52.94	\$85.02



### 2.1.2 Administration expense components

The total administration expense has a number of components (Graph 2). The largest components relate to contribution processing and member contact centres, which together make up around half of fund administration expenses.

**Graph 2: Administration expenses per member by component (all fund types)**



### 2.1.3 Distribution of administration expense components

As with other expenses, there is considerable variation between funds in the amount spent on different administration expenses. Size of fund and type of benefit provided explain part of the variation. As well, for many company and public sector funds, the costs of contribution processing may form only a small part of expenses given that contributions by employers are generally made electronically in such funds.

The quality and extent of services are relevant considerations when assessing the cost of direct member services such as member contact centres or financial planning. Individual funds may have varying objectives and service level requirements, based on the needs of members and the trustee's assessment of service objectives. Minimising the amount spent on meeting the needs of members is not an objective in itself.

**TABLE 2. DISTRIBUTION OF ADMINISTRATION EXPENSE COMPONENTS (ALL FUND TYPES)**

Expense component	Administration expense per member per annum				
	Min.	Lower quartile	Median	Upper quartile	Max.
Contribution processing	\$2.85	\$6.71	\$8.91	\$9.94	\$21.20
Pension administration	\$0.13	\$0.66	\$1.80	\$4.15	\$19.45
Insurance administration	\$1.80	\$3.85	\$6.01	\$9.71	\$19.92
Other benefit processing	\$1.66	\$3.70	\$4.88	\$6.24	\$18.06
Member contact centre	\$4.47	\$7.70	\$11.23	\$15.25	\$21.16
Financial planning services	\$0.65	\$1.77	\$2.99	\$11.01	\$26.28

### 2.1.4 Administration expenses per transaction

The survey results also allow for more granular analysis of expense components and the data collected included some level of transactional information. The table below summarises some key results.

**TABLE 3. DISTRIBUTION OF ADMINISTRATION EXPENSES PER TRANSACTION (ALL FUND TYPES)**

Expense component	Administration expense per transaction				
	Min.	Lower quartile	Median	Upper quartile	Max.
Cont. processing per active member	\$3	\$10	\$15	\$18	\$34
Pension administration per pensioner	\$51	\$146	\$251	\$443	\$1,667
Insurance administration per claim*	\$590	\$2,050	\$2,549	\$3,560	\$5,630
Other benefit processing per transaction	\$7	\$41	\$54	\$82	\$173
Member contact centre per enquiry	\$7	\$13	\$17	\$22	\$62

\* Excludes six high value outliers for small funds where expenses are difficult to isolate.

The results indicate that insurance administration can involve substantial amounts per claim, and pension administration is much more costly than contribution processing.

As well, there is a reasonably wide variation across each of these expenses. Significant contributors to the variation include:

- level and quality of service, particularly in respect of member contact centre services;
- ability to obtain efficiencies through use of technology, particularly in respect of contribution processing; and
- scale (eg number of pensioners, number of active members).

While contribution processing is a significant expense for funds, on average it makes up only around one-quarter of administration expenses. For a fund with total administration costs of around \$36 a year per member (the median in Table 3), contribution processing costs are around \$9 a member per year. Of course some funds will have contribution processing costs per member greater than this, while others will have lower costs (particularly when there is only one or relatively few employer sponsors making contributions). Table 3 indicates that at least one fund has costs for contribution processing of \$24 a member per year.

Even if contribution processing costs were reduced by 25 per cent on average, as a result of SuperStream initiatives to make the contributions process more efficient and less prone to errors, the cost savings would come to around \$2 a member per year on average. Aggregate costs savings for the superannuation sector as a whole might be in the order of \$100 million a year based on a 25 per cent reduction in costs related to contributions processing.

However, for some funds, particularly those with many contributing employers and/or where contributions are made by cheque and with inadequate details of members, current costs will be higher and the scope for cost reduction will be greater as a result of the SuperStream changes. In a fund where contribution processing costs are currently \$34 a year, then cost savings per member could be as much as \$10 or even \$20 per year.

