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INSIGHTS from Rice Warner

The long-term projections contained within the Rice Warner *Superannuation Market Projections 2014* report show two dominant themes: growth and cost (fees). In this first of a two-part series, Alun Stevens explores the projected growth of super for the next 15 years.

Rice Warner's latest *Superannuation Market Projections 2014* report shows an industry that will continue to grow strongly - both in dollar terms and as a proportion of GDP - for several decades.

This should provide trustees with confidence that (collectively) funds will have strong liquidity and will be able to maintain long-term, growth-based investment strategies. This also will reward fund members and pensioners.



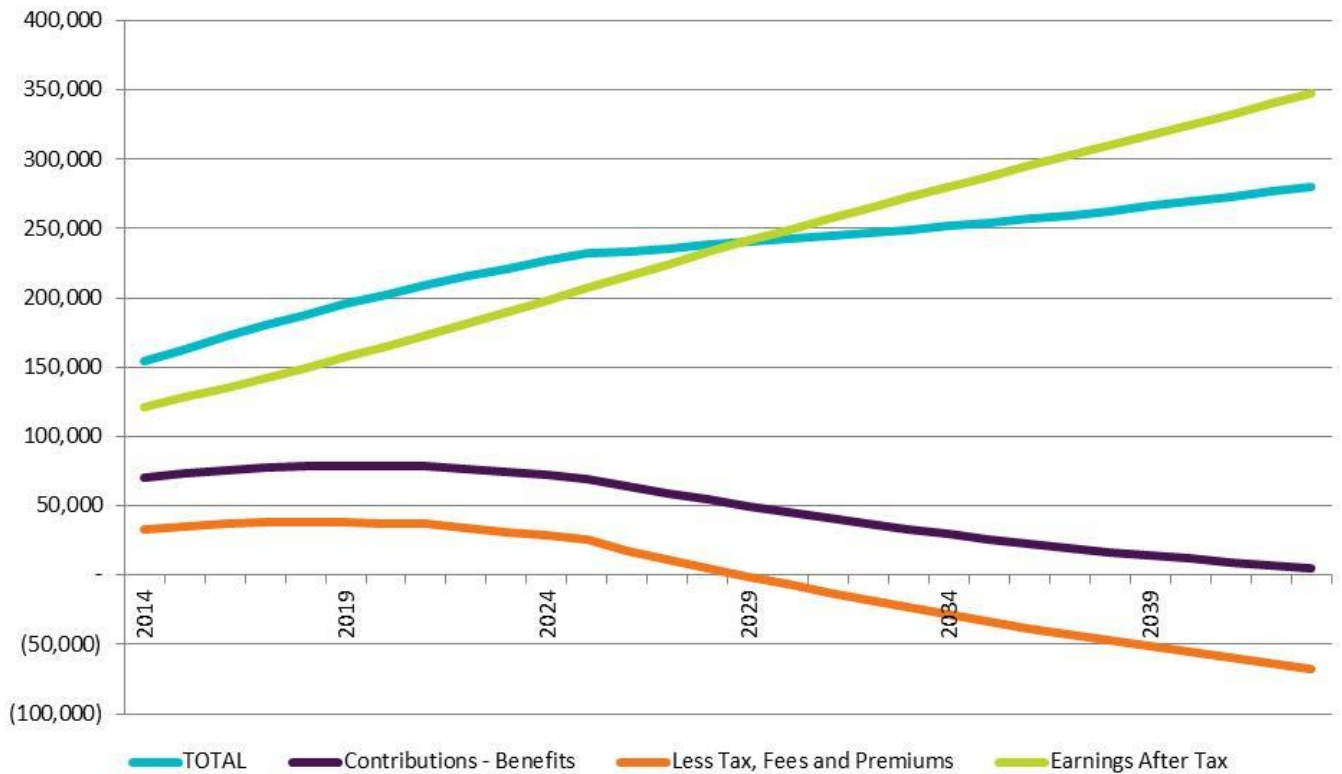
This strong industry growth will occur despite the ageing of the population and the movement over the

15 year projection period of a significant proportion of Baby Boomers shifting from the accumulation phase of superannuation to the retirement phase.

This movement into retirement will result in increasing pension payments from this group's retirement accounts as well as reduced contributions as the cohort ceases work. This has led some commentators to suggest incorrectly that there are instabilities in the market as a result because cash flows will become negative and expose investments in less liquid assets.

It is therefore worthwhile considering the cash flows across the market. Graph 1 shows the projected cash flows in the market for the next thirty years.

Graph 1. Cash flow for the superannuation market (\$M) (2014 Dollars)



The Total cash flow is strong over the whole period driven by increasing investment earnings as the market matures. Non-investment cash flows do decline over the period. Gross non-investment cash flows (Contributions less Benefits) are positive over the whole period, but net non-investment cash flows (ie contributions less benefits, taxes, fees and premiums) do become negative, but only some fifteen years into the future. If the increases in the SG had not been deferred for seven years, the cash flows would not have become negative for another five to seven years.