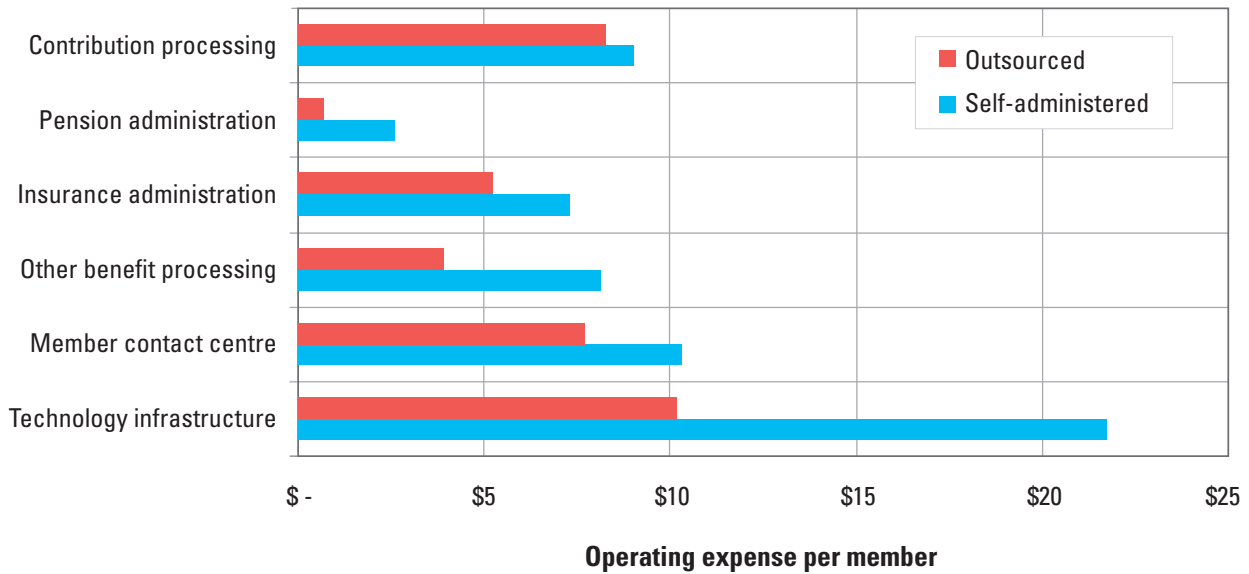
### *2.1.5 The impact of outsourcing*

Many funds outsource part or all of their administration service provision. Graph 3 provides estimates of various costs depending on whether the administration function is outsourced.

Most of the differences are not statistically significant, particularly given that self-administered funds are more likely to be defined benefit funds than outsourced funds. The notable exception is in regard to technology infrastructure. This is likely to be due to IT systems costs being relatively high, with savings made when IT capital costs are shared across a number of funds.

Some large funds which are outsourced have many contributing employers. This would tend to equalise the cost of contribution processing between outsourced funds and the self-administered. The latter are more likely to deal with fewer employer contributors.

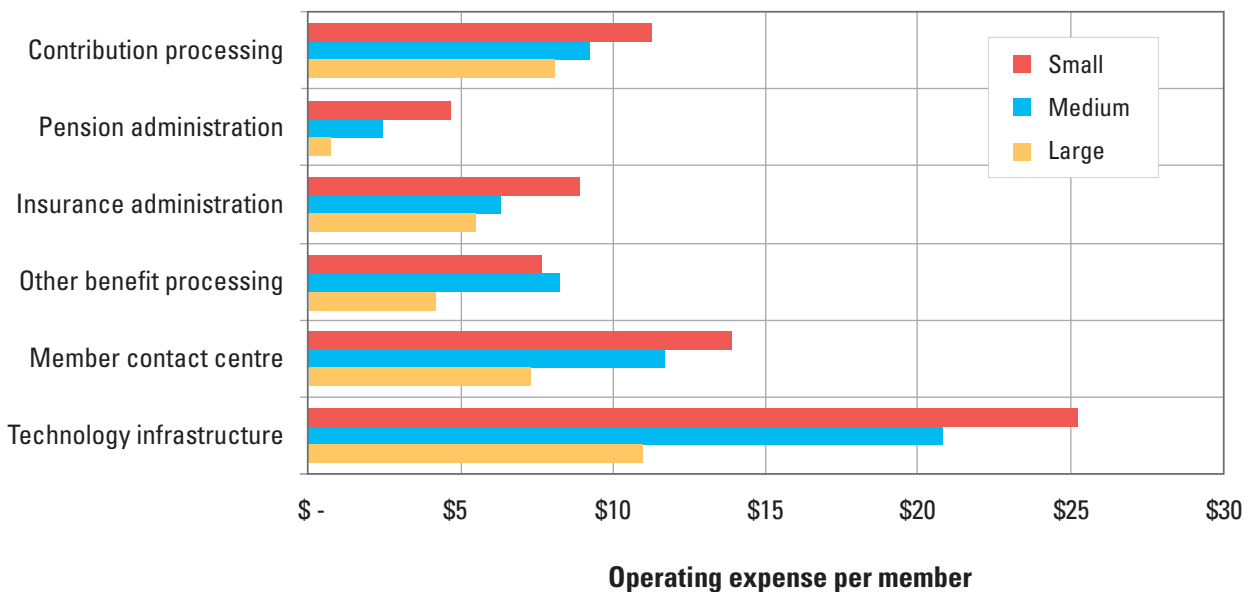
**Graph 3: Administration expense components by administration structure**



**2.1.6 The impact of scale**

The following graph identifies the impact of fund size on each administration component. Each component of administration expenses tends to decrease as fund size increases. Again, differences between type of fund in benefit design and in the proportion of members who are receiving a pension, may be responsible for some of the differences.

**Graph 4: Administration expense components by fund size (membership)**

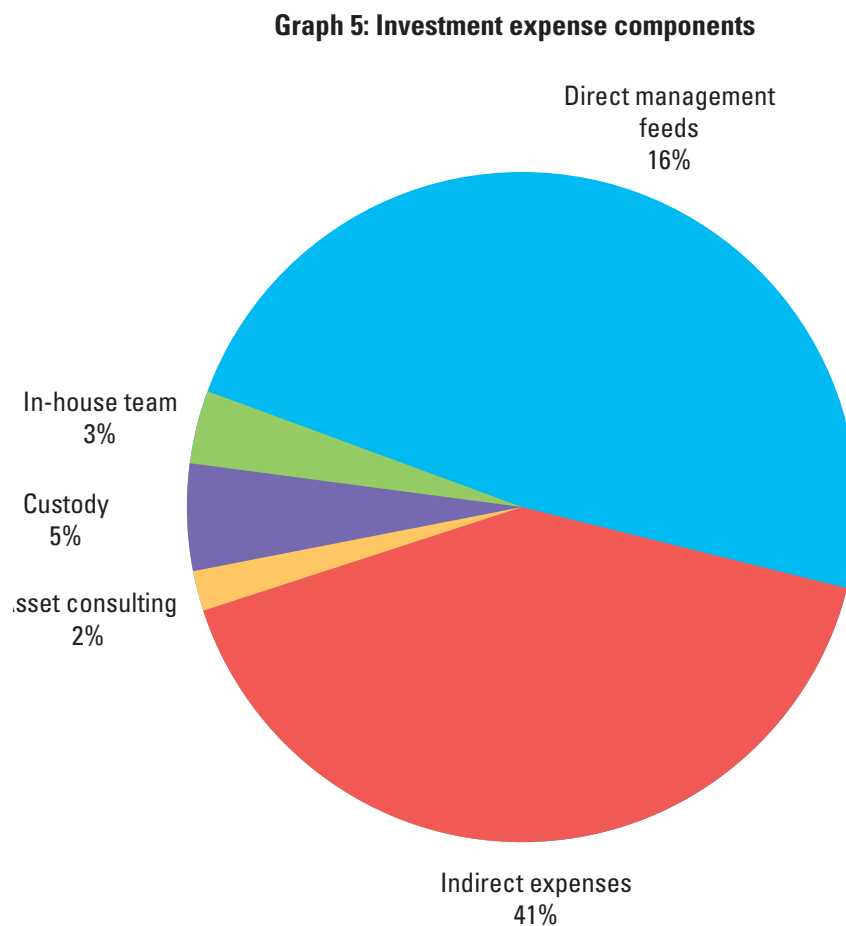


## 2.2 Investment expense components

Investment expenses have fewer recorded cost components and the bulk of expenses are comprised of management fees. The major difficulty is in identifying 'indirect' management fees. For the purposes of this report, total management fees have been identified using each fund's ICR (Investment Cost Ratio) breakup applied to average assets per investment option (using data from the Expenses Survey), and subtracting an estimate of direct management fees (from the fund's APRA return). The resulting figure should be a reasonable estimate of the indirect investment expense component.

### 2.2.1 Investment expense components

Graph 5 examines the distribution of investment expense components, weighted by average net assets during the year:



For most funds, direct management fees plus indirect expenses make up the great bulk of the cost of managing assets.

'Indirect expenses' comprise mainly investment management fees that are not passed through fund financial statements as a direct fee paid to a manager, but are indirectly incurred, generally via an adjustment to unit prices within a trust or implemented consulting arrangement.

### 3. THE IMPACT OF SCALE

#### 3.1 Operating expenses and scale

##### 3.1.1 By broad size category based on number of members

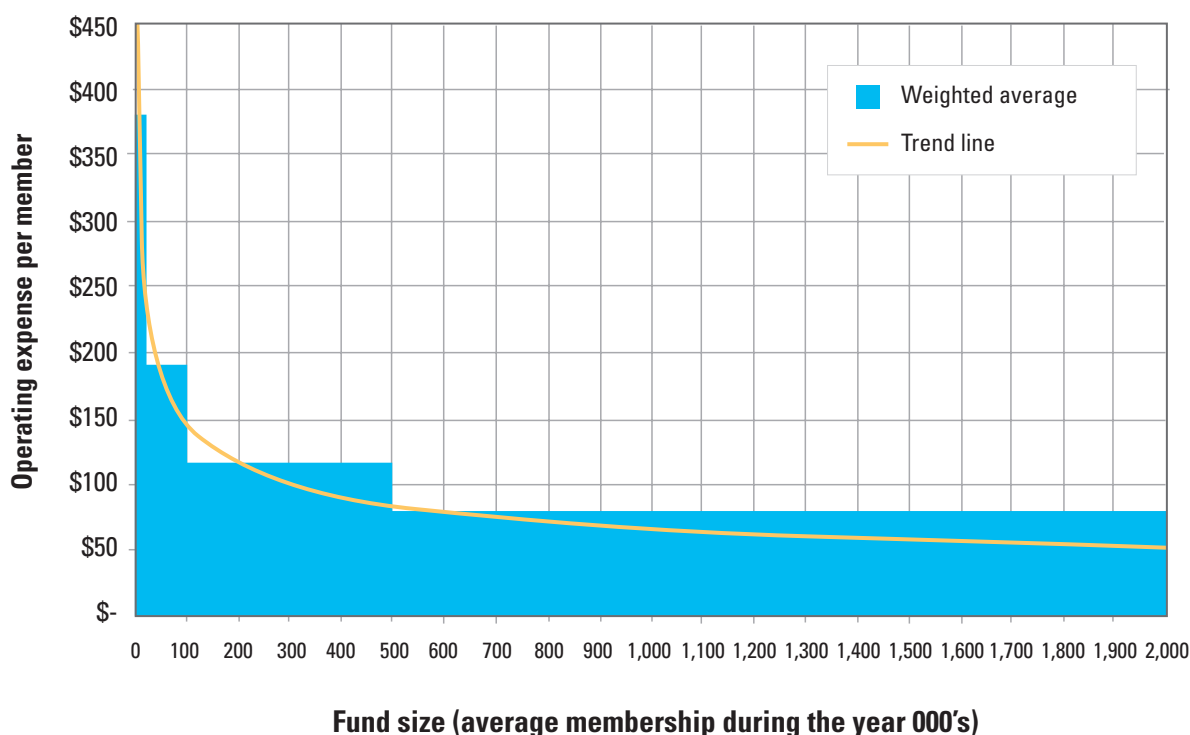
The following graph measures the variation in total operating expenses by fund size, measured as average total membership during the financial year to 30 June 2010.