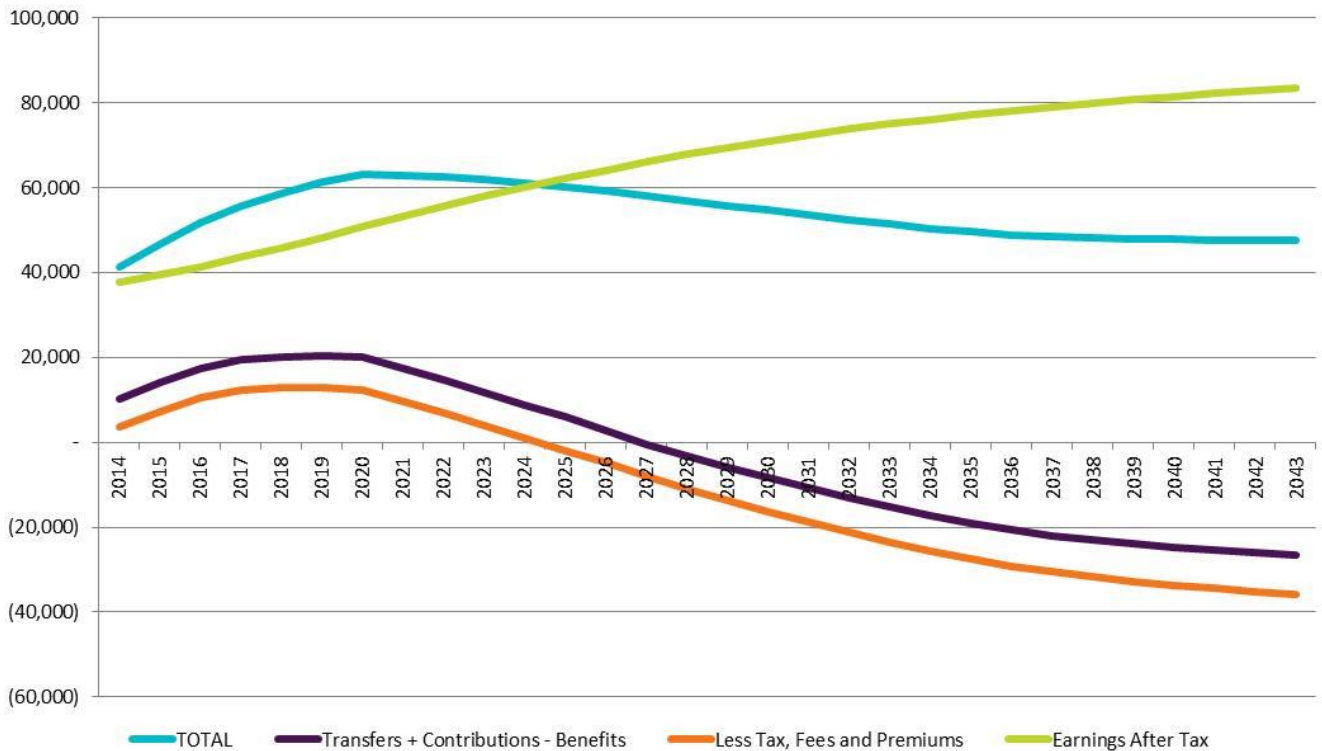
Meanwhile, these charges remain modest in the context of total cash flows and are well covered by net investment cash flows. Consequently, the TOTAL (blue) line shows continued growth in assets for many decades to come.

The strong growth and cash flow provide significant capacity for scale growth in the industry. Some segments of the market will decline. For example, corporate funds will largely disappear as they convert into industry funds and master trusts. The Public Sector will also decline through lower employment and the transition from high contribution defined benefit funds to SG funds. Funds in these sectors will need to consider their cash flows and investment strategies carefully, but their specific issues can undoubtedly be absorbed by the market via mergers.

The larger and more diversified funds will benefit from the general market growth and cash flow and will have capacity to absorb those funds, for instance, whose membership base has aged to the point where significant proportions of their assets need to be realised.

Many members of the SMSF segment are already in the Retirement phase and more will join them in coming years. This sector will increasingly be drawing income from their pension accounts rather than contributing to building up their accumulation accounts. Consequently, it does move to a negative non-investment cash flow position earlier than the market overall (see Graph 2).

Graph 2. Cash flow for the SMSF segment (\$M) (2014 Dollars)



The non-investment cash flow includes transfers into the segment as well as contributions received.

The non-investment cash flow is still lower than the income generated by investments and the segment will continue to grow, albeit it at a slower rate than currently.

Finally, the future is bright but not without its challenges. Business press headlines in the opening weeks of 2015 have been dominated by coverage of the underlying mechanics of the superannuation industry.

It is hoped that Rice Warner’s continuing long-term perspective provides an appropriate context against which such debates and future policy measures can sensibly be drawn.