Funds have been separated into the following four categories based on membership size:

- Very small: fewer than 25,000 members.
- Small: between 25,000 and 100,000 members.
- Medium: between 100,000 and 500,000 members.
- Large: more than 500,000 members.

Settling on particular size bands in terms of number of members necessarily involves matters of judgement. In addition, these size categories were determined so as to obtain a representative sample of approximately equal numbers of funds in each group.

**Graph 6: Operating expenses per member by fund size (membership)**



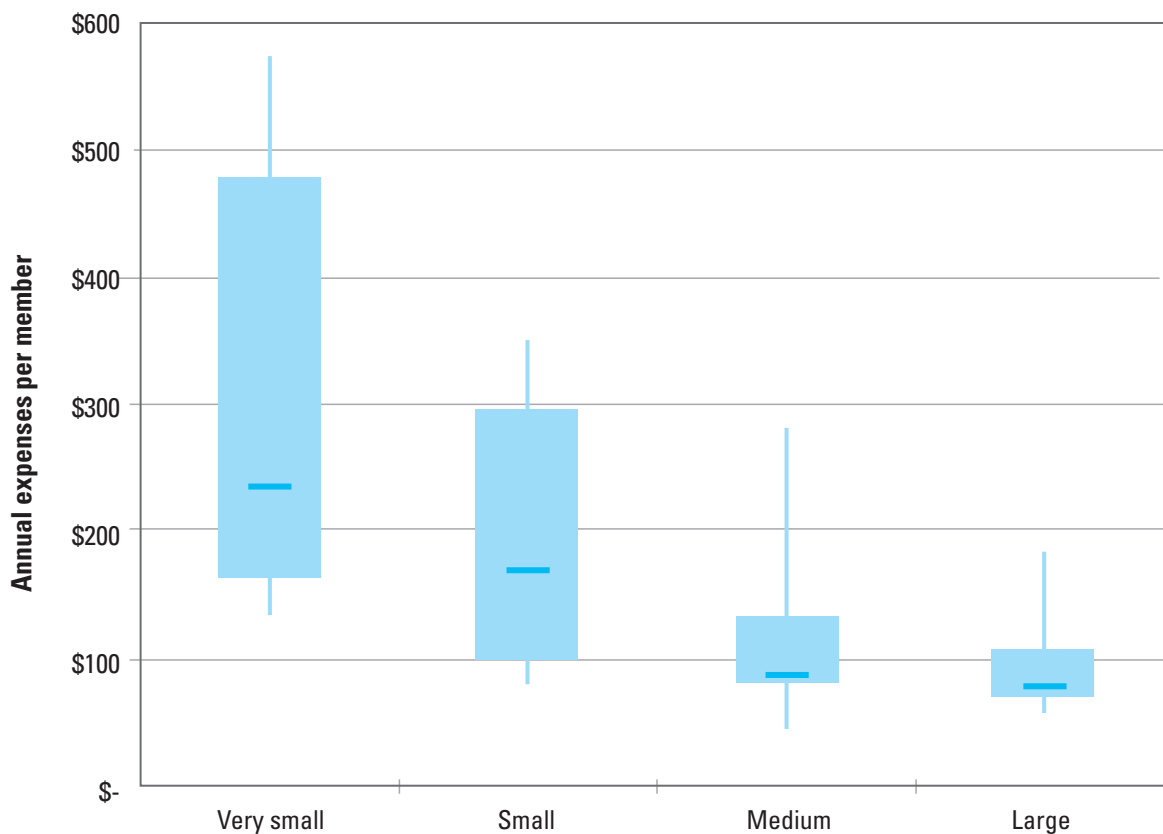
Graph 6 illustrates a clear scale effect, with the bulk of the reduction in operating expenses flowing from scale generally achieved with a fund membership of 500,000 or more.

However, there can be a substantial amount of variation in total operating expenses within each size grouping. Some very small funds have lower operating costs than some large funds.

Graph 7 shows the variation in costs across each group, and should be interpreted as follows:

- The light blue boxes represent the second and third quartiles around the median. In other words, 50 per cent of funds fall within each blue box.
- The dark blue horizontal lines represent the median result (50 per cent of funds are above the median and 50 per cent below).
- The light blue vertical lines at each end of the light blue boxes represent the 'outside' quartiles. Twenty-five per cent of fund participants lie in the top quartile and 25 per cent in the bottom quartile.

**Graph 7: Distribution of operating expenses per member**



Source: Rice Warner Superannuation Expense Survey 30 June 2010

While the most costly of the very small funds has operating expenses per member far in excess of the highest cost large fund, there are some very small funds which have lower operating costs than the higher cost large funds.

However, the median operating cost clearly declines with increasing size. That said, the decrease in average operating costs between medium and large funds is not great.

It should be noted that the Expense Survey covers a wide range of fund types, including funds that provide defined benefits as well as accumulation-style benefits. Some of the variation will be due to these factors, while there are also differences in service levels and membership characteristics between funds.

## 3.2 Investment expenses and scale

### 3.2.1 Introduction

The major components of investment expenses are:

1. Investment management fees (direct and indirect, including performance-based fees).
2. Costs of managing direct investments.
3. Custody fees.
4. Asset consulting fees.
5. Expenses relating to in-house investment teams.

Investment management fees comprise roughly 90 per cent of investment expenses. While scale does impact on management fees, the scale effects are masked by major variations in management fees resulting from asset allocation and strategy – for example, the use of indexed investment approaches (which carry lower fees) and ‘alternatives’ (including direct property) which carry higher fees. Larger funds tend to have greater exposure to alternative assets.

### 3.2.2 Data sources

The APRA fund level performance and profile statistics that were used above for the scale analysis of total operating expenses are of limited value in analysing investment expenses. The reason is that the quoted investment expenses were extracted from each fund’s APRA return, which is in turn based on the fund’s published financial statements. Accordingly, only direct investment expenses are included. The major component of the excluded indirect expenses relates to investment management fees that do not pass through the financial statements as a cash outflow, but are charged via an adjustment to unit prices in a trust or pooled superannuation trust (PST). These indirect costs represent nearly half of total management fees across all funds, the proportion being progressively larger for smaller funds, where most investment will be via trust arrangements. For retail funds in particular, no investment expenses may be disclosed (and are not required to be disclosed) in the APRA return at all.

For this reason, the analysis below uses the investment expense rates derived from the Expense Survey. These have the advantage of being broken up into the components listed earlier, and also exclude any non-investment expenses that may be charged to members via the fund’s investment management fee structure – for example, any asset-based administration fee that might be incorporated in the investment fees.

### 3.2.3 Investment expenses by fund size

Graph 8 measures the variation in total investment expenses by fund size, measured as average net assets during the financial year to 30 June 2010.

Funds have been separated into the following three categories based on asset size:

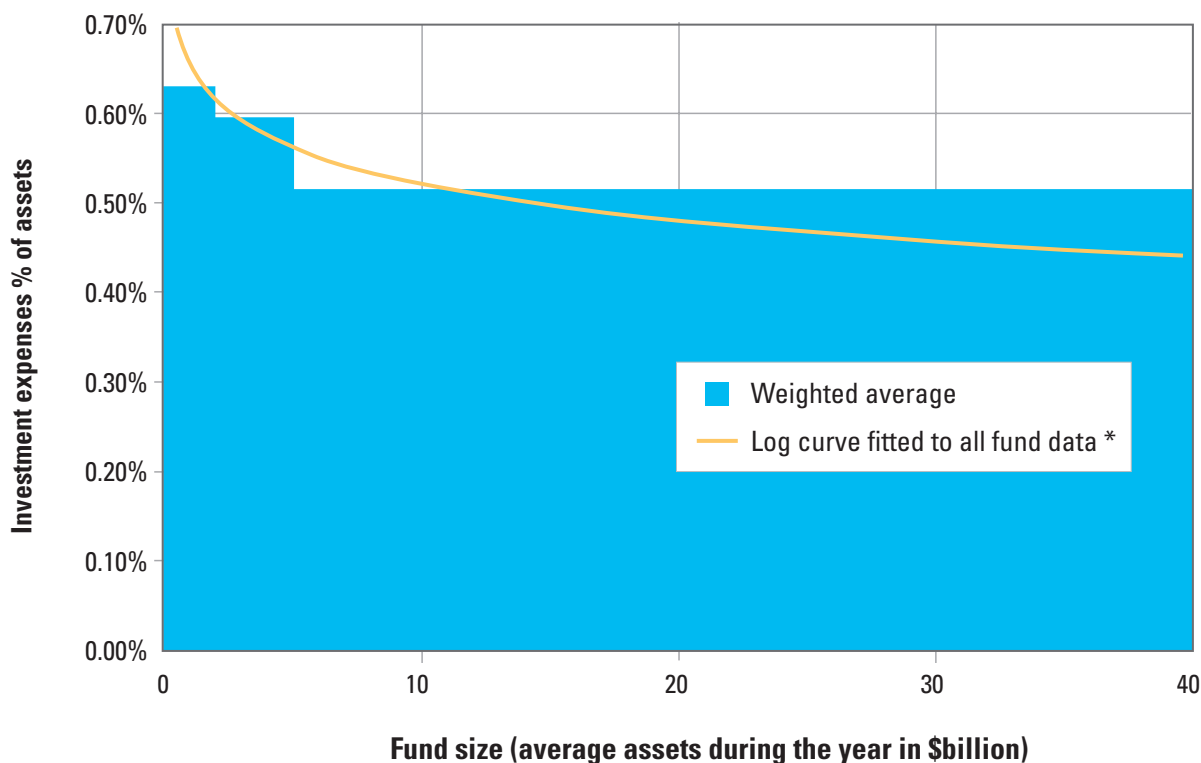
- Small: less than \$2 billion.
- Medium: between \$2 and \$5 billion.
- Large: more than \$5 billion.



These classifications were determined to obtain a representative sample of approximately equal numbers of funds in each group. Note that the classifications are independent of the classifications used to group funds by membership for the operating expense analysis.

Investment expenses as a percentage of net assets for each group were calculated as the aggregate investment expenses for the group divided by the aggregate net assets of the group (ie the averages are weighted by net assets).

**Graph 8: Investment expenses by fund size (net assets)**



*\* The fitted log curve is based on the distribution of all data, not just the three points in the weighted average.*

As indicated earlier, the lack of scale variation (when compared with the analysis of total operating expenses) is partly the result of the diversity of investment strategies (and hence management fees) at all fund sizes. Many larger funds have significant components of alternative assets, such as infrastructure, private equity and direct property, which cost more to manage but are expected by the trustee to provide higher net returns over the long-term.

The relatively minor scale variation evident in Graph 8 is partly due to scale economies in the areas of outsourced services such as asset consulting and custody. However, these costs are a relatively small part of overall investment expenses.

### Investment expense components by fund size

Graph 9 measures the variation in investment expense components by fund size, measured as the average size of net assets during the financial year to 30 June 2010.

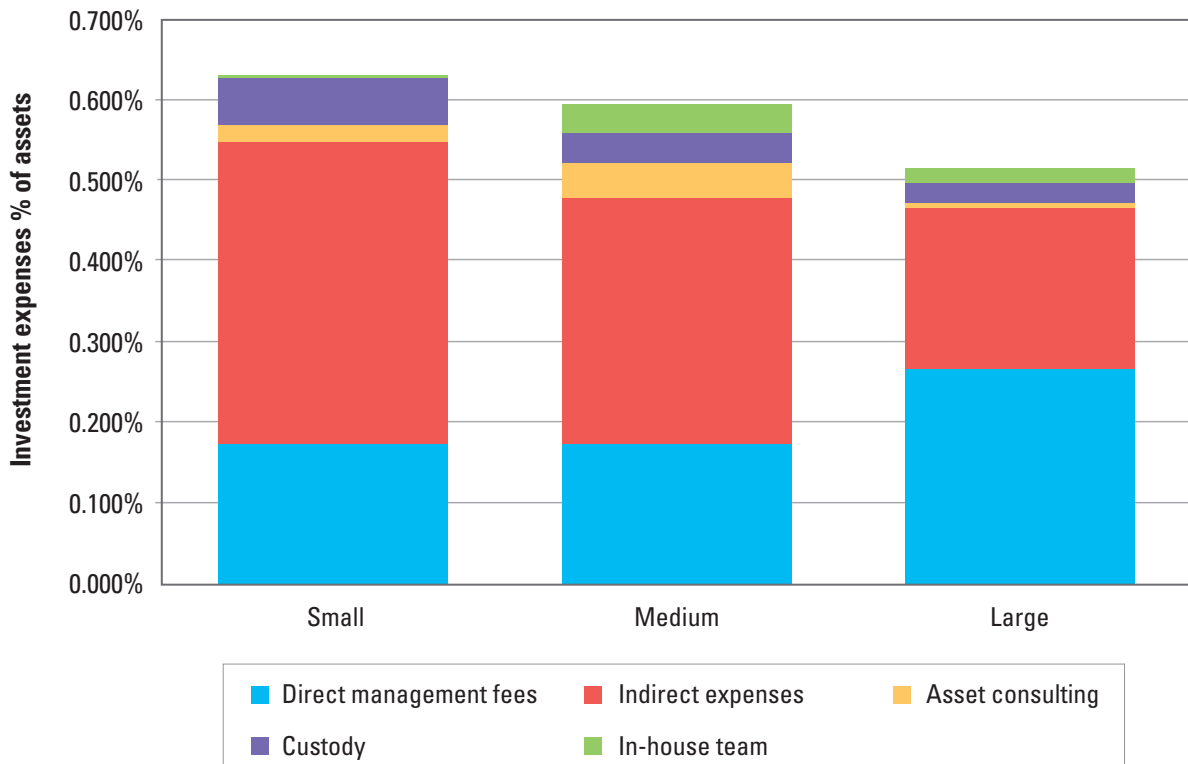
The comparison has been limited to asset consulting fees and custody fees, as they are the only easily measurable expense items that exhibit a clear scale effect. The size of in-house investment teams varies as a result of each trustee's decision regarding maintaining any in-house asset management services, as well as on scale.

Funds have been separated into the following three categories based on asset size:

- Small: less than \$2.5 billion.
- Medium: between \$2.5 and \$8 billion.
- Large: more than \$8 billion.

Investment expenses as a percentage of net assets for each group were calculated as the aggregate investment expenses for the group divided by the aggregate net assets of the group (ie the averages are weighted by net assets).

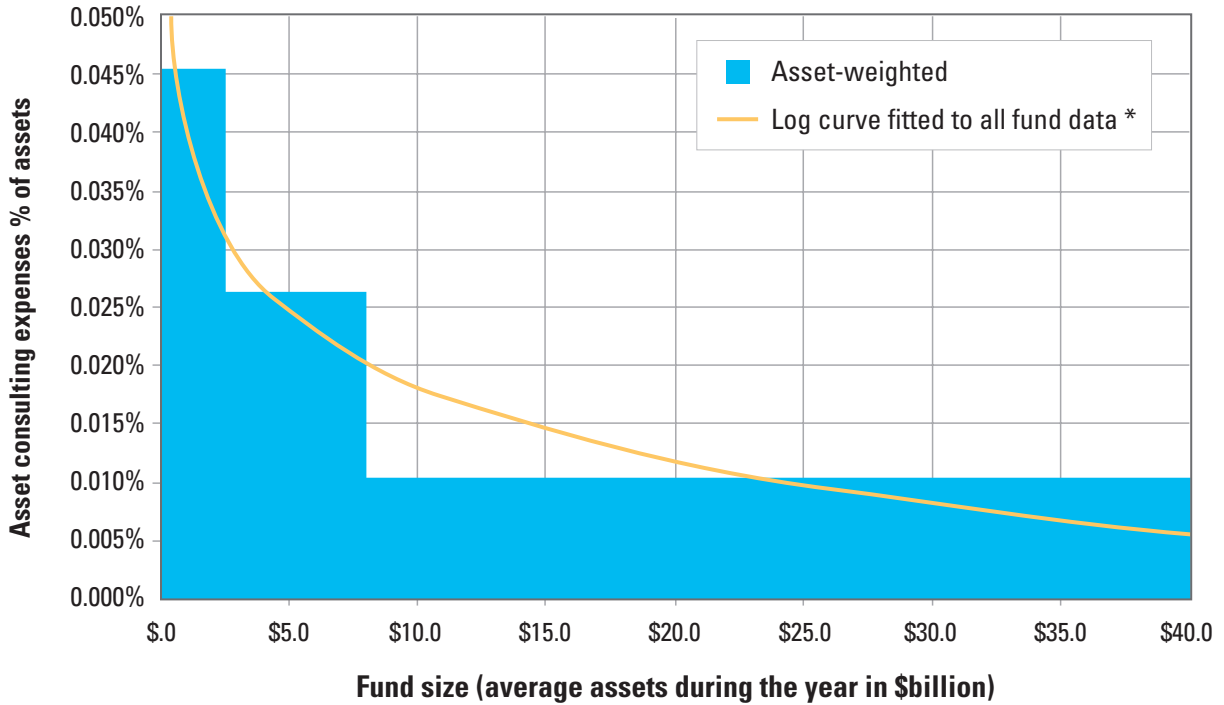
**Graph 9: Investment expense components by fund size (assets)**



As expected, the larger funds have a higher proportion of direct management fees. The graph suggests that total management fees are the same for large and medium funds, but this does not mean that no scale benefits are available above \$2.5 billion as total management fees are affected by asset allocation as well as by asset class fees.

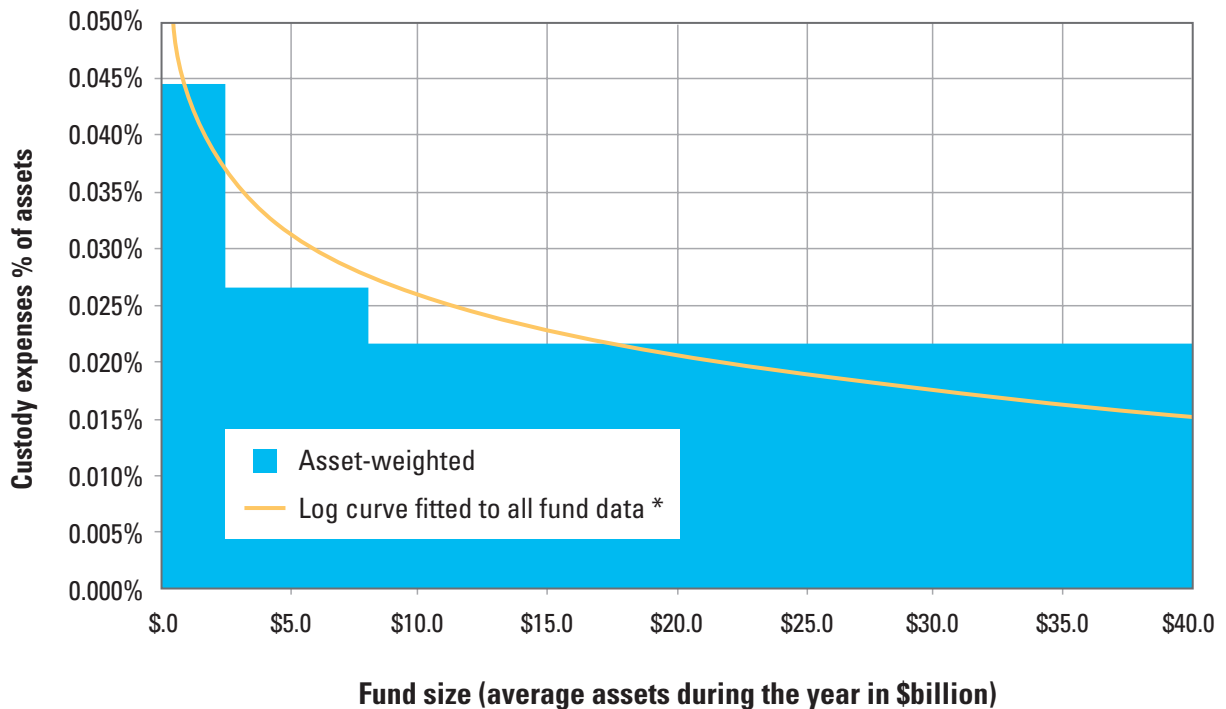
### 3.2.4 Asset consulting expenses by fund size

**Graph 10: Asset consulting expenses by fund size (assets)**



### 3.2.5 Custody expenses by fund size

**Graph 11: Custody expenses by fund size (assets)**



As with administration expenses, the Expense Survey does not attempt to measure and compare the level of services provided by each fund’s asset consultant or custodian. Nevertheless, the above graphs demonstrate the existence of significant scale economies.

Note that the absence of variation above \$8 billion in assets does not mean that larger funds do not or cannot achieve further savings, but simply reflects the smaller universe of large funds for detailed comparison.

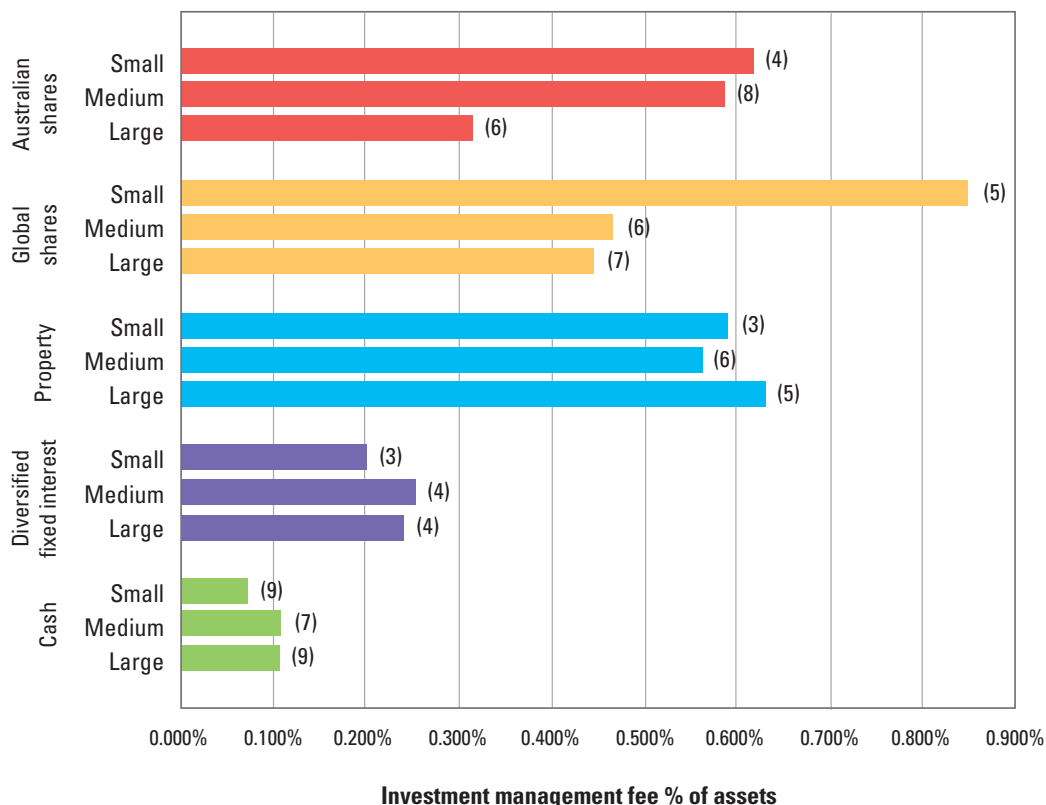
### 3.2.6 Investment management expenses by fund size

As mentioned earlier, it is difficult to compare management fees between funds because of differences in asset allocation and adoption of strategies involving index portfolios and alternative assets.

However, in this study there has not been any access to the ICR information for asset class options (eg Australian shares or property) for those funds that offer such options. On the basis that the ICR for these options is a fair representation of the fund’s overall cost of managing these asset classes, a comparison of management fees can be carried out for at least the most common asset classes.

The following graph covers management expenses for Australian shares, global shares, property, diversified fixed interest, and cash options. The fund size classifications are the same as those used earlier for comparing asset consulting and custody expenses. Indexed options and socially responsible investing (SRI) options have been excluded from the comparison, and global shares options only include unhedged portfolios.

**Graph 12: Investment management expenses by fund size (assets)**



Based on this limited data, it can reasonably be concluded that there appears to be scale benefits from leveraging fund size in negotiating fees for the management of listed shares (both Australian and overseas), but that no such benefits are obvious for the other asset classes.